

# CA Final (New Syllabus)

## Paper 3



# AUDITING PRONOUNCEMENTS

## VOL 1



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# Our Rankers

**AIR 5**



**Sarthak Aggarwal**  
CA Inter May-23

**AIR 19**



**Aman Mahajan**  
CA Inter Dec-21

**AIR 33**



**Sundar B**  
CA Inter Dec-21

**AIR 49**



**Ria Gupta**  
CA Inter May-22

# What Our Students have to Say....

## **Aman Mahajan (CA AIR 19)**

I really liked your classes, especially the practical linkages explained with amazing graphics. The full subject test series helped a lot in improving my writing speed and presentation skills.

## **Sundar Sri Renganathan B (AIR 33)**

I took Accounting from IndigoLearn and the classes were really good. They emphasized on conceptual clarity over getting things done quickly, which is really vital to score good marks in practical papers. Other resources like Notes, Quizzes and Forum was beneficial too.

## **Dwarakesh**

Thank you IndigoLearn team for the guidance and support throughout the past few months. I had great conceptual clarity in all the subjects and the revision classes by Suraj Sir were very helpful. Study planner and Free resources were very useful. Thank you Team IndigoLearn.

## **Yug Manoj Kumar Bhattad**

I have cleared my CA Foundation examination with the total of 286. And this was not possible without the efforts and support of IndigoLearn. The way of teaching with utmost conceptual clarity is the best thing at IndigoLearn.

## **Prakash Bhatt**

Superb, one stop solution for All CA and Accountancy students they serve real Education at very very reasonable price

## **Naveen Kumar S**

Good experience, unlimited views helped a lot in last one month preparation. Looking forward for

## **Bhagyasree Chougule**

It was only because of IndigoLearn that my concepts became very clear, and I was able to crack the exam. I wasn't 100% prepared I needed more practice but luckily I got through. I'm definitely choosing IndigoLearn for group 2 preparation. A big thanks!

## **Mohd Thayyab**

Theoretical subjects made easier through story based examples and charts. Concept clarity 100%. Fully exam+practical oriented classes will help not only to retain the concepts during exams but for the longer duration.

## **Lalit Chetan Sanpal**

IndigoLearn has been fantastic and brilliant. Helped me a lot in my preparations. I cleared both the groups in first attempt with your brilliant classes and notes. Thanks to all the faculties, coordinators, forum admins and everyone at IndigoLearn. Really grateful. Will go for CA Finals at IndigoLearn For sure. Thank you so much IndigoLearn.

# #StudentFirst

## Abishek M

I'd like to thank IndigoLearn for all the support they've provided me with. Modules were great. They were time saving and straight to the point. I extensively used the materials provided before exams, they were so helpful. Also I'd appreciate them for providing unlimited views as I kept looking into the maths modules till the end.

## Munnur Nandini Sree

Accounting classes I have taken from IndigoLearn. Now I feel that it's a great choice that I have made (after seeing my result ) because only in Accounting I got exemption. Thank you IndigoLearn.

## Harshita G

Thank u so much IndigoLearn for your guidance. This is only possible because of u people.... For my finals also my journey will continue with IndigoLearn.

## Bharathsha PS

I purchased Economics, IT, FM, EIS and Audit from IndigoLearn. All your classes are superb and anyone can easily crack the CA exams. What makes u special is your classes help us to understand the concepts very well. Special thanks to the FM faculty, I studied only 2 chapters in economics, and still managed to score exemption in the 8th paper.

## Nayi Mihir kumar

This platform is very helpful in all activity like mcq practise, notes, teaching activities, revisions and the forum interaction with all students which I like the most. If anybody want to clear their exams in first attempt then IndigoLearn is the best platform for them. My all regards to IndigoLearn. Thank you so much.

## Rajalaxmi CA Inter

Can't believe I cleared. Sathya Sir, Suraj Sir, Yogita Mam ... thanks to all my faculties. Basically an Eng student with zero accounts knowledge. Thanks IndigoLearn for making me clear in first attempt.

## Priyanka Udeshi

All the faculties have excellent knowledge of the subject and deliver it in very crisp & effective manner. Also, quick response at Forums never let any of my doubts go unresolved no matter how small they were. Thank you once again to all the teachers & staff at IndigoLearn!

## Naveen Kumar T

It been a great journey with indigo learn team. Thanks to all the facilities and forum friends who support me a lot.

## **Disclaimer**

This book is designed for students pursuing CA Final course, who are appearing for the **Advanced Auditing, Assurance and Professional Ethics** exam in **May-24 or afterwards**. The content in the book is not in the order provided by ICAI to ensure logical and comprehensive learning.

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# STANDARDS ON AUDITING

## SA 200-299 General Principles and Responsibilities

### Contents

- SA 200 Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing
- SA 210 - Agreeing the Terms of Audit Engagements
- SA 220 - Quality Control for an Audit of Financial Statements
- SQC 1
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- SA 250 - Consideration of Laws and Regulations in an Audit of Financial Statements
- SA 260 - Communication with Those Charged with Governance
- SA 265 - Communicating Deficiencies in Internal Control to Those Charged with Governance and Management

# SA 200 - Overall Objectives of the Independent Auditor and the conduct of an Audit in accordance with Standards on Auditing

## Contents

- Scope of SA
- Overall objectives of Independent Auditor & Scope of Audit
- Audit of Financial Statements
- Requirements of Auditor
- Compliance with SAs
- Audit Risk
- Inherent Limitations of Audit

## 1.1 Introduction

Standards on auditing are written in context of an audit of financial statements by an auditor.

Independent auditor is obliged to comply with all the SAs relevant for the audit of financial statements. They are to be adapted if the circumstances addressed in the SAs exists in the audit.

The auditor is required to have an understanding of the complete SA, with respect to its objectives and application.

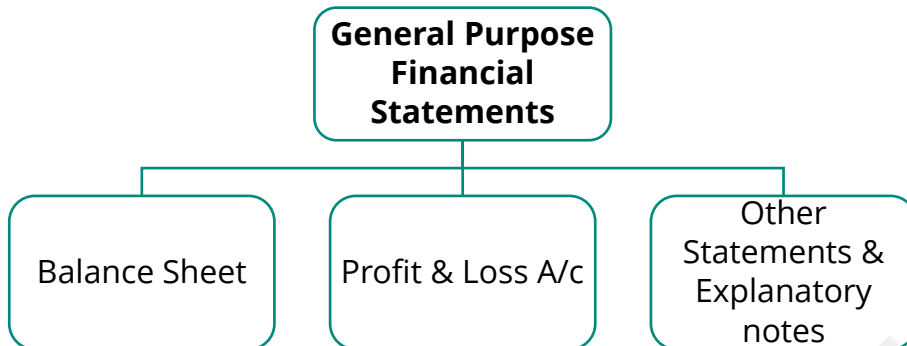
SAs do not impose responsibilities on management or those charged with governance and do not override laws and regulations that govern their responsibilities.

## 1.2 Scope of SA 200

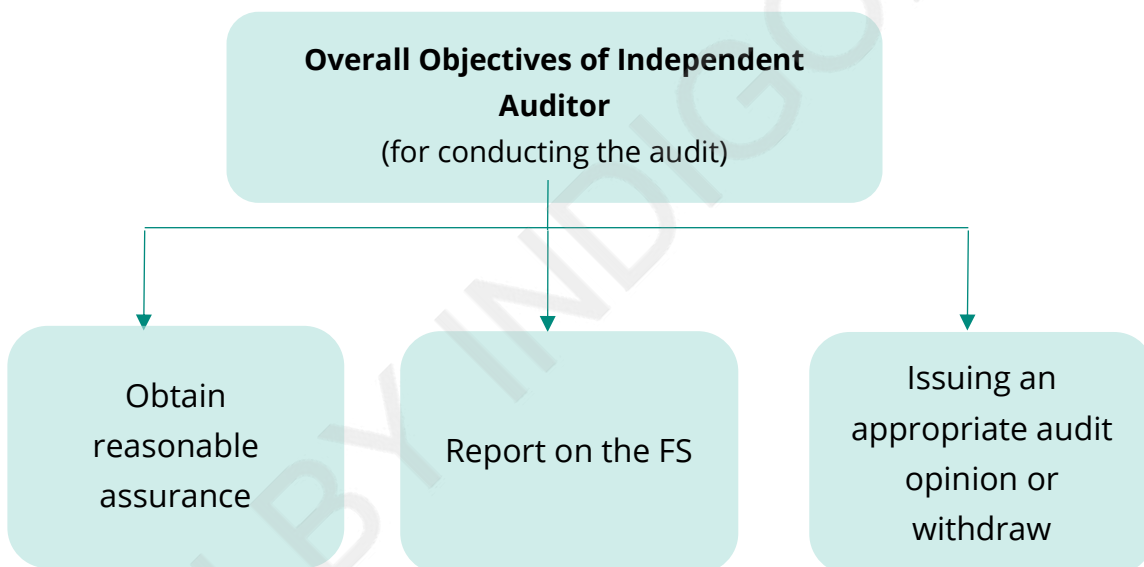
- Establishing overall responsibilities of Independent Auditor when conducting an audit of financial statements.
- Explains the nature and scope of an audit.
- Scope, authority & structure of Standards on Auditing

- General responsibilities which independent auditor should adhere to in all audits.
- Conduct of the audit in accordance with the Standards on Auditing (SA)

### 1.2.1 General Purpose Financial Statements



### 1.2.2 Overall objectives of Independent auditor



- To **obtain reasonable assurance** about whether the financial statements as a whole are free from material misstatement, due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework;

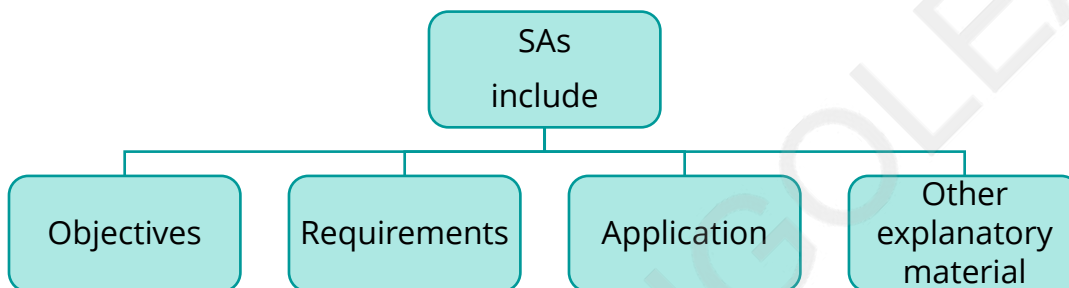


Reasonable assurance is a high level of assurance but is not an absolute level of assurance, because there are inherent limitations of an audit.

- To **report on the financial statements**, and communicate as required by the SAs, in accordance with the auditor's findings.
- **Issuing an appropriate audit opinion** or withdraw from the engagement, if required and legally permitted.

*Auditor expresses opinion regarding financial health of the organisation*

When reasonable assurance cannot be obtained and a qualified opinion in the auditor's report is insufficient, auditor can disclaim an opinion or withdraw from the engagement, where withdrawal is legally permitted



These support auditor in obtaining reasonable assurance.

### 1.2.3 Audit of Financial Statements

<b>Performed by</b>	Auditor for the benefit of members/ intended users
<b>Objective</b>	Enhance degree of confidence of intended users in financial statements
<b>Outcome</b>	Opinion expressed whether or not financial statements prepared as per financial reporting framework give true and fair view
<b>Requirements</b>	Auditor to ensure audit is conducted as per SAs & other ethical requirements

- Financial statements are prepared by the management of the entity and the auditor carries out an audit on such financials to express an opinion whether such financial statements reflect true and fair view of the financial condition of the entity.

Audit is an independent examination of financial information of an entity with a view to expressing an opinion there on.

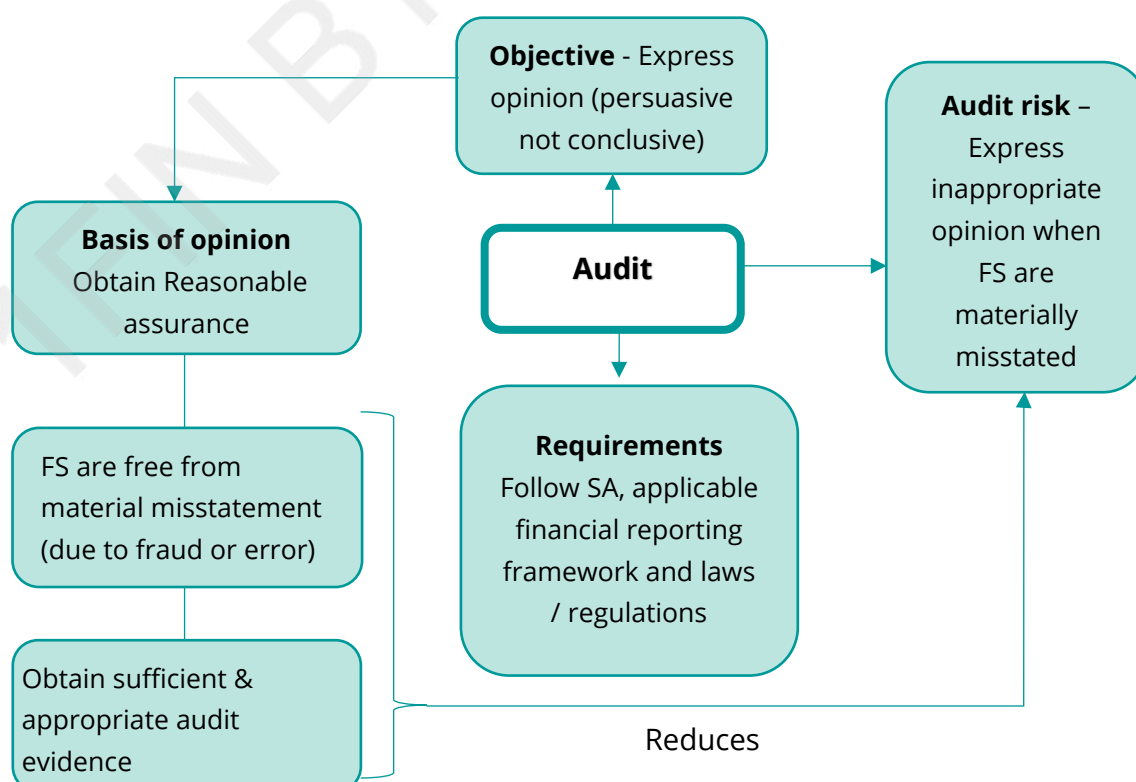
### Management's Responsibility

The audit of the financial statements does not relieve management or those charged with governance of their responsibilities. Their main responsibilities are:

- Maintain adequate accounting records
- Select and apply appropriate accounting policies
- Design internal controls in line with size and nature of the entity
- Prevent and early detection of fraud and error
- Follow fundamental accounting assumptions
- Preparation of financial statements in accordance with applicable framework
- Safeguard assets

- An audit conducted in accordance with SAs and relevant ethical requirements enables the auditor to form an opinion that financial statements as a whole are free from material misstatement, whether due to fraud or error.

*Audit enhances degree of confidence of intended users in the FS.*

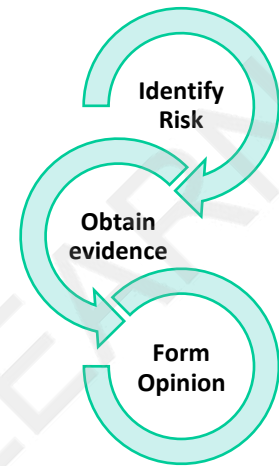




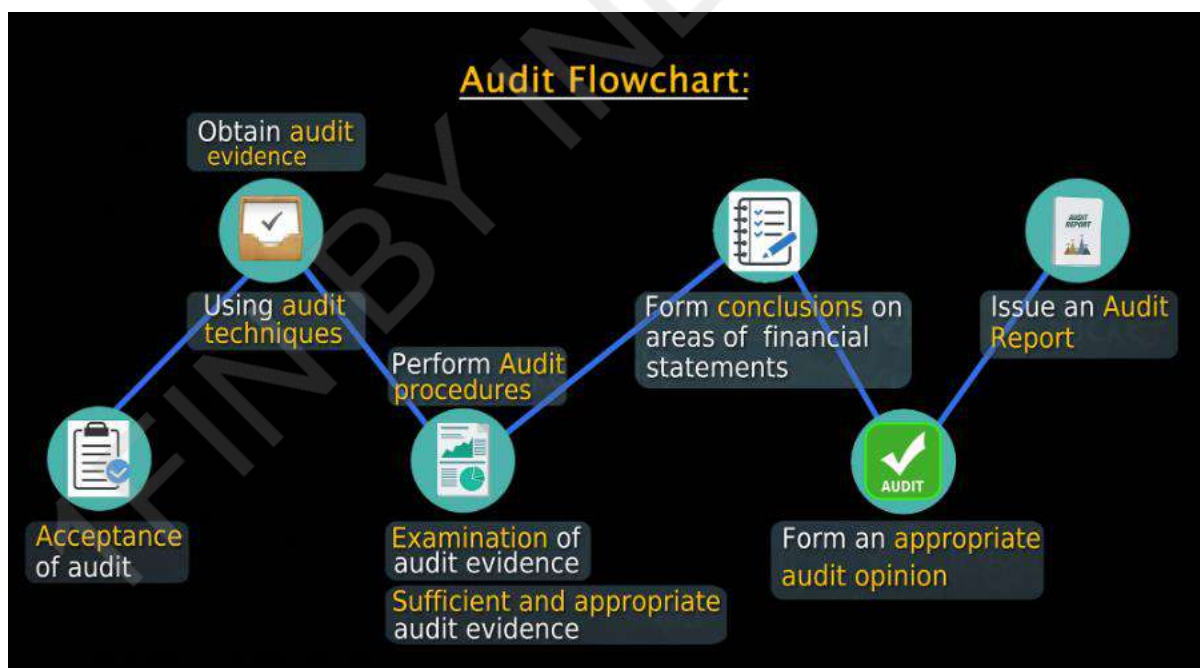
- Auditor shall obtain reasonable assurance, which is the basis for his opinion. Reasonable assurance is a high level of assurance.

### Auditors' approach

- Identify and assess **risks of material misstatement**, whether due to fraud or error, based on an understanding of
  - the entity
  - entity's environment,
  - entity's internal control.
- Obtain **sufficient appropriate audit evidence** about whether material misstatements exist, through designing and implementing appropriate responses to the assessed risks.
- Form an **opinion on the financial statements** based on conclusions drawn from the audit evidence obtained and will depend upon the applicable financial reporting framework and any applicable laws or regulations.



- The auditor may communicate and report to users, management or others as per SAs or applicable laws or regulations.



### 1.2.4 Scope of audit

- Statute governing the enterprise

- Pronouncements of ICAI like AS and SAs
- Terms of engagement.

However, terms of engagement can't override the other two

### 1.3 Concept of True and Fair

The concept of true and fair is a fundamental concept in auditing. The phrase "true and fair" in the auditor's report signifies that the auditor is required to express his opinion as to whether the state of affairs and the results of the entity as ascertained by him in the course of his audit are truly and fairly represented in the accounts under audit. 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:

- that the assets are neither undervalued nor overvalued, according to the applicable accounting principles,
- no material asset is omitted
- the charge, if any, on assets are disclosed
- material liabilities should not be omitted
- the profit and loss account and balance sheet disclose all the matters required to be disclosed
- accounting policies have been followed consistently and
- all unusual, exceptional or non-recurring items have been disclosed separately.

### 1.4 Requirements of an Auditor as per SA 200

SA 200 covers the following major aspects with respect to the requirements an auditor has to fulfil:

- Ethical requirements in relation to financial statements.
- Carry out audit with professional skepticism
- Exercise professional judgement wherever required.
- Obtain sufficient and appropriate audit evidence.
- Comply with Standards on Auditing.

#### 1.4.1 Ethical Requirements of an Auditor



- **Professional behaviour**- Professional relation should be maintained between client and auditor throughout the audit and other interest should override this objective.
- **Objectivity** –Auditor should be independent not just outwardly, but also inwardly. Also, auditor should be focused on the purpose of audit and discharge his duty effectively.

- **Professional competence and due care** – This indicate thorough professional knowledge and its dynamic updation, coupled with its meticulous application.
- **Confidentiality**- Not to part with information obtained by him regarding client during the course of audit with any person other than
  - The client
  - A person authorized by the client
  - A person who legally is entitled to know this information
- **Integrity** – Honest and loyal behaviour of auditor towards users of financials. This gets strengthened with high degree of independence.

#### 1.4.2 Professional Skepticism

Professional skepticism is an attitude of auditor which requires auditor's alertness towards information provided to him by the client / auditee.

- Professional skepticism is necessary to the critical assessment of audit evidence, includes being alert to ascertain sufficiency and appropriateness of audit evidence, for example, auditor needs to be :
  - Audit evidence that contradicts other audit evidence obtained.
  - Information about the reliability of documents and responses to inquiries to be used as audit evidence.
  - Conditions that may indicate possible fraud.
  - Circumstances that suggest the need for audit procedures in addition to those required by the SAs.

**Benefits** of following professional skepticism – **Minimize the risk of overlooking**

- Unusual circumstances
- Using inappropriate assumptions

- Professional skepticism doesn't mean that auditor doubts every bit of information given by the client. Auditor may accept records provided to him as genuine unless he has a reason to believe the contrary. However, he should bear in mind that there is a possibility of its misstatement and follow a cautious

*Auditor should not doubt everything but always be alert that there is a possibility of misstatement.*

approach.

### 1.4.3 Professional Judgement

Professional judgement is judgement taken by auditor out of his professional experience in an audit situation

- Professional Judgment is necessary for audit procedures in aspects like
  - Materiality and audit risk.
  - The nature, timing, and extent of audit procedures used to meet the requirements of the SAs and gather audit evidence.
  - Evaluating whether sufficient appropriate audit evidence has been obtained, and whether more needs to be done to achieve the objectives of the SAs and thereby, the overall objectives of the auditor.
  - The evaluation of management's judgments in applying the entity's applicable financial reporting framework.
  - The drawing of conclusions based on the audit evidence obtained, for example, assessing the reasonableness of the estimates made by management **in** preparing the financial statements.

*Auditor's professional judgement should be rational, reasonable and appropriate to the circumstances.*

#### **Professional Skepticism vs Professional Judgement**

Professional skepticism is necessary for high-quality professional judgment, but it is only one component of what is necessary for the auditor to exercise sound professional judgment. For example, skepticism without requisite accounting and auditing industry expertise is not sufficient to obtain high-quality judgment.

### 1.4.4 Sufficient & Appropriate Audit Evidence

Audit evidence is cumulative in nature and is primarily obtained from audit procedures performed during the course of the audit.

**Sufficient Audit Evidence** = Quantity of evidence.

(Eg. Testing the 70% of the transactions.)

**Appropriate Audit Evidence** = Quality of evidence. (relevance & reliability in supporting auditor's conclusion)

(Eg. Obtaining 3rd Party confirmations.)

In Audit both quality and quantity are equally important. This concept is elaborated in SA 500.

### 1.4.5 Compliance with SAs

The auditor shall comply with all SAs relevant to the audit. SA is relevant to the audit when the SA is in effect and the circumstances addressed by the SA exist. The auditor shall have an understanding of the entire text of a SA, including its application and other explanatory

The auditor shall not represent compliance with SAs in the auditor's report unless the auditor has complied with the requirements of this SA and all other SAs relevant to the audit.

material, to understand its objectives and to apply its requirements properly.

## 1.5 Audit Risk

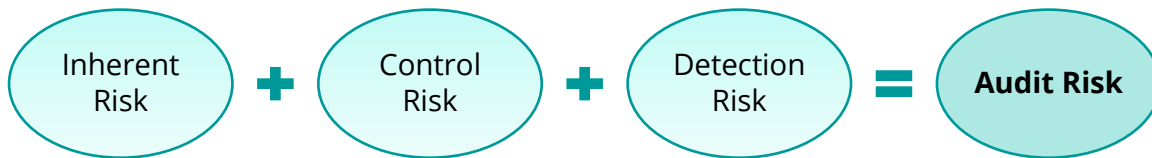
Audit risk is the risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated.

### 1.5.1 Components of Audit risk

Audit risk is a function of the risks of material misstatement (i.e. Inherent Risk + Control Risk) and detection risk.

Material misstatement is a combination of Inherent Risk and Control Risk





- **Inherent Risk**

The susceptibility of an assertion about a class of transaction, account balance or disclosure to a **misstatement that could be material**, either **individually or when aggregated** with other misstatements, before consideration of any related controls.

- **Control risk**

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**.

- **Detection risk**

The risk that the procedures performed by the auditor to reduce audit risk to an acceptably low level will **not detect a misstatement that exists** and that could be material, either individually or when aggregated with other misstatements.

**Control Risk is inversely related to Detection Risk.**

If the internal controls of an organization are effective it means the control risk is low and auditor will perform lesser audit procedures which results in higher detection risk and vice versa.

Auditor has to plan his procedures to minimize the audit risk after taking into consideration the three risks.

### 1.5.2 Risk of Material Misstatement

Misstatement – A difference between the amount, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework

**Risk of material misstatement exists at two levels.**

#### **Overall financial statement level**

The overall financial statement level (risks of material misstatement that relate pervasively to the financial statements as a whole and potentially affect many assertions) and

## Assertion level

The assertion level for classes of transactions, account balances, and disclosures.

SA 315 establishes requirements and provides guidance on identifying and assessing the risks of material misstatement at the financial statement and assertion levels.



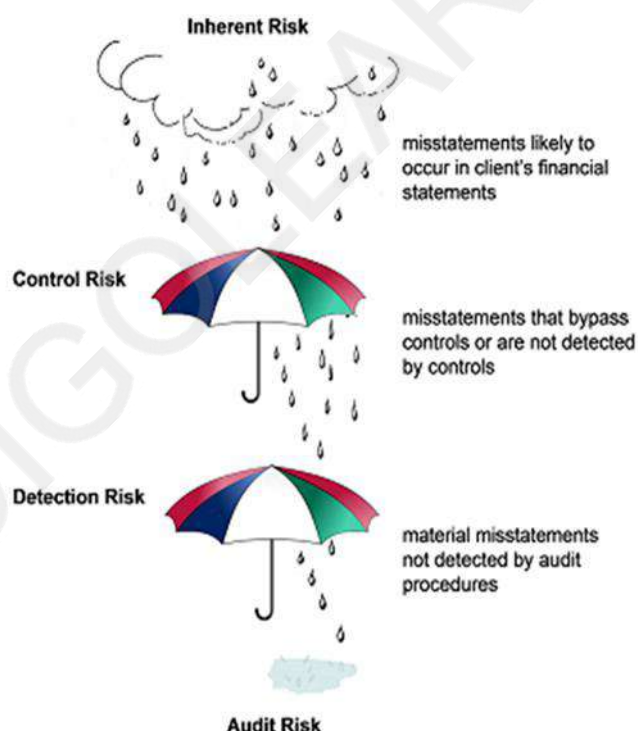
Misstatements can arise from error or fraud.

guidance  
assertion

### 1.5.3 Audit risk & Audit plan

Auditor has to plan his procedures to minimize the audit risk after taking into consideration the three risks.

**Example:** The inherent risk is that it's raining, which is controlled by the nature and has no bearing of the audit. This is compared to the risk that misstatements are likely to occur in Financial Statements. Like how an umbrella can help us from not getting wet, controls of company are designed to avoid misstatements. The risk that we might get wet even after using an umbrella is control risk. Next is the detection risk, where we did not anticipate the rainfall or the size of the umbrella is smaller than required is compared to audit procedures to apply during the audit. All the three risks together make Audit risk.



### 1.6 Objective Stated in Individual SAs

To achieve the overall objectives of the auditor, the auditor shall use the objectives stated in relevant SAs in planning and performing the audit, having regard to the interrelationships among the SAs, to

- Determine whether any audit procedures in addition to those required by the SAs are necessary in pursuance of the objectives stated in the SAs; and
- Evaluate whether sufficient appropriate audit evidence has been obtained.

#### 1.6.1 Failure to achieve an objective

If an objective in a relevant SA cannot be achieved, the auditor shall evaluate whether this prevents the auditor from achieving the overall objectives of the auditor and thereby

requires the auditor, in accordance with the SAs, to modify the auditor's opinion or withdraw from the engagement.

Failure to achieve an objective represents a significant matter requiring documentation in accordance with SA 230 (Revised).

### 1.7 Complying with Relevant Requirements

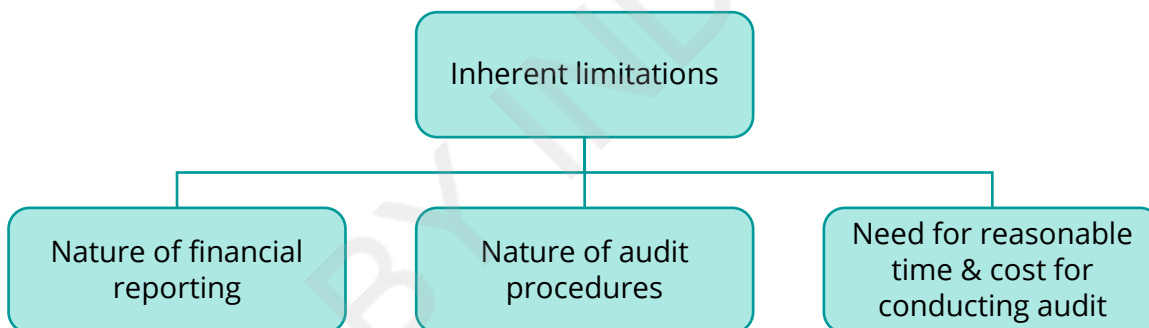
If the standard is applicable, it shall be complied with.

In exceptional circumstances, the auditor may judge it necessary to depart from a relevant requirement in a SA. In such circumstances, the auditor shall perform alternative audit procedures to achieve the aim of that requirement.

The need for the auditor to depart from a relevant requirement is expected to arise only where the requirement is for a specific procedure to be performed and, in the specific circumstances of the audit, that procedure would be ineffective in achieving the aim of the requirement.

### 1.8 Inherent Limitations of the Audit

The inherent limitations of an audit do not allow an auditor to reduce the audit risk to zero. It is because of these limitations; the auditor gives a persuasive opinion and not a conclusive opinion.



- **Nature of financial reporting**

- Preparation financials also involves certain estimates, assumptions, assessments and acceptable interpretations.
- In such cases, inherent level of variability cannot be eliminated by the application of additional auditing procedures.

- **Nature of audit procedures**

- Management or others may not provide, intentionally or unintentionally, the complete information that is relevant to the preparation and presentation of the financial statements.
- Certain carefully laid frauds might not be unearthed during the normal course of audit.
- Generally, test check basis is adopted, not 100% checking. So, some underlying misstatement might remain undetected.

- Audit is persuasive, not conclusive.
- Limitations on knowledge of client's business also poses a problem.
- Need for the audit to be conducted within a **reasonable period of time** and at a reasonable cost.

### 1.8.1 Factors affecting inherent limitations

Factors affecting inherent limitations are addressed in other auditing standards. Following are few of the factors:

- Fraud, particularly fraud involving senior management or collusion.
- The existence and completeness of related party relationships and transactions.
- The occurrence of non-compliance with laws and regulations.
- Future events or conditions that may cause an entity to cease to continue as a going concern.

### 1.8.2 Inherent limitations and Auditors' responsibility

Because of 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 SAs.

Accordingly, the subsequent discovery of a material misstatement of the financial statements resulting from fraud or error does not by itself indicate a failure to conduct an audit in accordance with SAs.

Whether the auditor has performed in accordance with SAs is determined audit procedures performed in the circumstances, the sufficiency and appropriateness of the audit evidence obtained as a result thereof and the suitability of the auditor's report based evaluation of that evidence in light of the overall objectives of the auditor.



The inherent limitations of an audit cannot be a justification for the auditor to be satisfied with less-than-persuasive audit evidence

an audit by the on an

## 2. SA 210 Agreeing the Terms of Audit Engagements

### Contents

- Terms of Engagement
- Pre-conditions of an Audit
- Factors affecting independence of audit
- Engagement Letter
- Change in terms of engagement

### 2.1 Introduction

An auditor has to ascertain few aspects before accepting or continuing an audit engagement.

- Ascertain whether the pre-conditions for an audit are present and
- Confirming that there is a common understanding between the auditor and management of the terms of the audit engagement.

#### 2.1.1 Terms of Engagement (TOE)

Terms of Engagement - The official conditions that someone must agree to before they can start to be employed/ engaged by someone.

The auditor shall agree the terms of the audit engagement with management or those charged with governance, as appropriate through an engagement letter.

**Prepared by** – Auditor (Chartered Accountant – Proprietor or Partner of the firm)

**Signed by** – Management (Those charged with governance like CEO or MD) & Auditor

**Prepared at** – Start of the audit

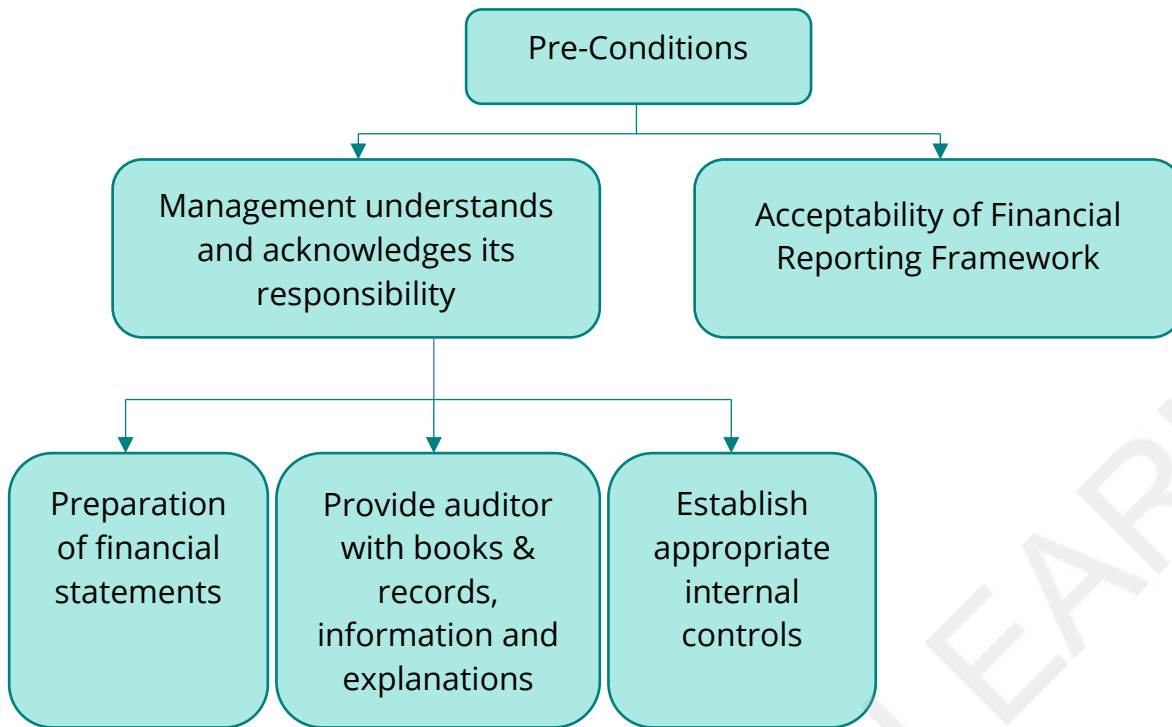
**Contains** - Terms of engagement i.e. the terms agreed by the auditor with management as to how to conduct the audit.

The following are the broad aspects included in the engagement letter:



<b>PRELIMINARY INFORMATION</b>	Objective and scope.
	Responsibilities (auditor & management).
	Financial Reporting Framework.
	Inherent limitations of audit.
	Planning and performance of the audit, including the composition of audit team.
<b>MANAGEMENT AGREEMENT TERMS</b>	Written representations.
	To provide adequate information on time.
	To inform auditors on subsequent events.
	Any other agreements between auditor and the entity.
<b>MISCELLANEOUS ISSUES</b>	Peer review under CA Act 1949.
	Provide audit working papers to other parties.
	Restriction on auditors liabilities when such possibility exists.
	Fee and billing arrangements.
	Arrangements with predecessor auditor, internal auditor, other auditors, experts, if any in the case of initial audit.

### 2.1.2 Pre-conditions of an Audit



Aspects to be ascertained before accepting or continuing an audit:

- **Reporting framework**

Determine whether the financial reporting framework to be applied in the preparation of the financial statements is acceptable (Eg. Schedule II of Companies Act, 2013 etc.,).

- **Management responsibility**

Obtain the agreement of management that it acknowledges and understands its responsibility.

- For the preparation of the financial statements in accordance with the applicable financial reporting framework.
- For placing internal control necessary for preparing financial statements which are free from material misstatement and
- To provide the auditor with:
  - Access to all information necessary for the purpose of audit;
  - Unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

### 2.2 Scope of SA

Auditor's responsibilities in agreeing the terms of the audit engagement with

- management and,
- those charged with governance.

Ascertaining preconditions for the audit, which will be the responsibility of the management.

## 2.3 Factors affecting acceptance of Audit

### 2.3.1 Management doesn't accept responsibility

Management denies its responsibility to prepare and present the financial statements (or)

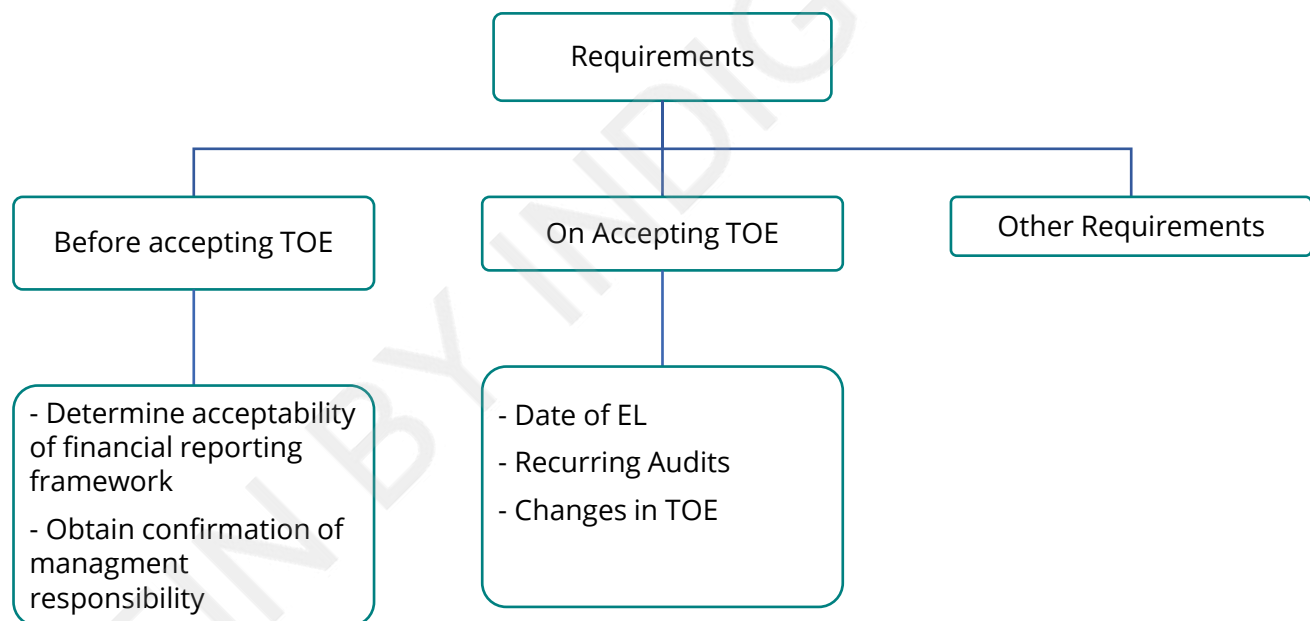
### 2.3.2 Financial reporting framework not acceptable

If auditor determines that financial reporting framework to be applied in the preparation of the financial statements is unacceptable (unless the same is mandated by law governing the enterprise) (or)

### 2.3.3 Limitation on auditor's scope

Management or those charged with governance impose a limitation on the scope of the auditor's work in proposed engagement & the auditor believes the limitation will result in the auditor disclaiming an opinion on the financial statements, to do so

## 2.4 Requirements of SA 210



## 2.5 Engagement Letter (EL)

### 2.5.1 EL when Audit terms are not prescribed by any law

In case of voluntary audits, Audit terms are not prescribed by any law or regulation. (Eg. Audit of Proprietary concern). In such cases, scope of work would be determined by the engagement letter.

Other aspects to be included in the engagement letter in such cases:

- Objective and scope of the audit of financial statements.
- Responsibility of the auditor.
- Responsibilities of management.
- Financial reporting framework for the preparation of the financial statements.
- Expected form and content of any reports to be issued by the auditor.

### 2.5.2 EL when Audit terms are prescribed by law and regulation

Auditor needs to mention in the engagement letter that

- the terms of audit are driven by such law or regulation and
- management understands and acknowledges its responsibilities.

#### Scope of work for an Auditor

Law specifies Audit terms – Law will prevail over the engagement letter

Law does not Audit terms – Engagement Letter shall prevail

### 2.5.3 EL for recurring audits

In case of recurring audit where the same auditor is reappointed for subsequent years, the same engagement letter would be valid unless there is any change in the existing terms. Auditor should assess whether

- Circumstances require the terms of engagement to be revised.
- There is a need to remind the entity of the existing terms of the audit engagement.



Recurring audits - same EL would be valid unless there is any change in terms

### 2.6 Change in terms of audit engagement

Auditor needs to review any change in terms of engagement and cannot accept them outrightly. Only after careful review can the auditor accept changes if they are reasonable and acceptable, in other circumstances he can withdraw from the engagement.

## 2.6.1 Scenarios for changes

<b>Management does not give reasonable justification for change in audit terms .</b>	<ul style="list-style-type: none"><li>• Do not agree for such change.</li><li>• Withdraw if necessary</li></ul>
<b>Management requests auditor to limit his scope. during assignment</b>	<ul style="list-style-type: none"><li>• If reasonable - agree</li><li>• If not reasonable - withdraw from engagement</li></ul>
<b>Auditor is unable to agree to the change in terms.</b>	<ul style="list-style-type: none"><li>• Withdraw from audit engagement</li><li>• Report matter to others like owners /members, regulators, etc if required.</li></ul>
<b>Reasons for change in engagement are valid.</b>	<ul style="list-style-type: none"><li>• Accept the new terms of engagement</li></ul>
<b>Auditor himself proposes changes in terms of engagement.</b>	<ul style="list-style-type: none"><li>• Send a new engagement letter to the client to communicate revision of terms and take client's acceptance for the same</li></ul>

## 2.7 Engagement acceptance – considerations

### 2.7.1 Financial reporting standards supplemented by law or regulation

If there is any conflict between standard setting organization (like ICAI) and law governing the enterprise (like Companies Act 2013),

- Auditor has to discuss with management to give additional disclosures in financials to explain the conflict and make the facts understandable.
- If the above is possible, auditor to determine whether it will be necessary to modify the auditor's opinion.

### 2.7.2 Financial reporting framework prescribed by law or regulation

If the auditor has determined that the financial reporting framework prescribed by law or regulation would be unacceptable but for the fact that it is prescribed by law or regulation, the auditor shall accept the audit engagement only if the following conditions are present:

- Management agrees to provide additional disclosures in the financial statements required to avoid the financial statements being misleading; and
- It is recognized in the terms of the audit engagement that
  - Auditor will issue an opinion with emphasis of matter **and**
  - Auditor will not use the phrases 'true and fair' or 'presently fairly in all material aspects' while expressing an opinion, unless the same is mandated by applicable law.

### 2.7.3 Auditor's report prescribed by law or regulation




Auditor shall evaluate whether

- users might misunderstand the assurance obtained from the audit of the financial statements and, if so
- additional explanation in the auditor's report can mitigate possible misunderstanding
- If such additional explanations also can't mitigate the possible misunderstanding, then he shall not accept such assignments, unless required by law.
- Auditor shall decide on whether reference to Standards on Auditing is necessary.

## 2.8 Acknowledgement of Engagement letter

Engagement letter issued by the auditor may or may not be acknowledged by addressee and returned to the auditor to indicate that the client understanding of the terms of the engagement is in accordance with the engagement letter issued by the auditor. It depends on the type of the audit.



*It is sufficient if an engagement letter is delivered to the client and the auditor retains the evidence of such delivery.*

### 2.8.1 Statutory audit

In case of statutory audits i.e., audit engagements, where the objective and scope of the engagement and the auditor's obligations are laid down in the applicable statute or regulations. E.g., Audit under section 143 of the Companies Act, 2013, audit of public sector banks; it is not necessary that the engagement letter sent by the auditor is acknowledged by the addressee and returned to the auditor to establish that the client's understanding of the engagement is in accordance with the engagement letter issued by auditor.

### 2.8.2 Voluntary audit

Obligations for a voluntary audit are not laid down in any statute or regulations, the auditor should request the client that a copy of the engagement letter be acknowledged by the addressee and returned to the auditor.

## 2.9 Format of Engagement Letter

To

*The Board of Directors of ABC Company Limited.*

*You have requested that we audit the financial statements of ABC Company Limited, which comprise the Balance Sheet as at March 31, 20X1, and the Statement of Profit & Loss, and Cash Flow Statement for the year then ended, and a summary of significant accounting policies and other explanatory information. We are pleased to confirm our acceptance and our understanding of this audit engagement by means of this letter. Our audit will be conducted with the objective of our expressing an opinion on the financial statements*

*We will conduct our audit in accordance with Standards on Auditing (SAs), issued by the Institute of Chartered Accountants of India (ICAI). Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.*

*Because of the inherent limitations of an audit, together with the inherent limitations of internal control, there is an unavoidable risk that some material misstatements may not be detected, even though the audit is properly planned and performed in accordance with SAs.*

*In making our risk assessments, we consider internal control relevant to the entity's preparation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. However, we will communicate to you in writing concerning any significant deficiencies in internal control relevant to the audit of the financial statements that we have identified during the audit.*

*Our audit will be conducted on the basis that [management and, where appropriate, those charged with governance acknowledge and understand that they have responsibility:*

*A. For the preparation of financial statements that give a true and fair view in accordance with the Financial Reporting Standards. This includes:*

- The responsibility for the preparation of financial statements on a going concern basis.*
- The responsible for selection and consistent application of appropriate accounting policies, including implementation of applicable accounting standards along with proper explanation relating to any material departures from those accounting standards.*
- The responsibility for making judgments and estimates that is reasonable and prudent so as to give a true and fair view of the state of affairs of the entity at the end of the financial year and of the profit or loss of the entity for that period.*

*B. For such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and*

*C. To provide us with:*

- Access, at all times, to all information, including the books, account, vouchers and other records and documentation, of the Company, whether kept at the head office of the company or elsewhere, of which management is aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;*
- Additional information that we may request from management for the purpose of the audit; and*
- Unrestricted access to persons within the entity from whom we determine it necessary to obtain audit evidence. This includes our entitlement to require from the officers of the Company such information and explanations as we may think necessary for the performance of our duties as auditor.*

*As part of our audit process, we will request from [management and, where appropriate, those charged with governance], written confirmation concerning representations made to us in connection with the audit.*

*We also wish to invite your attention to the fact that our audit process is subject to 'peer review' under the Chartered Accountants Act, 1949 to be conducted by an Independent reviewer. The reviewer may inspect, examine or take abstract of our working papers during the course of the peer review.*

*We look forward to full cooperation from your staff during our audit.*

*[Other relevant information]; [Insert other information, such as fee arrangements, billings and other specific terms, as appropriate.]; [Insert appropriate reference to the expected form and content of the auditor's report.]*

*The form and content of our report may need to be amended in the light of our audit findings.*

*Please sign and return the attached copy of this letter to indicate your acknowledgement of, and agreement with, the arrangements for our audit of the financial statements including our respective responsibilities.*

*XYZ & Co.*

*Chartered Accountants*

*(Signature)*

*(Name of the Member)*

*(Designation)*

*Date:*

*Place:*

*Acknowledged on behalf of ABC Company by*

*(Signature)*

*Name and Designation:*

*Date:*

## 3. SA 220 – Quality Control for an Audit of Financial Statements

### Contents

- Terms of Engagement
- Pre-conditions of an Audit
- Factors affecting independence of audit
- Engagement Letter
- Change in terms of engagement

### 3.1 Introduction

SA 220 deals with the specific responsibilities of the auditor with respect to quality control procedures for an audit. **Quality control systems, policies and procedures are the responsibility of the audit firm.** The auditor has to implement quality control procedures at the engagement level that provide the auditor with reasonable assurance that:

- Audit complies with professional standards and legal regulations
- Audit report is appropriate.

### 3.2 Important terms

#### 3.2.1 Quality Control Process

The firm's system of quality control should include policies and procedures addressing each of the following elements:

- Leadership responsibilities for quality within the firm.
- Ethical requirements.
- Independence
- Acceptance and continuance of client relationships and specific engagements.
- Assignment of competent and capable engagement teams.
- Engagement performance.
- Monitoring.
- The quality control policies and procedures should be documented and communicated to the firm's personnel.

#### 3.2.2 Engagement partner

The partner or other person in the firm who is a member of the ICAI and is in full time practice and is responsible for

- the engagement and its performance, and

- the report that is issued on behalf of the firm.

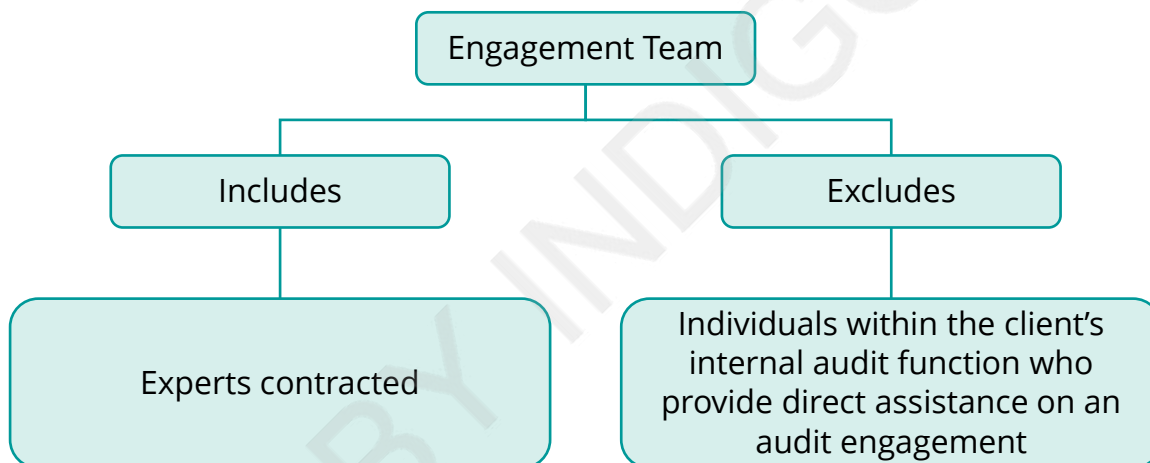
As a part of this responsibility Engagement Partner should emphasize the following to the engagement Team (ET):

- Compliance with professional Standards and legal requirements.
- Compliance with firm's Quality Control Policies and procedures as applicable.
- Issuance of appropriate audit report.
- Ability to raise concerns without fear.
- Quality is essential & indispensable in engagement performance.

### 3.2.3 Engagement Quality Control Review

A process designed to provide an objective evaluation, before the report is issued, of the significant judgments the engagement team made and the conclusions they reached in formulating the report.

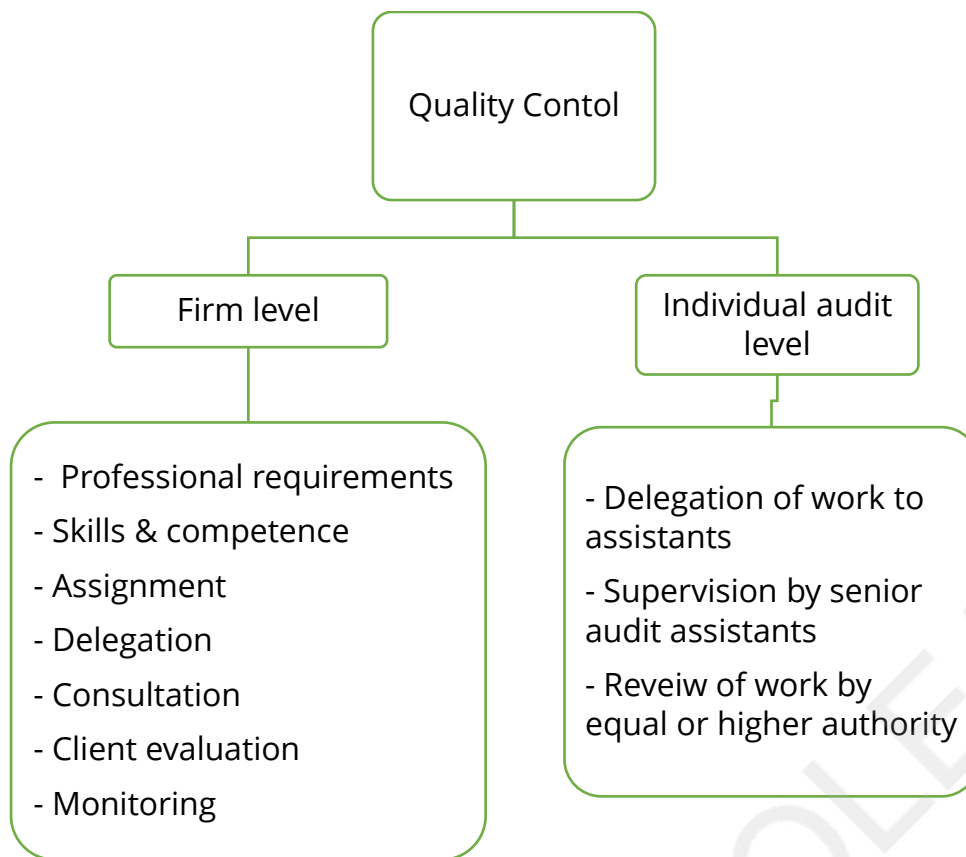
### 3.2.4 Engagement Team - All personnel performing an audit engagement.



## 3.3 Quality Control

Quality control of an audit can be ensured at two levels.





### 3.4 Quality controls at firm level

The audit firm should implement quality control policies and procedures designed to ensure that all audits are conducted in accordance with SAs.

- Compliance with Standards on Auditing.
- Communicating quality control policies to personnel.

#### 3.4.1 Objectives of quality control policies

The objectives of the quality control policies to be adopted by an audit firm will incorporate the following:

- **Professional requirements:** Personnel in the firm should adhere to the principles of independence, integrity, objectivity, professional competence, confidentiality and professional behaviour.
- **Skills and competence:** the engagement partner may take into consideration such matters as the team's:
  - Understanding of, and practical experience with, audit engagements of a similar nature and complexity through appropriate training and participation.
  - Understanding of professional standards and regulatory and legal requirements.
  - Technical expertise, including expertise with relevant information technology and specialised areas of accounting or auditing.

- Knowledge of relevant industries in which the client operates.
- Ability to apply professional judgment.
- Understanding of the firm's quality control policies and procedures.
- **Assignment:** Audit work is to be assigned to personnel who have the required degree of technical training and proficiency.
- **Delegation:** When the work is delegated to the assistants, the auditor should carefully direct, supervise and review the work to ensure that audit meets appropriate standards of quality.
- **Consultation:** If necessary, the auditor may consult experts either within or outside the firm.

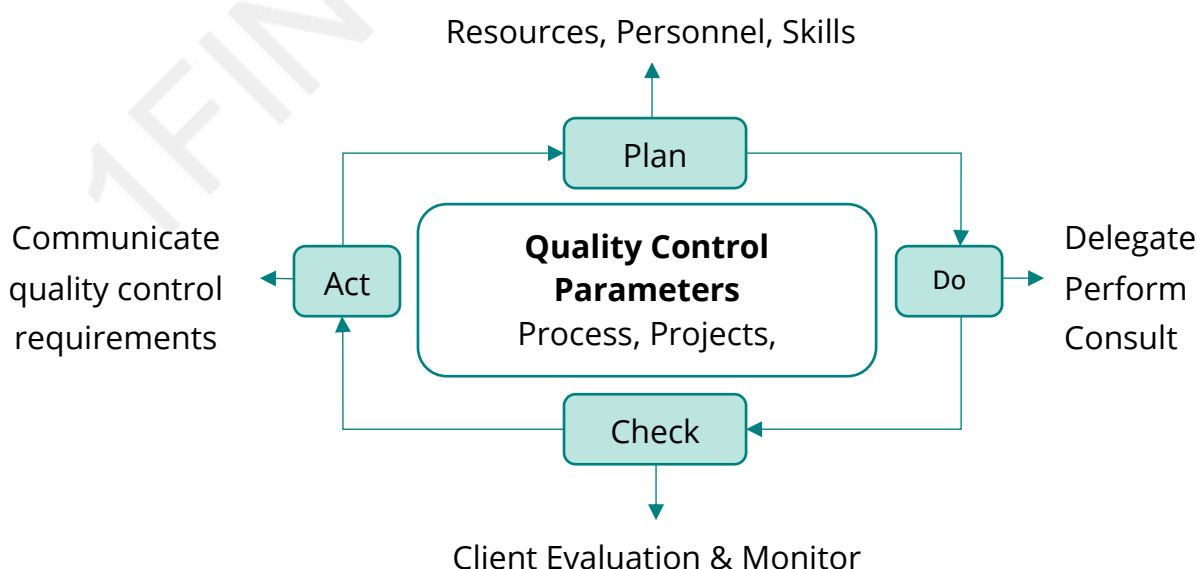
Effective consultation on significant technical, ethical, and other matters within the firm or, where applicable, outside the firm can be achieved when those consulted:

- Are given all the relevant facts that will enable them to provide informed advice; and
- Have appropriate knowledge, seniority and experience

- **Client evaluation:** The firm must evaluate the client and risk associated with such audit before accepting or continuing a client engagement.
- **Monitoring:** The firm must monitor the adequacy and effectiveness of quality control policies and procedures.

### 3.4.2 Communication of quality control policies

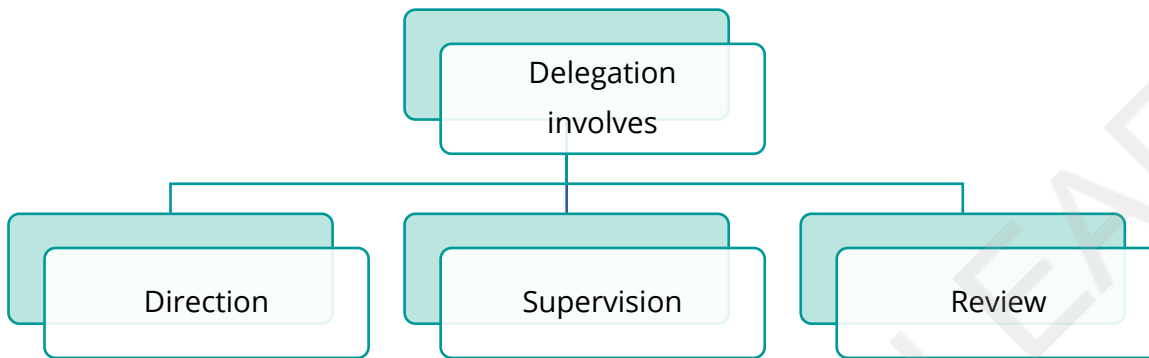
**3.4.3** The quality control policies and procedures must be communicated to all partners and staff of the firm engaged in audit practice in a manner that provides reasonable



assurance that the policies and procedures are understood and implemented.

### 3.5 Quality controls at individual audit level

The auditor should implement only those quality control policies and procedures of the firm, which are appropriate to the individual audit.



#### 3.5.1 Direction of work

- Depends on professional competence of each assistant.
- Involves informing assistants about their responsibilities; objectives of procedures to be performed by them and other important matters affecting the nature, timing and extent of their audit procedures.
- Important tools for communication are audit programs, time budgets and overall audit plan.

#### 3.5.2 Supervision by senior assistants

Senior assistants in the engagement team should:

- Monitor the progress of audit.
- Obtain information about significant accounting and auditing questions raised and review the audit program to carry out necessary modifications.
- Resolve differences of professional judgment, if any, among the audit personnel.
- Identify matters for consultation or consideration by more experienced team members.

#### 3.5.3 Review of work

Review of work done by engagement team should be done by a person of equal or higher competence at all stages of the audit process to ensure:

- Completion of audit work as per the audit program.
- Achievement of objective of audit procedures.
- Consideration of all significant matters.
- Consistency of audit conclusions with the results of the work performed and should support audit opinion

### 3.6 Review Procedures

The engagement partner shall take responsibility for reviews being performed in accordance with the firm's review policies and procedures. Review procedures consists of the considerations, whether,

- the work has been performed in accordance with professional standards and regulatory and legal requirements;
- Significant matters have been raised for further consideration;
- appropriate consultations have taken place and the resulting conclusions have been documented and implemented;
- the work performed supports the conclusions reached and is appropriately documented;
- the evidence obtained is sufficient and appropriate to support the auditor's report; and
- the objectives of the engagement procedures have been achieved.
- When the auditor delegates work to assistants or uses work performed by other auditors/experts he will continue to be responsible for forming and expressing his opinion on the financial statements.



The engagement partner need not review all audit documentation, but may do so.

However, he will be entitled to rely on the work performed by others, provided he exercises adequate skill and care and is not aware of any reason to believe that he should not have so relied.

- The auditor should carefully direct, supervise and review work delegated to assistants. He should obtain reasonable assurance that work performed by other auditors/experts and assistants is adequate for his purpose.

### 3.7 Engagement Quality Control Review

The engagement partner shall:

- Ensure appointment of engagement quality control reviewer
- Discuss significant matters with the engagement quality control reviewer;

- Issue auditor's report only after the completion of the engagement quality control review.

The engagement quality control reviewer shall perform an objective evaluation of the significant judgments made by the engagement team, and the conclusions reached in formulating the auditor's report.

### **3.7.1 Objective Evaluation by the reviewer**

- Discussion of significant matters with the engagement partner;
- Review of the financial statements and the proposed auditor's report;
- Review of selected audit documentation relating to the significant judgments and the conclusions reached; and
- Evaluation of the conclusions to ensure appropriateness of report issued.

### **3.7.2 Additional requirements for review of listed companies**

- Firm's independence
- Ensure appropriate consultation taken for difference of opinions and engagement team has followed the firm's policies and procedures for dealing with and resolving differences of opinion

## **3.8 Documentation**

### **3.8.1 Auditor shall document**

- Issues relating to compliance with ethical requirements and how they were resolved.
- Conclusions on compliance with independence requirements including discussions with the firm that support these conclusions.
- Conclusions reached regarding the acceptance and continuance of client relationships and audit engagements.
- The nature and scope of, and conclusions resulting from, consultations

### **3.8.2 Engagement Quality Control Reviewer shall document**

- Procedures have been performed as per firm's policies
- Review has been completed before audit report date
- No unresolved matters that would cause judgements and conclusions inappropriate.

# SQC 1 - Quality Control for Firms that perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements

## • Purpose of SQC

Firm should establish a system of QC designed to provide it with reasonable assurance that:

- a. the firm and its personnel comply with professional standards and regulatory and legal requirements, and
- b. Reports issued by the firm or engagement partner(s) are appropriate in the circumstances.

## • Elements of a System Quality

Firm's system of QC should include policies and procedures addressing the following elements:

a. Leadership responsibilities for quality within the firm.
b. Ethical requirements.
c. Acceptance and continuance of client relationships and specific engagements.
d. Human resources.
e. Engagement performance.
f. Monitoring.

Quality Control policies and procedures should be documented and communicated to the firm's personnel.

### 3. Leadership responsibilities for quality within of the firm

- Firm should establish policies and procedures designed to promote an internal culture based on the recognition that quality is essential in performing engagements.
- Such policies and procedures should require firm's CEO or managing partners to assume ultimate responsibility for the firm's system of QC.
- Any person or person's assigned operational responsibility for the firm's QC system by the firm's CEO or managing board of partners should have sufficient and appropriate experience and ability, and the necessary authority, to assume that responsibility.

### 4. Ethical requirements

- Firm should establish policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with relevant ethical requirements.
- The Code establishes the fundamental principles of professional ethics, which include:
  - Integrity;
  - Objectivity;
  - Professional competence and due care;
  - Confidentiality; and



- Professional behavior.
- Firm should establish policies and procedures designed to provide it with reasonable assurance that the firm and its personnel maintain independence where required by the Code.
- Such policies and procedures should enable the firm to:
  - a) Communicate its independence requirements to its personnel
  - b) Identify and evaluate circumstances and relationships that create threats to independence, and to take appropriate action to eliminate those threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the engagement.
- There should exist a mechanism in the firm by which EPs provide the firm with relevant information about client engagements and personnel of firm promptly notify firm of circumstances and relationships that create a threat to independence. All breaches of independence should be promptly notified to firm for appropriate action. Its objective is to ensure that independence requirements are satisfied.
- At least annually, the firm should obtain written confirmation of compliance with its policies and procedures on independence from all firm personnel required to be independent in terms of the requirements of the Code.

#### • **Acceptance and Continuance of Client Relationships and Specific Engagements**

- A firm before accepting an engagement should acquire vital information about the client. Such an information should help firm to decide about:
  - a) Integrity of Client, promoters and key managerial personnel.
  - b) Competence (including capabilities, time and resources) to perform engagement.
  - c) Compliance with ethical requirements.
- Firm should obtain such information as it considers necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client. Where issues have been identified, and the firm decides to accept or continue the client relationship or a specific engagement, it should document how the issues were resolved.
- If there is any conflict of interest between the firm and client, it should be properly resolved before accepting engagement. Where the firm obtains information that would have caused it to decline an engagement if that information had been obtainable earlier, policies and procedures on the continuance of the engagement and the client relationship should include consideration of:
  - a) professional and legal responsibilities that apply to the circumstances, including whether there is a requirement for the firm to report to the person or persons who made the appointment or, in some cases, to regulatory authorities; and
  - b) Possibility of withdrawing from the engagement or from both the engagement and the client relationship.

#### **Considerations as to integrity of clients**

With regard to the integrity of a client, matters that the firm considers include, for example:

1. The identity and business reputation of the client's principal owners, key management, related parties and those charged with its governance.
2. The nature of the client's operations, including its business practices.
3. Information concerning the attitude of the client's principal owners, key management and those charged with its governance towards such matters as aggressive interpretation of accounting standards and the internal control environment.
4. Whether the Client is aggressively concerned with maintaining the firm's fees as low as possible.
5. Indications of an inappropriate limitation in the scope of work.
6. Indications that the client might be involved in money laundering or other criminal activities.
7. The reasons for the proposed appointment of the firm and non-reappointment of the previous firm.

#### • Human resources

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- Firm should establish policies and procedures designed to provide it with reasonable assurance that it has sufficient personnel with the capabilities, competence, and commitment to ethical principles necessary to perform its engagements in accordance with professional Standards and regulatory and legal requirements, and to enable the firm or engagement partners to issue reports that are appropriate in the circumstances.
- Such policies and procedures address the following personnel issues:
  - a) Recruitment;
  - b) Performance evaluation;
  - c) Capabilities;
  - d) Competence;
  - e) Career development;
  - f) Promotion;
  - g) Compensation; and
  - h) Estimation of personnel needs.

#### • Engagement Performance

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Consistency in quality of engagement performance is achieved through briefing of engagement teams of their objectives, processes for complying with engagement standards, processes of engagement supervision and training, methods of reviewing performance of work, appropriate documentation of work performed.

#### Consultation

- Consultation should take place in difficult matters pertaining to an engagement and includes discussion, at appropriate professional level, with individuals within or outside the firm who have specialized expertise, to resolve a difficult matter.
- "A firm needing to consult externally, for example, a firm without appropriate internal resources, may take advantage of advisory services provided by other firms or professional & regulatory bodies.

## Engagement Quality Control Review (EQCR)

- Significant judgments made in an engagement should be reviewed by EQC reviewer for taking an objective view before the report is issued.
- The extent of the review depends on the complexity of the engagement and the risk that the report might not be appropriate in the circumstances. The review does not reduce the responsibilities of the EP.
- EQCR is mandatory for all audits of F.S. of listed entities. In respect of other engagements, firm should devise criteria to determine cases requiring performance of EQCR.

## Differences of opinion

- There might be difference of opinion within ET, with those consulted and between EP and EQC reviewer. The report should only be issued after resolution of such differences.
- In case, recommendations of EQC reviewer are not accepted by EP and matter is not resolved to reviewer's satisfaction, the matter should be resolved by following established procedures of firm like by consulting with another practitioner or firm, or a professional or regulatory body.

## Engagement documentation

- Firm should establish policies and procedures for ETs assembly of final engagement files on a timely basis after the engagement reports have been finalized. Engagement files should be completed in not more than 60 days after date of auditor's report.
- Firm should establish policies and procedures designed to maintain the confidentiality, safe custody, integrity, accessibility and retrievability of engagement documentation.
- Unless otherwise specified by law or regulation, engagement documentation is the property of the firm. The firm may, at its discretion, make portions of, or extracts from, engagement documentation available to clients, provided such disclosure does not undermine the validity of the work performed, or, in the case of assurance engagements, the independence of the firm or its personnel.
- Engagement documentation has to be retained for a period of time sufficient to permit those performing monitoring procedures to evaluate the firm's compliance with its system of QC, or for a longer period if required by law or regulation.
- In specific case of audit engagements, the retention period ordinarily is no shorter than 7 years from the date of the auditor's report, or, if later, the date of the group auditor's report.

## • Monitoring

- Firm should establish policies and procedures designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate, operating effectively and complied with in practice.
- Such policies and procedures should include an ongoing consideration and evaluation of the firm's system of quality control, including a periodic inspection of a selection of completed engagements.

## 4. SA 230 – Audit Documentation

### Contents

- Nature & Purpose of Audit documentation
- Form, Content & Extent of Audit documentation
- Time limit, ownership and retention of working papers
- Permanent and Current Audit Files

### 4.1 Introduction

The auditor shall prepare audit documentation of the audit procedures performed and audit evidence obtained on a timely basis.

Audit documentation – The record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached (terms such as “working papers” or “workpapers” are also sometimes used).

Documentation is synonymous with working papers. Audit working papers constitute all documents

- prepared
- obtained
- retained

by the auditor during the course of audit and the audit conclusions.

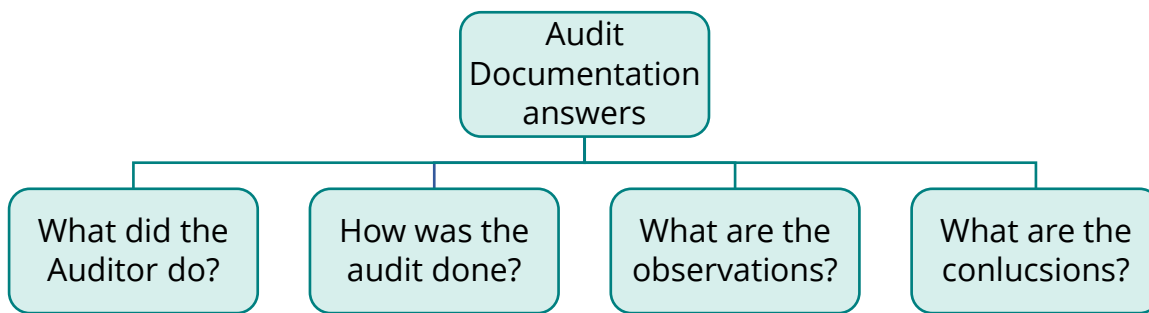
Audit done but not documented is audit not done

Audit file contains the records (physical or electronic form) that comprise the audit documentation for a specific engagement

### 4.2 Nature & Purpose of Audit Documentation

Audit documentation mainly serves as an evidence:

- (a) Evidence of the auditor's basis for audit report; and
- (b) Evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements.



#### 4.2.1 Additional Purposes

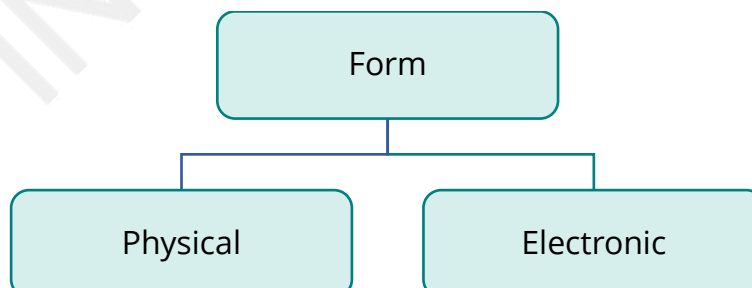
- Assisting the engagement team to plan and perform the audit.
- Assisting members of the engagement team responsible for supervision to direct and supervise the audit work.
- Enabling the engagement team to be accountable for its work.
- Retaining a record of matters of continuing significance to future audits.
- Enabling the conduct of quality control reviews and inspections.
- Enabling the conduct of external inspections in accordance with applicable legal, regulatory or other requirements.

#### 4.3 Form, Content & Extent

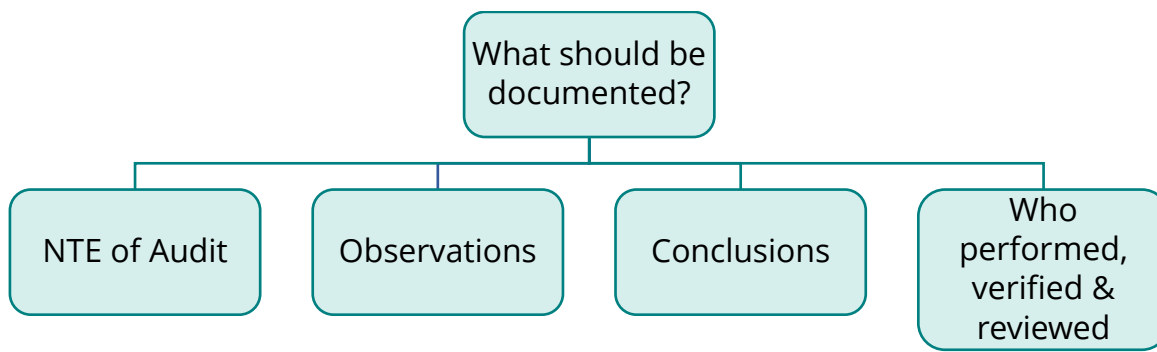
The form, content and extent of audit documentation depend on factors such as:

- size and complexity of the entity.
- nature of the audit procedures to be performed.
- identified risks of material misstatement.
- significance of the audit evidence obtained.
- nature and extent of exceptions identified.
- 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.
- audit methodology and tools used.

##### 4.3.1 Form

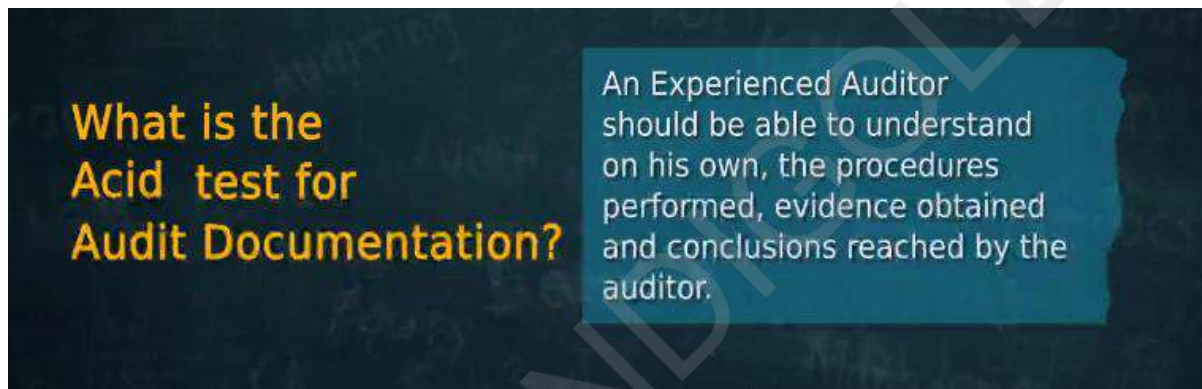


##### 4.3.2 Content



The auditor shall prepare audit documentation that is sufficient to enable an experienced auditor to understand:

- The nature, timing, and extent of the audit procedures; (NTE)
- The results / observations of the audit procedures performed, and the audit evidence obtained; and
- Significant matters arising during the audit and the conclusions reached thereon.



### **Experienced Auditor**

An individual (whether internal or external to the firm) who has practical audit experience, and a reasonable understanding of:

- Audit processes
- SAs and applicable legal & regulatory requirements
- Business environment in which entity operates
- Auditing and financial reporting issues



Auditor shall also record:

- The identifying **characteristics** of the **specific items or matters tested**;
- **Who performed** the audit work and the date work was completed;
- **Who reviewed** the audit work performed and date and extent of such review?



If the auditor identified inconsistent information, the auditor shall document how the auditor addressed the inconsistency.

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the

#### 4.3.3 Departure from SAs

If, in exceptional circumstances, the departures from SA, the auditor shall document the reasons for the departure and alternative procedures performed.

#### 4.3.4 Matters arising after the Date of the Auditor's Report

If, in exceptional circumstances, the auditor performs new or additional audit procedures or draws new conclusions after the date of the auditor's report, the auditor shall document:

- The circumstances encountered;
- The new or additional audit procedures performed, audit evidence obtained, and conclusions reached, and their effect on the auditor's report; and
- When and by whom the changes to audit documentation were made and reviewed.

#### 4.4 Time limit for Documentation

Auditor should, ideally document contemporaneously. That means as the work is being done, documentation should happen simultaneously.

The auditor shall finally assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely after the date of the auditor's report.



SQC 1 suggests maximum period of **60 days** from the date of auditor's report for completion of assembly of audit files

basis

#### Assembly of final audit file:

SQC-1 requires firm to establish policies and procedures for timely completion of assembly of audit files.

**Preparation Period** → Within 60 days from the date of audit period.

**Retention Period** → Minimum 7 years from the date of audit period.

After the assembly, the auditor shall not delete audit documentation before the end of its retention period.

#### 4.5 Ownership of Audit Documents

Auditor owns audit documents but he can make copies available to the client or to any person authorized by the client.

Auditor is prohibited from disclosing confidential client information without management consent.

The auditor's property rights are subject to limitations of the Chartered Accountants Act, 1949, which prohibits disclosure of confidential client information without the managements consent except when required by the law.

As per SQC - 1, unless otherwise specified by law or regulation, Audit documentation is the property of the auditor.

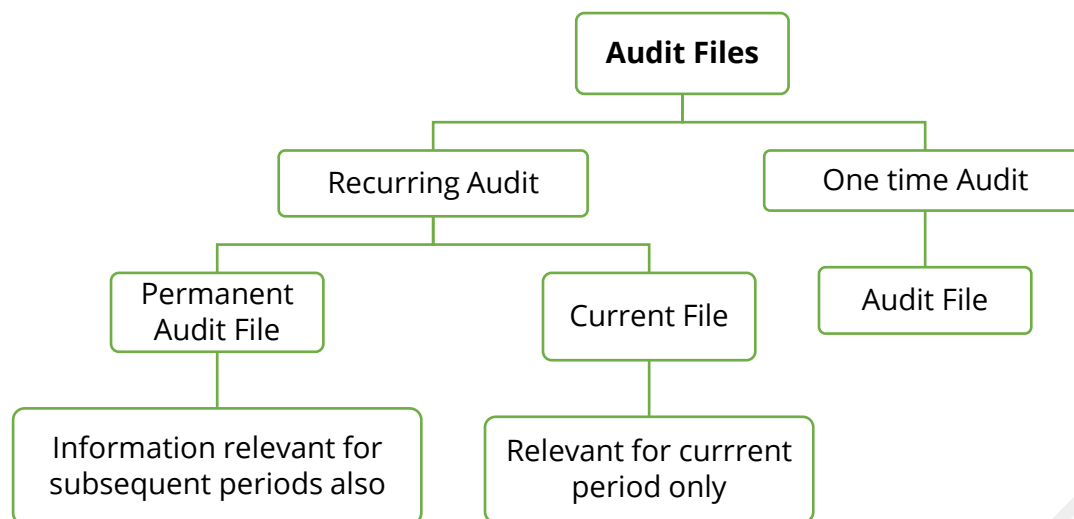
#### 4.6 Retention of Audit Documentation

There are no explicit rules relating to the retention of working papers. They should be retained as long as the auditor opines them to be useful in servicing the client or to comply with legal or professional requirements.

SQC 1 requires retention of working papers to be at least for **7 years** from the date of auditor's report.

#### 4.7 Filing of working papers

Although audit of each entity is unique in itself, a general approach to the arrangement/ organization of working papers can be adopted.



#### 4.7.1 Permanent Audit File

Permanent audit file should contain information, which is of continuing interest and relevance to succeeding audits.

Much of the information contained in this file is collected in the first audit and is updated for each subsequent audit.

#### Contents of Permanent Audit File

- Information regarding legal and organizational structure of the entity (e.g. partnership deed in case of a partnership firm).
- Extracts or copies of important legal documents, agreements and minutes relevant to the audit (e.g. lease agreement, contracts with major suppliers and so on).
- Record of study and evaluation of internal controls related to accounting system (e.g. flow charts, questionnaires, narrative descriptions and observations concerning the strengths, weaknesses and action taken by the company to eliminate weaknesses).
- Copies of audited financial statements for previous years.
- Analysis of significant ratios and trends (e.g. changes in ratios such as gross profit, current ratio and rate of return on shareholder's equity helps the auditor in identifying areas where there are unusual changes during the year, and which require special attention).
- Copies of management letters issued by the auditor, if any (e.g. management letter).
- Record of communication with the retiring auditor, if any.
- Notes regarding significant accounting policies.
- Significant audit observations of earlier years.

#### 4.7.2 Current File

Current audit file contains information relating to and relevant to the audit of current period. The following information may be filed in the current audit file:

- Correspondence relating to acceptance of annual re-appointment.
- Extracts of important matters in the minutes of the board meetings and general meeting as are relevant to audit (e.g. minutes relating to declaration of dividend).
- Audit plan and audit program.
- Analysis of transactions and balances (e.g. age- wise analysis of debtors).
- Record of audit procedures and their results (e.g. test checking of purchase invoices to vouch payments for purchases).
- Evidence regarding the supervision and review of the work of assistants.
- Copies of communication with other auditors (e.g. branch auditor), experts (e.g. lawyers, architects) and other third parties (e.g. banks, debtors).
- Copies of letters or notes concerning audit matters communicated to or discussed with client.
- Management representations.
- Auditor's conclusions regarding significant matters.
- Copies of financial statements being reported on and the related audit report.



It is not necessary to document separately compliance with SAs if it is demonstrated by documents included within the audit file.

Documentation of the professional judgments made explain the auditor's conclusions and are required for

- (i) reviewing audit documentation,
- (ii) subsequent audits, when reviewing matters of continuing significance

#### 4.7.3 Audit Completion Memorandum

It is a summary of audit approach planned and performed including the results and conclusions.

It helps auditors to consider whether the conclusions reached are appropriate and backed with appropriate supporting.

#### 4.8 Audit Note Book

Audit Note Book contains information regarding day-to-day work performed by the audit staff on any particular date. It is maintained by the audit staff to record important points observed, errors, doubtful queries, explanations and clarifications to be received from the clients.

Audit note book should contain General information & current information.

#### **4.8.1 General Information**

- Nature of business
- Important provisions of MOA & AOA
- Structure of organisation
- List of books of accounts
- Name of principal officers, duties and responsibilities
- Particulars of accounts and internal controls, financial policies
- Significant contracts

#### **4.8.2 Current Information**

- Audit queries not cleared
- Mistakes or irregularities observed
- Unsatisfactory book-keeping arrangements
- Important information about company, not forming part of the accounts
- Special points requiring consideration at the time of verification of final accounts
- Important matters for future reference.

## 5. Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements

### Contents

- Fraud
- Responsibility of Auditor
- Risk assessment procedures and related activities
- Inquiries of Management and those charged with governance
- Evaluation of Fraud Risk Factors
- Responses to the Assessed Risks
- Evaluation of Audit evidence
- Communication and Documentation

### 5.1 Fraud

Fraud, for the purpose of this SA is essentially a misstatement in the financial statements. Misstatements in the financial statements can arise from either fraud or error.

'Error' in context of audit has been defined by SA 240 as "Unintentional" misstatement in financial statements, including omission of an amount or a disclosure. Fraud is due to intentional misstatement whereas error is an unintentional misstatement.

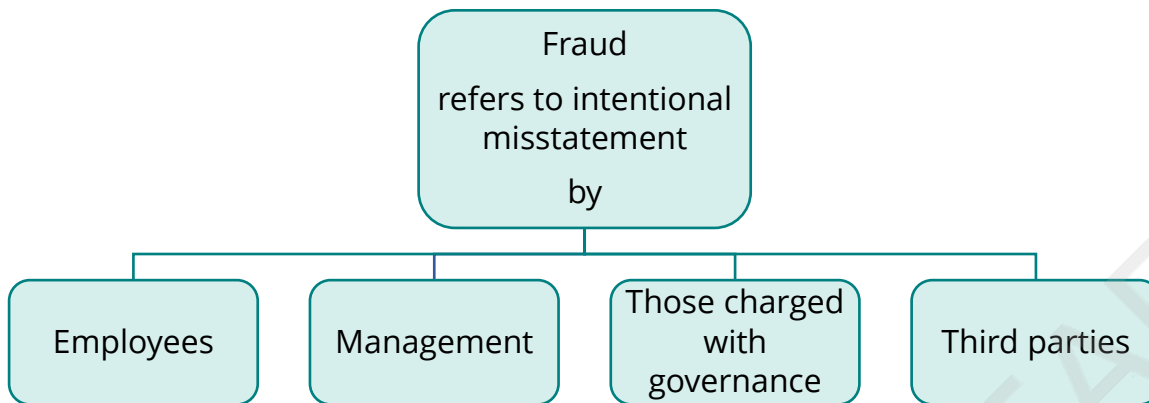
**'Fraud'** refers to intentional misstatement, which is material to the Financial Statements. Management, those charged with governance, employees or third parties may get involved in committing frauds to obtain an illegal advantage or personal gain.

#### 5.1.1 Characteristics of Fraud

- Fraud results in a misstatement in financial statement
  - Misappropriation of assets – Employee Fraud
  - Manipulation of accounts – Management Fraud
- Frauds are caused generally due to the involvement of employees or management.
- Frauds are intentional in nature, they are committed with due care. Frauds are deliberately concealed.

- Frauds are planned. A person responsible for fraud has knowledge of what he is doing
- Usually errors are rectified and ratified but frauds should be reflected in financial statements.

### 5.1.2 Parties involved in a Fraud



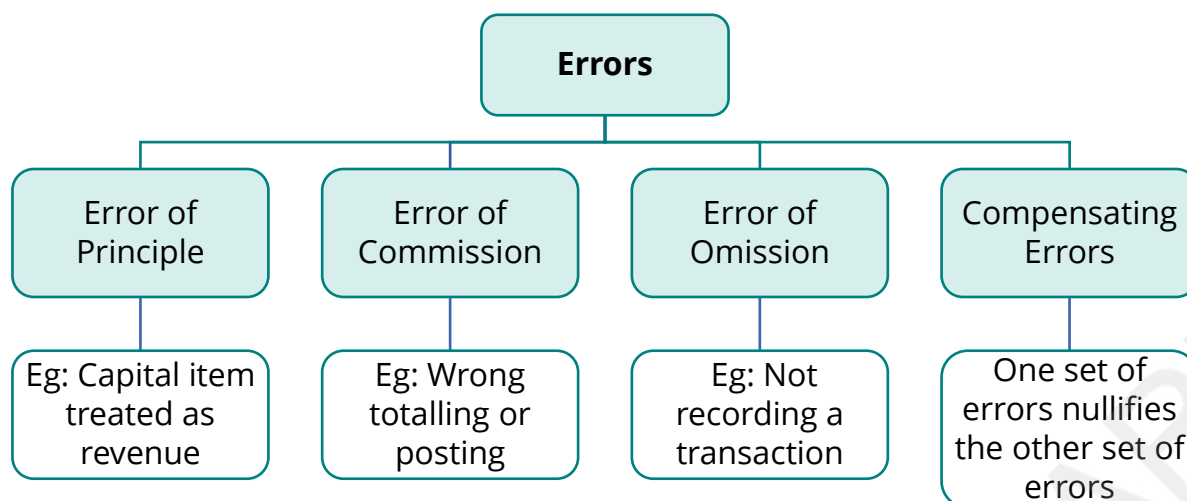
#### Example

To reflect a good financial position deliberately purchase is suppressed. Here suppression of purchase is used for deception, which is done intentionally by management and employees with the directions of those charged with governance. As a result of this by showing inflated profit the entity will enjoy unjust or illegal advantage of fictitious financial health.

- Fraud – Suppression of Purchases
- Misstatement – Inflated profits

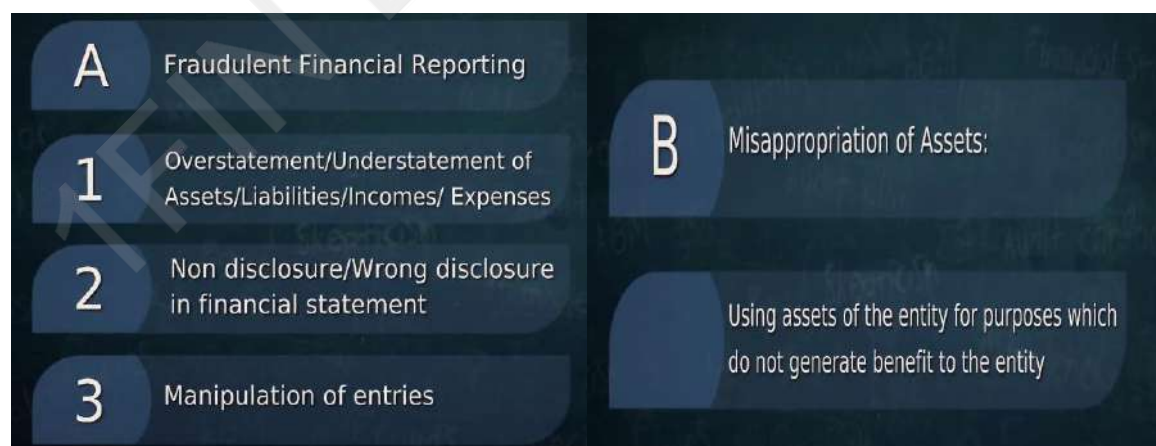
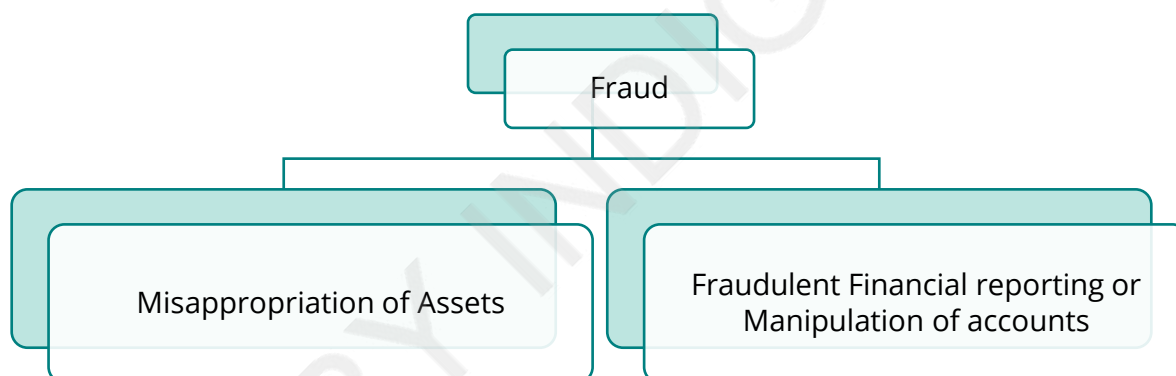


### 5.1.3 Types of Errors



## 5.2 Types of Fraud

### 5.2.1 Based on effect



### 5.2.2 Based on organisational structure

- **Employee fraud**

It generally involves the theft of assets, mostly of cash or goods from the firm, using assets for personal use, payment for purchase of assets not received, etc. Transactions are recorded in a manner so as to conceal theft.

**For example**, fictitious purchases may be recorded to misappropriate cash; actual sales may be shown as 'goods on consignment' to misappropriate good; good production may be sold as defective or as scrap and then may be used for personal purposes and so on. Business relies on the system of internal control to reduce the probability of occurrence of employee fraud.

- **Management fraud**

It involves manipulation of accounts by the upper level management for the purpose of deliberately misrepresenting the firm's financial position or results of operations to

- evade taxes,
- receive higher remuneration (when it is based on a percentage of profits),
- show better performance of management, etc.

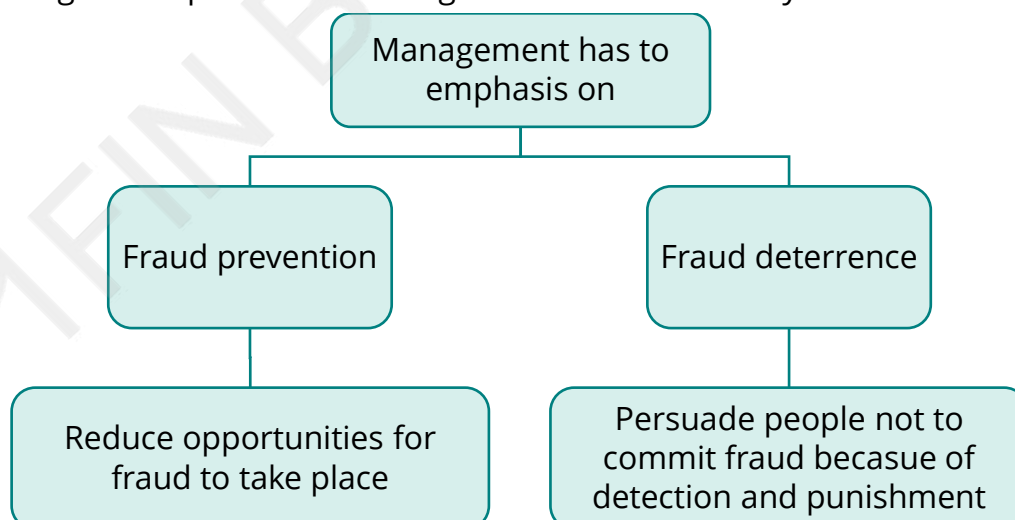
This process is also called "Window Dressing" The internal control procedures may be overridden by the management's directive to perpetuate this kind of fraud.

**For example** – Overvaluation of stock, undervaluation of assets, escalating profits, hyping expenses, intentional misapplication of accounting principle.

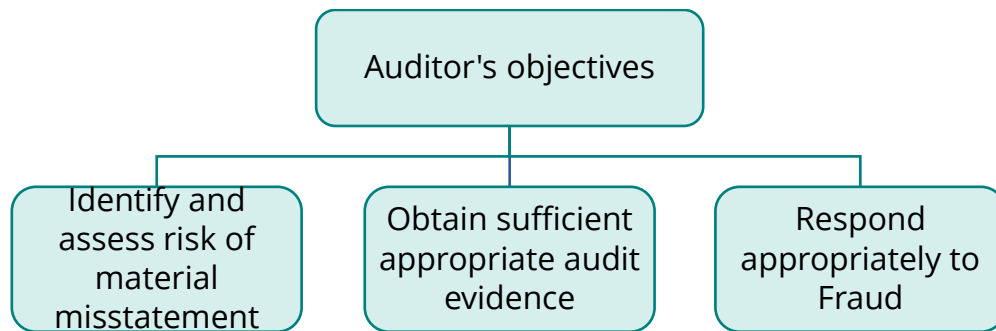
### 5.3 Responsibility for Prevention & Detection of the Fraud

Primary responsibility is that of **management or those charged with governance**. They are responsible for

- Prevention of fraud and error.
- Design and operate accounting and internal control system.



### 5.4 Objectives of Auditor in relation to a Fraud



- To identify and assess the risks of material misstatement in the financial statements due to fraud;
- To obtain sufficient appropriate audit evidence about the assessed risks of material misstatement to fraud, through designing and implementing appropriate responses; and
- To respond appropriately to identified or suspected fraud.

Auditor has to act like a watch dog and not a blood hound.

## 5.5 Responsibility of auditor in relation to a fraud

Due to certain inherent limitations, even an audit, which is properly planned and performed in accordance with generally accepted auditing standards, may fail to detect a cleverly concealed fraud. E.g. Forgery or collusion among employees or management or those charged with governance. The auditor, thus, cannot be held responsible for the prevention and detection of fraud and error.



The auditor's responsibility for detecting errors and fraud is identical as both results in misstatements in financial statements.

among with

Risk of not detecting fraud > Risk of not detecting error

Risk of not detecting management fraud > Risk of not detecting employee fraud

### 5.5.1 Obtain reasonable assurance

A financial audit is conducted by the auditor to obtain reasonable (not absolute) assurance that financial statements are free from material misstatements caused by fraud and/ or

error.

### 5.5.2 Consider risk of material misstatement

The term reasonable assurance implies that some risk of material misstatement could be present in the financial statements and auditor will fail to detect it. Therefore, he should consider the risk of material misstatement resulting from fraud or error during all the stages of audit process.

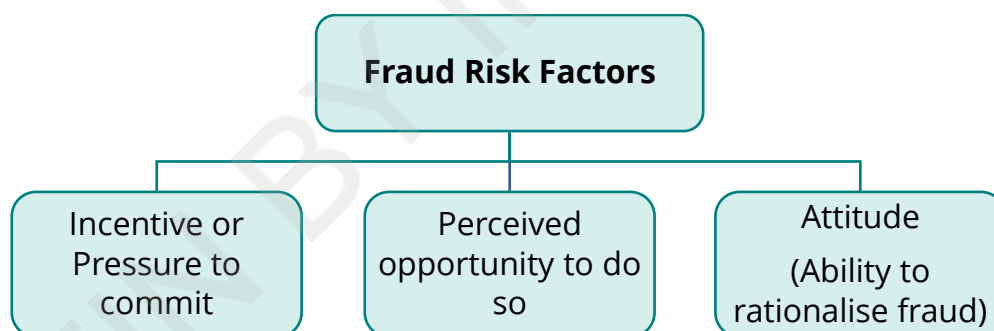
Auditor should consider the risk of material misstatement resulting from fraud or error during all the stages of audit.

The management is responsible for identification of fraud. However, where auditor comes across a situation where any misstatement due to fraud or error exists, then he should apply additional procedures to confirm.

## 5.6 Fraud Risk Factors

They refer to events or conditions that become the reason for one to commit fraud.

**Fraud Risk Factors** - Events or conditions that indicate an incentive or pressure to commit fraud or provide an opportunity to commit fraud.



### 5.6.1 Incentive or Pressure to commit

#### Misappropriation of Assets

- Personal financial obligations may create pressure on management or employees with access to cash or other assets susceptible to theft to misappropriate those assets.
- Adverse relationships between the entity and employees with access to cash or other assets susceptible to theft may motivate those employees to misappropriate those assets.

#### Fraudulent Financial Reporting

- Financial stability or profitability is threatened by economic, industry, or entity operating conditions, such as high competition, low customer demand, negative cash flows.

- Excessive pressure exists for management to meet the requirements or expectations of third parties due to trend level expectations, debt or listing requirements,
- Sometimes personal financial situation of management or those charged with governance is threatened by the entity's financial performance due to significant financial interests in the entity, performance related compensations, etc

### 5.6.2 Perceived opportunity to do so

#### Misappropriation of Assets

- Certain characteristics or circumstances may increase the susceptibility of assets to misappropriation. For example, opportunities to misappropriate assets increase when there are the following:
  - Large amounts of cash on hand or processed.
  - Inventory items that are small in size, of high value, or in high demand.
- Easily convertible assets, such as bearer bonds, diamonds, or computer chips.
- Inadequate internal control over assets may increase the susceptibility of misappropriation of those assets.

#### Fraudulent Financial Reporting

- The nature of the industry or the entity's operations provides opportunities to engage in fraudulent financial reporting like significant related party transactions, subjective judgements, complex transactions.
- The monitoring of management is not effective due to single person domination on management or oversight by those charged with governance.
- Complex or unstable organisational structure
- Inadequate monitoring of controls
- High turnover of employees
- Non effective accounting and information systems

### 5.6.3 Attitude

#### Misappropriation of Assets

- Disregard for internal controls
- No appropriate remedial action on known deficiencies in internal control.
- Behaviour indicating displeasure or dissatisfaction with the entity or its treatment of the employee.
- Changes in behaviour or lifestyle
- Tolerance of petty theft.

## Fraudulent Financial Reporting

- Non effective communication, implementation, support, or enforcement of the entity's values or ethical standards by management
- Non-financial management's excessive participation
- Excessive interest by management in maintaining or increasing the entity's stock price or earnings trend
- Low morale among senior management.
- No distinction between personal and business transactions

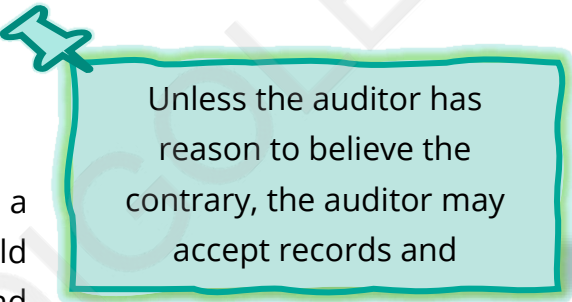
### 5.7 Auditor's Approach

The auditor can consider the following approach at the planning stage of the audit process

#### 5.7.1 Approach work with professional skepticism:

- Be alert to any signals of misstatement and to expand audit procedures accordingly.
- Unless there is a reasonable ground of doubt, the auditor should not question the authenticity of documents and records.

For example, when presented with a photocopied document, the auditor should exercise professional skepticism and consider the need to obtain original documents



Unless the auditor has reason to believe the contrary, the auditor may accept records and

#### 5.7.2 Discussion with his audit team member

He should discuss with his audit team about the susceptibility of the entity's financial statements having material misstatements from fraud and error and design audit procedures accordingly.

#### 5.7.3 Risk Assessment procedures:

To assess the risk of material misstatement resulting from fraud, the auditor should

- Consider whether fraud risk factors are present that indicate the possibility of fraud.
- Make enquiries of management to obtain information about its understanding of possibility of fraud occurring within the entity.
  - nature, extent and frequency of risk assessments;
  - process for identifying and responding to the risks of fraud in the entity
  - communication to those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity; and
  - communication to employees regarding its views on business practices and ethical behaviour
  - any knowledge of any actual, suspected or alleged fraud

#### 5.7.4 Responses to Fraud Risk factors identified



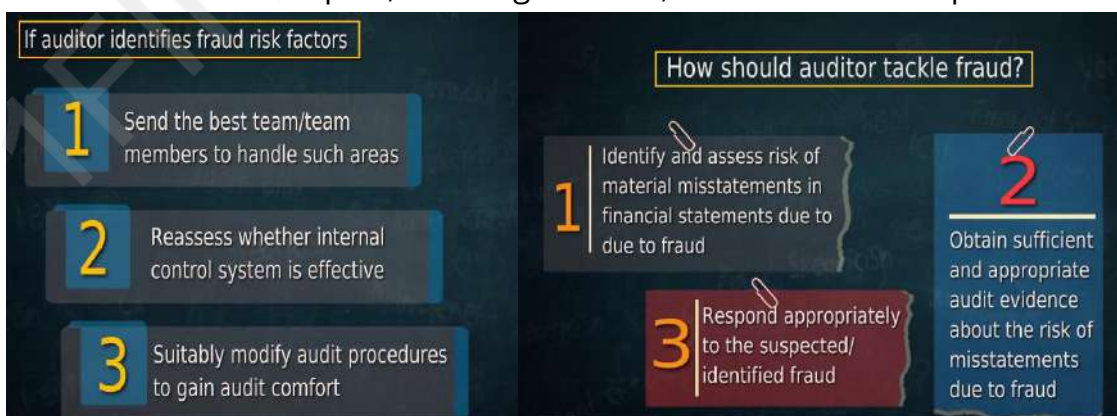
- Auditors has to respond appropriately to fraud risk factors they have identified and should document in working papers:
  - The specific risk factors they have been identified; and
  - Their response to those factors:
- Based on fraud risk assessment the auditor assesses the inherent and control risk and then determines the level of detection risk.
- Next the auditor has to design procedures to address them.
  - In some cases, tests of controls and substantive procedures can be sufficient to address them.
  - But in some situation, it may be necessary to modify the nature, timing and extent of substantive account balance level or at both.
- He should document the assessment and identification of fraud risk factors along with his response to them.

## 5.8 Auditor's approach

Procedures to be performed by auditor when circumstances indicate a possible misstatement and when an identified misstatement may be indicative of fraud

### 5.8.1 Action

- Auditor to perform modified or additional procedures to gain required amount of audit evidence.
- If his suspicion is confirmed,
  - he should consider the implications of misstatement in relation to other aspects of audit, particularly the reliability of management representations
  - Ascertain whether any management's disclosure to this effect in financial statements is required. If the same is required but not done, he should suitably indicate the same in his Audit Report to members.
- If his suspicion is neither confirmed nor dispelled,
  - assess the impact of such fraud or error on financial statements and should also assess their impact, in the light of SAs, on the auditor's report.



### 5.8.2 Documentation

- Significant decisions with engagement team regarding susceptibility of misstatement due



to fraud

- Identified and assessed risks
- Overall responses to assessed risks
- results of the audit procedures, including those designed to address the risk of management override of controls.
- communications about fraud made to management, those charged with governance, regulators and others

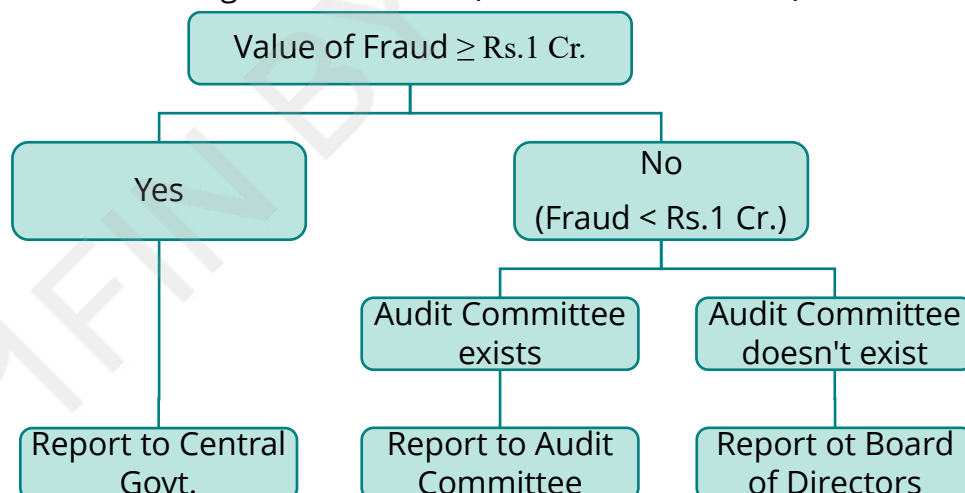
### 5.8.3 Communication

- Communicate the misstatement to management on timely basis.
- If required by laws and regulations, he should report about it to the regulatory and enforcement authorities also.
- Communicate weakness in internal controls to management
- If his suspicion is confirmed, he should communicate the findings to an appropriate level of management and discuss the approach to further investigation. He may advise the management to take legal opinion.

#### Communicating to Regulatory and Enforcement Authorities, is it required?

SA 240 has a provision that if law requires such reporting auditor should report accordingly. Although the auditor's professional duty to maintain the confidentiality of client information may preclude such reporting, the auditor's legal duty may have an overriding effect over the same

**For Example** - Under Companies Act, 2013 [as per Section 143(12)] Auditor has to report the details of fraud to govt. authorities (in few circumstances) and also in CARO.



#### Summary : (report on frauds)

S.No	Amount involved	Report to	Details in report	Company's Responsibility	Report within	
A	< Rs. 1 Cr	Report to Audit Committee or BoD	Nature, persons involved, Amounts, Action taken	Disclosure in Board report	Within 2 days to Audit Committee or BoD	
B	≥ Rs.1 Cr	Report to Central Government	Nature, persons involved, Amounts, Action taken	Company to reply to clarifications sought by Auditor within 45 days	Within 2 days to Audit Committee or BoD	Within 15 days from the lapse of 45 days to CG

National Financial Reporting Authority (NFRA) can ask the auditor to verify and report on any particular issue related to Company in case of suspicion.

#### 5.8.4 Written Representations from Management

The auditor shall obtain written representations from management and, where applicable, those charged with governance that:

- they acknowledge their responsibility
- they disclosed results of their assessment to auditor
- they disclosed knowledge or allegations of fraud

#### 5.9 Unable to complete the engagement

If the auditor is unable to complete the engagement due to misstatement resulting from fraud or suspected fraud or suspected fraud,

- He should consider the professional and legal requirements for reporting them.
- If he decides to withdraw from the engagement, he should discuss it with the appropriate level of management and those charged with governance.
- He may also consider legal or professional requirements for reporting reasons for such withdrawal.

#### 5.10 Subsequent discovery of undetected material misstatements

Subsequent discovery of undetected material misstatements of financial information resulting from errors and frauds does not necessarily mean that the auditor has been negligent in performing his duties. If he has adopted adequate audit procedures that are in conformity with basic principles governing an audit and has issued appropriate report based on the results of such procedures, he may not be held liable for such non-detection

## 5.11 Summary of Auditor's Potential Reactions to the Assessment of Fraud Risk Factors

### 5.11.1 Overall Responses

- Professional skepticism- increased sensitivity in selecting documentation substantiating material transactions.
- Assignment of personnel – staff the audit team with individuals having knowledge, skill and ability which commensurate with audit risk.
- Accounting principles and policies – consider further those selected by the management.
- Assessment of control risk – may be unable to assess below maximum, obtain an understanding of the components of entity's internal control system.

### 5.11.2 Nature, timing and extent of procedures

- Nature – more reliable or additional corroborative information
- Timing – closer to or at year end
- Extent – increase sample size
  - Visit locations on surprise basis
  - Request inventory count at date close to year – end
  - Alter audit approach (e.g. oral and written confirmations)
- Detailed review of quarter – end or yearend adjusting entries
- Investigate unusual transactions
- Perform substantive analytical procedures at a detailed level
- Conduct interview of personnel in areas of high risk
- Perform additional procedures with respect to specialist's assumption, methods and findings.

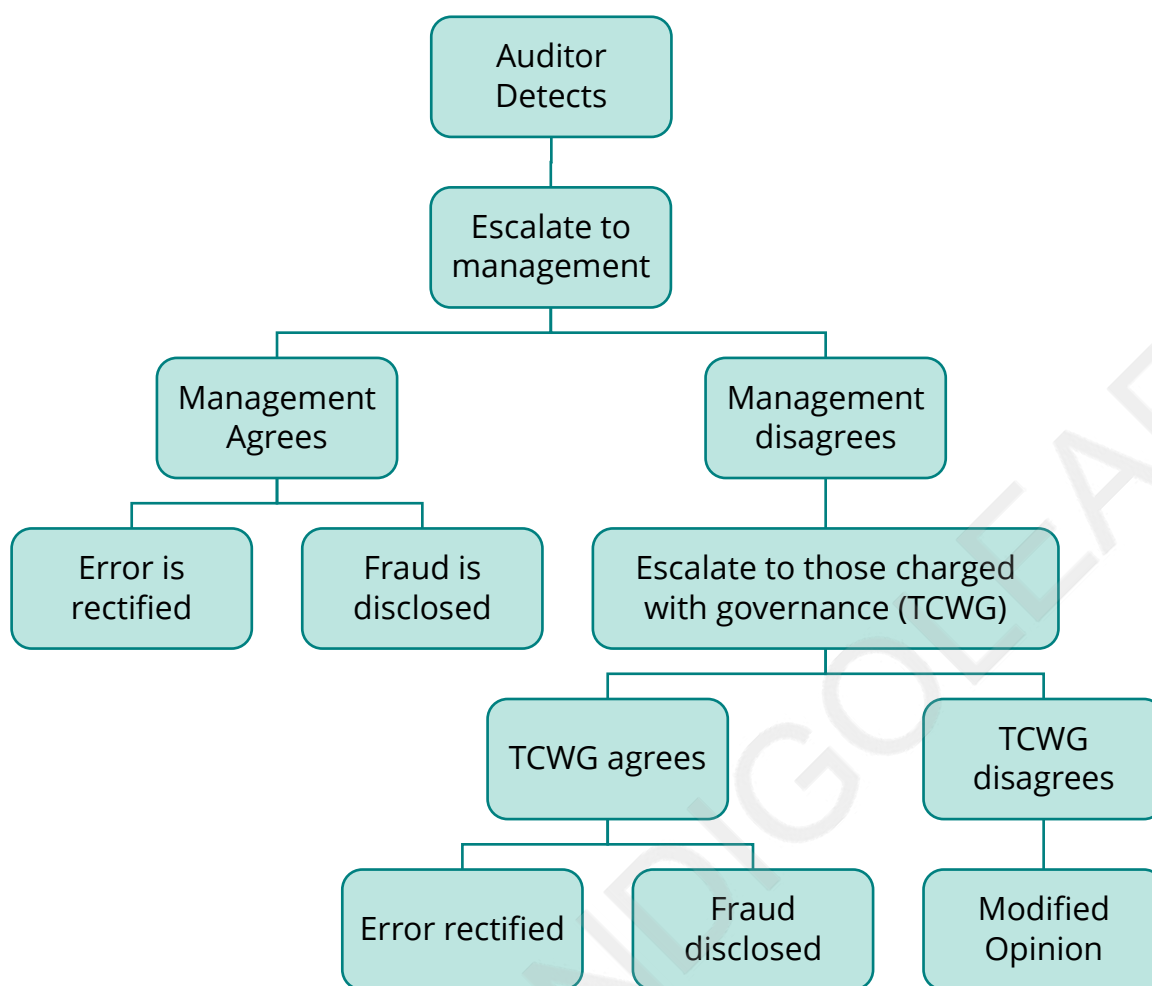
### 5.11.3 Specific responses

- Misstatements from Fraudulent Financial Reporting
  - Revenue recognition – additional confirmation of receivables, terms and the absence of side agreements
  - Inventory quantities – surprise checks
  - Verify non – standard journal entries
  - Review accounting estimates and assumptions made by management
  - Business rationale of significant transactions
- Misstatements Arising from Misappropriation of assets:
  - Modify control risk assessment
  - Generally directed toward certain account balances.

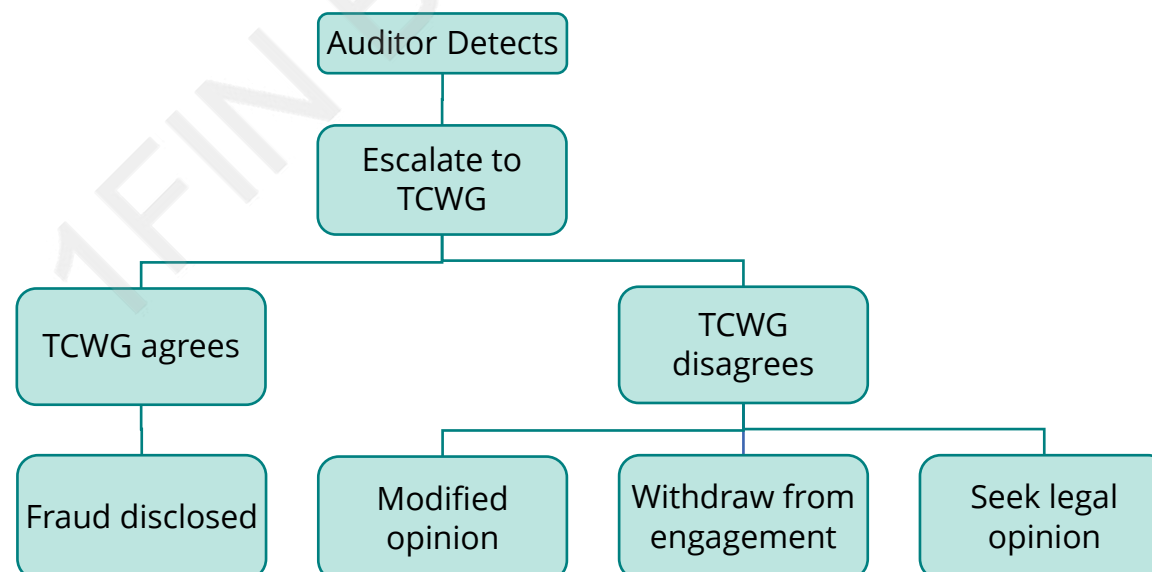
## 5.12 Auditor's status after responding to Fraud

Fraud or error is committed, the auditor identifies and detects and responds accordingly, the final stand an auditor can take is as follows:

### 5.12.1 Fraud or Error involving Employees



### 5.12.2 Fraud involving Management



## 5.13 Questions

- 1) Fraud, whether fraudulent financial reporting or misappropriation of assets, involves incentive or pressure to commit fraud, a perceived opportunity to do so and some rationalization of the act. Explain. [MTP-March 2018, March 19]
- 2) Although fraud is a broad legal concept, for the purposes of the SAs, the auditor is concerned with fraud that causes a material misstatement in the financial statements. Explain. [RTP-May 18]
- 3) "Fraudulent financial reporting involves intentional misstatements including omissions of amounts or disclosures in financial statements to deceive financial statement users." Discuss. [MTP-Oct.19]
- 4) The risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting one resulting from error. Explain. [RTP-Nov. 18]
- 5) State true or false – "The primary responsibility for prevention and detection of fraud rests with both TCWG and Management. "
- 6) When an Auditor identifies a misstatement resulting from fraud, it is his responsibility to communicate it to regulatory and enforcement authorities apart from those charged with governance. [May 10 (2 Marks)]
- 7) Explain how would you deal as an auditor if, as a result of a misstatement resulting from fraud or suspected fraud, you encounter exceptional circumstances that bring into question your ability to continue performing the audit. [RTP-May 19]

## 6. SA 250 -Consideration of Laws and Regulations in an Audit of Financial Statements

### Contents

- Effects of laws & regulations on the financial statements
- Responsibility for Compliance
- Auditor's consideration for Compliance

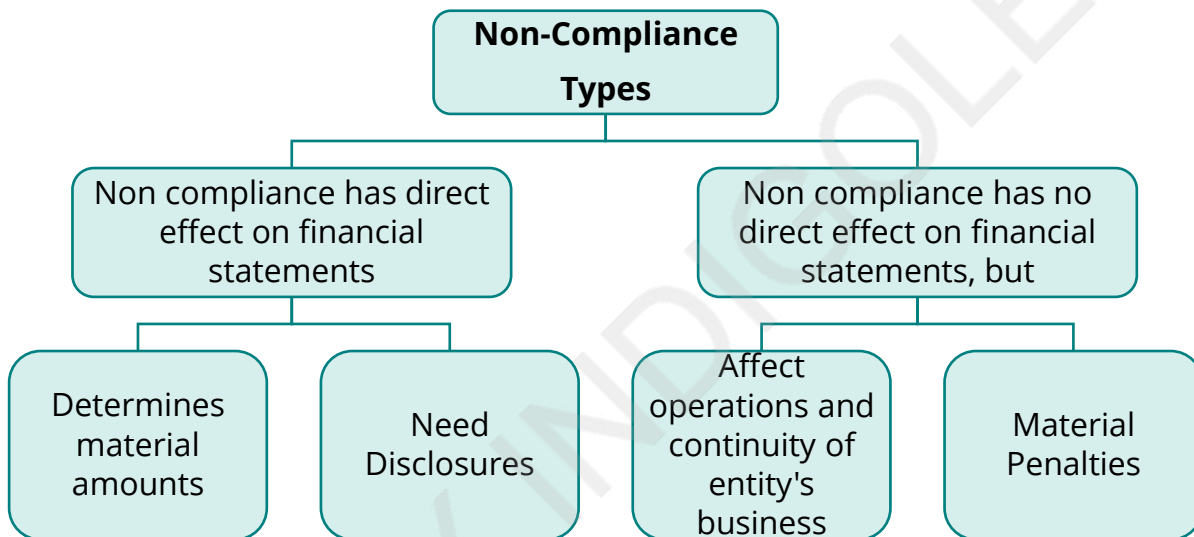
### 6.1 Non-compliance with laws and regulations

Laws and regulations to which an entity is subject constitute the legal and regulatory framework. Some have direct effect on financial statements and some are just rules to be complied with for operations to continue legally.

**Noncompliance** is omission or commission by the entity under audit, either intentional or unintentional, which is contrary to the prevailing laws and regulations.

Non-compliance may involve conduct designed to conceal it, such as collusion, forgery, deliberate failure to record transactions, management override of controls or intentional misrepresentations being made to the auditor.

Non-compliance with laws and regulations may result in fines, litigation or other consequences for the entity that may have a material effect on the financial statements.



## 6.2 Responsibility regarding compliance with laws and regulations

Management has to ensure compliance with laws and regulations through

- monitoring legal requirements and procedures to meet them;
- designing and operating appropriate of internal control;
- developing a code of conduct; and
- maintaining an up-to-date register of significant laws and regulations
- effective internal audit



Management is responsible to ensure compliance with laws and regulations applicable to it and prevent and detect non-compliance

establishing  
system

- review by audit committee

In larger entities, the management can ensure better compliance through internal audit function and an audit committee.

### 6.3 Auditor's Responsibility

Compliance with laws and regulations is the responsibility of the management for the welfare of the company.



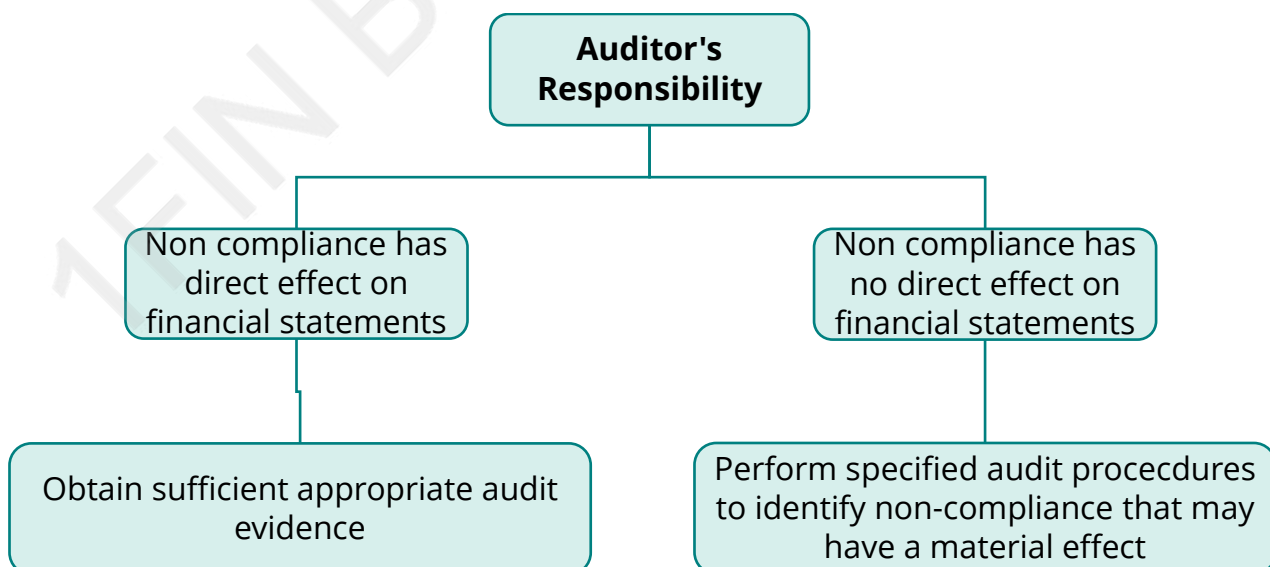
Auditor's responsibility is to understand and bring out any non-compliant actions.

With respect to auditor's responsibility:

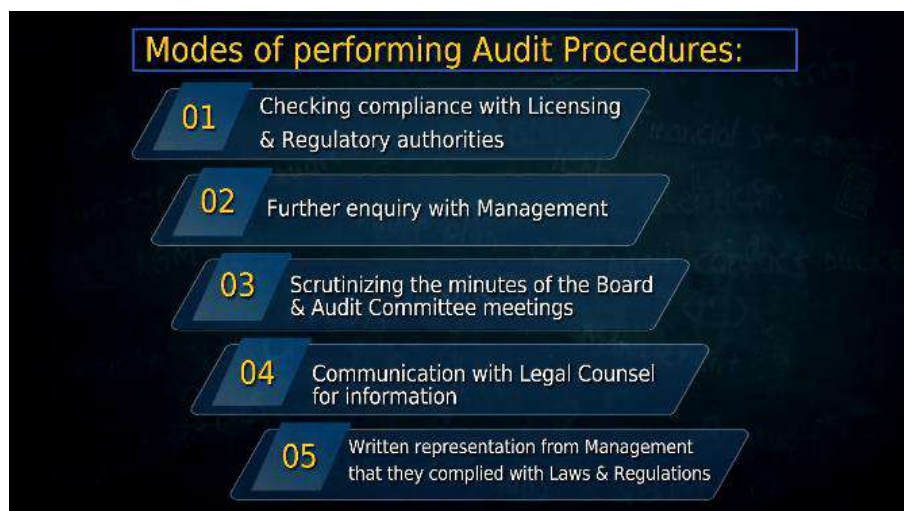
- Ordinarily, determination of non-compliance is beyond the auditor's professional competence.
- However, his training, experience and understanding of the entity and industry of which he is a part of may enable him to recognize acts constituting non-compliance.
- Generally, he takes help of legal experts. Ultimate authority to decide on this is court of law.

The auditor is responsible for obtaining reasonable assurance that the financial statements, taken as a whole, are free from material misstatement, whether caused by fraud or error. Auditor needs to draw the attention towards the implication and consequences of non-compliances.

#### 6.3.1 Audit Procedures







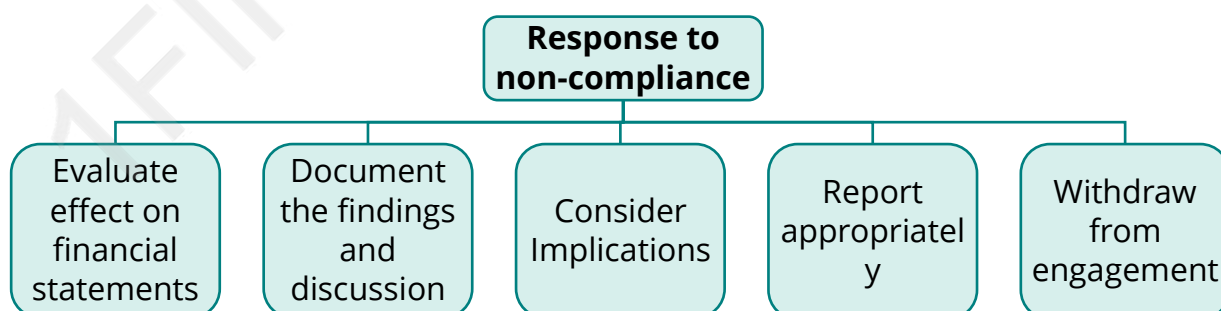
- **To ensure management is ensuring compliance**

- Obtain a general understanding of legal and regulatory framework applicable to the entity and related procedures.
- Inquire of material effect on financial statements.
- Inspect correspondence with relevant licensing or regulatory authorities.
- Obtain evidence about compliance with such laws and regulations, which affect the determination of material amounts and disclosures in financial statements.

- **To identify non-compliance**

- Obtain written representations from management regarding disclosure to auditor of all possible non-compliance with laws and regulations together with consequences;
- Read minutes of board meetings;
- Inquire with management and legal counsel about litigation, claims and assessments; and
- Inspect correspondence with the relevant licensing or regulatory authorities
- Perform substantive test of details of transactions or balances.

### 6.3.2 Auditor's Response to non-compliance



### 6.3.3 Evaluation

- The auditor should obtain an understanding of the nature of such noncompliance, its circumstances (intentional or unintentional) and obtain other important information.
- He should consider potential financial consequences (Fines, penalties etc.) of such acts, need to disclose such consequences and evaluate their impact on the truthfulness and fairness of financial statements.
- Discuss with legal counsel



#### 6.3.4 Documentation

- When the auditor discovers non-compliance, he should document these findings in the form of copies of records, documents and also make minutes of conversations with the management.
- If he is not able to obtain sufficient information about possible non- compliance from management, he should obtain legal advice from entity's lawyer.
- The auditor may obtain advice from some other lawyer if it is not considered appropriate to consult client's lawyer or rely on his opinion.
- In cases of inadequate information, the auditor should consider its impact on audit report and issue appropriate audit report.

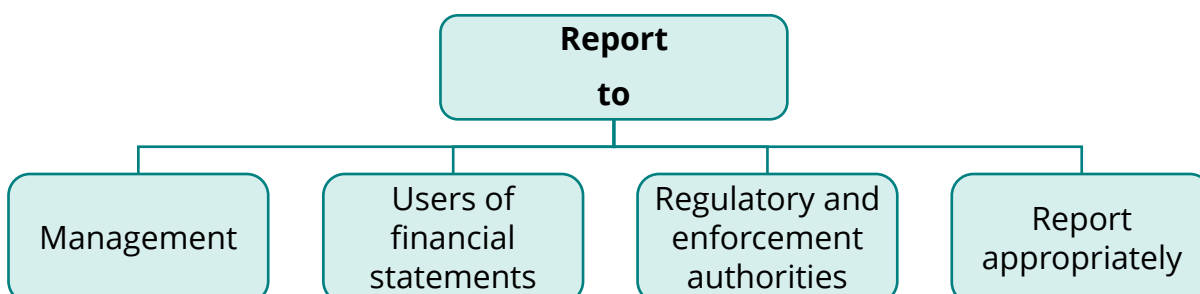
#### 6.3.5 Consider implications

Consider implications for the audit, in particular,

- reconsider risk assessment and
- reliability of management representations

#### 6.3.6 Report

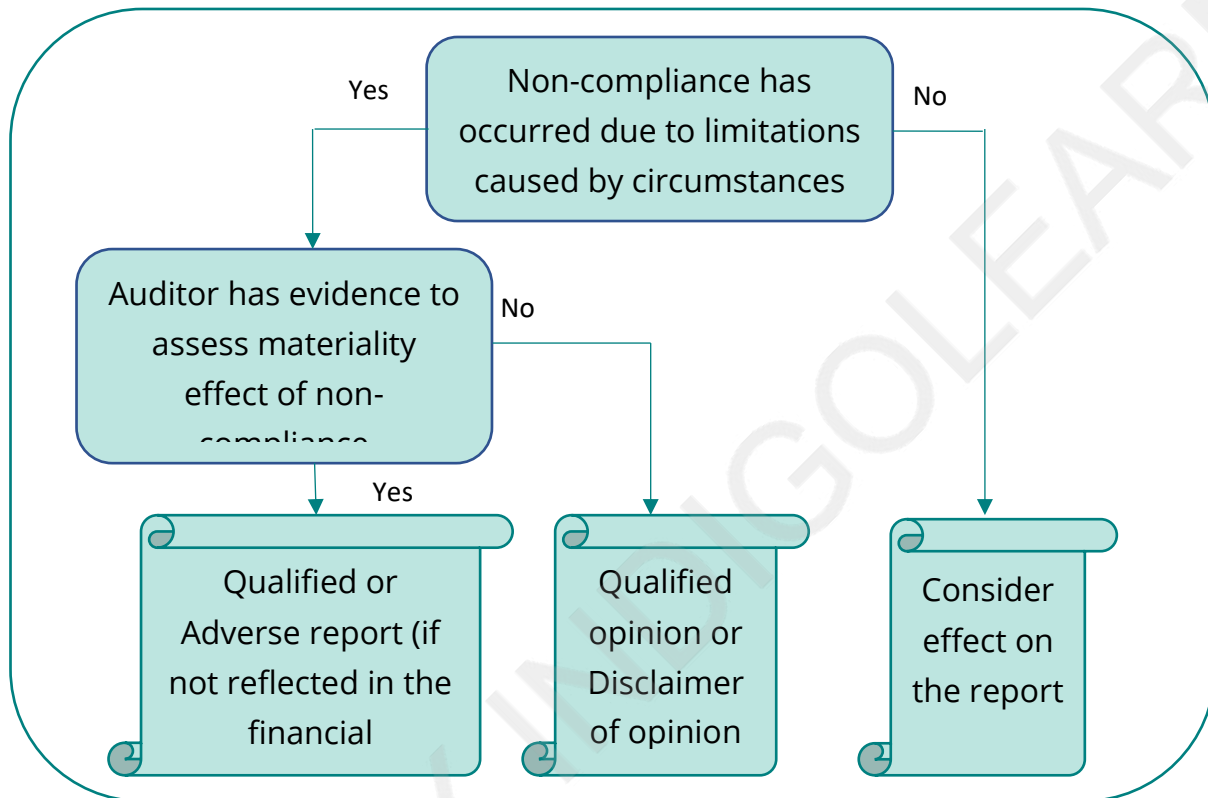
Auditor has to report appropriately on non-compliance (material/intentional or immaterial/unintentional) to relevant authorities through appropriate modes as early as possible.



- **To management**

- Communicate it to Board of directors,
- If the act is intentional and material, the auditor shall communicate the matter to those charged with governance as soon as practicable.
- If both management and those charged with governance are involved in the act, communicate to audit committee.
- If such authority does not exist, seek legal advice.

- **To users of audited financial statements**



- non-compliance has a material effect on financial statements, but they do not reflect it, the auditor should give qualified opinion or adverse opinion.
- If he is unable to obtain sufficient appropriate audit evidence to assess materiality of non-compliance, he should give a qualified opinion or disclaimer of opinion.
- In some instances, non-compliance may have occurred because of limitations imposed by circumstances, the auditor in such cases should consider the effect on auditor's report.

- **To regulatory and enforcement authorities,**

- Inform about non-compliance to such authorities, if required by law.

### 6.3.7 Withdraw from engagement

- The auditor may withdraw from engagement when-
  - Client does not take necessary remedial action;
  - Reliability of management representations has been affected due to involvement of highest authority in the entity.
- Seek legal advice, if necessary, before withdrawal.
- Advise the incoming auditor on the circumstances leading to withdrawal, when he communicates with the outgoing auditor. He should not disclose client information to the incoming auditor without the permission of the former.

#### 6.4 Questions

- 1) While verifying the employee records in a company, it was found that a major portion of the labour employed was child labour. On questioning the management, the auditor was told that it was outside his scope of the financial audit to into the compliance with other laws. (5 marks) (Nov 2012)

## 7. SA 260 – Communication with those charged with governance

### Contents

- Those Charged with Governance
- Matters to be communicated with Those charged with Governance

### 7.1 Communication

#### 7.1.1 Requirement

Communication with those charged with governance will help auditor with

- Understanding matters related to audit better
- Obtaining relevant information for audit
- Reducing risk of material misstatement

#### 7.1.2 Responsibility

Auditor and Management both are responsible for communicating with those charged with governance. If any law or regulation prohibits such communication the auditor may consider obtaining legal advice.

Communication by the auditor does not relieve management of this responsibility.

Communication by the management does not relieve auditor of this

### 7.2 Objective of Auditor

The objectives of the auditor while communicating with those charged with governance are:

- communicate clearly auditor's responsibilities overview of the planned scope and timing of the audit;
- obtain relevant information to the audit
- provide timely & significant observations arising from the audit
- promote effective two-way communication

### 7.3 Important Terms

### 7.3.1 Those Charged With Governance (TCWG)

**TCWG** - Persons who are entrusted with the responsibility to supervise, control and direct an entity e.g. management and audit committee.

'TCWG' means the person(s) with responsibility for overseeing

- the strategic direction of the entity and
- obligations related to the accountability of the entity.
- the financial reporting and disclosure process.
- approving the financial statements (in other some cases)

#### Those charged with Governance

If Company -  
Board of Directors,  
Audit Committee

If Society -  
Managing Committee

If Trust -  
Board of Trustees

### 7.3.2 Management

The person(s) with executive responsibility for the conduct of the entity's operations.

'Management' comprises of officers and others who also perform senior managerial functions. Management includes TCWG only in those instances when they perform such functions.

Those charged with Governance -	Management -
1. Persons responsible to: i. Supervise ii. Control iii. Direct	1. Persons responsible for: Day to day functioning of entity
2. Concerned with Supervision	2. Concerned with Implementation

### 7.3.3 Audit matters of governance Interest

Matters which have come to the knowledge of the auditor through audit procedures during the course of audit and are important for those charged with governance to discharge their function.

## 7.4 Identification of TCWG

### 7.4.1 Factors to be considered

Factors to be considered for such identification:

- Governance structure of the entity.

- Circumstances of the engagement.
- Legal requirement.
- Importance and relevance of the audit matter of governance interest.

#### 7.4.2 Identification not possible

If identification is not possible, he should come to an agreement with the entity about how such matters are to be communicated.

### 7.5 Matters to be Communicated

#### 7.5.1 What to communicate

Communicate only those matters, which have come to his notice during the course of audit and are of importance to those charged with governance. These matters may include

- Auditor's responsibility in relation to the Financial statement audit
- Overall scope of the audit including timing;
- Adoption of or changes in significant accounting policies;
- Significant discussions with management and representations sought.
- Issues to be communicated under any law and regulation
- Issues which affect form and content of audit report
  - Important accounting adjustments;
  - Material uncertainties give rise to going concern doubt;
  - Material weaknesses in internal control system;
  - Suspected fraud and error;
  - Expected modifications to the auditor's report.
- Compliance with auditor's independence in case of listed companies



Communication on governance related matters does not substitute the similar requirements under other laws and regulations.

A communication matter, which may result in a modified report, to those charged with governance, is no substitute to communication with shareholders through audit report.

#### 7.5.2 How to communicate

Preferably in writing. Especially if in auditor's professional judgement oral communication would be inadequate.

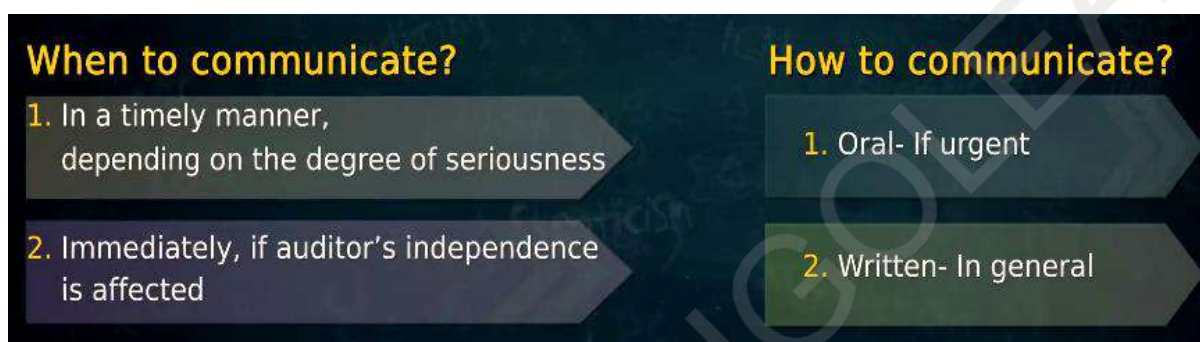


Compliance with respect to auditor's independence has to be in writing.

#### 7.5.3 When to communicate



<b>Planning Matters</b>	Early in audit engagement.
<b>Material weakness in internal</b>	As soon as possible
<b>Legally obliged matters</b>	Within time limit specified in the relevant law
<b>Independence of Auditor</b>	Whenever threat to independence is perceived (in writing)
<b>Accounting practices – qualitative issues</b>	Concluding discussions



#### 7.5.4 Inadequacy of the Communication Process

If auditor feels that the communication with TCWG is not adequate for the purpose of the audit, he shall

- Evaluate effect on
  - assessment of risk of material misstatement
  - ability to obtain sufficient appropriate audit evidence
- Take appropriate action

#### 7.5.5 Documentation

Documentation may be in the form of minutes of the discussion between auditor and those charged with governance and in certain cases, a confirmation in writing may be obtained by the auditor of any oral communication from TCWG.

- If communication done orally – Make note of when and to whom communicated.
- If communication done in written – retain copy.

If all of TCWG are involved in managing the entity, i.e not much difference between management team and TCWG team, then no separate communication to TCWG is required.

## 7.6 Questions

- 1) What audit matters of governance interest need to be communicated to the relevant persons?
- 2) What are significant difficulties encountered during the Audit?
- 3) What matters need to be communicated to those charged with governance?

## 8. SA 265 – Communicating Deficiencies in Internal Control to Those Charged with Governance and Management

### Contents

- Deficiency & significant deficiency in internal control
- Communication of deficiencies

### 8.1 Objective

The auditor is required to obtain an understanding of internal control relevant to the audit when identifying and assessing the risks of material misstatement.

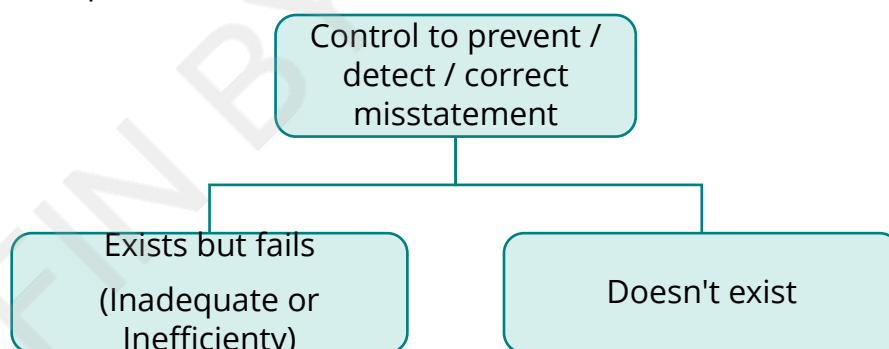
The auditor has to communicate appropriately to TCWG and management deficiencies in internal control of sufficient importance, that the auditor has identified during the audit

### 8.2 Important Terms

#### 8.2.1 Deficiency in Internal Control

If a control exists but is unable to prevent, or detect and correct, misstatements in the financial statements on a timely basis; or

If a control to prevent / detect / correct misstatement does not exist.



#### 8.2.2 Significant deficiency in Internal Control

A deficiency or combination of deficiencies in internal control that, in the auditor's professional judgment, is of sufficient importance to merit the attention of those charged with governance.

## 8.3 Requirements

### 8.3.1 Identify Deficiencies

The auditor shall determine whether, on the basis of the audit work performed, the auditor has identified one or more deficiencies in internal control.

### 8.3.2 Recognise significant deficiencies

If the auditor has identified one or more deficiencies in internal control, the auditor shall determine, on the basis of the audit work performed, whether, individually or in combination, they constitute significant deficiencies.

### 8.3.3 Communicate significant deficiencies

- To TCWG - in writing significant deficiencies in internal control identified during the audit on a timely basis, in writing (LETTER OF WEAKNESS).
- To Management - at an appropriate level of responsibility on a timely basis
  - Significant deficiencies communicated to TCWG
  - Other deficiencies in internal control not communicated to TCWG



### 8.3.4 Matters to be included in written communication

- A description of the deficiencies and an explanation of their potential effects; and
- Sufficient information to enable TCWG and management to understand the context of the communication and its potential impact on financials and audit report.

## 8.4 Examples of matters to be considered in determining whether deficiencies are significant.

- The likelihood of the deficiencies leading to material misstatements in the financial statements in the future.
- The susceptibility to loss or fraud of the related asset or liability.
- The subjectivity and complexity of determining estimated amounts, such as fair value accounting estimates.
- The financial statement amounts exposed to the deficiencies.
- The volume of activity that has occurred or could occur in the account balance or class of transactions exposed to the deficiency or deficiencies.
- The importance of the controls to the financial reporting process; for example:
  - General monitoring controls (such as oversight of management).
  - Controls over the prevention and detection of fraud.
  - Controls over the selection and application of significant accounting policies.
  - Controls over significant transactions with related parties.
  - Controls over significant transactions outside the entity's normal course of business.
  - Controls over the period-end financial reporting process (such as controls over non-recurring journal entries).

## 8.5 Examples of indicators of significant deficiencies in internal control

- Evidence of ineffective aspects of the control environment, such as:
  - Indications that significant transactions in which management is financially interested are not being appropriately scrutinized by those charged with governance.
  - Identification of management fraud, whether or not material, that was not prevented by the entity's internal control.
  - Management's failure to implement appropriate remedial action on significant deficiencies previously communicated.
- Absence of a risk assessment process within the entity where such a Communicating Deficiencies in Internal Control process would ordinarily be expected to have been established.
- Evidence of an ineffective entity risk assessment process, such as management's failure to identify a risk of material misstatement that the auditor would expect the entity's risk assessment process to have identified.
- Evidence of an ineffective response to identified significant risks (e.g., absence of controls over such a risk).
- Misstatements detected by the auditor's procedures that were not prevented, or detected and corrected, by the entity's internal control.
- Disclosure of a material misstatement due to error or fraud as prior period items in

the current year's Statement of Profit and Loss.

- Evidence of management's inability to oversee the preparation of the financial statements.

## 8.6 Questions

- 1) When auditor identifies deficiencies and report on internal controls, he determines the significant financial statement assertions that are affected by the ineffective controls in order to evaluate the effect on control risk assessments and strategy for the audit of the financial statements. Explain. [RTP-May 20]
- 2) SA 265 provides that auditor shall not report on the deficiencies but only check its effectiveness whereas Section 143(3)(i) mentions that its the responsibility to check as well as report on the same? Practically how to deal with this contradiction?
- 3) What is the auditor's role with respect to deficiencies in internal controls?
- 4) What should be the contents of deficiency to be communicated by the auditor?

## 9. SA 299 – Joint Audit of Financial Statements

### Contents

- Joint Audit
- Audit planning & Risk Assessment of Joint Audit
- Allocation & Division of work for Joint Auditors
- Relationship between Joint Auditors
- Reporting Responsibilities

### 9.1 Joint Audit

**Joint audit** refers to audit of financial statements of business by more than one auditor. Such auditors are called Joint Auditors

Large scale operations of business entities like geographical spread or volume of operations, necessitate appointment of joint auditors so as to finish the audit work more quickly and efficiently. These auditors conduct audit jointly and report on the financial statements of the entity.

### 9.2 Scope

#### 9.2.1 Applicability

SA 299 lays down the professional responsibility, which the auditors undertake in accepting such appointments as joint auditors.

#### 9.2.2 Exclusion

Branch Audit or Using work of another auditor

### 9.3 Audit Planning, Risk Assessment and Allocation of Work

#### 9.3.1 Audit Planning



- The engagement partner and other key members of the engagement team from each Joint auditor should involve in planning of the audit.
- The joint auditors shall jointly establish an overall audit strategy that sets
  - the scope,
  - timing and
  - direction of the audit,



The joint auditors shall obtain **common** engagement letter and common management representation letter.

- and that guides the development of the audit plan.
- Prior to the commencement of the audit, the joint auditors shall discuss and develop a joint audit plan. In developing the joint audit plan, the joint auditors shall
  - Divide audit areas and identify common audit areas
  - Ascertain reporting objectives
  - Communicate significant matters amongst themselves
  - Consider results of preliminary engagement activities
  - Sign off of the Audit Plan



Copy of Sign of document should be given to TCWG

### 9.3.2 Risk Assessment

Risks of material misstatement need to be considered and assessed by each of the joint auditors. Such risks assessed shall be

- Communicated to all joint auditors
- Documented by all joint auditors

Documentation of risk assessment should be done by each joint auditor whether pertaining to

- the overall financial statements level or
- the area of allocation among the other joint auditors.

### 9.3.3 Allocation of Work

- The joint auditors shall discuss and document the nature, timing, and the extent of the audit procedures for common and specific allotted areas.
- Communicate the work allocated to TCWG

## 9.4 Co-ordination among Joint Auditors

An effective conduct of joint audit requires proper division of work among the auditors, coordination between them and assumption and fixation of responsibility including

reporting responsibilities of the auditor to ensure smooth and efficient flow of audit work in case of joint audit.

#### **9.4.1 Manner of Division**

Upon mutual discussion among themselves, joint auditors may divide work in any of the following manner:

- In terms of identifiable units or
- Specific areas or
- Items of assets / liabilities / Incomes / Expenditures
- With reference to time period

#### **9.4.2 Common coverage areas**

Important audit areas should not be divided and therefore, should be covered by all joint auditors. (For example, valuation of inventory in case of a trading company).

#### **9.4.3 Documentation of division**

The actual division of work should be adequately documented and, preferably communicated to the entity also. Coordination (Communication one of the joint auditors to all other joint auditors):

- During the course of the audit work, an auditor may come across any matter, which, though relevant to the area of responsibility of other joint auditors, is material for ascertaining the true and fair view of state of affairs or result of operations of the entity as a whole.
- He should communicate such a matter to all other joint auditor in writing (if the impact is on financial statements as a whole).
- Timing of communication
  - This should be done by the submission of a report or a note before the finalization of audit.
  - If any such matter is brought to the attention of the entity or other joint auditors by an auditor after the audit report has been submitted, the other joint auditor would not be responsible for those matters.

### **9.5 Relationship among Joint Auditors**

#### **9.5.1 Jointly and Severally responsible for**

The joint auditors are jointly and severally responsible in respect of the following;

- Work that is not divided and is carried out by all of them.

- Decisions taken by all the joint auditors regarding the appropriateness of the nature, timing and extent of all audit procedures to be performed by any one of them. However, responsibility for proper execution of audit procedures would be of the auditor who is to perform the assigned task.
- Matters that are brought to the notice of the joint auditors by any one of them but all of them agree on it.
- Financial statements of the entity comply with the disclosure requirements of the relevant statute.
- Audit report complies with the applicable SAs and pronouncements by ICAI.
- For obtaining and evaluating information and explanations from the management (unless there is an agreement among the joint auditors on a specific pattern of distribution of this responsibility).

### 9.5.2 Individual Responsibility

Each of the joint auditors is individually responsible for the following;

- determine the nature, timing and extent of audit procedures to be applied in relation to the areas of work allocated to said joint auditor
- study and evaluate the prevailing system of internal control of the work area they are responsible to give opinion on
- assessment of risk relating to the areas of work allocated to said joint auditor.
- reviewing the audit reports/returns of the divisions or branches allocated to him and to ensure that they are properly incorporated into the accounts of the entity.
- carrying out part of the audit work assigned to him in accordance with the generally accepted audit procedures.
- ensuring compliance with all the legal and professional requirements regarding the disclosures to be made and presenting a true and fair view of the state of affairs and of the working results of the division or branch that is assigned to him for audit.

If a joint auditor comes across matters which are relevant to the areas of responsibility of other joint auditors and which deserve their attention, or which require disclosure or require discussion with, or application of judgment by other joint auditors, the said joint auditor shall **communicate** the same to all the other joint auditors **in writing prior to the completion of the audit**.

## 9.6 Reporting Responsibilities

Before finalizing their audit report, the joint auditors shall discuss and communicate with each other their respective conclusions that would form the content of the audit report.

- A joint auditor is not bound by the views of the majority of the joint auditors regarding matters to be covered in the report.



The joint auditors are required to give **one single report**, if they agree on matters stated therein.

Where there is **disagreement** with regard to any matter, each one of them should express his opinion through a **separate report**.

- In such circumstances, the audit report(s) issued by the joint auditor(s) shall make a reference to the separate audit report(s) issued by the other joint auditor(s).
- Such **reference shall be made under the heading “Other Matter Paragraph”** as per SA 706(Revised), “Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor’s Report”
- Work done by other auditors is assumed to be done with due diligence

## 9.7 Assumptions of Joint Auditor

Joint auditors need not review the work of other joint auditors. Each joint auditor is entitled to proceed on the basis that division / branch audited financial statements comply with all the legal and regulatory requirements.

And joint auditor is also entitled to assume that:

- Work is carried by the other joint auditors with due diligence and as per SAs
- Departures from financial reporting framework has been brought to notice

## 9.8 Communication with TCWG

Joint Auditors should communicate with TCWG when the joint auditors give an audit report other than under SA 700. If the joint auditor expects

- to modify the opinion as per SA 705 in the auditor’s report,
  - Circumstances that led to modification
  - Proposed wording of modification
- To include an emphasis of matter or other matter paragraph as per SA 706
  - Details of such expectation
  - Proposed wording

## 9.9 Questions

- 1) A joint auditor is not bound by the views of the majority of the joint auditors regarding matters to be covered in the report. Justify this statement in the light of responsibilities of Joint Auditors under SA 299. [May 10 (5 Marks)]
- 2) Explain the concept of Joint Audit. Discuss its advantages and Disadvantages. [May 11 (8 Marks)]
- 3) In joint Audit, “each joint auditor is responsible only for the work allocated to him”. [May 12 (5 Marks)]
- 4) Discuss the following: Advantages and Disadvantages of Joint Audit. [Nov. 14 (5 Marks)]
- 5) Mention the points/areas in which all the joint auditors are jointly and severally responsible. Nov. 15 (5 Marks)]
- 6) A joint auditor is not bound by the views of the majority of the joint auditors regarding matters to be covered in the auditor’s report. [May 17 (2 Marks)]
- 7) State correct or not “Joint auditor is always bound by the views of majority of the joint auditors regarding matters to be covered in report. ” [May 19 (2 Marks)]
- 8) You have been appointed as an auditor of a company along with 2 other auditors. What steps would you like to take to ensure a smooth and effective audit? To what extent do you think you will be responsible in relation to the work performed by your co-auditors and vice versa?
- 9) The practice of appointing Chartered Accountants as joint auditors is quite widespread in big companies and corporations. Explain stating the advantages of the joint audit. [RTP-Nov. 19]
- 10) “Before the commencement of audit, the joint auditors should discuss and develop a joint audit plan.” Discuss the points to be considered in developing the joint audit plan by the joint auditors. [Nov. 19 (4 Marks)]
- 11) Before the commencement of the audit, the joint auditors should discuss and develop a joint audit plan. In developing the joint audit plan, the joint auditors should identify division of audit areas and common audit areas. Explain stating the other relevant considerations in this regard. [RTP-May 20]

# STANDARDS ON AUDITING

## 300-399 Risk Assessment and Response to Assessed Risks

### Contents

- SA 300 - Planning an Audit of Financial Statements
- SA 315- Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment
- SA 320 - Materiality in Planning and Performing an Audit
- SA 330 - The Auditor's Responses to Assessed Risks

# 1) SA 300 – Planning an Audit of Financial Statements

## 1.1 Introduction

The objective of auditor is to plan the audit so that it will be performed in an efficient manner.

**Audit plan** is a detailed programme giving instructions as to how each area of the audit will be conducted. In other words, the audit plan details the specific procedures to be carried out obtain sufficient appropriate evidence to implement the audit strategy and complete the audit.

It helps the auditor obtain sufficient appropriate evidence for circumstances, helps keep audit costs at a reasonable level, and helps avoid misunderstandings with the client.

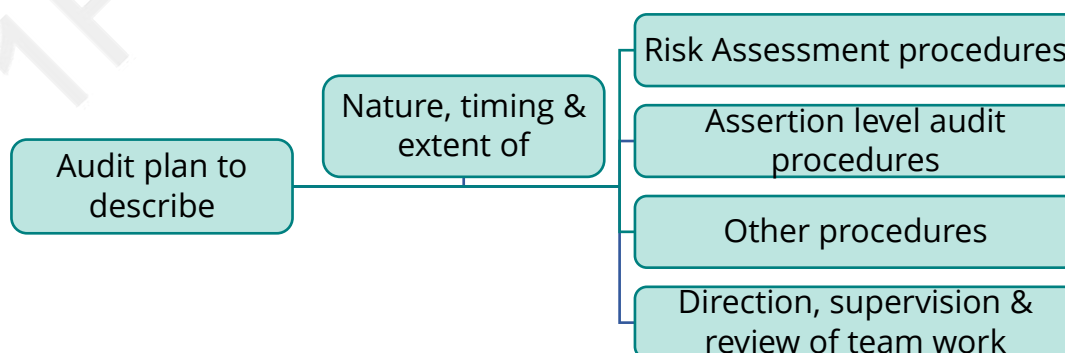
Engagement partner and other key members of the audit team shall be involved in planning the audit.

The audit plan is more detailed than the overall audit strategy

## 1.2 Preliminary Engagement Activities

- Carrying out audit procedures as required by SA 220 “Quality Control for Audit Work” regarding the continuance of the client relationship and the specific audit engagement
- Evaluating compliance with ethical requirements, including independence, as required by SA 220; and
- Establishing an understanding of terms of engagement as required by SA 210, “Terms of Audit Engagement.”

## 1.3 Planning



### 1.3.1 Points considered in audit plan

- What are the deliverables?
- How to achieve the reporting objective?



- The quantum of resources required?
- The time required and the time budget available?
- What procedures and new methods to be involved?
- Review the engagement formalities
- Explain the scope of the engagement to the team.

## Points to be considered in Audit Planning:



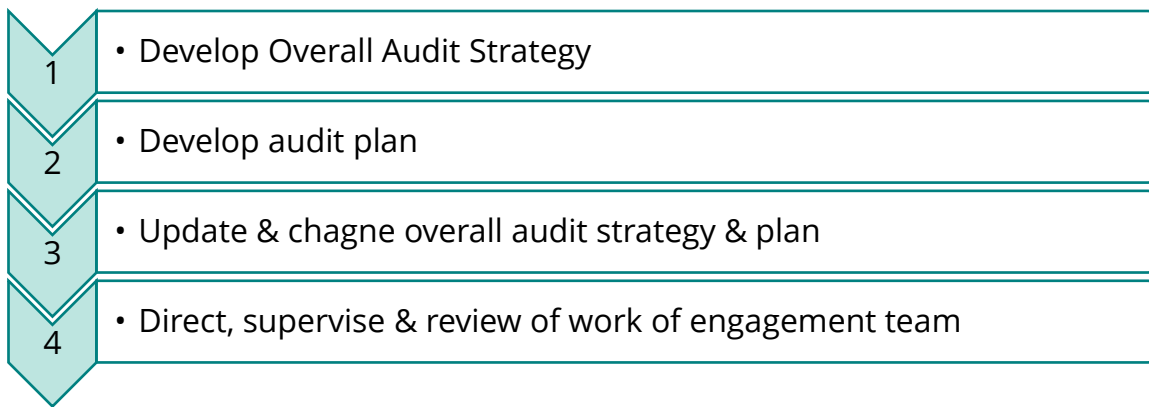
### 1.3.2 Benefits of Planning

- To ensure appropriate attention is devoted to important areas of audit;
- Prompt identification and resolution of potential problems;
- Proper organization and management of audit engagement;
- Selection of appropriate engagement team members and proper assignment of work to them.
- To facilitate direction, supervision and review of their work.
- To ensure coordination of work done by other auditors and experts.

### 1.3.3 Factors to be considered in Planning

- Size and complexity of entity;
- Previous experience of the key engagement team members with the entity;
- Changes in circumstances during the audit engagement.

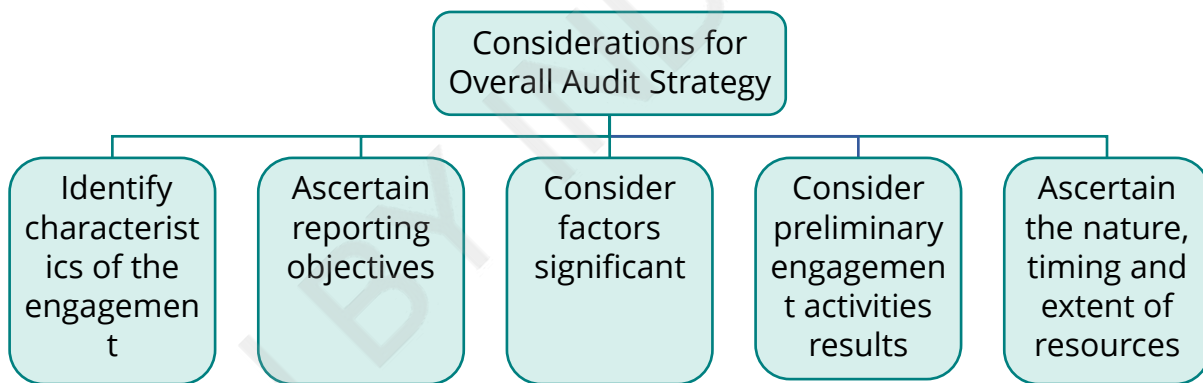
## 1.4 Critical aspects of Planning



### 1.4.1 Overall audit strategy

Auditor has to develop an overall audit strategy that defines the scope, timing and direction of the audit. For that auditor has to:

- Identify the characteristics of engagement.
- Ascertain the reporting objectives.
- Consider factors which are significant to direct the audit team.
- Consider results of preliminary engagement activities and experience from other engagements
- Ascertain the nature, timing and extent of resources necessary to perform the engagement.



### 1.4.2 Audit Plan

An audit plan should include detailed description of procedures to be performed by engagement team members, which includes

- the nature, timing and extent of risk assessment as per SA 315
- the nature timing extent of planned audit procedures at assertion level as per SA 330
- other planned procedures to ensure compliance with SAs

The auditor has to considering the appropriate amount of time to set aside for areas where there may be higher risks of material misstatement.

Planning the nature, timing and extent of specific further audit procedures depends on the outcome of those risk assessment procedures.

#### **1.4.3 Updating and improvisation.**

Continuous update and change in overall audit strategy and the audit plan desiring the course of audit as a result of unexpected events, changes in conditions or the audit evidence obtained from audit procedures.

This may be the case when information comes to the auditor's attention that differs significantly from the information available when the auditor planned the audit procedures.

#### **1.4.4 Direction, supervision and review**

The auditor shall plan the nature, timing and extent Direction, supervision and review of work of engagement team members. This depends on factors like

- Size and complexity of the entity
- Area of audit
- Assessed risks of material misstatements
- Capabilities and competence of the team members

### **1.5 Documentation**

#### **1.5.1 Overall audit strategy**

In the form of a memorandum that contains key decisions regarding the

- overall scope,
- timing and
- conduct

of the audit;

#### **1.5.2 Audit plan**

In the form of standard audit programs and/or audit completion checklists.

#### **1.5.3 Significant changes**

A record of the significant changes to the overall audit strategy and the audit plan, and resulting changes to the planned nature, timing and extent of audit procedures, explains why the significant changes were made, and the overall strategy and audit plan finally adopted for the audit.

## 7. TASKS

1. Name of client: Lanco Infra tech Ltd.

2. Nature of assignment: Statutory Audit

3. Period of audit: F.Y ended 31/03/2017

4. Start date: 01/04/2017

End date: 30/04/2017

5. Audit Team: A, B, C, D, E

6. Audit Partner: XYZ

Area	Allotted person	Start Date	End Date	Management co-ordinator	Review
Fixed assets	A	02/04/17	06/04/17	L	X
Debtors	B	01/04/17	15/04/17	M	Y
Investments	C	04/04/17	09/04/17	N	Z
Bank OD	D	03/04/17	10/04/17	O	Y
Creditors	E	01/04/17	08/04/17	P	Z

Remarks

### 1.6 Additional Considerations in Initial Audit Engagements

- Perform procedures required by SA 220 regarding the accepting of client relationship;
- Communicate with predecessor audit, where there has been a change of auditors.
- Checking opening balances

### 1.7 Questions

- 1) The auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner. Plans should be based on knowledge of the client's business. Explain. [RTP-Nov. 18]
- 2) Plans should be made to cover acquiring knowledge of the client's accounting systems, policies and internal control procedures. Explain. [RTP-Nov. 19]
- 3) Comment on the following in relation to SAs: Auditor shall establish an overall strategy that sets the scope, timing and direction of the audit, and that guides the development of the audit plan". [May 11 (5 Marks)]
- 4) In establishing overall audit strategy, the auditor shall ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required. Elucidate those cases by which auditor can ascertain the reporting objectives of the engagement. [Nov. 19 (4 Marks)]
- 5) State correct or not "Planning is not a discrete phase of an audit, but rather a continual and iterative process. [RTP-May 19]
- 6) "The Nature, timing and extent of the direction and supervision of engagement team members and review of their work vary depending on any factors." Explain

## 2) SA 315- Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment

### Contents

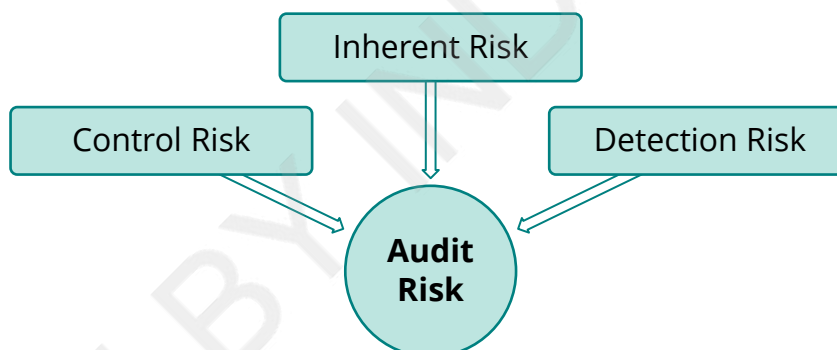
- Risk & Risk assessment procedures
- Understanding of the Entity and its Environment
- Understanding Internal control
- Risk of Material Misstatement
- Auditor's Responsibility

### 2.1 Introduction - Risk

Auditor's objective is to identify and assess the risks of material misstatement in the financial statements, through understanding the entity and its environment, including the entity's internal control



Risk is deviation from Expectation



#### 2.1.1 Inherent Risk

**Inherent risk** is the risk of misstatement in the financial statements, arising due to an error or omission as a result of factors other than a failure of

The susceptibility of an assertion about a class of transaction, account balance or disclosure to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls. Inherent risk arises on account of nature of financial reporting & auditing.

#### 2.1.2 Control Risk

Risk of controls designed by Management, being weak or non-existent, and thereby, not arresting the inherent risk, is called **Control Risk**

Control Risk arises on account of Inherent limitations of internal control. 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 entirely.

Internal control can provide only reasonable, but not absolute, assurance on account of several inherent limitations.

### 2.1.3 Detection Risk

Risk that procedures performed by Auditor to reduce Audit Risk to an acceptable low level, will not detect a misstatement that exists, that could be material, either individually or when aggregated with other misstatements is

Detection risk arises on account of judgement on part of auditor, test nature of audit and nature of audit evidences collected.

### 2.1.4 Relationship between Components of Audit Risk

- **Risk of Material Misstatement (RMM) and Internal & Control Risk**

Management often reacts to inherent risk situations by designing accounting and internal control systems to prevent or detect and correct misstatements and therefore, in many cases, inherent risk and control risk are highly interrelated. In such situations, if the auditor attempts to assess inherent and control risks separately, there is a possibility of inappropriate risk assessment.

$\text{Risk of Material Misstatements (RMM)} = \text{Inherent Risk} + \text{Control Risk}.$

- **Risk of Material Misstatement and Detection Risk**

There is an inverse relationship between detection risk and the combined level of inherent and control risks. When inherent and control risks are high, acceptable detection risk needs to be low to reduce audit risk to an acceptably low level. When inherent and control risks are low, an auditor can accept a higher detection risk and still reduce audit risk to an acceptably low level.

## 2.2 Important Terms

### 2.2.1 Assertions

Representations by management that are embodied in the financial statements. These are used by the auditor to consider different types of potential misstatements that may occur.



Assertions : <b>Transactions during the year</b>	Assertions : <b>Account balances at the period end</b>	Assertions : <b>Presentation and Disclosure</b>
<ul style="list-style-type: none"> <li>• Occurrence</li> <li>• Completeness</li> <li>• Accuracy</li> <li>• Cut-off</li> <li>• Classification</li> </ul>	<ul style="list-style-type: none"> <li>• Existence</li> <li>• Rights and obligations</li> <li>• Completeness</li> <li>• Valuation and allocation</li> </ul>	<ul style="list-style-type: none"> <li>• Occurrence and Rights &amp; obligations</li> <li>• Completeness</li> <li>• Classification and understandability</li> <li>• Accuracy and Valuation</li> </ul>

### 2.2.2 Business Risk

A risk resulting from significant conditions, events, circumstances etc. This risk could adversely affect an entity's ability to achieve or set objectives and execute its strategies.

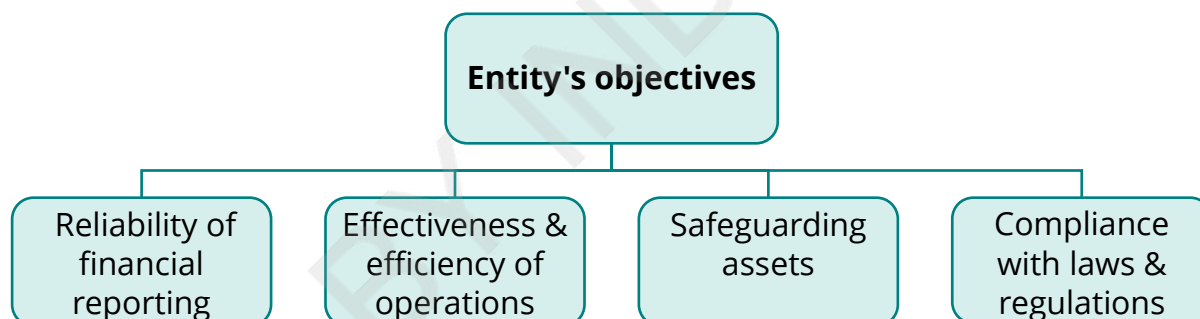
### 2.2.3 Internal Control

The process designed, implemented and maintained by

- TCWG,
- management and
- other personnel

Effective internal controls help achieve entity's objective

to provide reasonable assurance about the achievement of an entity's objectives.

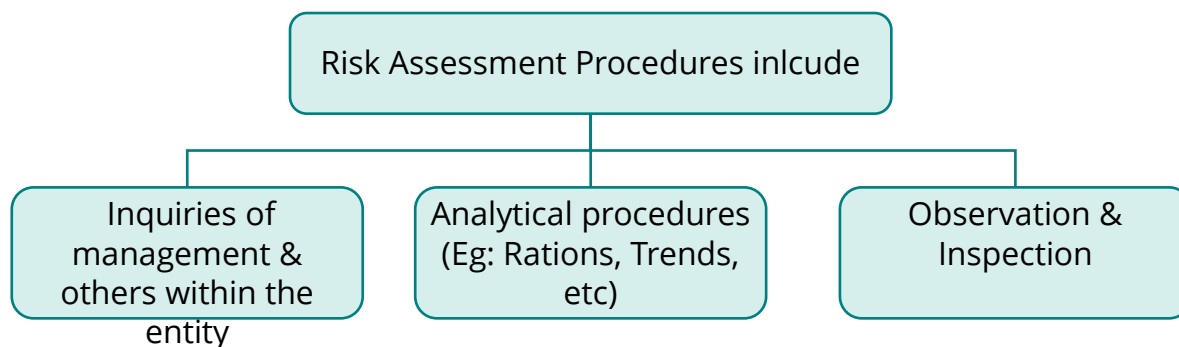


### 2.2.4 Risk Assessment Procedures

Audit procedures performed to

- Obtain understanding of entity and its environment including the entity's internal control;
- To identify and assess the risks of material misstatement at the financial statement and assertion levels.





**Information obtained in prior periods** (may provide auditor with information about matters such as past misstatements and their correction. Nature of entity and its environment, etc.). He should assess the relevance of such information in present period.

#### **Discussion among the engagement team**

The engagement partner and other key engagement team members shall discuss the susceptibility of the entity's financial statements to material misstatement, and the application of the applicable financial reporting framework to the entity's facts and circumstances.

Risk assessment procedures by themselves, however, do not provide sufficient appropriate audit evidence on which to base the audit opinion.

#### **2.2.5 Significant Risk**

An identified and assessed risk of material misstatement. In auditor's judgment it requires special audit consideration.

#### **2.2.6 Material Weakness**

A weakness in internal control that could have a material effect on financial statements.

### **2.3 Understanding of the Entity and its Environment, including the Entity's Internal Control**

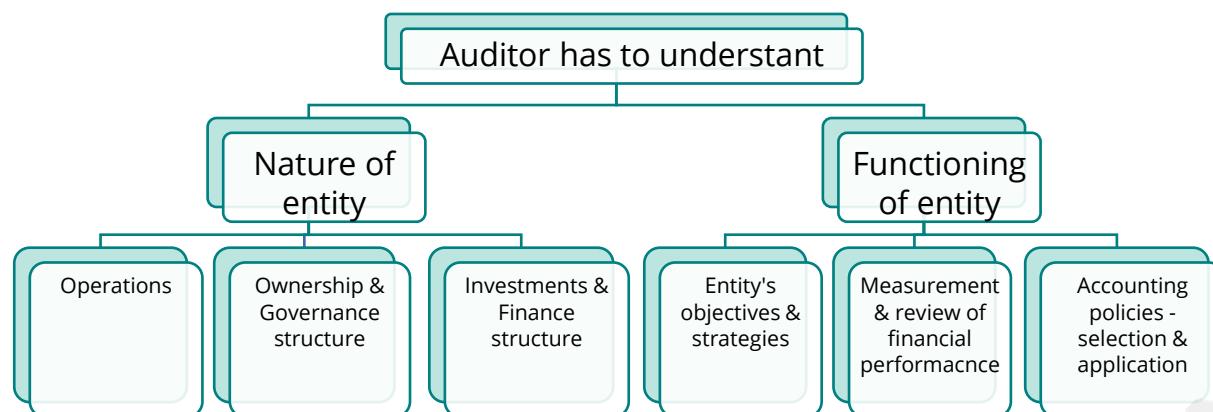
Auditor needs to understand

- Entity's nature and operations
- Environment in which the entity exists
- Entity's Internal Control

to enable the auditor to understand the classes of transactions, account balances, and disclosures to be expected in the financial statements

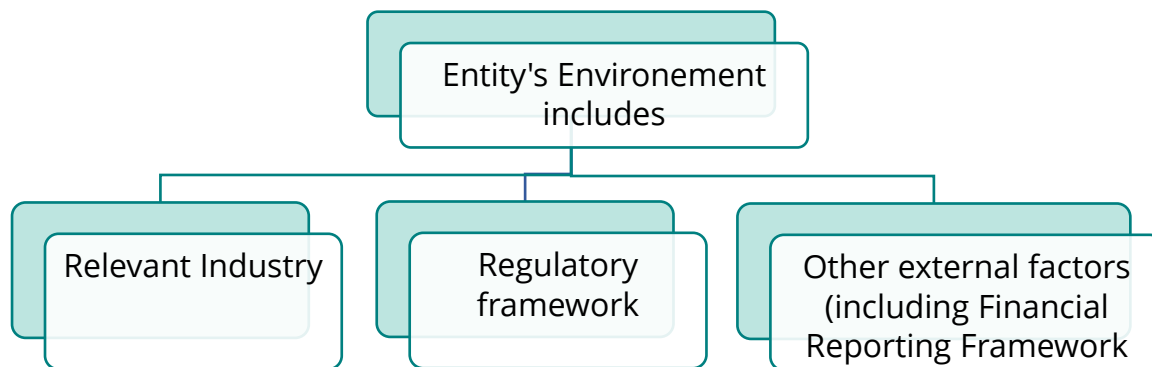
#### **2.3.1 Entity**

Auditor has to understand the nature and functioning of the entity.



Factor	Aspects to understand
<b>Business operations</b>	<ul style="list-style-type: none"> <li>• Nature of revenue sources, products or services and market;</li> <li>• Conduct of operations</li> <li>• Alliances, Joint ventures and outsourcing activities</li> <li>• Geographic dispersion and industry segmentation</li> <li>• Transactions with related parties.</li> </ul>
<b>Investments and investment activities</b>	<ul style="list-style-type: none"> <li>• Planned or recently executed acquisitions</li> <li>• Investments and disposition of securities or loan</li> <li>• Capital investment activities</li> <li>• Investments in non-consolidated entities such as special purpose entities</li> </ul>
<b>Financing and financing activities</b>	<ul style="list-style-type: none"> <li>• Major subsidiaries and associated entities</li> <li>• Debt structure</li> <li>• Beneficial owners and related parties</li> <li>• Use of derivative financial instruments.</li> </ul>
<b>Financial reporting</b>	<ul style="list-style-type: none"> <li>• Accounting principles and industry specific practices</li> <li>• Revenue recognition practices</li> <li>• Accounting for fair values</li> <li>• Foreign currency assets, liabilities and transactions.</li> </ul>

### 2.3.2 Entity's Environment



The auditor should obtain understanding the factors to assess risk

Factor	Aspects to understand
<b>Industry factors</b>	<ul style="list-style-type: none"> <li>• Competitive environment</li> <li>• Supplier and customer relationships.</li> <li>• Technological development.</li> <li>• Cyclical or seasonal activity</li> </ul>
<b>Regulatory factors</b>	<ul style="list-style-type: none"> <li>• Accounting principles and industry specific practices</li> <li>• Regulatory framework</li> <li>• legislation and regulation affect entity's operations</li> <li>• Legislation and regulation affect entity's operations</li> <li>• Taxation</li> <li>• Government policies</li> </ul>
<b>External factors</b>	<ul style="list-style-type: none"> <li>• General economic conditions</li> <li>• Interest rates</li> <li>• Availability of financing</li> <li>• Inflation.</li> </ul>



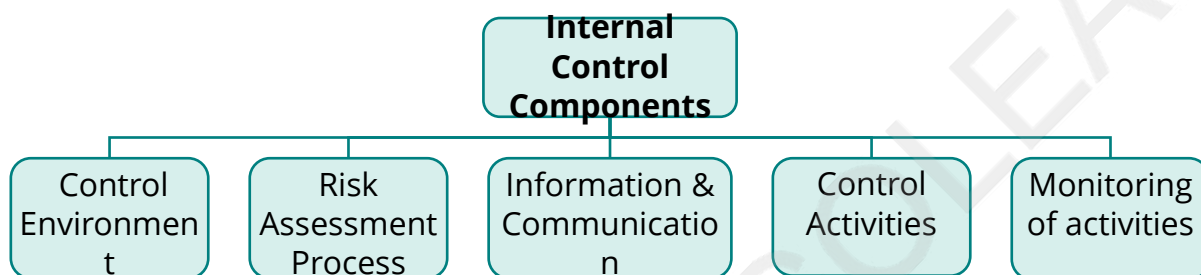
## 2.4 Internal Control System

Auditor, to understand internal controls of the entity has to evaluate the design of relevant controls and ensure they have been implemented by performing procedures SA 315

Most controls relevant to the audit are likely to relate to financial reporting, but not all controls that relate to financial reporting are relevant to the audit. Auditor uses professional judgement to decide which control is relevant

provides a useful framework for auditors to consider how different aspects of internal control affect the audit.

There are five components of Internal Control System which the auditor has to understand



### 2.4.1 Control Environment

The control environment factors lay the foundation of all other components of the internal control system. They influence the control consciousness of its people. Auditor has to evaluate if the management and TCWG have created and maintained such environment. These factors are:

- Integrity and ethical values;
- Commitment to competence;
- Management's philosophy and operating style;
- Organizational structure;
- Assignment of authority and responsibility;
- Human resource policies and procedures; and
- Participation by those charged with governance.

### 2.4.2 Risk Assessment Process

For financial reporting purposes an entity's risk assessment process shall have

- Identification
- Analysis as to the significance
- Assessing probability of occurrence and
- management through action

of risks relevant to the preparation of financial statements in accordance with relevant accounting principles.

The following risks may affect an entity's ability to properly record, process, summarize and report financial data:

- Changes in operating environment
- New personal
- New information systems
- Rapid growth
- New Technology
- New business models, products or activities
- Corporate restructuring
- Foreign operations
- New accounting pronouncements

Auditor shall understand the existing risk assessment process of the entity, and if a misstatement is noticed, he shall also understand why such process failed or determine deficiency in the internal control

If there is no risk assessment process or entity has an ad hoc process, the auditor shall discuss with management whether business risks relevant to financial reporting objectives have been identified and how they have been


#### 2.4.3 Information & Communication

Auditor has to understand the information system including related business processes relevant to financial reporting

It includes the accounting systems, consisting of the methods/ procedures and records established to record, process, correct, summarize and report entity transactions and to maintain accountability of the related assets and liabilities.

To be effective, such a system must accomplish following transaction related goals-

- Identify and record all valid transactions
- Describe on a timely basis
- Measurement of proper value
- Record in the appropriate time period
- Properly present and disclose
- Communicate responsibilities to employees
- Capture significant events or conditions (other than transactions) that affect financial statements
- Communications between management and TCWG
- External communications. Eg: regulatory authorities



The records may be in either manual or electronic form.  
The procedures may be controlled either by automated (IT) or manual

#### 2.4.4 Control Activities

The fourth component is composed of the various policies and procedures that help ensure that necessary actions are taken to address risks to achieve the entity's objectives.

These policies and procedures include.

- Performance reviews (reviews of actual performance against budgets, forecasts, one another, etc.)
- Information processing (controls that check accuracy, completeness and authorization of transactions)
- Physical controls (activities that assure the physical security of assets and records)
- Segregation of duties (separate authorization, record keeping and custody)
- Response to IT risk

#### 2.4.5 Monitoring

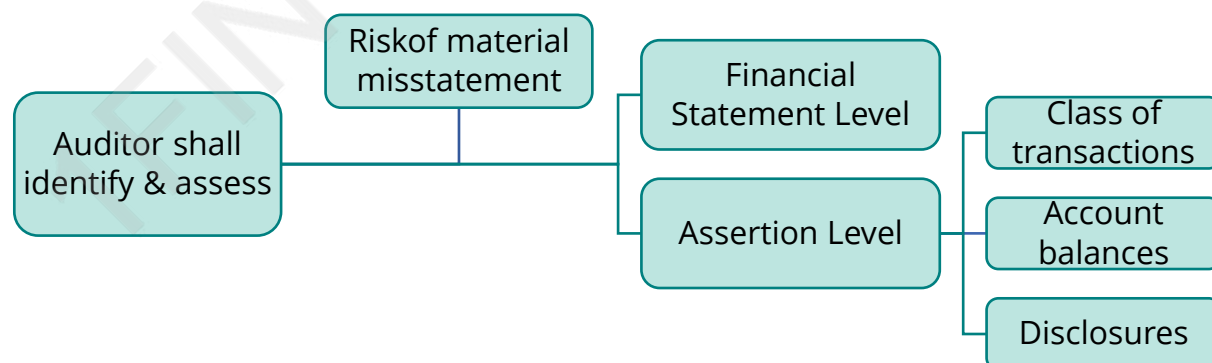
Monitoring assesses the quality of internal control performance over time. It may be

- Ongoing monitoring (designed into recurring activities such as sales and purchases)
- Separate evaluations (performed by auditors or other such internal personnel)
- Evaluation by external parties (e.g. payment of an invoice by a customer corroborates the billing data generated by internal control system).

Auditor shall obtain an understanding the internal audit function in order to determine whether it is likely to be relevant to the engagement. Auditor shall understand:

- Internal audit functions' place in the organisational structure
- Internal auditor's responsibilities
- Activities performed by internal auditor team

### 2.5 Auditor's Responsibility



#### 2.5.1 Audit steps

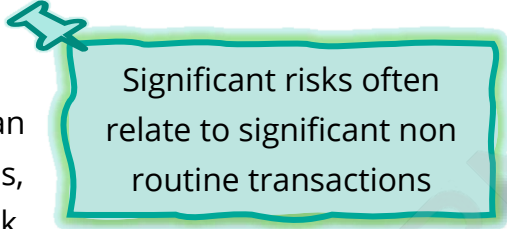
- **Identify risks** during the process of obtaining an understanding of the entity and its environment.
- **Assess the identified risks** and determine whether these exists misstatement at

financial statement level or at assertion level.

- **Identify controls** that are likely to prevent or detect or correct material misstatement at assertion level.
- Consider the likelihood of misstatement and **assess its materiality**.

### 2.5.2 Identification of significant risk

- As part of risk assessment, the auditor should identify significant risk.
- If it exists, the auditor shall obtain an understanding of the entity's controls, including control activities, relevant to that risk.
- Revision of risk assessment – if during the course of audit, the audit's assessment of risk at ascertains level changes, he shall revise the risk assessment and modify further planned audit procedures.



Significant risks often relate to significant non routine transactions

### 2.5.3 No Sufficient Appropriate Audit Evidence

If it is not possible or practicable to obtain sufficient appropriate audit evidence only from substantive procedures for some risks (e.g.: highly automated processing with little or no manual intervention), then auditor shall obtain understanding entity's control over such risks.

### 2.5.4 Revision of Risk Assessment

If the auditor shall revise the risk assessment and modify planned audit procedures if

- obtains audit evidence from performing further audit procedures, or
- if new information is obtained, either of which is inconsistent with the audit evidence on which the auditor originally based the assessment.

### 2.5.5 Documentation

- Discussions with engagement team and significant decisions
- Key elements of the understanding of entity and its environment and its internal control
- Sources of information of such understanding
- Risk assessment procedures performed
- Risks identified and assessed at both financial statement and assertion levels
- Risk identified and associated controls

## 2.6 Auditor's approach – Identifying & Assessing RMM

There are 5 main aspects to be addressed

- Assessment of Risks of Material Misstatement at the Financial Statement level
- Assessment of Risks of Material Misstatement at the Assertion level
- The Entity's Selection and Application of Accounting Policies
- Objectives and Strategies and related Business Risks



- Measurement and Review of the Entity's Financial Performance

### **2.6.1 Assessment of Risks of Material Misstatement at the Financial Statement level**

This risk relates pervasively to the financial statements as a whole and may potentially affect many assertions. The following are some factors which may raise doubts about the adaptability of entity's financial statements:

- Management's lack of competence and integrity
- Reliability of an entity's records
- Weak control environment, etc.

### **2.6.2 Assessment of Risks of Material Misstatement at the Assertion level**

The auditor should identify such risks in order to determine the nature, timing and extent of other audit procedures.

### **2.6.3 The Entity's Selection and Application of Accounting Policies**

An understanding of the entity's selection and application of accounting policies including the reasons for changes therein if necessary.

### **2.6.4 Objectives and Strategies and related Business Risks**

The auditor's understanding of the entity's objectives, strategies and related business risks increases the likelihood of identifying risks of material misstatement. Examples of such matters are-

- Industry developments
- New products and services
- Expansion of business
- New accounting requirements, etc.
- Use of IT

### **2.6.5 Measurement and Review of the Entity's Financial Performance**

An understanding of entity's performance measures assists the auditor in considering whether pressures to achieve performance targets may result in management policies that increase the risk of material misstatement. These measures may include-

- Budgets
- Employee performance measures and incentive compensation policies
- Ratios and trends
- Analyst's reports
- Credit rating agency reports

## **2.7 Questions**

1) The assessment of risks is a matter of professional judgment. Explain stating clearly what

- is not included in Audit Risk? [MTP-Aug. 18]
- 2) "Risk of material misstatement consists of two components" Explain clearly defining risk of material misstatement.
  - 3) "The SAs do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the "risks of material misstatement". Explain. [RTP-Oct. 19]
  - 4) Obtaining an understanding of the entity and its environment, including the entity's internal control, is a continuous, dynamic process of gathering, updating and analysing information throughout the audit. Analyse and explain giving examples. [RTP-May 20]
  - 5) Internal control over safeguarding of assets against unauthorised acquisition, use, or disposition may include controls relating to both financial reporting and operations objectives. Explain stating clearly the objectives of Internal Control. [RTP-May 20]
  - 6) When auditor identifies deficiencies and report on internal controls, he determines the significant financial statement assertions that are affected by the ineffective controls in order to evaluate the effect on control risk assessments and strategy for the audit of the financial statements. Explain. [RTP-May 20]
  - 7) As part of the risk assessment, the auditor shall determine whether any of the risks identified are, in the auditor's judgment, a significant risk. In exercising judgment as to which risks are significant risks, state the factors which shall be considered by the auditor. Explain the above in context of SA-315. [RTP-May 18]
  - 8) Discuss what is included in risk assessment procedures to obtain audit evidence about the design and implementation of relevant controls. [RTP-May 18]
  - 9) In the context of SA 315, state the assertions used by auditor to consider the different types of potential mis-statements that may occur w.r.t. classes of transactions and events for period under audit. [Nov. 17 (4 Marks)]
  - 10) Discuss the following: The assertions used by auditor to consider potential misstatements about account balances at the period end. [Nov. 15 (5 Marks)]
  - 11) Discuss in brief the types of audit risk and inter relationship of components of audit risk. [Nov. 14 (4 Marks)]
  - 12) Write short note on: Inherent Risk. [Nov. 12 (4 Marks)]
  - 13) "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.
  - 14) Explain the concept of Internal Control. Also state the objectives of Internal Control.

# SA 320 – Materiality in Planning & Performing an Audit

## Contents

- Materiality
- Performance Materiality

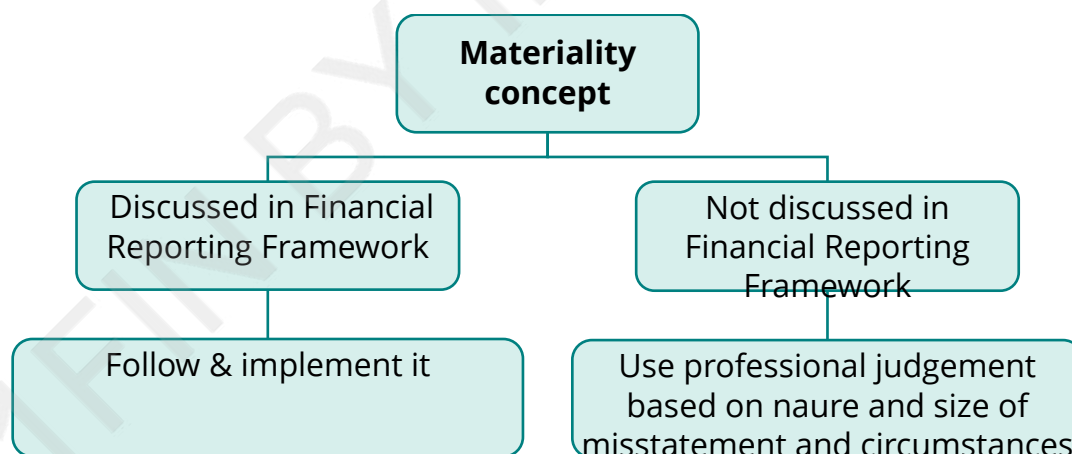
### 3.1 Materiality

Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

The possible effect of misstatements on specific individual users, whose needs may vary widely, is not considered only general effect on all users put together is considered.

Materiality can be of two types – Specific materiality affected by the nature of the item (Eg: Share capital, Reserves balances, statutory items, taxation, legal expenses) and Amount driven materiality which is subjective computation of materiality levels.

Materiality concept may be discussed in the applicable financial reporting framework.



#### 3.1.1 Auditor's judgement

Auditor's judgement about materiality are affected by

- Surrounding circumstances; and
- Size and nature of misstatement

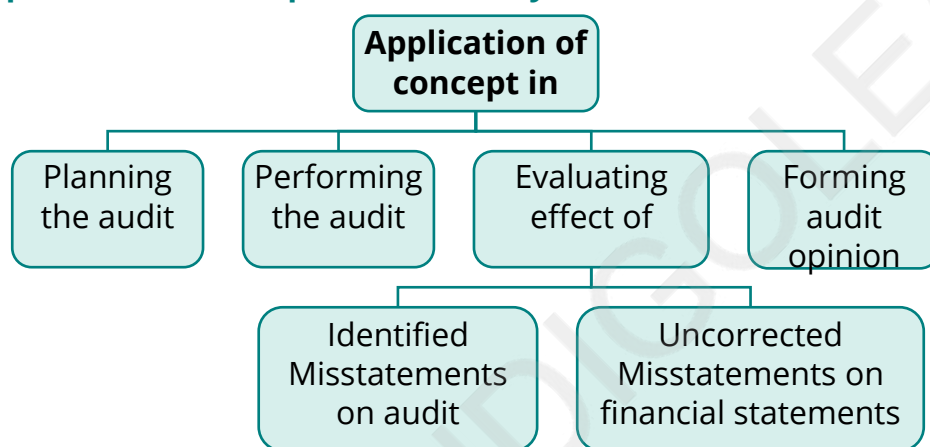
#### 3.1.2 Auditor's assumptions

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.

Auditor, in this regard can assume that users

- Have reasonable knowledge of business and economic activities and accounting and study financial statements with due diligence
- Understand that financial statements are prepared, presented and audited to levels of materiality;
- Recognize inherent limitations associated with accounting estimates and judgements of future events
- Make reasonable economic decisions on the basis of the information

### 3.1.3 Application of concept of Materiality



In planning the audit, the auditor makes judgments about the size of misstatements that will be considered material. These judgments provide a basis for

- Determining the nature, timing and extent of risk assessment procedures;
- Identifying and assessing the risks of material misstatement; and
- Determining the nature, timing and extent of further audit procedures

Steps to Apply Materiality in Audit:			
Statutory Materiality		High Risk Items	Balance Items
<ol style="list-style-type: none"> <li>1. List out all Account balances</li> <li>2. Segregate accounts of Statutory materiality</li> <li>3. Identify high risk areas</li> <li>4. Sort the remaining accounts in descending order of amounts</li> <li>5. Group small accounts cumulating to the level of planning materiality, and ignore them</li> <li>6. Conduct audit of remaining areas</li> </ol>		<ul style="list-style-type: none"> <li>• Fixed assets</li> <li>• Creditors</li> <li>• Opening balance</li> <li>• Share capital</li> <li>• Dividends</li> </ul>	<ul style="list-style-type: none"> <li>• Cash in hand</li> <li>• Debtors</li> <li>• Inventory</li> <li>• Purchases</li> <li>• Salary</li> <li>• Advances</li> </ul>
			<ul style="list-style-type: none"> <li>• Closing balance</li> <li>• Sales</li> <li>• Bank OD</li> <li>• Provision for bad debts</li> <li>• Depreciation</li> </ul>

### 3.1.4 Benchmark in determining overall materiality

For calculating overall materiality, auditor has to choose a benchmark. 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:

- Elements of the financial statements (for example, assets, liabilities, equity, revenue, expenses);
- Financial statement items that attract attention of users
- The nature of the entity, stage of entity's life cycle, and the industry and economic environment in which the entity operates;
- The entity's ownership structure and the way it is financed
- The relative volatility of the benchmark.

Determining a percentage to be applied to a chosen benchmark involves the exercise of professional judgment. There is a relationship between the percentage and the chosen benchmark, such that a percentage applied to profit before tax from continuing operations will normally be higher than a percentage applied to total revenue.

### Examples

- profit before tax,
- total revenue,
- gross profit and
- total expenses,
- total equity or
- net asset value.

Profit before tax from continuing operations is often used for profit-oriented entities. When profit before tax from continuing operations is volatile, other benchmarks may be more appropriate, such as gross profit or total revenues

### 3.2 Planning Materiality

Planning materiality basically refers to the misstatement amount set by auditors at the planning stage of an audit based on the materiality financial statements.



Planning Materiality is the adjusted overall materiality level, after considering company

to

The preliminary estimate of materiality at the financial statement level, often called planning materiality, is the maximum amount by which the auditors believe the statements could be misstated, by known or unknown error or fraud, and still not affect the decisions of reasonable financial statement users. This estimate is only a guide and is not a specific determination of what is, and is not, material in an audit.

### 3.3 Performance Materiality

Performance Materiality means the amount or amounts set by the auditor at less than materiality for the financial statements as a whole to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole.

Performance materiality is reduced in order to allow for the risk that there may be several smaller errors or omissions that have not been identified by the auditor.

These smaller items could be material when aggregated, so the performance materiality level is set to accommodate them.

If applicable, performance materiality also refers to the amount or amounts set by the auditor at less than the materiality level or levels for particular classes of transactions, account balances or disclosures

The level of performance materiality can be set at different levels for different accounts. This has a direct bearing on sample size, since a greatly reduced level of performance materiality will call for significantly larger sample sizes in order to reduce the risk of accepting a sample when the associated population actually contains a material misstatement.

### 3.4 Materiality vs Performance Materiality

Planning materiality is the materiality of the financial statements as a whole while Performance materiality is generally a percentage of Planning based on risk and qualitative factors.

Once the auditor identifies and assesses the financial statements' materiality, then the auditor sets the performance materiality (tolerable misstatement) of financial statements. Planning materiality must be larger than performance materiality.

### Materiality

- Determination of materiality is main goal of overall audit strategy.
- Materiality refers to the state where financial information has the ability to affect economic decisions of users if some information is misstated, omitted, or not disclosed
- It is for the financial statements as a whole
- Materiality is based on needs and expectations of the users of financial information (a group of users; possible effect on specific individual users is not considered), not those of the auditor based on audit risk.

### Performance Materiality

- Determination of performance materiality is conducted for the purpose of assessing audit risk.
- Performance Materiality refers to the amount of variation that can exist in individual financial accounts due to errors and omissions without affecting the auditor's opinion regarding the objectivity of financial statements
- It is the percentage of Planning materiality based on risk and qualitative factors.
- Performance materiality does not have to be set for all individual accounts as this can be done for a selected set of accounts or for a particular class of accounts.

#### 3.4.1 Determination of Materiality

The auditor shall determine materiality for the financial statements as a whole when establishing overall audit strategy.

But for any class of transactions, account balances or disclosures misstatements of lesser amounts than the materiality determined overall can influence economic decisions of users, the auditor can determine different materiality levels for those.

#### 3.4.2 Determination of Performance Materiality

The auditor shall determine performance materiality for purposes of assessing the risks of material misstatement and determining the nature, timing and extent of further audit procedures.

#### 3.4.3 Computation

Usually, a single base such as the higher of total revenues or total assets is selected for the financial statements taken as a whole and multiplied by a percentage factor, to compute the Planning materiality. Next, a percentage factor based on risk at the financial statement level



is multiplied with planning materiality amount to determine performance materiality, which is the maximum amount of known error and likely error an auditor can accept in the financial statements without adjustment.

### 3.4.4 Revision as Audit progresses

The auditor shall revise materiality for the financial statements as a whole or at individual item, if required as and when there is any information to the contrary that he believed while determining materiality initially.

Accordingly, if lower materiality is determined as appropriate, then auditor shall revise performance materiality.

### 3.5 Documentation

Auditor shall document the amounts and the factors considered in determination of:

- Materiality for the financial statements as a whole
- If applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures
- Performance materiality and
- Any revision of materiality amounts and performance materiality

### 3.6 Questions

- 1) Materiality for the financial statements as a whole may need to be revised as a result of a change in circumstances that occurred during the audit. Explain with the help of example. [MTP-Oct. 19]
- 2) Write short note on: Audit Planning and Materiality. [May 13 (4 Marks)]
- 3) Materiality for the financial statements as a whole (and, if applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures) does not need any revision.
- 4) State the factors which are to be considered in determining materiality. [Nov. 15 (4 Marks)]
- 5) Explain concept of materiality and factors which act as guiding factors to this concept. [Nov. 09 (6 Marks)]
- 6) State the factors which are to be considered in determining materiality. [Nov. 15 (4 Marks)]
- 7) Write short note on: Factors affecting the identification of an appropriate benchmark in determining materiality.
- 8) "Determining materiality involves the exercise of professional judgment". Discuss stating the factors that may affect the identification of an appropriate benchmark. Also give examples. [RTP-May 18]
- 9) With reference to SA 320 indicate the factors which may affect the identification of an appropriate benchmark in determining materiality for the financial statements as a

whole. [Nov. 15 (5 Marks)]

- 10) Materiality for the financial statements as a whole may need to be revised as a result of a change in circumstances that occurred during the audit. Explain with the help of example. [MTP-Oct. 19]

## 4) SA 330 - The Auditor's Responses to Assessed Risks

### Contents

- Auditor's response
- Test of Controls
- Substantive Procedures

#### 4.1 Auditor's objective

Obtain sufficient appropriate audit evidence about the assessed risks of material misstatement and accordingly, design and implement appropriate responses to those risks. Audit steps to achieve such objective can be broadly classified into

- Compliance Procedures
  - Test of compliance with laws and regulations
  - Test of controls
- Substantive Procedures
  - Test of details
  - Substantive analytical procedures



SA 315 – Identify risks

SA 330 – How the auditor should respond to such risks

#### 4.2 Important Terms

##### 4.2.1 Substantive Procedure

An audit procedure designed to detect material misstatement at the assertion level. These comprise:

- Tests of details (e.g. vouching and verification)
- Substantive analytical procedures.

##### 4.2.2 Test of Controls

An audit procedure designed to evaluate the operating effectiveness of controls in preventing, or detecting and correcting material misstatements at the assertion level.

#### 4.3 Auditor's Overall Responses

Auditor shall design and implement overall responses to address the assessed risk of material misstatement at financial statement level. Auditor shall design further audit procedures which depend on the overall responsiveness to the assessed risks.

An overall response includes:

- Ensuring high degree of professional skepticism amongst audit team members
- Assigning more experienced staff or those with special skills or using experts
- Providing more supervision
- Incorporating element of surprise into the audit.
- Making suitable changes to nature, timing and extent of audit procedures.
- Emphasis on substantive procedures or may use tests of controls as well as substantive procedures.

#### **4.3.1 Audit procedures responsive to the assessed risks of material misstatement at the assertion level**

- To address the assessed risk of material misstatement at the financial statement level, the auditor should design overall responses such as providing more supervision, assigning more experienced/ skilled staff, etc.
- The auditor shall consider the reasons for the assessment given to a risk including the related inherent risk and control risk.
- Higher the assessment of risk, more persuasive audit evidence should be obtained.

### **4.4 Test of Controls**

A test of controls is an audit procedure to test the effectiveness of a control used by a client entity to prevent or detect material misstatements.

Depending on the results of this test, auditors may choose to rely upon a client's system of controls as part of their auditing activities. However, if the test reveals that controls are weak, the auditors will enhance their use of substantive testing, which usually increases the cost of an audit.

#### **4.4.1 Application**

The auditor shall design and perform test of controls to obtain sufficient appropriate audit evidence only when:

- controls are effective; or
- Substantive procedures and tests of controls are to be used together.

The auditor may design tests of control to be performed concurrently with test of details on same transaction.

#### **4.4.2 Nature & extent**

- The auditor shall use other audit procedures such as
  - inspection or
  - performance (how, by whom, consistency) in combination with
  - inquiry
 to obtain audit evidence or to test about the operating effectiveness of controls.
- If the auditor needs more persuasive audit evidence, he may increase the extent of tests of control.
- Determine whether the controls to be tested depend upon other controls and if so, the auditor should test the operating effectiveness of these indirect controls.

#### 4.4.3 Timing

The auditor shall test controls pertaining only to a point in time or over a period of time. The objective is to provide an appropriate basis for the reliance auditor needs to place on the internal control.

The timing for test of controls also depends on usage of audit evidence obtained about operating effectiveness of controls during the interim period or from previous audit

#### 4.4.4 Using audit evidence obtained during an interim period

Obtain audit evidence about significant changes to those controls subsequent to interim period.

Determine additional evidence to be obtained for the remaining period

#### 4.4.5 Using audit evidence obtained in previous audit about

##### • Controls in general

The auditor may increase or decrease the expected audit evidence to be obtained in current period about the operating effectiveness of the controls after considering

- the effectiveness of other elements of internal control, including the control environment, the entity's monitoring of controls, and the entity's risk assessment process;
- Risk from controls depending on automation of the control
- The effectiveness of general IT-controls;
- The effectiveness of the control and its application by the entity, including the nature and extent of deviations in the application of the control noted in previous audits, and whether there have been personnel changes that significantly affect the application of the control;
- Whether the lack of a change in a particular control poses a risk due to changing

circumstances; and

- The risks of material misstatement and the extent of reliance on the control

#### • **Specific Controls**

The auditor has to check the continuing relevance of the evidence by obtaining further evidence considering the significant changes occurred since previous audit. The procedure followed to obtain such further evidence may include:

- If there are any changes, test the controls in the current audit
- If there are no changes, test controls at least once in every third audit and shall test some controls in each audit

When the auditor plans to rely on controls over a risk the auditor has determined to be a **significant risk**, the auditor shall test those controls in the **current period**

#### 4.4.6 Evaluating operating effectiveness of controls

##### • **If misstatements detected by substantive procedures**

- If the auditor has detected a material misstatement, it may indicate the existence of a material weakness in operating effectiveness of controls.
- He should communicate such material weaknesses in internal control identified during the audit on a timely basis to appropriate level of management.

No misstatements detected by substantive procedures does not mean that controls related to the assertion being tested are effective.


##### • **If deviations from controls detected**

Auditor shall make specific inquiries to understand potential consequences and shall ensure

- Effectiveness of test of controls to provide evidence to rely on controls
- Additional tests required
- Potential misstatements are addressed using substantive procedures.

#### 4.5 Substantive Procedures

Irrespective of the assessed risk of misstatement, the auditor shall design and substantive procedures for each material transactions, account balance and disclosure.



The auditor shall consider whether external confirmation procedures are to be performed as substantive audit. procedures.

material  
perform  
class of

#### **4.5.1 Substantive procedures related to financial statements closing process**

- Auditor shall agree or reconcile the financial statements with the underlying accounting records
- Auditor shall examine material journal entries and other adjustments made during the course of preparing financial statements

#### **4.5.2 Substantive procedures responsive to significant risks**

When auditor has determined that an assessed risk of material misstatement at the assertion level is a significant risk, perform substantive procedures that are specifically responsive to that risk, such procedures shall also contain test of details.

#### **4.5.3 Timing of substantive procedures**

When substantive procedures are performed at an interim date, he shall cover the remaining period.

#### **4.5.4 Evaluating the sufficiency and appropriateness of audit evidence**

- The assessment of the risks of material misstatement at the assertion level remain appropriate
- sufficient appropriate audit evidence has been obtained
- sufficient appropriate audit evidence is not obtained, he shall express a qualified opinion or a disclaimer of opinion or a disclaimer of opinion

#### **4.5.5 Conclusion**

The auditor has to ascertain whether sufficient appropriate audit evidence has been obtained, if not express qualified / disclaimer.

### **4.6 Documentation**

The auditor shall document:

- Overall responses to address the assessed risks of material misstatement at financial statement level;
- Nature, timing and extent of audit procedures performed at the financial statement level and at the assertion level;
- Results of audit procedures and whether financial statements agree or reconcile with the underlying accounting records and audit evidence about the operating effectiveness of controls obtained in previous audit, if relying upon



# 1) SA 402 - Audit Considerations Relating to an Entity Using a Service Organisation

## Contents

- Service organisation & its services
- Service Auditor's report – Type 1 & Type 2
- User auditor's responsibilities

### 1.1 Introduction

Many entities outsource aspects of their business to organisations that provide services. Many of the services provided by such organisations can be important part of the entity's business operations but not all those services are relevant to the audit.

When user entity under audit outsources a part of the operations to other entity, auditor is concerned more with those functions, which are relevant for the audit, i.e. have an impact on financial reporting.

**User entity** - An entity that uses a service organization and whose financial statements are being audited.

**User Auditor** - An auditor who audits and reports on the financial statements of a user entity

This SA deals with the user auditor's responsibility to obtain sufficient appropriate audit evidence when a user entity uses the services of one or more service organizations applying SA 315 and SA 330.

SA 402 only talks about those services outsourced to a service organisation which:

- Impact significant financial transactions of the user entity
- Affect accounting records of the user entity

### 1.2 Service Organisation

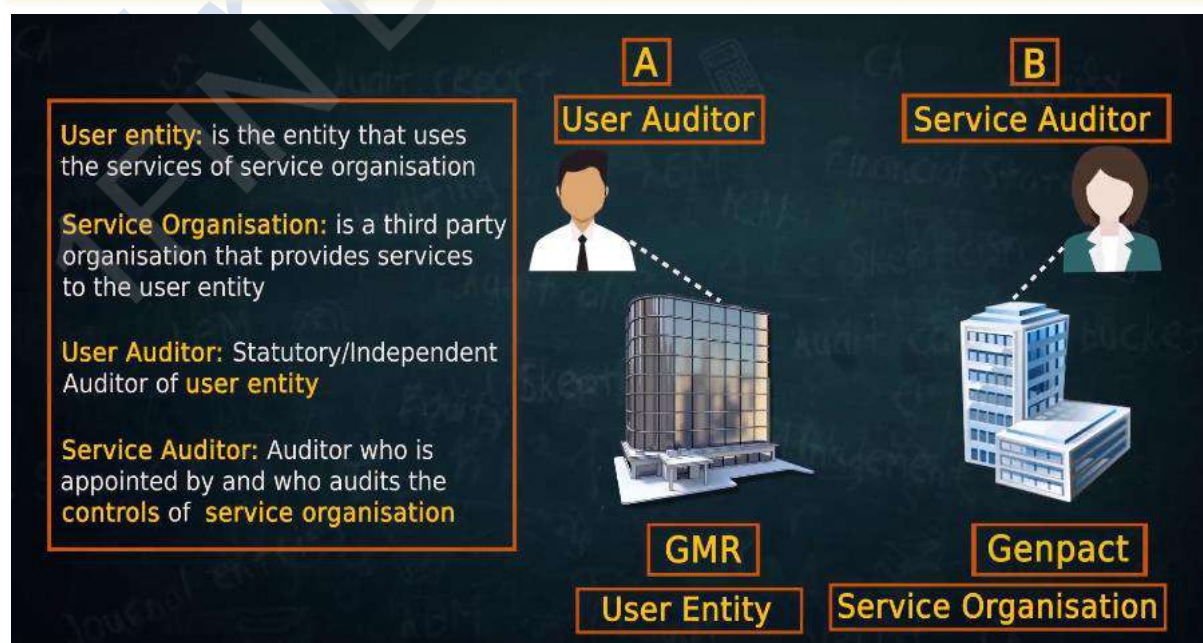
When service organization's services or controls over them are part of a user entity's information system then such services become relevant to audit. Controls related to financial reporting or safeguarding of assets are relevant to audit.

**Service organisation** is a third-party organization (or segment of a third-party organization) that provides services to user entities that are part of those entities' information systems relevant to financial reporting.

Services that affect any of the following become part of the user's information system:

- Significant transactions in the user entity
- Recording, processing and generating transactions recorded in financial statements, including accounting records like
  - Journal entries and general ledgers
  - financial statements
  - accounting policies
  - accounting estimates
  - disclosures
- Related accounting records
- Entity's method of capturing events and conditions
- Financial reporting process used to prepare
  - financial statements
  - Significant accounting estimates
  - Disclosures
- Controls related to journal entries especially unusual journal entries

The nature and extent of audit work with respect to such services depends on the nature and significance of services to the user entity and to the audit.



### 1.2.1 Exclusions under this SA

- Services provided by financial institutions that are limited to processing the user entity's account (Eg: processing of checking account transactions by a bank or the processing of securities transactions by a broker)
- Transactions from proprietary financial interests of the user entity in other organisations (Eg: partnerships, joint ventures, etc)

## 1.3 Objectives of the User Auditor

- Understand
  - Nature and significance of services provided
  - Effect of such services on user entity's internal control relevant to the audit
- Identify and assess RMM due to such services and effected controls
- Design and perform responsive audit procedures

## 1.4 Important Terms

### 1.4.1 Complementary user entity controls

Controls to be implemented by user entity in the design of the service provided by service organisation. Such controls are identified in the description of its system to achieve control objective.

Management of user entity is responsible for implementation of "Complementary user entity internal control".

### 1.4.2 Service Auditor

An auditor who, at the request of the service organization, provides an assurance report on the controls of a service organization.

### 1.4.3 Service organisation's system

The policies and procedures designed, implemented and maintained by the service organization to provide user entities with the services covered by the service auditor's report.

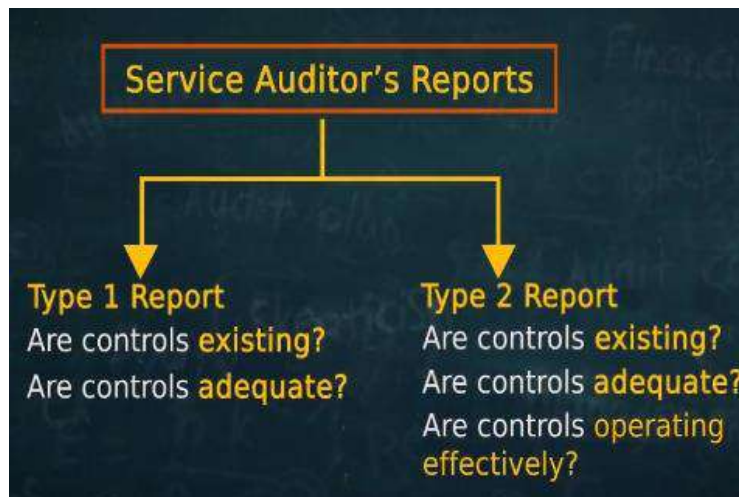
Service auditor is an independent auditor appointed by Service organisation.

### 1.4.4 Subservice organisation

A service organization used by another service organization to perform some of the services provided to user entities that are part of those user entities' information systems relevant to financial reporting.

### 1.4.5 Reports issued by Service Auditor

The Service auditor may issue two types of report – Type 1 & Type 2



### 1.4.6 Type 1 Report

Report on **the description and design of controls at a service organization**. It comprises:

- A **description, prepared by management** of the service organization, of
  - the service organization's system,
  - control objectives and related controlsthat have been designed and implemented as at a specified date; and
- A **report by the service auditor** with the objective of conveying reasonable assurance that includes the **service auditor's opinion** on
  - the description of the service organization's system,
  - control objectives and related controls and
  - the suitability of the design of the controls to achieve the specified control objectives

### 1.4.7 Type 2 Report

Report on the **description, design, and operating effectiveness of controls at a service organization**. It comprises:

- A **description, prepared by management** of the service organization, of
  - the service organization's system,
  - control objectives and related controls,
  - their design and implementationas at a specified date or throughout a specified period and, in some cases, their operating effectiveness throughout a specified period; and
- A **report by the service auditor** with the objective of conveying reasonable assurance that includes:
  - The **service auditor's opinion** on the description of the service organization's system, control objectives and related controls, the suitability of the design of the controls to achieve the specified control objectives, and the operating effectiveness of the controls; and
  - A **description of the service auditor's tests** of the controls and the results thereof.

#### Type 1 Report

- Accuracy of description
- Systems controls have been placed in operations
- Design is suited to achieve the stated objectives

#### Type 2 Report

- Accuracy of description
- Systems controls have been placed in operations
- Design is suited to achieve the stated objectives
- Systems are operating effectively based on the results from the test of controls

## 1.5 User Auditor's Responsibilities

### 1.5.1 Understanding the services provided

- Understanding regarding **service organization** – the auditor shall obtain understanding about
  - The nature of the services provided
  - The nature and materiality of the transactions processed
  - The degree of interaction between the activities of the service organization and those of the user entity
  - The nature of the relationship between the user entity and the service organization



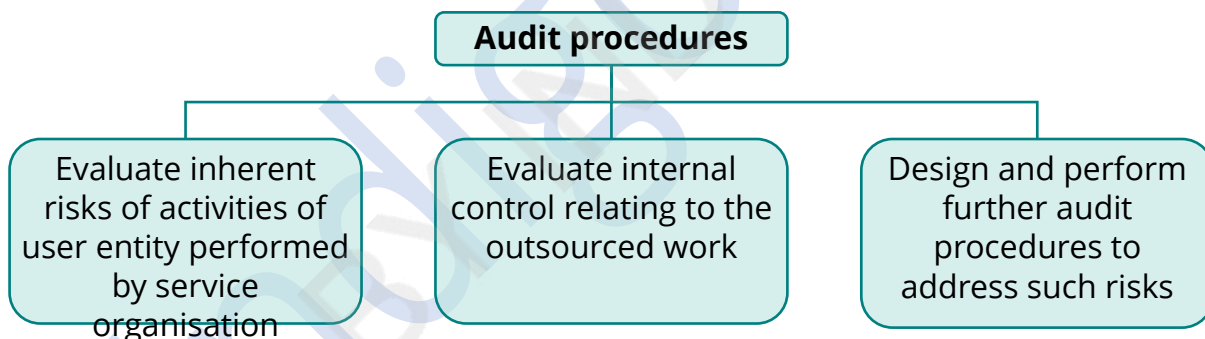
### Sources of information about the service provided by the service organisation

- User manuals.
- System overviews.
- Technical manuals.
- The contract or service level agreement between the user entity and the service organisation.
- Reports by service organisations, internal auditors or regulatory authorities on controls at the service organisation.
- Reports by the service auditor, including management letters, if available

- Understanding of **internal controls** - he shall evaluate the design and implementation of the relevant controls at the user entity that relate to the services provided by the service organization.

The user auditor shall determine whether a sufficient understanding of the nature and significance of the services provided by the service organization and their effect has been obtained to provide basis for identification & assessment of RMM.

#### 1.5.2 Audit procedures - Using Type 1 & Type 2 report



- If the user auditor is unable to obtain a sufficient understanding, he shall obtain that understanding from one or more of the following procedures
  - Obtaining a Type 1 or Type 2 report, if available
  - Contacting the service organization, through the user entity, to obtain specific information
  - Visiting the service organization and performing specific audit procedure
  - Using another auditor to perform the procedures (SA 600)
- In determining the sufficiency and appropriateness of the audit evidence provided by Type 1 or Type 2 report, the user auditor shall be satisfied as to:
  - The service auditors' professional competence except where the service auditor is a member of ICAI and independence from the service organization and
  - The adequacy of the standards under which the Type 1 or Type 2 report was issued

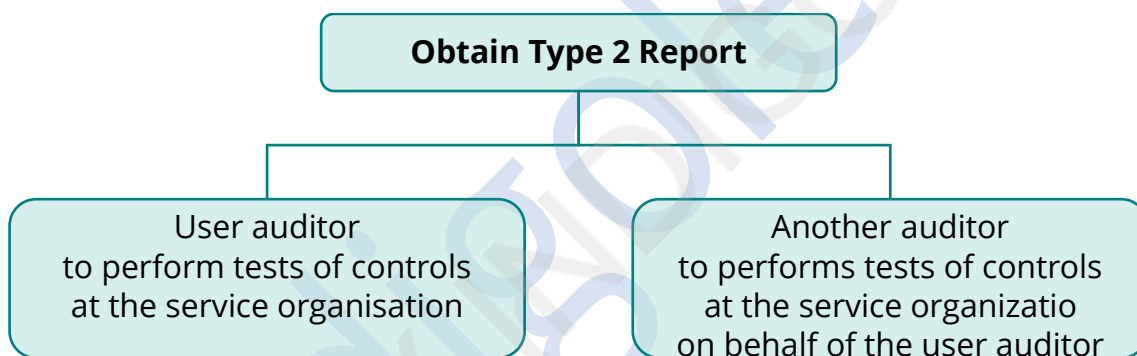
## 1.6 Respond to the assessed risk of material misstatement

- Determine whether sufficient appropriate audit evidence concerning the relevant financial statement assertions is available from the records held at the user entity;
- If no such evidence available
  - Perform further audit procedures or
  - use another auditor to conduct procedures at the service organization on the user auditor's behalf

## 1.7 Test of Controls

The user auditor shall obtain audit evidence about the operating effectiveness of those controls from one or more of the following procedures:

- Obtain Type 2 report
- Perform test of controls



### 1.7.1 Using Type 2 Report

The user auditor shall determine whether the service auditor's report provides sufficient appropriate audit evidence about the effectiveness of the controls to support the user auditor's risk assessment by

- Evaluate if report is at a date or for a period and if that is appropriate for the audit purposes
- Determining whether complementary user entity controls are relevant to the user entity and
- Obtain an understanding of whether the user entity has designed and implemented such controls and is the operating effectiveness tested
- Evaluating the adequacy of the time period covered by the tests of controls and the time elapsed since the performance of the tests of controls; and
- Evaluating whether the tests of controls performed by the service auditor are relevant to the assertions in the user entity's financial statements



- Provide sufficient appropriate audit evidence to support the user auditor's risk assessment.

## 1.8 User Auditor's responsibility for Exclusions

If the user auditor plans to use a Type 1 or a Type 2 report that excludes the services provided by a subservice organization and those services are relevant to the audit of the user entity's financial statements, the user auditor shall apply the requirements of this SA with respect to the services provided by the subservice organization

## 1.9 Fraud, Non-compliance with laws and regulations and uncorrected misstatements in Relation to Activities at the Service Organisation

The user auditor shall inquire of management of the user entity

- whether the service organization has reported any fraud to the user entity, or
- Whether the user entity is otherwise aware of, any fraud, non-compliance with laws and regulations or uncorrected misstatements affecting the financial statements of the user entity.

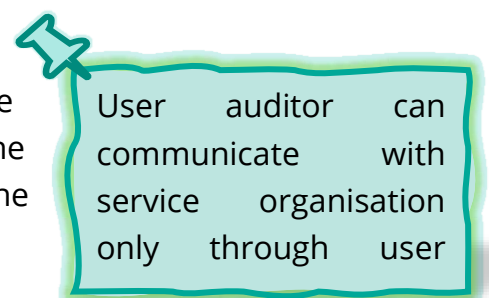
The user auditor shall evaluate the effect of such matters on

- the nature, timing and extent of the user auditor's further audit procedures, and
- the effect on the user auditor's conclusions and user auditor's report.

## 1.10 Reporting Responsibilities of the User Auditor

### 1.10.1 Modification

The auditor shall modify the opinion in the user auditor's report in accordance with SA 705 if the user auditor is unable to obtain sufficient appropriate audit evidence regarding the services provided by the service organization relevant to the audit of the user entity's financial statements



### 1.10.2 Refer to service auditor's work

- The user auditor shall not refer to the work of a service auditor in the user auditor's report containing an unmodified opinion unless required by law or regulation to do so.
- If such reference is required by law or regulation, the user auditor's report shall indicate that the reference does not diminish the user auditor's responsibility for the audit opinion.
- If reference to the work of a service auditor is relevant to an understanding of a

modification to the user auditor's opinion, the user auditor's report shall indicate that such reference does not diminish the user auditor's responsibility for that opinion.

#### Reporting by the User Auditor:

1. If **sufficient, appropriate audit evidence** is not obtained, modified opinion shall be given as per **SA 705**
2. If User Auditor issues an unmodified opinion, the audit report shall **not refer** to the work done by **service auditor**
3. If such reference is required by **laws or regulations**, user auditor shall mention that the **user auditor's** responsibility is not reduced because of this

## 2) SA 450 - Evaluation of Misstatements Identified During the Audit

### Contents

- Misstatement
- Uncorrected Misstatement
- Communication & Correction of misstatements
- Evaluating effect of uncorrected misstatements

### 2.1 Introduction

Auditor's Objective is to evaluate:

- The effect of identified misstatements on the audit; and
- The effect of uncorrected misstatements, if any, on the financial statements

After applying the provisions of SA 700 and SA 320.

### 2.2 Important Terms

#### 2.2.1 Misstatement

A difference between the amounts, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that is required for the item to accordance with the applicable financial reporting framework.



Misstatements can arise from error or fraud.

be in

Misstatements also include those adjustments of amounts, classifications, presentation, or disclosures that, in the auditor's judgment, are necessary for the financial statements to give a true and fair view or present fairly, in all material respects.

Misstatements may result from:

- An inaccuracy in gathering or processing data
- An omission of an amount or disclosure;
- An incorrect accounting estimate arising from overlooking, or clear misinterpretation of facts; and
- Judgments of management concerning accounting estimates which are unreasonable or inappropriate.



Misstatements can be by overstating or understating of account balances through fraud

## 2.2.2 Uncorrected Misstatements

Misstatements that the auditor has accumulated during the audit and that have not been corrected.

## 2.3 Identified Misstatements

### 2.3.1 Accumulation

The auditor shall accumulate misstatements identified during the audit, other than those that are clearly trivial.

### 2.3.2 Revision of audit strategy & audit plan

The auditor shall determine whether the overall audit strategy and audit plan need to be revised if

- The nature of identified misstatements and the circumstances of their occurrence indicate that other misstatements may exist that, all such identified and probable misstatements together could be material or
- The aggregate of misstatements accumulated during the audit approaches materiality.

### 2.3.3 Additional Procedures

If management, on auditor's request has

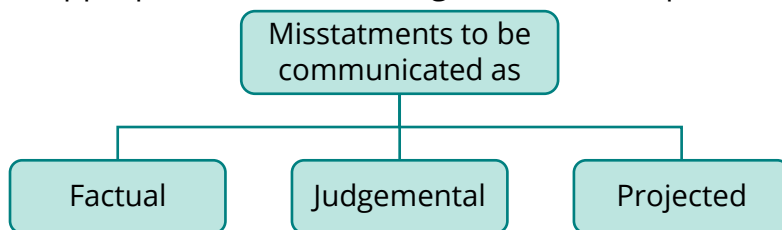
- examined a class of transaction, account balance or disclosure and
- corrected misstatements that were detected;

then the auditor shall perform additional audit procedures to determine whether misstatement remains

## 2.4 Communication and Correction of Misstatements

### 2.4.1 Communication

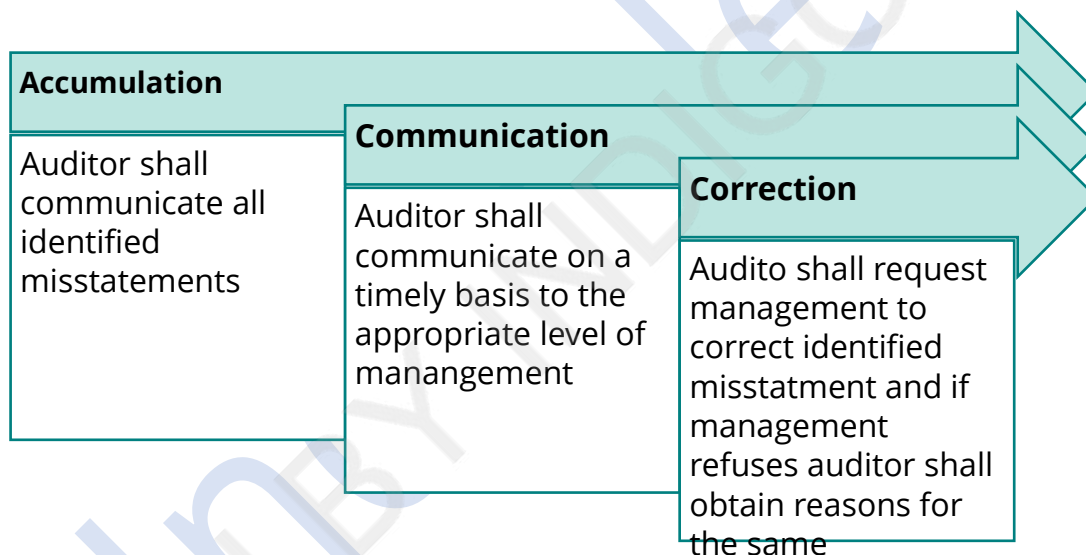
The auditor shall communicate on a timely basis all misstatements, accumulated during the audit, with the appropriate level of management, unless prohibited by laws or regulation.



Appropriate level of management is the one that has responsibility and authority to evaluate the misstatements and to take the necessary action.

### 2.4.2 Correction

The auditor shall request management to correct those misstatements. If management refuses to correct some or all the misstatements communicated by the auditor, the auditor shall obtain an understanding of management's reasons for not making the corrections.



## 2.5 Evaluating the Effect of Uncorrected Misstatements

### 2.5.1 Reassess Materiality

Prior to evaluating the effect of uncorrected misstatements, the auditor shall reassess materiality determined in accordance with SA 320 to confirm whether it remains appropriate in the context of the entity's actual financial results

The auditor shall determine whether uncorrected misstatements are material, individually or in aggregate.

320 to

In making this determination, the auditor shall consider

- The size and nature of the misstatements, both in relation to particular item and the

financial statements as a whole and

- The effect of uncorrected misstatements related to prior periods on the relevant account balance and the financial statements as a whole.

## 2.6 Communication with Those Charged with Governance

The auditor shall communicate (unless prohibited by law or regulation) with those charged with governance

- Material uncorrected misstatements (individually) and
- the effect that they individually or in aggregate, related to
  - current period
  - prior periods

## 2.7 Written Representations

- The auditor shall request a written representation from management and where appropriate, those charged with governance, whether they believe the effects of uncorrected misstatements are immaterial, individually and in aggregate, to the financial statements as a whole
- A summary of such items shall be included in or attached to the written representation

## 2.8 Documentation

- The amount below which misstatements would be regarded as clearly trivial
- Summary of differences - All misstatements accumulated during the audit
- Communications made to the management



Clearly trivial is not another expression for “not material”.

Matters that are “clearly trivial” are matters that are clearly inconsequential, whether taken individually or in aggregate and whether judged by any criteria of size, nature or circumstances. When there is any uncertainty about whether one or more items are clearly trivial, the matter is considered not to be clearly trivial

- Responses received from management
- Whether misstatements communicated have been corrected / resolved or not and the reasons for not resolving
- The auditor’s conclusion as to whether uncorrected misstatements are material, individually or in aggregate, and the basis for that conclusion.

The effect of uncorrected misstatements on the Audit Report.

# SA 500 - 599 Audit Evidence

## Contents

- SA 500 - Audit Evidence
- SA 501 - Audit Evidence-Specific Considerations for Selected Items
- SA 505 - External Confirmations
- SA 510 - Initial Audit Engagements – Opening Balances
- SA 520 - Analytical Procedures
- SA 530 - Audit Sampling
- SA 540 - Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures
- SA 550 - Related Parties
- SA 560 - Subsequent Events
- SA 570 - Going Concern
- SA 580 - Written Representations



# 1) SA 500 – Audit Evidence

## Contents

- Audit Evidence
- Sufficiency & Appropriateness of Audit Evidence
- Audit procedures for obtaining evidence
- Techniques of obtaining audit evidence
- Relevance & Reliability of evidence

## 1.1 Introduction

**Audit Evidence** - Information used by the auditor in arriving at the conclusions on which the auditor's opinion is based.

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

## 1.2 Audit Evidence and Auditor's objective

### 1.2.1 SA 200

The auditor's objective is to give an opinion on the financial statements and for that

- The auditor should obtain sufficient appropriate audit evidence through the performance of compliance and substantive procedures to enable him to draw reasonable conclusions and then the opinion on the financial information"
- The auditor should review and assess the conclusions drawn from the audit evidence obtained and from his knowledge of business of the entity as the basis for the expression of his opinion on the financial information.

Hence from the above we can conclude that auditor's opinion should be supported by reasonable conclusions and reasonable conclusions should be backed by sufficient and appropriate audit evidences.

### 1.2.2 SA 330

SA 330 requires the auditor to conclude whether sufficient appropriate audit evidence has been obtained.

### 1.2.3 SA 500

The auditor shall design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence.

## 1.3 Important Terms

### 1.3.1 Accounting Records

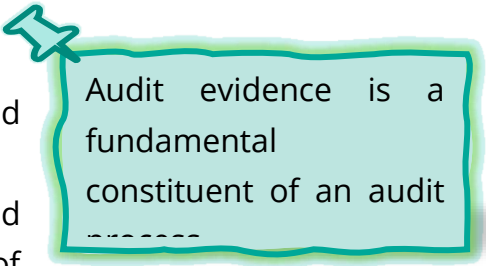
The records of initial accounting entries and supporting records, such as checks and records of electronic fund transfers; invoices; contracts; the general and subsidiary ledgers, journal entries and other adjustments to the financial statements that are not reflected in journal entries; and records such as work sheets and spreadsheets supporting cost allocations, computations, reconciliations and disclosures.

### 1.3.2 Management's Expert

An individual or organisation 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.

## 1.4 Significance of Audit Evidence

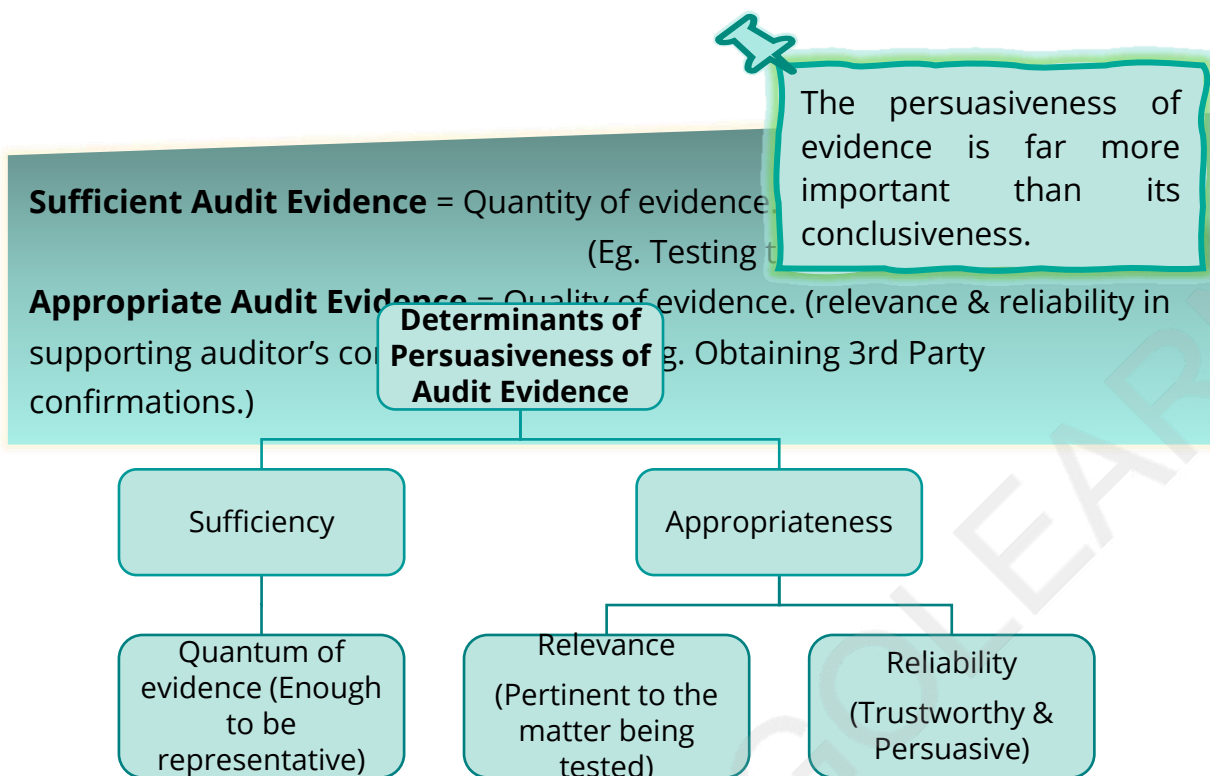
- The auditor applies his professional judgment to the evidence gathered and obtained during the audit process.
- He forms his opinion as to the truthfulness and fairness of financial statements on the basis of review of such evidence and expresses his opinion through an audit report.



Audit evidence is a fundamental constituent of an audit process

**Audit evidence** can be any **document, record or information**, which is available **to substantiate any assertion** made in financial statements or transactions recorded in the books of account.

## 1.5 Sufficiency and Appropriateness of Audit Evidence



The auditor shall design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence

The auditor places more importance on persuasive evidence than conclusive evidence because

- cost of obtaining conclusive evidence may exceed the usefulness of evidence obtained and
- it is widely accepted that audit is designed to provide reasonable not absolute assurance about management's assertions in financial statements.

### 1.5.1 Sufficiency of Audit Evidence

The measure of the quantity of audit evidence. The quantity of the audit evidence needed is affected by the auditor's assessment of the risks of material misstatement and also by the quality of such audit evidence. viz. at least two evidences are required to conclude about the balance in bank - copy of Bank Statement and bank reconciliation statement);

### 1.5.2 Appropriateness of Audit Evidence

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. (Copy of bank statement should be duly certified by the bank manager and BRS shall be passed by Managers account and corresponding entries required have been made in books of accounts).

### 1.5.3 Professional Judgement

Auditor shall use professional judgment to ascertain whether Sufficient and Appropriate audit evidences have been obtained or not.

It all depends upon how much the item concerned is material, whether risk of misstatement is there or not relating to any item of financial statement, nature and complexity of financial information etc.

### 1.6 Sources of Audit Evidence

- Some audit evidence is obtained by performing **audit procedures** to test the accounting records
- The auditor may determine whether the accounting records are internally consistent and agree to the financial statements.
- Consistency of audit evidence enhances the audit comfort (i.e. relevance and reliability)

### 1.7 Audit procedures for obtaining audit evidence

- Auditors' Opinion shall be an outcome of
  - Risk assessment procedures performed;
  - Tests of controls, when required by the SAs or when the auditor has chosen to do so; and
  - Substantive procedures, including tests of details and substantive analytical procedures
- 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.
- 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.

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.

### 1.8 Techniques of Audit Evidence

#### 1.8.1 Inspection

- Inspection refers to the examination of records and of documentary evidence such as lease deeds, investment certificates, whether originating from the third parties or the entity and held by either.

- It also indicates physical examination of tangible assets to ensure their actual existence.
- The various records and documents provide evidence of varying degree of reliability depending on their nature and source and effectiveness of internal controls over their processing.
- Inspection of tangible assets may provide reliable audit evidence with respect to their existence, but not necessarily about the entity's rights and obligations or the valuation of the assets.
- Inspection of individual inventory items may accompany the observation of inventory counting.

### 1.8.2 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, or of the performance of control activities.
- Observation provides audit evidence about the performance of a process or procedure but is limited to the point in time at which the observation takes place, and by the fact that the act of being observed may affect how the process or procedure is performed.

### 1.8.3 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.
- External confirmation procedures frequently are relevant when addressing assertions associated with certain account balances and their elements.
- However, external confirmations need not be restricted to account balances only.

### 1.8.4 Recalculation

Recalculation consists of checking the mathematical accuracy of documents or records. Recalculation may be performed manually or electronically.

### 1.8.5 Repperformance

Reperformance involves the auditor's independent execution of procedures or controls that were originally performed as part of the entity's internal control.

### 1.8.6 Analytical Procedures


- Analytical procedures consist of evaluations of financial information made by a study of plausible relationships among both financial and non-financial data.
- Analytical procedures also encompass the investigation of identified fluctuations and relationships that are inconsistent with other relevant information or deviate significantly from predicted amounts.

### 1.8.7 Inquiry

- Inquiry consists of seeking information of knowledgeable persons, financial and non-financial, within the entity or outside the entity.
- Inquiries may be formal written inquiries or informal oral inquiries.
- Evaluating responses to inquiries is an integral part of the inquiry process. Responses to inquiries may provide the auditor with information not previously possessed or with corroborative audit evidence.
- Alternatively, responses might provide information that differs significantly from other information that the auditor has obtained, for example, information regarding the possibility of management override of controls.
- In some cases, responses to inquiries provide a basis for the auditor to modify or perform additional audit procedures
- Although corroboration of evidence obtained through inquiry is often of particular importance, in the case of inquiries about management intent, the information available to support management's intent may be limited.
- In these cases, understanding 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 may provide relevant information to corroborate the evidence obtained through inquiry
- 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

### 1.9 Relevance & Reliability of Information

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



Reliability of audit evidence is influenced by its source and by its nature, and is dependent on the individual circumstances under which it is obtained.

#### 1.9.1 Relevance

- Relevance deals with the logical connection with, or bearing upon, the purpose of the audit procedure and, where appropriate, the assertion under consideration. The relevance of information to be used as audit evidence may be affected by the direction of testing
- Obtaining audit evidence regarding a particular assertion, for example, the existence of inventory, is not a substitute for obtaining audit evidence regarding another assertion, for example, the valuation of that inventory. On the other hand, audit evidence from

different sources or of a different nature may often be relevant to the same assertion.

- Tests of controls are designed to evaluate the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements at the assertion level.
- Designing tests of controls to obtain relevant audit evidence includes identifying conditions (characteristics or attributes) that indicate performance of a control, and deviation conditions, which indicate departures from adequate performance.
- The presence or absence of those conditions can then be tested by the auditor.
- Substantive procedures are designed to detect material misstatements at the assertion level.

### 1.9.2 Reliability

- In the existence of effective internal controls, reliability of internal evidence increases
- Audit evidence obtained directly by the auditor is more reliable than audit evidence obtained indirectly or by inference.
- Written evidence more reliable than oral.
- Following is the level of reliability based on the source of information (external or internal source to the entity) and the destination (external destination means received by the auditor directly) of the information:



Evidence from independent external source is more reliable than that from internal source

Type of Audit evidence	Example	Ranking of reliability
External Source – External Destination	Debtor balance confirmation	1
External source – Internal Destination	Purchase Invoice	2
Internal Source – External Destination	Sales Invoice	3
Internal Source – Internal Destination	Goods receipt note	4

### 1.10 Using Management's Expert opinion as evidence

When information to be used as audit evidence has been prepared using the work of a management's expert, the auditor shall, to the extent necessary, having regard to the significance of that expert's work for the auditor's purposes ensure the following:

#### 1.10.1 Evaluate competence, capabilities and objectivity of the expert

- Personal experience with previous work of that expert
- Discussions with that expert
- Discussions with others who are familiar with that expert's work.
- Knowledge of that expert's qualifications, membership of a professional body or industry



- association, license to practice, or other forms of external recognition.
- Published papers or books written by that expert.

When evaluating the objectivity, determine any interests and relationships that may create threats to the expert's objectivity, and evaluate whether the safeguards are adequate. Interests and relationships creating threats may include:

- Financial interests.
- Business and personal relationships.

#### **1.10.2 Obtain understanding of the work of the expert**

- Whether that expert's field has areas of specialty within it that are relevant to the audit
- Whether any professional or other standards, and regulatory or legal requirements apply
- What assumptions and methods are used by the management's expert, and whether they are generally accepted within that expert's field and appropriate for financial reporting purposes
- The nature, scope and objectives of that expert's work;
- The respective roles and responsibilities of management and that expert;

#### **1.10.3 Evaluate appropriateness of that expert's work as audit evidence for the relevant assertion**

- The relevance and reasonableness of that expert's findings or conclusions, their consistency with other audit evidence, and whether they have been appropriately reflected in the financial statements;
- If that expert's work involves use of significant assumptions and methods, the relevance and reasonableness of those assumptions and methods; and
- If that expert's work involves significant use of source data, the relevance, completeness, and accuracy of that source data.

#### **1.11 Information produced by the entity used by Auditor**

When any information is produced by the entity which becomes the audit evidence, the auditor shall ensure

- Accuracy and completeness of evidence
- Evaluating whether information is precise and detailed for the auditor's purpose

#### **1.12 Test of Controls**

In designing and performing test of controls, the auditor shall:

- Perform other audit procedures in combination with inquiry to obtain audit evidence about the operating effectiveness of the controls, including:
  - How the controls were applied at relevant times during the period under audit.
  - The consistency with which they were applied.
  - By whom or by what means they were applied.
- Determine whether the controls to be tested depend upon other controls (indirect controls), and if so, whether it is necessary to obtain audit evidence supporting the effective operation of those indirect controls.

### 1.12.1 Extent of Test of Controls

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

- The frequency of the performance of the control by the entity during the period.
- The length of time during the audit period that the auditor is relying on the operating effectiveness of the control.
- The expected rate of deviation from a control.
- The relevance and reliability of the audit evidence to be obtained regarding the operating effectiveness of the control at the assertion level.
- The extent to which audit evidence is obtained from tests of other controls related to the assertion.

### 1.12.2 Timing of Test of Controls

The auditor shall test controls for the particular time, or throughout the period, for which the auditor intends to rely on those controls in order to provide an appropriate basis for the auditor's intended reliance.

## 1.13 Selecting items for Testing for obtaining Audit Evidence

When designing tests of controls and tests of details, the auditor shall determine means of selecting items for testing that are effective in meeting the purpose of the audit procedure.

In selecting items for testing, the auditor is required to determine the relevance and reliability and sufficiency of information to be used as audit evidence.

The means available to the auditor for selecting items for testing are:

- Selecting all items (100% testing)
- Selecting specific items – Targeted Testing
- Audit Sampling



100% examination is unlikely in the case of tests of controls but it can be used for test of details

The application of any one or combination of these means may be appropriate depending on the particular circumstances.

### 1.13.1 100% Testing

100% examination may be appropriate when, for example:

- The population constitutes a small number of large value items;
- There is a significant risk and other means do not provide sufficient appropriate audit evidence; or
- The repetitive nature of a calculation or other process performed automatically by an information system makes a 100% examination cost effective.

### 1.13.2 Selecting Specific Items

The judgmental selection of specific items is subject to non-sampling risk. Specific items selected may include:

- High value or key items.
- All items over a certain amount.
- Items to obtain information.

### 1.13.3 Audit Sampling

Audit sampling is designed to enable conclusions to be drawn about an entire population on the basis of testing a sample drawn from it.

## 1.14 Specific Enquiries by auditor when deviations from controls are detected

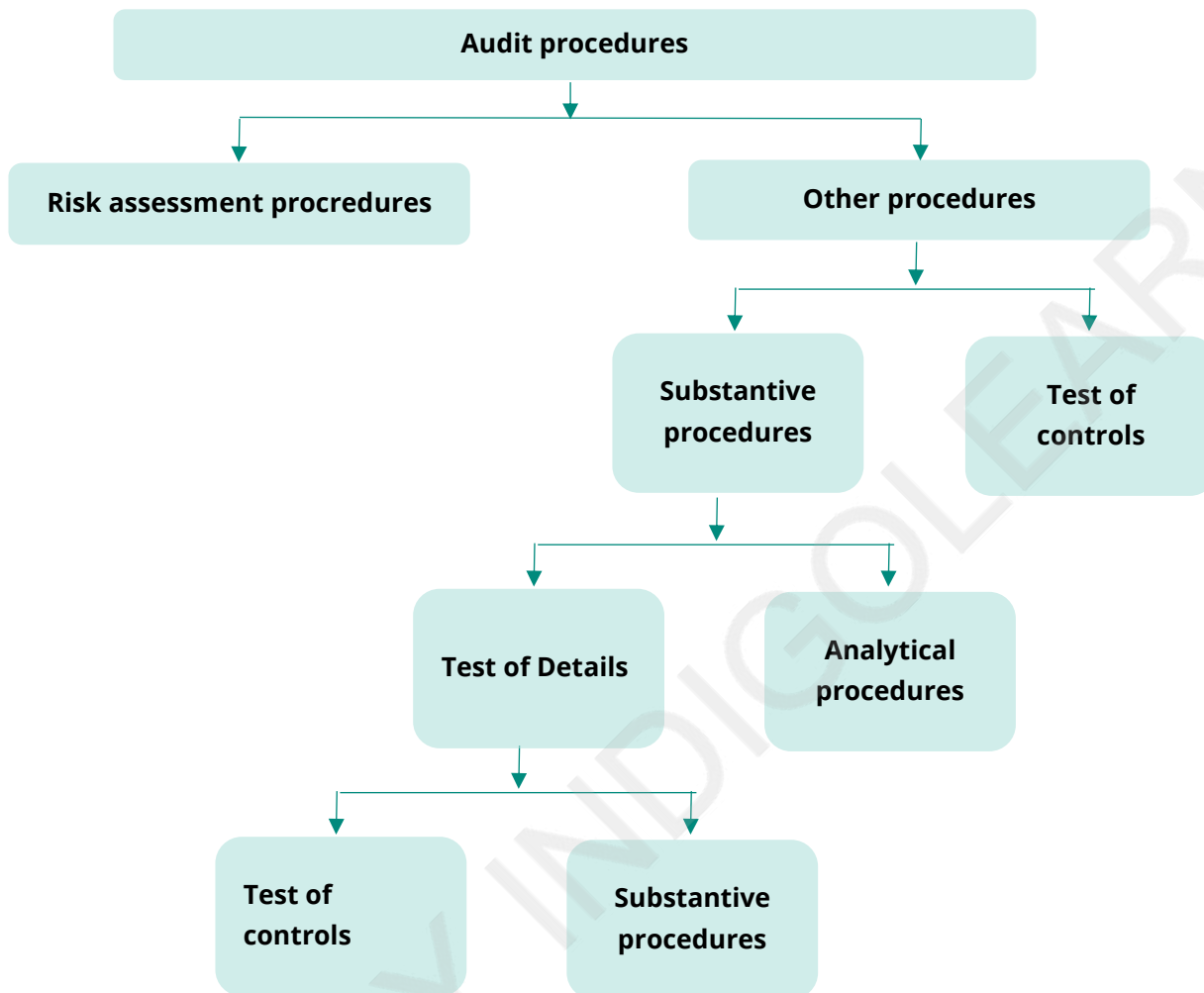
When deviations from controls upon which the auditor intends to rely are detected, the auditor shall make specific inquiries to understand these matters and their potential consequences, and shall determine whether:

- The test of controls that have been performed provide an appropriate basis for reliance on the controls;
- Additional test of controls is necessary; or
- The potential risks of misstatement need to be addressed using substantive procedures.

### 1.15 Substantive Procedures

Substantive procedure may be defined as an audit procedure designed to detect material misstatements at the assertion level. Substantive procedures comprise:

- Tests of details (of classes of transactions, account balances, and disclosures), and
- Substantive analytical procedures.



### 1.16 Using Audit Evidence obtained in Previous Audits

In determining whether it is appropriate to use audit evidence about the operating effectiveness of controls obtained in previous audits, and, if so, the length of the time period that may elapse before retesting a control, the auditor shall consider the following:

- The effectiveness of other elements of internal control, including the control environment, the entity's monitoring of controls, and the entity's risk assessment process;
- The risks arising from the characteristics of the control, including whether it is manual or automated;
- The effectiveness of general IT-controls;
- The effectiveness of the control and its application by the entity, including the nature and extent of deviations in the application of the control noted in previous audits, and whether there have been personnel changes that significantly affect the application of the control;

- Whether the lack of a change in a particular control poses a risk due to changing circumstances; and
- The risks of material misstatement and the extent of reliance on the control.

### 1.17 Inconsistency in, Doubts over Reliability of Audit Evidence

The auditor shall determine what modifications or additions to audit procedures are necessary to resolve the following:

- audit evidence obtained from one source is inconsistent with that obtained from another; or
- the auditor has doubts over the reliability of information to be used as audit evidence

Auditor shall consider the effect of the matter, if any, on other aspects of the audit.

### 1.18 Financial Statement Assertions

Management makes the assertions and the auditor verifies by obtaining sufficient and appropriate audit evidence.

Assertion	Example of Audit Evidence
<b>Existence</b>	<ul style="list-style-type: none"> <li>• Existence of inventory may be tested through the auditor's observation of inventory items</li> <li>• Physical verification of Fixed Assets</li> <li>• Debtors may be tested through the auditor's observation of inventory items</li> </ul>
<b>Rights &amp; Obligation</b>	<ul style="list-style-type: none"> <li>• Ownership of inventory can be verified through examining the documents as to title and inquiring about consignment activity</li> <li>• Examine the debt instrument giving rise to liability for testing obligation assertion</li> </ul>
<b>Accuracy</b>	<ul style="list-style-type: none"> <li>• Confirming that the amount in the voucher / invoice is correctly recorded in the books of account</li> </ul>
<b>Occurrence</b>	<ul style="list-style-type: none"> <li>• Sales may be tested for occurrence by examining the invoices and cancelled cheques supporting them. These documents indicate that sales are results of exchange of goods or services for a valid asset</li> </ul>
<b>Completeness</b>	<ul style="list-style-type: none"> <li>• Completeness of accounts payable is usually tested by confirmations with the creditors and by tracing payments to creditors made after year- end to corresponding initial recording of the debt</li> </ul>
<b>Valuation</b>	<ul style="list-style-type: none"> <li>• Debtors should be shown in the balance sheet at net realization value i.e. Gross debtors less provision for bad and doubtful debts to meet the valuation assertion.</li> </ul>
<b>Measurement</b>	<ul style="list-style-type: none"> <li>• As per measurement assertion, interest earned on</li> </ul>

	debentures must be allocated to the accounting period it was earned in, whether it has actually been received or not
<b>Presentation &amp; Disclosure</b>	<ul style="list-style-type: none"> <li>Assets pledged as collateral for a debt should be disclosed in the financial statements.</li> <li>Similarly, AS- 18, requires the disclosure of related party transactions in the financial statements.</li> </ul>

### 1.19 Question

- 1) Audit evidence includes both information contained in the accounting records underlying the financial statements and other information. Discuss. [RTP-May 18]
- 2) Auditing is a logical process. An auditor is called upon to assess the actualities of the situation, review the statements of account and give an expert opinion about the truth and fairness of such accounts. This he cannot do unless he has examined the financial statements objectively. He needs evidence to obtain information for arriving at his judgment. Discuss explaining clearly the detailed meaning of audit evidence. [RTP-Nov. 19]
- 3) Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence. Explain. [RTP-Nov. 18]
- 4) Audit evidence is necessary to support the auditor's opinion and report. It is cumulative in nature and is primarily obtained from audit procedures performed during the course of the audit. Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence. Explain. [RTP-Nov. 19]
- 5) What do you mean by sufficient appropriate audit evidence? State various factors that help the auditor to ascertain as to what is sufficient appropriate audit evidence. [Nov. 10 (6 Marks)]
- 6) State various factors that help the auditor to ascertain as to what is sufficient and appropriate audit evidence. [Nov. 17 (4 Marks)]
- 7) The quantity of audit evidence needed is affected by the auditor's assessment of the risks of misstatement. Auditor's judgment as to sufficiency may be affected by few factors. Explain. [RTP-May 18]
- 8) 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 by the quality of such audit evidence (the higher the quality, the less may be required). Obtaining more audit evidence, however, may not compensate for its poor quality. Analyse and Explain stating clearly the factors affecting the auditor's judgement as to sufficiency of audit evidence. [RTP-May 19]
- 9) What are the audit procedures to obtain audit evidence? Mention the same in brief.

- 10) Explain various methods to obtain audit evidence. [May 11 (8 Marks)]
- 11) Write short note on: Methods to obtain audit evidence. [May 15 (4 Marks)]
- 12) 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. [Nov. 15 (6 Marks)]
- 13) Discuss the following: Inquiry is one of the audit procedure to obtain audit evidence. [May 13 (5 Marks)]
- 14) Evaluating responses to inquiries is an integral part of the inquiry process. Explain. [RTP-May 18]
- 15) Distinguish between: Internal Evidence and External Evidence. [Nov. 08 (6 Marks)]
- 16) With reference to SA 500, "Audit Evidence", discuss the different sources and their reliability, of audit evidence. [May 17 (6 Marks)]
- 17) "Even when information to be used as audit evidence is obtained from sources external to the entity, circumstances may exist that could affect its reliability". Explain. Also state clearly generalisations about the reliability of audit evidence. [RTP-May 18]



## 2. SA501 Audit Evidence – Specific Considerations for Selected Items

### Contents

Evidence for

- Inventory
- Litigations & Claims
- Segment Information

### 2.1 Scope of SA

The objective of the auditor under this SA is to obtain sufficient appropriate audit evidence regarding the:

- Existence and condition of inventory.
- Completeness of litigation and claims involving the entity; and
- Presentation and disclosure of segment information in accordance with the applicable financial reporting framework.

### 2.2 Inventory – Existence & Condition

When inventory is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by

- Attendance at physical counting
- Performing audit procedures on final inventory records

#### 2.2.1 Physical Count – Attendance

Auditor shall attend physical inventory counting, unless impracticable, and shall:

- Evaluate management's instructions and procedures for recording and controlling the

- results of the entity's physical inventory counting;
- Observe the performance of management's procedures;
  - Inspect the inventory; and
  - Perform test counts; and

count



Management shall carry out inventory counting at least once in every year.

Test counts should be two way, for example by tracing items selected from management's count records to the physical inventory and tracing items selected from the physical inventory to management's count records.

1

**Tag to Floor testing:** Checking whether the items given in the management's stock records are actually existing

2

**Floor to Tag testing:** Checking whether items observed in the stock of inventory are appearing in the stock records

Attending physical verification of inventory involves

- ascertaining their condition (slow-moving, non-moving, obsolete or good),
- verifying compliance with management's instructions and
- addressing other risk factors identified in this regard

If the auditor is **unable to attend** physical inventory counting due to unforeseen circumstances, the auditor shall make or observe some physical counts on an alternative date, and perform audit procedures on intervening transactions.



If needed, the auditor may use the work of an expert to verify the existence and condition of the . . .

If attendance at physical inventory counting is **impracticable**, the auditor shall perform alternative audit procedures to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory. If it is not possible to do so, the auditor shall modify the opinion in the auditor's report appropriately.

### 2.2.2 Audit procedures on final inventory records

Auditor shall perform audit procedures over the entity's final inventory records to determine whether they accurately reflect actual inventory count results.

### 2.2.3 Factors affecting attendance of physical inventory counting

Matters relevant in planning attendance at physical inventory counting include:

- Nature of inventory.
- Stages of completion of work in progress.
- The risks of material misstatement related to inventory.
- The nature of the internal control related to inventory.
- Instructions issued for physical inventory counting.
- Whether adequate procedures are expected to be established for counting
- The timing of physical inventory counting.
- Whether the entity maintains a perpetual inventory system.
- The locations at which inventory is held
- Whether the assistance of an auditor's expert is needed.

### 2.2.4 Evaluating management's instructions

Management should include the following while issuing instructions:

- Application of appropriate control activities
- The accurate identification of the stage of completion of work in progress, of slow moving, obsolete or damaged items and of inventory owned by a third party, for example, on consignment.
- The procedures used to estimate physical quantities E.g. Quantity of a coal pile
- Control over the movement of inventory between areas
- The shipping and receipt of inventory before and after the cut-off date.

### 2.2.5 Observance of Counting Procedure

Auditor shall observe the performance of management's count procedures to obtaining audit evidence that management's instructions and count procedures are adequately designed and implemented.

Auditor may obtain copies of cut off information, such as details of the movement of inventory, to assist the auditor in performing audit procedures over the accounting for such movements at a later date.

### 2.2.6 Inventory counting is conducted at a date other than the date of the financial statements

If physical inventory counting is conducted at a date other than the date of the financial statements, the auditor shall, in addition to the above procedures, perform audit procedures to obtain audit evidence about whether changes in inventory between the count date and the date of the financial statements are properly recorded by using either

- Roll back process (if counting date is before financial statement date)
- Roll forward process (if counting date is after financial statement date)

Auditor shall determine:

- Whether the perpetual inventory records are properly adjusted and their reliability.
- Reasons for discrepancies noted in physical verification

### **2.2.7 Inventory under custody or control of third party**

If inventory is under the Custody and Control of a third party and is material, auditor shall

- Request confirmation from the third party as to the quantities and condition of inventory held on behalf of the entity. AND / OR
- Perform inspection or other audit procedures appropriate in the circumstances

## **2.3 Litigations and Claims -Completeness**

Litigation and claims involving the entity may have a material effect on the financial statements and thus may be required to be disclosed or accounted for in the financial statements.

The auditor shall design and perform audit procedures in order to identify litigation and claims involving the entity which may give rise to a risk of material misstatement.

### **2.3.1 Audit Procedures**

Such procedures shall include

- Inquiry of management and, where applicable, others within the entity, including in-house legal counsel or external confirmation of lawyer;
- Review minutes of meetings of those charged with governance and correspondence between the entity and its external legal counsel; and
- Review legal expense accounts
- Such other alternative audit procedures as appropriate like seeking direct communication with entity's legal counsel.

### **2.3.2 Communication with Entity's External Legal Counsel**

Direct communication with the entity's external legal counsel helps in knowing whether there are any potentially material litigation and claims and it also determines the reasonableness of management's estimates of the financial implications, including costs.

Auditor may seek direct communication with the entity's external legal counsel through a letter of general inquiry or specific inquiry

Specific inquiry includes

- List of litigation and claims
- Management's assessment of the litigations and claims

- Auditor's request to the counsel to confirm
  - Confirm management's assessment.
  - Provide information if list is incomplete

### 2.3.3 Modification of Audit Report

The auditor shall modify the opinion in the auditor's report if

- management refuses to give the auditor permission to communicate or meet with the entity's external legal counsel, or
- the entity's external legal counsel refuses to respond appropriately to the letter of inquiry, or is prohibited from responding; and
- the auditor is unable to obtain sufficient appropriate audit evidence by performing alternative audit procedures.

### 2.3.4 Written Representation

Auditor shall obtain from those charged with governance a written representation indicating that litigations and claims have been disclosed in accordance with applicable financial reporting framework

## 2.4 Segment Information – Presentation & Disclosure

Depending on the applicable financial reporting framework, the entity may be required or permitted to disclose segment information in the financial statements.

The auditor shall obtain sufficient appropriate audit evidence regarding the presentation and disclosure of segment information in accordance with the applicable financial reporting framework i.e AS 17.

### 2.4.1 Audit Procedures

- Obtain an understanding of the methods used by management in determining segment information,
- Evaluating whether such methods are likely to result in disclosure in accordance with the applicable financial reporting framework; and
- Where appropriate, test application of such methods; and
- Perform analytical procedures or other audit procedures appropriate in the circumstance

## 2.5 Questions

- 1) Explain the procedures to be performed by auditor to obtain sufficient and appropriate audit evidence regarding the existence and condition of inventory.
- 2) How would an auditor proceed to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory? Also, state reporting requirements in this respect.

- 3) ABC Ltd is engaged in manufacturing of different type of yarns. Ongoing through its financial statements for the past years, it is observed that inventory is material to the financial statements. You as an auditor of the company wanted to obtain sufficient appropriate audit evidence regarding the existence and condition of the inventory as appearing in the financial statements. Discuss, how would you proceed as an auditor.  
[MTP-March 18]
- 4) Explain the auditor's procedures w.r.t. determination of existence and condition of inventory under the following circumstances:
- (a) Inventory count conducted at a date other than balance sheet.
  - (b) To attend the inventory is impracticable.
- 5) State true or false "The Statutory Auditor is required to verify inventory physically."  
[Nov. 14 (2 Marks)]

## 3. SA 505 – External Confirmations

### Contents

- Auditor's objective
- External confirmation
- Responses and outcomes to Confirmation Request
- Management's refusal to obtain confirmation

### 3.1 Objective of Auditor

The objective of the auditor, when using external confirmation procedures, is to design and perform such procedures to obtain relevant and reliable audit evidence.

### 3.2 Characteristics of Audit Evidence

- Audit evidence is more reliable when it is obtained from independent sources outside the entity.
- Audit evidence obtained directly by the auditor is more reliable than audit evidence obtained indirectly or by inference.
- Audit evidence is more reliable when it exists in documentary form, whether paper, electronic or other medium.

### 3.3 Importance of External Confirmation

- SA 500 - External Confirmations are the most reliable source of audit evidence as they are from independent source which increase the auditor's assurance from accounting records.
- SA 330 requires auditor to consider whether external confirmation procedures are to be performed as substantive audit procedures.
- SA 330 also insists to obtain more persuasive audit evidence whenever there is high assessment of risk and external confirmation is the most reliable persuasive audit evidence.



- SA 240 - Auditor shall design confirmation requests to obtain additional corroborative information as a response to address the assessed risks of material misstatement, whether due to fraud at the assertion level.

### 3.4 Important terms

#### 3.4.1 External Confirmation

Audit evidence obtained as a direct written response to the auditor from a third party (the confirming party), in paper form, or by electronic or other

External confirmations are confirmations given by parties external to Management, to the Auditor of the entity.

#### 3.4.2 Positive Confirmation Request

A request that the confirming party respond directly to the auditor indicating whether the confirming party agrees or disagrees with the information in the request or providing the requested information.

A response to a positive confirmation request ordinarily is expected to provide reliable audit evidence. There is a risk, however, that a confirming party may reply to the confirmation request without verifying that the information is correct.

#### 3.4.3 Negative Confirmation Request

A request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request.

#### 3.4.4 Non-Response

A failure of the confirming party to respond, or fully respond, to a positive confirmation request, or a confirmation request returned undelivered.

#### 3.4.5 Exceptions

A response that indicates a difference between information requested to be confirmed, or contained in the entity's records, and information provided by the confirming party

### 3.5 External Confirmation Procedure

It is a process of obtaining and evaluating a direct communication from a third party in response to a request for information about a particular item affecting financial statements / assertions.

### 3.5.1 Process

The process includes

- Determining the information to be confirmed or requested
- Selecting the appropriate confirming party
- Designing the confirmation requests,
- Ensuring requests are properly addressed and contain return information for responses to be sent directly to the auditor,
- Sending requests to the confirming party
- Sending follow-up requests to the confirming party when applicable

### 3.5.2 Designing confirmation request

Factors to be considered while designing confirmation requests include

- Layout & Form
  - The layout and presentation of the confirmation request.
  - The method of communication
- Content
  - The assertions being addressed.
  - Specific identified risks of material misstatement, including fraud risks.
- Others
  - Prior experience on the audit or similar engagements
  - Management's cooperation
  - The ability of the intended confirming party to confirm or provide the requested information

## 3.6 Management's Refusal to Allow the Auditor to send a Confirmation Request

### 3.6.1 Audit Procedures

If management refuses to allow the auditor to send a confirmation request, the auditor shall:

- Inquire into and seek reasonableness of Management's Refusal (E.g. Ongoing litigation with the party etc.,)
- Evaluate effect of refusal on the auditor's assessment of
- the relevant risks of material misstatement,

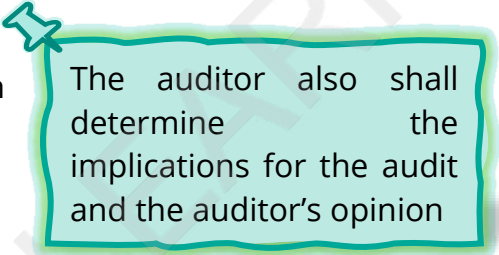
- the risk of fraud, and on the nature, timing and extent of other audit procedures; and
- Perform alternative audit procedures designed to obtain relevant and reliable audit evidence (E.g. Subsequent period transactions verification, etc.)

### 3.6.2 Auditor's approach

If the auditor concludes that

- management's refusal to allow the auditor to send a confirmation request is unreasonable, or
- the auditor is unable to obtain relevant and reliable audit evidence from alternative audit procedures,

the auditor shall communicate with those charged with governance in accordance with SA 260 (Revised).



The auditor also shall determine the implications for the audit and the auditor's opinion

### 3.7 Outcome of External Confirmation Requests

<b>Doubtful about the reliability</b>	<p>If auditor has any doubts on the evidence so obtained E.g.</p> <ul style="list-style-type: none"><li>• Received by the auditor indirectly; or</li><li>• Appeared not to come from the originally intended confirming party or</li><li>• Appears to be falsified / tampered</li></ul> <p><b>Auditor shall perform additional procedures to resolve those doubts</b></p>
<b>Evidence not reliable</b>	<p>If auditor concludes that the evidence not reliable, <b>the auditor may need to revise the assessment of the risks of material misstatement at the assertion level and modify planned audit procedures accordingly, in accordance with SA 315.</b></p> <p>For example, an unreliable response may indicate a fraud risk factor that requires evaluation in accordance with SA 240 (Revised).</p>
<b>Non-responses</b>	<p>The auditor shall <b>perform alternative audit procedures</b> like subsequent period transactions verification etc., to obtain relevant and reliable audit evidence</p>
<b>Positive Confirmation Request is essential</b>	<p>If auditor doesn't obtain positive confirmation when he opined that it is necessary to gain sufficient appropriate audit evidence, he shall <b>determine the implications for the audit and the auditor's opinion</b> in accordance with applicable standards</p>

The auditor shall investigate exceptions to determine whether or not they are indicative of misstatements.

### 3.8 Negative Confirmations

Auditor shall not use negative confirmation as the sole substantive audit procedure to address assessed risk of material misstatement at the assertion level unless all of the following conditions fulfilled:

Negative confirmations provide less persuasive audit evidence than positive

requests  
an  
are

- The auditor has assessed the risk of material misstatement as low and has obtained sufficient appropriate audit evidence regarding the operating effectiveness of controls relevant to the assertion;
- The population of items subject to negative confirmation procedures comprises a large number of small, homogeneous, account balances, transactions or conditions;
- A very low exception rate is expected; and
- The auditor is not aware of circumstances or conditions that would cause recipients of negative confirmation requests to disregard such requests.

### 3.9 Evaluate the Evidence Obtained

The auditor shall evaluate

- Whether the results of the external confirmation procedures provide relevant and reliable audit evidence, or
- Whether performing further audit procedures is necessary.

### 3.10 Balance Confirmation – Sample

#### Debtor / Creditor Balance confirmation

Dear sir

Date and ref.

no.....

Records of our client PQR Ltd show a debit balance / credit balance of Rs\_\_\_at the close of business as on 30th September 2011. To ensure an independent verification of this balance, we shall appreciate if you will kindly check this balance with your records and send your confirmation directly to us R&Co, the Statutory Auditors of PQR Ltd, by completing the form below for which an addressed postage paid envelop is enclosed. Your prompt response to this request will be appreciated.

Yours faithfully

### 3.11 Questions

- 1) Define the following:
  - (i) Positive confirmation request
  - (ii) Negative confirmation request
  - (iii) Non-response
  - (iv) Exception [RTP-May 20]
- 2) What is meant by external confirmation? Mention four situations where external confirmation may be useful for auditors.
- 3) Explain the process of External Confirmation. Give some examples where external confirmation may be used as audit evidence. [Nov. 11 (8 Marks)]
- 4) When using external confirmation procedures, the auditor shall maintain control over external confirmation requests including sending the requests, including follow-up requests when applicable, to the confirming party. Explain the other points as to when using external confirmation procedures, the auditor would be required to maintain control over external confirmation requests. [RTP-May 20]
- 5) What are the factors to be considered while designing a confirmation request? [Nov. 12 (8 Marks)]
- 6) The auditor of H Ltd. wanted to obtain confirmation from its creditors. But the management made a request to the auditor not to seek confirmation from certain creditors citing disputes. Can the auditor of H Ltd. Accede to this request?
- 7) Write short note on: Reliability of external confirmations. [Nov. 10 (4 Marks)]

## 4. SA 510 Initial Audit Engagements – Opening Balances

### Contents

- Opening Balances
- Predecessor Auditor
- Auditor's responsibilities
- Misstatements in Opening Balances
- Audit Conclusions & Reporting

### 4.1 Scope

This standard deals with the auditor's responsibility relating to Opening Balances when conducting an Initial engagement.

### 4.2 Important Terms

#### 4.2.1 Initial Engagement

An engagement in which the financial statements for the previous or prior period, were either audited (by a predecessor auditor) or not audited at all.

#### 4.2.2 Opening Balances

**Opening balances** refer to that account balance which exists at the beginning of the period.

Opening balances reflect the effect of transactions, events and accounting policies applied in the preceding period.

Opening balances are the closing balances of the preceding period brought forward to the current period.

#### 4.2.3 Predecessor Auditor

The auditor from a different audit firm, who audited the financial statements of the entity in the prior period and who has been replaced by the Current auditor

### 4.3 Auditor's Approach

#### 4.3.1 Reading of Financial Statements

The auditor shall read the most recent financial statements and the predecessor auditor's report thereon for information relevant to Opening balances, including disclosures.



### 4.3.2 Obtain Audit evidence

The auditor shall obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements by ensuring that:

- The closing balances of the preceding period have been correctly brought forward to the preceding period have been correctly brought forward to the current period;
- The opening balances do not contain material misstatements; and
- Appropriate accounting policies are being consistently applied and are reflected in the opening balances

The above can be ensured by performing the following:

- perusing the copies of the audited financial statements including the other relevant documents relating to the prior period financial statements;
- evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances; or
- specific audit procedures to obtain evidence regarding the opening balances.

## 4.4 Misstatement in Opening Balances

### 4.4.1 Additional Audit Procedures

If the auditor obtains audit evidence that the opening balances contain misstatements that could **materially affect the current period's financial statements**, the auditor shall perform such additional audit procedures as are appropriate in the circumstances to determine the effect on the current period's financial statements.

### 4.4.2 Communication of misstatements

If the auditor concludes that such **misstatements exist in the current period's financial statements**, the auditor shall communicate the misstatements with the appropriate level of management and those charged with governance in accordance with SA 450.

## 4.5 Additional Audit Procedures

If the prior period's financial statements were audited by a predecessor auditor, the auditor may be able to obtain sufficient appropriate audit evidence regarding the opening balances by perusing the copies of the audited financial statements including the other relevant documents relating to the prior period financial statements such as supporting schedules to the audited financial statements.

Ordinarily, the current auditor can place reliance on the closing balances contained in the financial statements for the preceding period, except when during the performance of audit procedures for the current period the possibility of misstatements in opening balances is indicated.

Following Audit procedures may be applied if previous year FS were unaudited or if audited auditor still wishes to apply additional procedures: -

#### **4.5.1 Current assets and liabilities**

Evidence about opening balances may be obtained as part of the current period's audit procedures. For example, the collection (payment) of opening accounts receivable (accounts payable) during the current period will provide some audit evidence of their existence, rights and obligations, completeness and valuation at the beginning of the period.

#### **4.5.2 Inventories**

The current period's audit procedures on the closing inventory balance provide little Audit evidence regarding inventory on hand at the beginning of the period. Therefore, additional audit procedures may be necessary, and one or more of the following may provide sufficient appropriate audit evidence:

- Observing a current physical inventory count and reconciling it to the opening inventory quantities.
- Performing audit procedures on the valuation of the opening inventory items.
- Performing audit procedures on gross profit and cut-off.

#### **4.5.3 Non-current Assets & Liabilities**

In case of property plant and equipment, investments and long-term debt, some audit evidence may be obtained by examining the accounting records and other information underlying the opening balances.

In certain cases, the auditor may be able to obtain some audit evidence regarding opening balances through confirmation with third parties, for example, for long-term debt and investments. In other cases, the auditor may need to carry out additional audit procedures.

### **4.6 Special Duties of Auditor**

#### **4.6.1 Consistency of Accounting Policies**

The auditor shall obtain sufficient appropriate audit evidence about

- Whether the accounting policies reflected in the opening balances have been consistently

applied in the current period's financial statements and

- Whether changes in the accounting policies have been properly accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework

#### **4.6.2 Modified Opinion in Predecessor's Report**

If the prior period's financial statements were audited by a predecessor auditor and there was a modification to the opinion,

- The auditor shall evaluate the effect of the matter giving rise to the modification in assessing the risks of material misstatement in the current period's financial statements in accordance with SA 315.
- If that modification remains relevant and material to the current period's financial statements, the auditor shall modify the auditor's opinion on the current period's financial statements in accordance with SA 705(Revised) and SA 710

## 4.7 Audit Conclusions and Reporting

Audit Conclusion	Report to be issued
Unable to obtain sufficient appropriate evidence regarding opening balance	Qualified or Disclaimer Of opinion as appropriate
If the auditor concludes <ul style="list-style-type: none"><li>Opening balances contain material misstatements whose effect has not been reflected / disclosed and</li><li>The effect of the misstatement is not properly accounted for or not adequately presented or disclosed</li></ul>	Qualified or Adverse opinion, as appropriate
If the auditor concludes that <ul style="list-style-type: none"><li>The current period's accounting policies are <b>not consistently applied</b> in relation to opening balances in accordance with the applicable financial reporting framework or</li><li>a change in accounting policies is <b>not properly accounted for or not adequately presented or disclosed</b> in accordance with the applicable financial reporting framework</li></ul>	Qualified or Adverse opinion, as appropriate
If the predecessor auditor's opinion regarding the prior period's financial statements included a modification to the auditor's opinion that remains <b>relevant and material to the current period's</b> financial statements	Modified opinion

## 4.8 Questions

- 1) Write short note on: Initial audit Engagement. [May 12 (4 Marks)]
- 2) Discuss the objective of Auditor with respect to Opening balances – in conducting an initial audit engagement.
- 3) Discuss with reference to SA '510' Initial Audit Engagements - Opening Balances", the procedures the auditor should undertake in respect of opening balances for a new audit engagement. [May 17 (5 Marks)]
- 4) What are the audit procedures to be followed by a statutory auditor in the audit of opening balances if the financial statements for the preceding year were audited by another auditor?
- 5) M/s Pankaj & Associates, Chartered Accountants, have been appointed as an auditor

of ABC Limited. CA Pankaj did not apply any audit procedures regarding opening balances. He argued that since financial statements were audited by the predecessor auditor therefore, he is not required to verify them. Is CA Pankaj correct in his approach? [Nov. 18 (5 Marks)]

- 6) Auditors of M/s Tender India (P) Ltd. were changed for the accounting year 2019-20. The closing inventory of the company as on 31.3.2019 amounting to Rs. 100 lacs continued as it is and became closing inventory as on 31.3.2020. The auditors of the company propose to exclude from their audit programme the audit of closing inventory of Rs. 100 lacs on the understanding that it pertains to the preceding year which was audited by another auditor. [MTP-Oct. 19]

## 5. SA 520 Analytical Procedures

### Contents

- Analytical Procedures
- Benefits and types of Analytical Procedures
- Methods of Analytical Procedures
- Steps to be followed
- Timing and Purpose

### 5.1 Auditor's Objective

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's understanding of the entity.

### 5.2 Analytical Procedures

Analytical procedures are part of substantial analytical procedures. It consists of evaluations of financial information made by a study of relationships among both financial and non-financial data.

Analytical procedures as per SA 520 means the analysis of significant ratios and trends.

It also includes investigation into fluctuations from predicted amounts and into relationships that are inconsistent with other relevant information.

Analytical procedures may help identify the existence of unusual transactions or events, and amounts, ratios, and trends that might indicate matters that have audit implications.

Analytical procedures consider two methods

- comparison of financial data (with prior period, with budgets, with industry benchmarks)
- study relationships of financial information (among other elements of financial statements or with relevant non-financial information)

### 5.3 Benefits of Analytical Procedures

- To assist the auditor in planning the nature, timing and extent of audit procedures.
- As a substantive procedure when their use can be more effective or efficient than tests of details in reducing detection risk for specific F.S. assertions; and
- As an overall review of the F.S. in the final review, stage of the audit."

### 5.4 Auditor's Responsibilities

- Determine the suitability of particular substantive analytical procedures for given assertions, taking account of the assessed risks of material misstatement and tests of details, if any, for these assertions
- Evaluate the reliability of data from which the auditor's expectation of recorded amounts or ratios is developed
- Develop an expectation of recorded amounts or ratios and
- Evaluate whether the expectation is sufficiently precise to identify a misstatement
- Determine the amount of any difference of recorded amounts from expected values that is acceptable without further investigation

The auditor shall design and perform analytical procedures near the end of the audit that assist the auditor when forming an overall conclusion.

### 5.5 Factors that affect the reliability of data on which analytical procedures are to be performed

#### 5.5.1 Sources of information

Information may be more reliable when it is obtained from independent sources outside the entity.

#### 5.5.2 Comparability of the information available

Bench mark data from industry or competitors may need to be supplemented to be comparable to that of an entity that produces or provides services and sells specialised products.

#### 5.5.3 Nature and relevance of the information available

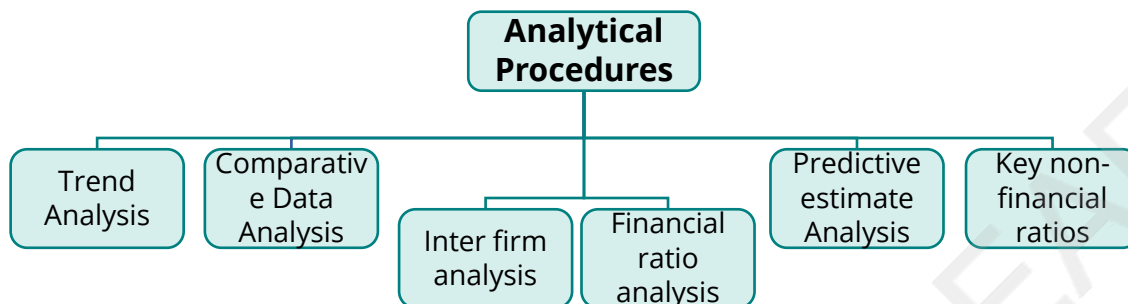
Budgets when are results expected are relevant for analysis but they are unrealistic projections then such data cannot be used.

#### 5.5.4 Controls over the preparation of the information



Controls over the preparation of information are designed to ensure its completeness, accuracy and validity, only then can such information be used for analytical procedures.

## 5.6 Types of Analytical Procedures



### 5.6.1 Trend Analysis

Comparison of the entity's financial information with prior periods.

### 5.6.2 Comparative Data Analysis

Comparisons of entity's financial information with anticipated results, such as budgets or forecasts.

### 5.6.3 Predictive Estimate Analysis

Relationship with predictive estimates prepared by the auditor, such as an estimation of depreciation charge for the year.

### 5.6.4 Inter-Firm Analysis

Comparison of key financial ratios of the entity with other firms of similar size in the industry and/ or with the overall industry average.

### 5.6.5 Financial Ratio Analysis

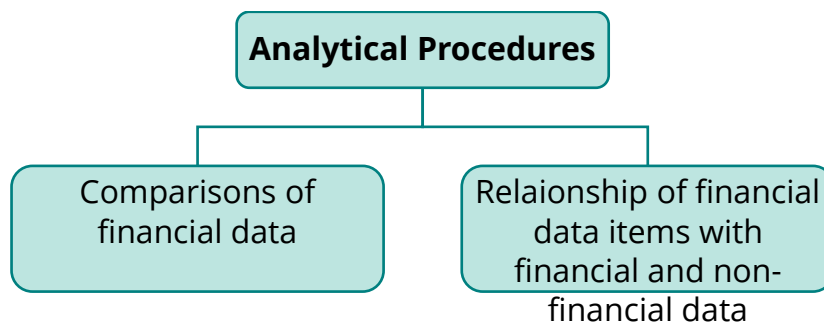
Relationships among elements of financial information e.g. Gross profits, Turnover ratios etc.,

### 5.6.6 Key non-financial Ratios

Relationships among elements of financial and relevant non-financial information E.g. Payroll costs to number of employees, Sales per employee etc.

## 5.7 Nature of Analytical Procedures

Analytical procedures encompass two types of procedures broadly.



### 5.7.1 Comparison of entity's financial information

- **With similar prior – period date**

- Example: An inventory turnover ratio might indicate that a particular product line had a turnover of three times for past four years but only two times this year but only two times this year. The change may indicate potential obsolescence or errors in accounting records.

- **With client –determined expected results**

- Most companies prepare budgets for various aspects of their operations and financial results. Since budgets represent the client's expectations for the period, an investigation the most significant areas in which differences exist between budgeted and actual results may indicate potential misstatements.

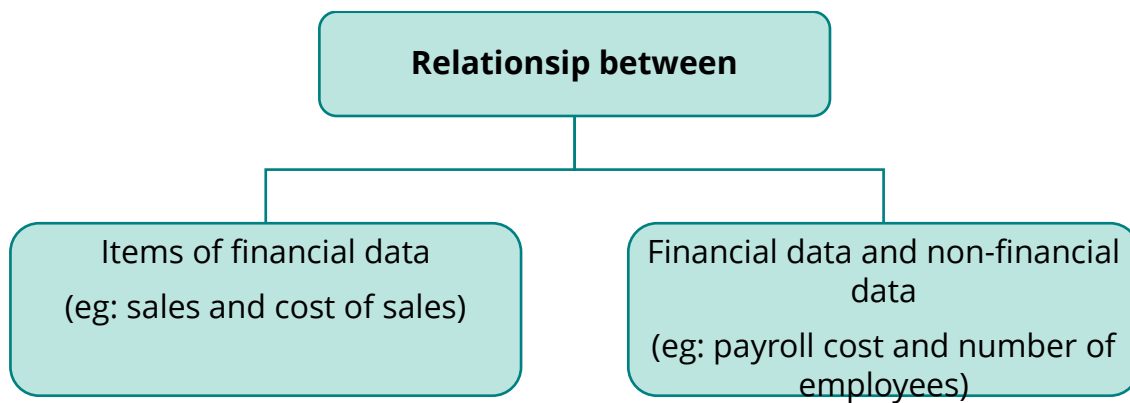
- **With auditor – determined expected results**

- Example: Moving average of the provision for bad debts as a percent of debtors is applied to the balance of debtors at the end of the audit
- year to determine an expected value for current allowance by the auditor.

- **With industry data**

- Industry data provides evidence of how aggregated industry – wise data is affected by conditions in the industry such as declining demand and constrained profit margins.
- Example: The average collection period for accounts receivable in an industry is 43 days, but the client's average collection period is 65 days. This might indicate problems with product quality or credit risk.

### 5.7.2 Relationship of financial data items with financial and non-financial data



## 5.8 Application of Analytical Procedures

The application of analytical procedures is based on the expectation that relationships among data exist and continue in the absence of known conditions to the contrary.

The presence of these relationships provides audit evidence as to the completeness, accuracy and validity of the data produced by the accounting system.

The procedures can range from simple comparisons to use of sophisticated computer software for advanced statistical techniques such as multiple regression analysis.

## 5.9 Timing and Purpose of Analytical Procedures

Analytical procedures should be applied at planning stage and the year-end overall review. The auditor may use it at substantive testing phase also.

### 5.9.1 Planning Phase

- The main purpose to use analytical procedures is to determine the nature, timing and extent of other audit procedures.
- It directs attention to potential risk areas.
  - Example: A decline in gross margin percentage over a period of time may indicate increasing competition in the company's market area and the need to consider inventory pricing during audit.
- It indicates important aspects of business.
  - Example: Operating profit for the business has declined. It may be due to labor problems, industry downturn, dropping of a product line, etc.

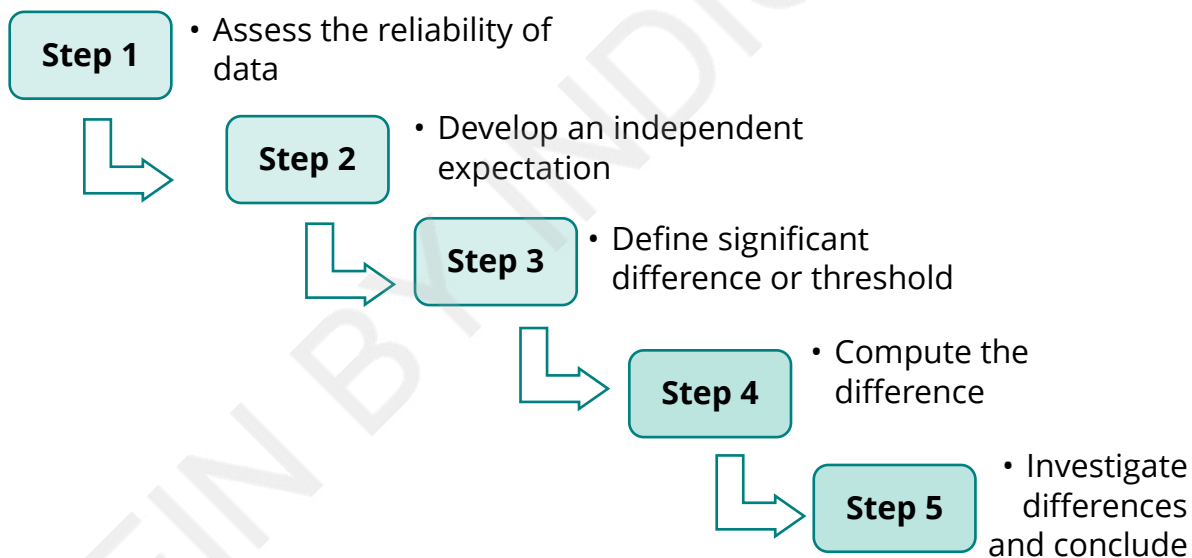
### 5.9.2 Substantive Testing Phase

- When used as substantive tests, the objective of analytical procedures is to accumulate evidence supporting the validity of a specific account balance.
  - Example 1: If average interest rate is applied to average debt outstanding, it provides evidence supporting the amount of interest expense,
- Analytical procedures are used with or without tests of detail to reduce specific detection

risk.

- Example 2: Instead of verifying individual write-offs in a low-risk credit sales system by obtaining direct confirmation (test of detail), an auditor can test provision for bad and doubtful debts by comparing management's estimate to an independent estimate based on prior-year actual and current year sales volume; and write-offs and payment history.
- Level of reliance that an auditor can obtain from analytical review will depend on:
  - Availability, reliability, relevance, independence and comparability of information being used;
  - Nature of the entity and degree to which information can be disaggregated;
  - Adequacy of controls over preparation of information;
  - Risk of non-detection of material misstatements;
  - Materiality of item involved;
  - Extent to which assurance from other sources can be obtained;
  - Accuracy with which figures can be predicated;
  - Assessment inherent and control risks; and
  - Prior knowledge of client and accounting adjustments made in prior periods.

### Audit Steps



### 5.9.3 Overall Review Phase

- As part of overall review phase, the auditor evaluates the reasonableness of audited financial statements i.e., assertions regarding transactions and balances.
- Knowledge of the client's business combined with effective analytical procedures helps to corroborate the conclusions drawn for individual elements/components of financial statements and in determining sufficiency and appropriateness of audit evidence.
- Example: The auditor has audited inventories. At the overall review stage, he may estimate the closing inventory using historical gross profit rates. If the estimated

inventory is nearly the same amount as audited inventory, it would vary, the auditor may have to resolve the reason for disparity.

- Analytical procedures at overall review stage also help to identify possible oversights in an audit and unusual transactions.
  - Example: Sales of the client have decreased in the current period by forty percent. An auditor may expect debtors to decrease by a comparable percent. If this does not happen, it may indicate that sales might have been understated or accounts receivable might be overstated.

## 5.10 Investigating Results

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, the auditor shall investigate such differences.

### 5.10.1 Unreasonable or Inconsistent Results

- Inquire with management and consider the need to corroborate management replies through additional procedures such as expanded substantive procedures; and
- Evaluate the reasonableness of management's replies in relation to the auditor's knowledge of the client's business and information obtained during the audit.
- Performing other audit procedures as necessary in the circumstances

## 5.11 Questions

- 1) Explain what do you mean by Analytical procedures. How such procedures are helpful in auditing?
- 2) While auditing purchases which types of analytical procedures will be performed by the auditor to obtain audit evidence as to overall reasonableness of purchase quantity and price. [May 19 (4 Marks)]
- 3) Discuss the audit procedure to be considered by an auditor while performing analytical procedure to obtain audit evidence as to overall reasonableness of purchase quantity and price. [Nov. 19 (3 Marks)]
- 4) Routine checks cannot be depended upon to disclose all the mistakes or manipulation that may exist in accounts, certain other procedures also have to be applied like trend and ratio analysis. Analyse and Explain stating clearly the meaning of analytical procedures. [RTP-Nov. 19]
- 5) Analytical procedures use comparisons and relationships to assess whether account balances or other data appear reasonable. Explain stating the purpose of analytical procedures. [RTP-May 18]
- 6) Give examples of Analytical Procedures having consideration of comparisons of the entity's financial information. [RTP-Nov. 19]

- 7) Use of substantive Analytical Procedures requires consideration of many factors. Explain those factors.
- 8) 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 determine the suitability of particular substantive analytical procedures for given assertions, taking account of the assessed risks of material misstatement and tests of details, if any, for these assertions. Explain the other relevant points in this context. [RTP-May 20]
- 9) 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".

## 6. SA 530 – Audit Sampling

### Contents

- Audit Sampling
- Sampling risk
- Steps in Sampling
- Type of Sampling

### 6.1 Introduction

Auditor uses statistical and non-statistical sampling as part of the audit procedures during:

- Designing and selecting the audit sample
- Performing tests of controls and tests of details and
- Evaluating the results from the sample

#### 6.1.1 Reason for Sampling

Audit in 70's to 80's meant checking every transaction to get confidence known as Traditional approach. But in the age of real time transaction processing and occurrence of million transactions per second, time is a major constraint to check every transaction.

The concept of Audit sampling was introduced, less than 100% of the population is tested to get reasonable reliance on the population. Introduction of formal internal controls are being introduced in the management of affairs of organisations, due to which the possibilities of routine errors and frauds have greatly diminished.

It is also not obligatory that the auditor must adopt the sampling technique

where

The present-day approach for auditing is more of Risk based approach.

### 6.2 Important Terms



## 6.2.1 Audit Sampling

**Audit sampling** is the process of applying audit procedures to less than hundred per cent of a population of audit relevance such that all sample units have a chance of selection, in order to provide the auditor with reasonable basis to draw conclusions about entire population.

## 6.2.2 Sampling Risk

Risk that the sample may not be a representative of the population is the

Sampling risk is the risk that auditor's conclusion based on a sample may be different conclusion he would reach if the same audit procedures were applied to the entire population.



The lower the risk the auditor is willing to accept, the greater the sample size will need to

from the

Sampling risk can lead to two types of erroneous conclusions:

- In the case of a test of controls, that controls are more effective than they actually are, or in the case of a test of details, that a material misstatement does not exist 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.
- In the case of a test of controls, that controls are less effective than they actually are, or in the case of a test of details, that a material misstatement 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.

Error type	In case of test of controls	In case of test of details	Effect of this erroneous conclusion
Type I	That controls are <b>more effective</b> than they actually are.	That a material Misstatement <b>doesn't exist</b> , when in fact it does	This affects <b>audit effectiveness</b> , and is more likely to lead to an inappropriate audit opinion
Type II	That controls are <b>less effective</b> than they actually are.	That a material misstatement <b>does exist</b> , when in fact it doesn't	This affect <b>audit efficiency</b> , as it would lead to additional work to establish that initial conclusions were incorrect

Type 1 Risk/Error:	Type 2 Risk/Error:
The sample selected is showing a <b>BETTER</b> picture of the population, but in reality, that is not the case	The sample selected shows a <b>WORSE</b> picture of the population, but in reality, that is not the case

### 6.2.3 Sampling Units

Sampling units are individual auditable elements that constitute the population.

### 6.2.4 Non-Sampling Risk

The risk that auditor reaches an erroneous conclusion for any reason not related to sampling risk.

### 6.2.5 Statistical Sampling

An approach to sampling that has the following characteristics

- Random selection of the sample items and
- Use of probability theory to evaluate sample results for measurement of sampling risk

Non-statistical sampling approach does not have characteristics of random selection and use of probability theory.

The expected degree of objectivity cannot be assured in non-statistical sampling because the risk of personal bias in selection of sample items cannot be eliminated

### 6.2.6 Stratification

The process of dividing a population into sub-populations, each of which is a group of sampling units, which have similar characteristics.

The objective of stratification is to reduce the variability of items within each stratum and therefore allow sample size to be reduced without increasing

Stratified Sampling is an effective method for selecting Sample in an Audit, by giving each unit in the sample, an **equal** chance of being selected

Assuming or concluding that the sample selected represents the rest of the population is called Extrapolation.

### 6.2.7 Tolerable Misstatement

A monetary amount set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that the monetary amount set by the auditor is not exceeded by the actual misstatement in the population.

The maximum amount of known error and likely error an auditor can accept in the financial statements without adjustment.

Objective of determining tolerable misstatement is to address the risk that the aggregate of individually immaterial misstatements may cause the financial statements to be materially misstated and provide a margin for possible undetected misstatements.

Tolerable misstatement is the application of performance materiality, as defined in SA 3202, to a particular sampling procedure. Tolerable misstatement may be the same amount or an amount lower than performance materiality.

### 6.2.8 Tolerable Rate of Deviation

A rate of deviation from prescribed internal control procedures set (a threshold) by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that the rate of deviation set by the auditor is not exceeded by the actual rate of deviation in the population.

If the deviation rate is higher than this threshold value, then the auditor cannot rely upon the control.

### 6.2.9 Expected Error vs Tolerable Error

- Expected error is the expected level of deviation, which is ok or acceptable.
- Tolerable Error is the cut-off level beyond which, deviation will not be acceptable.

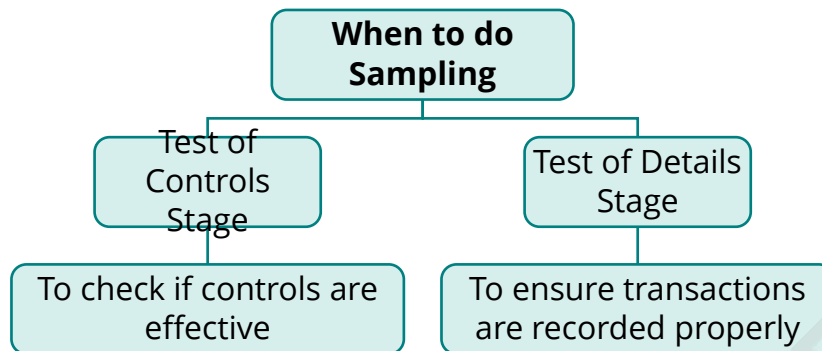
## 6.3 Requirements of SA

### Auditor shall consider

- Auditor while performing audit sampling, shall consider
  - purpose of audit procedure and

- characteristics of the population from which the sample will be drawn.
- Objective of determining a sample size is to reduce sampling risk to an acceptably low level.
- Auditor shall ensure that each sampling unit in the population has a chance of selection.

## 6.4 Stage of Audit to do Sampling



### 6.4.1 Timing of Sampling and Type of Risk



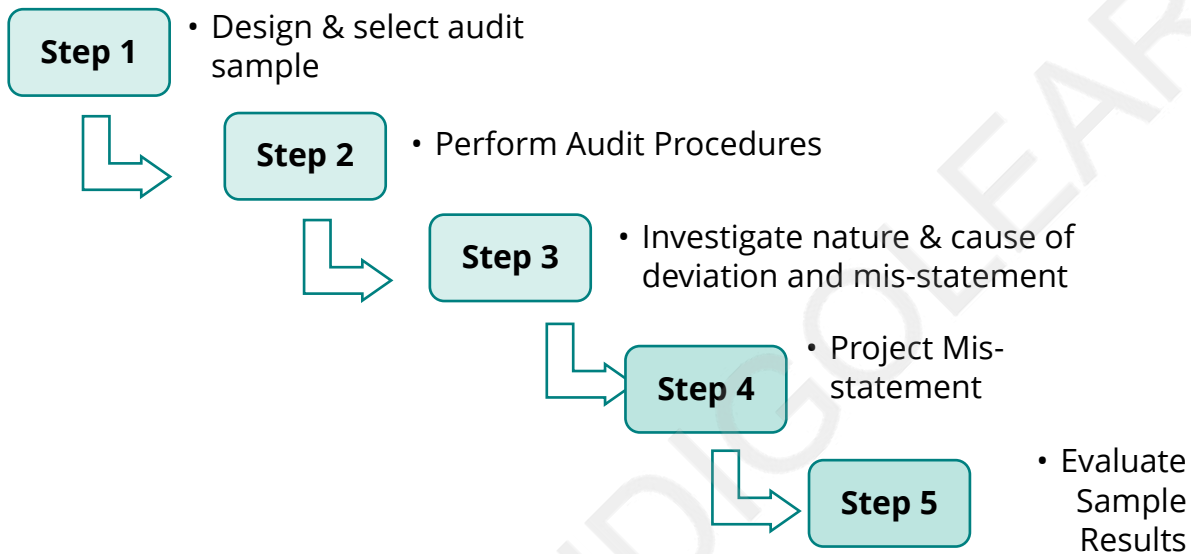
## 6.5 Targeted Testing vs Sampling

Since the auditor cannot make sampling risk as zero, auditor may take up targeted testing. Targeted testing can be used to test high value transactions and sampling can be used for the rest of the transactions.

## 6.6 Considerations for conducting Audit Sampling



## 6.7 Steps in Sample Selection



### 6.7.1 Design & select audit sample

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 need to be **representative of entire population**, irrespective of approach non-statistical or statistical sampling. Samples must be closely similar to the whole population although not necessarily exactly the same.

- Determine a sample size sufficient to reduce sampling risk to an acceptably low level. Sample size will depend on the degree of
  - Sampling risk,
  - Tolerable misstatement range of the auditor and



- Expected error.

More the sampling risk and expected errors, bigger shall be the sample size and vis a vis. More the tolerable misstatement range of the auditor lesser will be the sample size and vis a vis.

Here tolerable misstatement means a monetary amount set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that the monetary amount set by the auditor is not exceeded by the actual misstatement in the population

- Select items for the sample in such a way that each sample unit in the population has a chance of selection

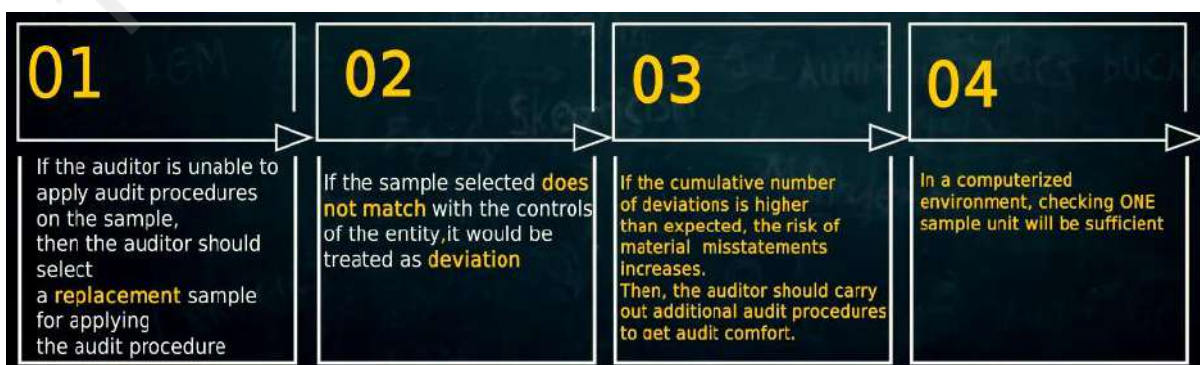


### 6.7.2 Performing Audit Procedures

- The auditor shall perform audit procedures, appropriate to the purpose, on each item selected
- If the audit procedure is not applicable to the selected item, the auditor shall perform the procedure on a replacement item.
- If the auditor is unable to apply the designed audit procedures, or suitable alternative procedures, to a selected item, the auditor shall treat them as a
  - Deviation from the prescribed control, in the case of tests of control
  - A misstatement in the case of test of details

### 6.7.3 Investigate nature and cause of deviation and misstatement

- The auditor shall investigate the nature and cause of any deviations or misstatements identified, and evaluate their possible effect on the purpose of the audit procedure and on other areas of the audit
- In the extremely rare circumstances when the auditor considers a misstatement or deviation discovered in a sample to be an anomaly, the auditor shall obtain a high degree of certainty that such misstatement or deviation is not representative of the population.
- The auditor shall obtain this degree of certainty by performing additional audit procedures to obtain sufficient appropriate audit evidence that the misstatement or deviation does not affect the remainder of the population.



Auditor may communicate any deviations to the management as per SA 260

#### 6.7.4 Project Mis-statement

For tests of details, the auditor shall project misstatements found in the sample to the population

For tests of controls, no explicit projection of deviations is necessary since the sample deviation rate is also the projected deviation rate for the population as a whole.

#### 6.7.5 Evaluation results of audit sampling

The auditor shall evaluate

- The results of the sample; and
- Whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested.

If the auditor concludes that audit sampling has not provided a reasonable basis for conclusions about the population that has been tested, the auditor may:

- Request management to investigate misstatements that have been identified and the potential for further misstatements and to make any necessary adjustments; or
- Tailor the nature, timing and extent of those further audit procedures to best achieve the required assurance.

If any error or misstatement identified, auditor shall after management's investigation into its nature and cause, evaluate their possible effect on the purpose of the audit procedure and on other areas of the audit.

#### Audit Sampling- Points:

01 Firstly, the **audit objective** needs to be clearly stated  
- let's say to test whether sales are recorded correctly

02 **Define the population** - Population in this case would be all invoices generated in the financial year - say, 500

03 **Define the sampling unit** - Each invoice would form the sampling unit

04 **Decide the sampling method** - Could be random, block, systematic etc.

05 **Define the tolerable error** - say, 5%

06 **Determine the sample size** - Based on past audit experience, and understanding of risk and materiality. Say, 40% invoices by number, covering at least 70% sales value

07 **Evaluate the sample.** End to end testing should be done

08 Based on results of test of the sample, auditor will **Form a conclusion**

#### 6.7.6 Documentation



Auditor shall document sampling techniques used. That shall include

- How sample was selected?
- How was the sample analysed?
- What was the result of sampling?

## 6.8 Sample Selection Methods

There are many methods of selecting samples. The principal methods are as follows:

### 6.8.1 Random Selection

Applied through random number generators, for example, random number tables.

### 6.8.2 Systematic Selection/ Interval Selection

- The number of sampling units in the population is divided by the sample size to give a sampling interval, for example 50, and having determined a starting point within the first 50, each 50th sampling unit thereafter is selected.
- Although the starting point may be determined haphazardly, the sample is more likely to be truly random if it is determined by use of a computerized random number of generator or random number tables.
- When using systematic selection, the auditor would need to determine that sampling units within the population are not structured in such a way that the sampling interval corresponds with a particular pattern in the population.

### 6.8.3 Monetary Unit Sampling

It is a type of value-weighted selection in which sample size, selection and evaluation results in a conclusion in monetary amounts.

### 6.8.4 Haphazard Selection

- The auditor selects the sample without following a structured technique.
- Although no structured technique is used, the would nonetheless avoid any conscious bias or predictability (for example, avoiding difficult to locate items, or always choosing or avoiding the first or last entries on a page) and thus attempt to ensure that all items in the population have a chance of selection.



Haphazard selection is not appropriate when using statistical sampling.

auditor

### 6.8.5 Block Selection

- It involves selection of a block(s) of contiguous items from within the population.
- Block selection cannot ordinarily be used in audit sampling because most populations

are structured such that items in a sequence can be expected to have similar characteristics to each other, but different characteristics from items elsewhere in the population.

- Although in some circumstances it may be an appropriate audit procedure to examine a block of items, it would rarely be an appropriate sample selection technique when the auditor intends to draw valid inferences about the entire population based on the sample.

### **Cluster Sampling vs Block Sampling**

Dividing the population into groups of items is known as Cluster sampling. Block sampling involves the selection of a defined block of consecutive items.

## **6.9 Sampling Not Suitable in Certain Circumstances**

- Population too small
- Heterogeneous population
- Improper maintenance of population data
- Certain transactions like
  - Opening and closing entries
  - Bank reconciliation statement
  - Balance sheet items
  - Mattes involving computation
  - Transactions that may be small in number but important and material
  - Transactions which are not recognized by law to be looked into by the auditor carefully
  - Seasonal industry, where test checking is carried out on annual basis
  - Transactions of non-recurring nature or exceptional transactions

## **6.10 Advantages of Statistical Sampling**

- The amount of testing (sample size) does not increase in proportion to the increase in the size of the area (universe) tested.
- The sample selection is more objective and thereby more defensible.
- The method provides means of estimating the minimum sample size associated with a specified risk & precision.
- 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.

- 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.

## 6.11 Stratification vs Value Weighed Sampling

In considering the characteristics of the population from which the sample will be drawn, the auditor may determine that stratification or value-weighted selection is appropriate.

### 6.11.1 Stratification

Stratification may be defined as the process of dividing a population into sub-populations, each of which is a group of sampling units which have similar characteristics (often monetary value).

Every such group so divided is called strata. Each stratum is treated as if it were a separate population and proportionate items are selected from each of the stratum. The groups into which the whole population is divided is determined by the auditor on the basis of his judgement.

Eg:

S.No	Strata Details of Purchase vouchers	Items selected for checking
(a)	Vouchers above ₹10,00,000	100%
(b)	Vouchers between ₹2,50,000 and ₹10,00,000	50%
(c)	Vouchers below ₹2,50,000	25%

The reasoning behind the stratified sampling is that for a highly diversified population, weights should be allocated to reflect these differences. This is achieved by selecting different proportions from each strata.

### 6.11.2 Value weighed selection

- When performing tests of details, it may be efficient to identify the sampling unit as the individual monetary units that make up the population.
- One benefit of this approach to defining the sampling unit is that audit effort is directed to the larger value items because they have a greater chance of selection and can result in smaller sample sizes.
- This approach may be used in conjunction with the systematic method of sample selection and is most efficient when selecting items using random selection.

## 6.12 Factors affect extent of Checking

### 6.12.1 Checking for Test of controls

An increase in the extent to which the auditor's risk assessment takes into account relevant controls will increase the sample size.

- (ii) An increase in the tolerable rate of deviation, will decrease the sample size.  
An increase in the expected rate of deviation of the population to be tested, will increase the sample size.
- (iv) An increase in the auditor's desired level of assurance that the tolerable rate of deviation is not exceeded by the actual rate of deviation in the population will increase the sample size.

### 6.12.2 Checking for Test of Details

An increase in the auditor's assessment of the risk of material misstatement will increase the extent of checking.

- (ii) An increase in the use of other substantive procedures directed at the same assertion will decrease the extent of checking.
- (iii) An increase in the auditor's desired level of assurance that tolerable misstatement is not exceeded by actual misstatement in the population will increase the extent of checking.
- (iv) An increase in tolerable misstatement will decrease the extent of checking.
- (v) An increase in the amount of misstatement the auditor expects to find in the population will increase the extent of checking.
- (vi) Stratification of the population when appropriate will decrease the extent of checking.

### 6.13 Questions

- 1) There is a growing realisation that the traditional approach to audit is economically wasteful because all efforts are directed to check all transactions without exception. Explain. [RTP-Nov. 19]
- 2) The extent of the checking to be undertaken is primarily a matter of judgment of the auditor.  
It is in the interest of the auditor that if he decides to form his opinion on the basis of a part checking, he should adopt standards and techniques which are widely followed. Explain. [RTP-Nov. 19]
- 3) What is the meaning and purposes of sampling. Explain in the light of SA 520 "Audit Sampling". [Nov. 06 (8 Marks)]
- 4) Whatever may be the approach non-statistical or statistical sampling, the sample must be representative. Discuss explaining Statistical and Non-Statistical sampling approaches. [RTP-May 18]
- 5) Write short note on: Advantages of Statistical Sampling. Nov. 11, May 14 (4 Marks)]
- 6) While planning the audit of S Ltd, you want to apply sampling techniques. What are the risk factors you should keep in mind. [RTP-Nov. 18, MTP-April 19]
- 7) "Sampling risk can lead to erroneous conclusion". Justify. [May 19 (4 Marks)]
- 8) Discuss the following: With reference to SA 530, meaning of audit sampling and

requirements relating to sample design, sample size and selection of items for testing.  
[May 16 (5 Marks)]

9) Write short note on: Stratified sampling.

[May 11 (5 Marks)]

10) XYZ Ltd is engaged in trading of electronic goods and having huge accounts receivables. For analysing the whole accounts receivables, auditor wanted to use sampling technique. In considering the characteristics of the population from which the sample will be drawn, the auditor determines that stratification or value-weighted selection technique is appropriate. SA 530 provides guidance to the auditor on the use of stratification and value-weighted sampling techniques. Advise the auditor in accordance with SA 530.

[RTP-May

18, MTP-Oct. 19]

11) Discuss the following: The level of sampling risk that the auditor is willing to accept affects the sample size required. The lower the risk the auditor is willing to accept, the greater the sample size will need to be. Explain Stating the examples of factors that the auditor may consider when determining the sample size for tests of controls.

[MTP-March 18]

12) The sample size can be determined by the application of a statistically based formula or through the exercise of professional judgment. When circumstances are similar, the effect on sample size of factors will be similar regardless of whether a statistical or non-statistical approach is chosen. Explain Stating the examples of factors that the auditor may consider when determining the sample size for tests of controls.

[MTP-Oct. 18]

13) Discuss the factors that should be considered for deciding upon the extent of checking on a sampling plan.

[RTP-May 19]

14) Write short note on: Random Sampling. [May 12, May 15 (4 Marks), May 17 (6 Marks)]

15) Write short note on: Haphazard sampling.

[Nov. 17 (4 Marks)]

16) Explain the sampling method which involves selection of a block(s) of contiguous items from within the population. Also give example.

[RTP-

May 20]

17) The auditor is required to project misstatements for the population to obtain a broad view of the scale of misstatement. Explain.

[RTP-May 19]

18) The auditor is required to project misstatements for the population to obtain a broad view of the scale of misstatement but this projection may not be sufficient to determine an amount to be recorded. Explain.

[RTP-May 20]

## 7. SA 540 – Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures

### Contents

- Accounting Estimate
- Fair Value Accounting Estimate
- Estimate Uncertainty
- Auditors approach

### 7.1 Accounting Estimates

An approximation of a monetary amount in the absence of a precise means of measurement.

Some financial statement items cannot be measured precisely, but can only be estimated.

It is important to understand and check the reasonability of accounting estimates because of their wide use in the businesses in the current times.

It is important understand and check the reasonability of accounting estimates because their wide use in the businesses in the current times.

#### 7.1.1 Objective

Measurement objective of accounting estimate may be

- To forecast the outcome of one or more transactions / events / conditions giving rise to the accounting estimate E.g. Provision for Bad and Doubtful debts
- To express the value of a transaction or financial statement item based on conditions prevailing on the measurement date (E.g. Fair value of asset / Investment / Liability etc.)

#### 7.1.2 Nature

- The degree of estimation uncertainty associated with accounting estimates depends on nature and reliability of the information available to the management while making such estimates.
- The degree of estimation uncertainty affects, in turn,
  - the risks of material misstatement of accounting estimates, including

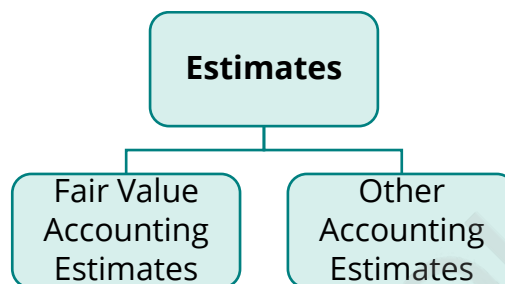
- their susceptibility to unintentional or intentional management bias.

(Outcome of an accounting estimate – Amount originally recognized or disclosed in the financial statements)  $\neq$  Mis-statement of the financial statements.

### **Revision of Estimates:**

Accounting estimates may be revised from time to time based on the **best available information** at a **given point of time**. Such revision will not be considered as a **misstatement**.

#### **7.1.3 Types**



##### • **Fair value accounting estimates**

It means where the measurement objective is expressed in terms of the value of a current transaction or financial statement item based on conditions prevalent at the measurement date, such as estimated market price for a particular type of asset or liability.

Examples

- Estimate of FMV of Inventory
- Calculation of Net Realisable Value
- Revaluation of fixed assets
- Complex financial instruments, which are not traded in an active and open market.
- Share-based payments.
- Property or equipment retired from active use and held for disposal.
- Certain assets or liabilities acquired in a business combination, including goodwill and intangible assets.
- Transactions involving the exchange of assets or liabilities between independent parties without monetary consideration, for example, a non-monetary exchange of plant facilities in different lines of business.

##### • **Other Accounting Estimate**

Every accounting estimate other than Fair value accounting estimate is other estimate.

Examples

- Provision for doubtful accounts.
- Inventory obsolescence.
- Warranty obligations.
- Depreciation method or asset useful life.



- Provision against the carrying amount of an investment where there is
- Uncertainty regarding its recoverability.
- Outcome of long-term contracts.
- Financial Obligations / Costs arising from litigation settlements and
- Judgments.

Some financial reporting frameworks prescribe specific methods of measurement and the disclosures that are required to be made in the financial statements, while other financial reporting frameworks are less specific

## 7.2 Objective of SA

In the context of the applicable financial reporting framework, whether

- Accounting estimates are reasonable, including fair value accounting estimates, in the financial statements, whether recognized or disclosed
- Related disclosures in the financial statements are adequate

## 7.3 Important Terms

### 7.3.1 Estimate Uncertainty

The susceptibility of an accounting estimate and related disclosures to an inherent lack of precision in its measurement.

The degree of estimation uncertainty depends on

- the nature of the accounting estimate, and
- the subjectivity of the assumptions used to make the accounting estimate.

Some accounting estimates may have relatively high estimation uncertainty, particularly where they are based on significant assumptions, for example:

- Accounting estimates highly dependent on judgement like those relating to the outcome of litigation.
- Accounting estimates that are not calculated using recognised measurement techniques like fair value accounting estimates for derivative financial instruments not publicly traded.
- Accounting estimates where the results of the auditor's review of similar accounting estimates made in the prior period financial statements indicate a substantial difference between the original accounting



Not all financial statement items requiring measurement at fair value, involve estimation uncertainty.

estimate and the actual outcome.

- Fair value accounting estimates for which a highly specialised entity-developed model is used or for which there are no observable inputs.

### 7.3.2 Auditor's point estimate or Auditor's range

The amount, or range of amounts, respectively, derived from audit evidence for use in evaluating management's point estimate.

### 7.3.3 Management's point estimate

The amount selected by management for recognition or disclosure in the financial statements as an accounting estimate.

### 7.3.4 Outcome of an accounting estimate

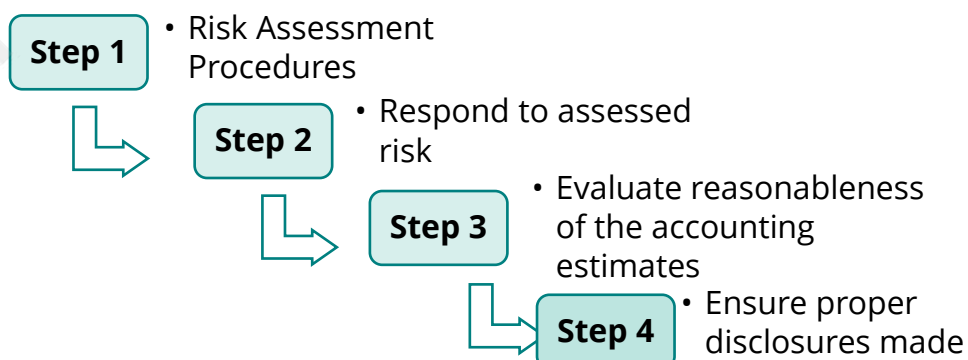
The actual monetary amount which results from the resolution of the underlying transaction(s), event(s) or condition(s) addressed by the accounting estimate.

## 7.4 Auditor's Responsibility

- While evaluating accounting estimate of complex nature, auditor should exercise judgment based on past experience whether estimates are reasonable
- If in some cases the accounting estimates are made by the management based on certain formula, the auditor should ensure that such formula is continuously reviewed.
- If as per the judgment of auditor, the estimation / provision for expenses cannot reasonably be made, because data for estimation are not objective but are very subjective, the auditor should consider this while expressing his opinion on the financial statements
- Ensure deviations in method of accounting estimates are properly disclosed

## 7.5 Audit Procedures over Accounting Estimates


Following steps are involved in audit of accounting estimates:



### 7.5.1 Risk Assessment procedures

Auditor shall perform risk assessment and related activities in order to provide a basis for the identification of risk of misstatement in relation to the accounting estimates.

procedures  
basis



In identifying and assessing the RMM the auditor shall evaluate the degree of estimation uncertainty associated with an accounting estimate

- Understand the following in order to provide a basis for the identification and assessment of the risks of material misstatement for accounting estimates
  - Applicable financial reporting framework's requirements regarding fair value measurement including disclosures
  - Method, procedures followed by the management to calculate accounting estimates
  - Environment under which estimates are made by the management like internal control system, external / internal evidence on which estimates are based
  - Assumptions on which estimates are based
- Review and test the process followed by the management at appropriate levels for accounting estimates
  - Test calculation involved in accounting estimates
  - Consider if assumptions are relevant and appropriate
  - Compare, if possible, with earlier year's estimates
  - Consider whether data on which accounting estimates are based, are objective
  - In case, accounting estimates are complex in nature, use the work of an expert
  - Review the continuing formula used by the management to calculate the accounting estimates
  - Make or obtain an independent estimate and compare it with accounting estimates
  - Consider whether there has been any change in the methods compared to the prior period
  - How has management assessed the effect of estimation uncertainty
- Review and consider the subsequent events after the balance sheet date but before the completion of audit to judge the appropriateness of the accounting estimates

The auditor shall determine whether, in the auditor's judgment, any of those accounting estimates that have been identified as having high estimation uncertainty give rise to significant risks.

### 7.5.2 Response to assessed risk

- **Management's Responsibility**

Based on the assessed risks of material misstatement, the auditor shall determine whether the

- Whether management has appropriately applied the requirements of the applicable financial reporting framework relevant to the accounting estimate; and
- Whether the methods for making the accounting estimates are appropriate and have been applied consistently, and whether changes, if any, in accounting estimates or in the method for making those from the prior period are appropriate in the circumstances.

- **Auditor's Approach**

- Auditor should respond to estimation risk as per SA 330.
- Determine whether events occurring up to the date of the auditor's report provide audit evidence regarding the accounting estimate
- Test how management made the accounting estimate and the data on which it is based. In doing so, the auditor shall evaluate whether:
  - method of measurement used is appropriate; and
  - assumptions used by management are reasonable
- Test the operating effectiveness of the controls over how management made the accounting estimate, together with appropriate substantive procedures.
- Develop a point estimate or a range to evaluate management's point estimate by
  - considering all the relevant variables
  - narrow the range when auditor decides to use a range

### 7.5.3 Evaluate the Reasonableness of the Accounting Estimates

The auditor shall evaluate, based on the audit evidence, whether the accounting estimates in the financial statements are

- reasonable in the context of the applicable financial reporting framework, or
- misstated.

### 7.5.4 Disclosures to be made

The auditor shall in the context of the applicable financial reporting framework ensure proper disclosures are made related to accounting estimates and shall obtain sufficient appropriate audit evidence regarding the same.

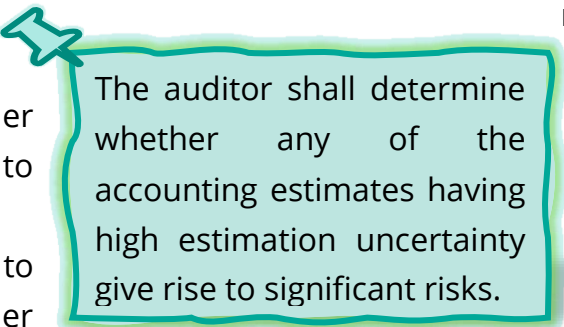
For accounting estimates that give rise to **significant risks**, the auditor shall also evaluate the adequacy of the **disclosure of their estimation uncertainty** in the financial statements.

## 7.6 Additional Audit Procedures

### 7.6.1 Estimation Uncertainty

Auditor's shall give response to assessed determining nature timing and extent of procedures. Auditor may apply further substantive procedures to respond to significant risks

- For accounting estimates that give rise to significant risks, in addition to other substantive procedures performed to meet the requirements of SA 330, the auditor shall evaluate the following:
  - alternative assumptions or outcomes considered by management, and
  - management's reason for rejecting the alternate assumptions?
  - how management has addressed estimation uncertainty in making the accounting estimate.
  - Reasonableness of significant assumptions used by management
  - management's intent to carry out specific courses of action which are relevant to reasonableness of the significant assumptions and its ability to do so.



The auditor shall determine whether any of the accounting estimates having high estimation uncertainty give rise to significant risks.

risk by  
audit

If, in the auditor's judgment, management has not adequately addressed the effects of estimation uncertainty on the accounting estimates that give rise to significant risks, the auditor shall, if considered necessary, develop a range with which to evaluate the reasonableness of the accounting estimate.

### 7.7 Accounting estimates with significant risks

For accounting estimates that give rise to significant risks, the auditor shall obtain sufficient appropriate audit evidence and ensure:

- Management's decision to
    - recognize, or
    - not recognize,the accounting estimates in the financial statements; and
  - The selected measurement basis for the accounting estimates
- are in accordance with the requirements of the applicable financial reporting framework

### 7.8 Written Representations

The auditor shall obtain written representations from management and, where appropriate, those charged with governance whether they believe significant assumptions used in making accounting estimates are reasonable.

## 7.9 Documentation

The audit documentation shall include

- The accounting estimates made
- The basis for the auditor's conclusion about the reasonableness of accounting estimates and their disclosure that give rise to significant risks and
- Disclosures of estimates that give rise to significant risks
- Indicators of possible management bias, if any.



Management bias can be difficult to detect at an account level

Indicators of possible management bias do not themselves constitute misstatements for the purposes of drawing conclusions on the reasonableness of individual accounting estimates.

## 7.10 Questions

- 1) How is Fair value estimate different from other accounting estimate?
- 2) What is Estimate Uncertainty? With reference to the Standards on Auditing state the examples of accounting estimates that may have a high estimation uncertainty.
- 3) What are procedures to assess and identify risk for material misstatement in relation to accounting estimates?
- 4) What is possible management bias?
- 5) While auditing Z Ltd., you observe certain material financial statement assertions have been based on estimates made by the management. As the auditor how do you minimize the risk of material misstatements?

## 8. SA 550 – Related Parties

### Contents

- Related party
- Related party transactions
- Auditor's Responsibilities for Disclosures

### 8.1 Related Party (RP)

#### 8.1.1 Relevant Financial Reporting Framework defines

As given in the framework. For example, a Company has to follow AS 18 for Related party Transactions.

As per **AS 18**, Related party means “at any time during the year, one party has an ability to:

- Control (through ownership; control over composition of board of directors or governing body; substantial interest in voting power) the other party
- Exercise significant influence over the other party in making financial and/or operating decisions

#### 8.1.2 Relevant Financial Reporting Framework doesn't define

- A person or other entity that has control or significant influence, directly or indirectly through one or more intermediaries, over the reporting entity;
- Another entity over which the reporting entity has control or significant influence, directly or indirectly through one or more intermediaries; or
- Another entity that is under common control with the reporting entity through having:
  - Common controlling ownership;
  - Owners who are close family members; or
  - Common key management.



Entities that are under common control by a state (i.e., a national, regional or local government) are not considered related unless they engage in significant transactions or share resources to a significant extent with one another.

## 8.2 Related Party Transactions (RPT)

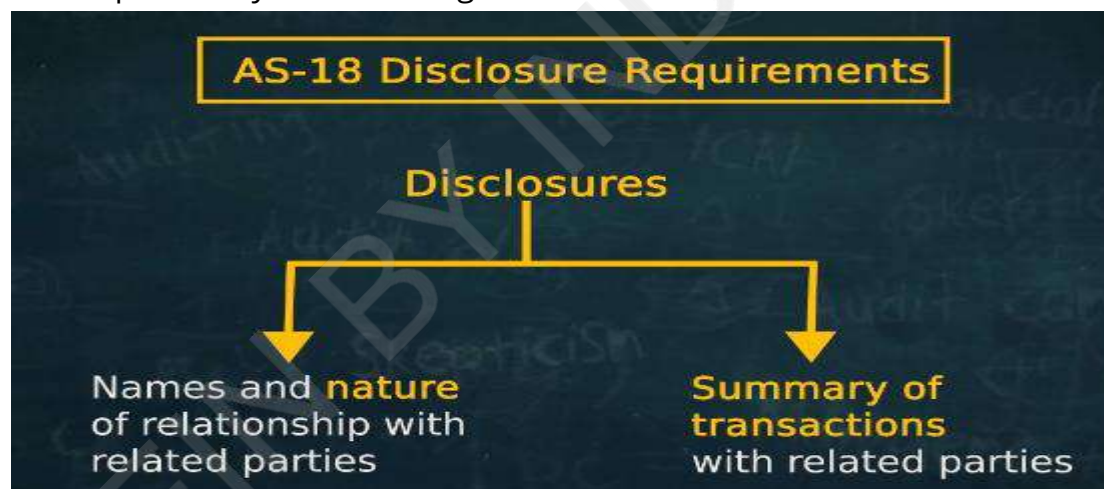
The nature of related party relationships and transactions may, in some circumstances, give rise to higher risks of material misstatement of the financial statements than transactions with unrelated parties.

The high risks can be attributed to

- Complex relationship structures
- Ineffective information systems
- Transactions are not conducted under normal market terms and conditions;

### 8.2.1 Management's Responsibility

Identifying, appropriate accounting and making disclosures of related party transactions is the responsibility of the management.



### 8.2.2 Auditor's Responsibility

Identifying risks of material misstatement with respect to related party transactions and evaluating the effect of such risk on financial statements and ensuring adequate disclosures are made is the responsibility of the auditor

## 8.3 Auditor's Responsibilities

### 8.3.1 Financial Reporting Framework provides regulations

Where the applicable financial reporting framework establishes requirements for accounting and disclosure, the auditor has a responsibility to perform audit procedures as per such framework. For eg: For Companies, AS 18 provides regulations.

### 8.3.2 Financial Reporting Framework does not provide any guidance

The auditor nevertheless needs to

- obtain an understanding of the entity's related party relationships and transactions.
- conclude whether the financial statements, insofar as they are affected by those relationships and transactions:
  - Achieve a true and fair presentation; or
  - Are not misleading (for compliance frameworks).

### 8.3.3 Any Scenario

The auditor has to evaluate whether one or more fraud risk factors are present as required by SA 2404 because fraud may be more easily committed through related parties.

In the context of related parties, the potential effects of inherent limitations on the auditor's ability to detect material misstatements are greater for such reasons as the following:

- Management may be unaware of the existence of all related party relationships and transactions
- Related party relationships may present a greater opportunity for collusion, concealment or manipulation by management leading to Risk of Management's Override of Controls.

## 8.4 Objectives of Auditor

- Obtain an understanding of related party relationships and transactions
- Recognise fraud risk factors, if any, arising from related party relationships and transactions that are relevant to the identification and assessment of the risks of material misstatement due to fraud; and
- Conclude whether the financial statements are true and fair and are not misleading
- Related party transactions are identified, accounted for and disclosed as per the relevant financial reporting framework

## 8.5 Arm's Length Transaction

A transaction conducted on such terms and conditions as between a willing buyer and a willing seller who are unrelated and are acting independently of each other and pursuing their own best interests.

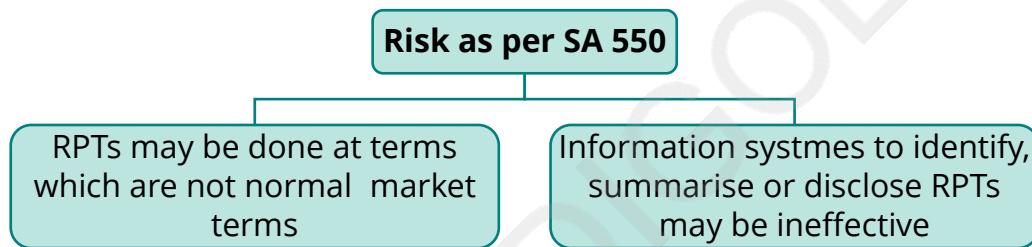
## 8.6 Audit Procedures

The auditor should perform the audit procedures with the objectives of obtaining sufficient appropriate audit evidence regarding:

- Identification and adequacy of disclosures of related parties; and
- Identification and adequacy of disclosures of material transactions with related parties.
- Understand motivation for such related party transactions
- Assess the reliability of audit evidence (e.g. management representations);

Auditor shall treat identified significant related party transactions outside the entity's normal course of business as giving rise to

## 8.7 Risk Assessment Procedures



- Discuss and consider possible fraud / error aspects resulting in misstatement due to RPTs
  - Fraud Risk Factors Associated with a RP with Dominant Influence through a single person or small group without compensating controls

In the presence of other risk factors, the existence of a related party with dominant influence may indicate significant risks of material misstatement due to fraud.

- Preliminary enquiries regarding identity of RPs, nature and purpose of RPTs and transactions during the period
- Understanding the management controls to identify, account and disclose RPs and RPTs and their authorization.
- Understand management controls to authorise and approve significant transactions and arrangements outside the normal course of business.
- Maintain alertness / professional skepticism in reviewing records and documents. In particular, the auditor shall inspect the following:
  - Bank, legal and third-party confirmations obtained
  - Minutes of meetings of shareholders and of TCWG; and
  - Such other records or documents as the auditor considers necessary in the

circumstances of the entity.

- Inquire regarding unusual transactions (transactions outside the normal course of business) with respect to
  - nature of these transactions; and
  - whether related parties could be involved
- Information regarding RPs and RPTs obtained shall be shared with other team members

## 8.8 Responses to Risk of RMM associated with RP and RPTs

### 8.8.1 Identify previously unidentified or undisclosed RP or significant RPTs

- Communicate to the team of such RPs
- Request management to identify all transactions newly identified RPs
- Inquire why controls failed to identify such RPs
- Perform appropriate substantive audit procedures
- Reconsider and reassess risk and perform additional audit procedures if required
- Re-evaluate the reliability of management's responses



If the non-disclosure by management appears intentional evaluate implications for the overall audit.

with

### 8.8.2 Identify Transactions outside entity's normal course of business

Auditor shall, for identified significant related party transactions outside the entity's normal course of business, the auditor shall:

- Inspect underlying contracts/agreements and evaluate whether:
  - Business rationale (or lack thereof) suggests that transactions entered to engage in fraudulent financial reporting or to conceal misappropriation of assets.
  - Terms of transactions consistent with management's explanations.
  - Transactions appropriately accounted for/disclosed in accordance with FRF.
- Obtain evidence that transactions have been appropriately authorised & approved.

## 8.9 Examination & Evaluation of RPTs

### 8.9.1 Examination

Examine identified related party transactions by obtaining evidence to ensure such transactions have been properly recorded and disclosed and perform additional audit procedures, if necessary.

Substantive audit procedures that the auditor may perform when the auditor has assessed a significant risk include:

- Confirming or discussing specific aspects of the transactions with intermediaries such as banks, law firms, guarantors, or agents, where practicable and not prohibited by law, regulation or ethical rules.
- Confirming the purposes, specific terms or amounts of the transactions with the related

parties

- Where applicable, reading the financial statements or other relevant financial information, if available, of the related parties for evidence of the accounting of the transactions in the related parties' accounting records.

### 8.9.2 Evaluation

Evaluation of accounting and disclosure of identified related party relationships and transactions- In forming an opinion on the financial statements as per SA 700, the auditor shall evaluate:

- Whether the identified RP relationships and RPTs have been appropriately accounted for and disclosed in accordance with the applicable financial reporting framework and
- Whether the effects of the RP relationships and RPTs
  - Prevent financial statements from achieving true and fair presentation or
  - Cause the financial statements to be misleading

### 8.10 Identification of Related Parties

- Refer to prior year's working papers to identify related parties.
- Assess the adequacy of company's procedures.
- Inquire about the affiliation of directors and key management personnel, officers with other entities.
- Review the register of shareholders to identify significant shareholders.
- Review memorandum of association, articles of association, and minutes of the meetings of shareholders and board of directors and other records like 301 register etc.,
- Review entity's income-tax returns and other information filed with regulatory authorities
- Review material investment transactions.
- Management representation

### 8.11 Identification of Related Party Transactions

- Consider the adequacy of entity's control procedures over authorization and recording of related party transactions.
- Assess the reliability of management representations as to identification and disclosures of such transactions through –
  - Substantive testing.
  - Reviewing the minutes of meetings of board of directors and shareholders
  - Reviewing the entity's income-tax returns and other information filed with regulatory authorities.
  - Review material investment transactions.

- Examine confirmations of loans receivable/payable for information of guarantee received or given.
- To identify previously unidentified relationships, the auditor should review accounting records for large, unusual or non-recurring transactions or balances such as
  - Transactions which have abnormal terms of trade (e.g. borrowing at rates of interest above/below market price)
  - Transactions lacking apparent logic (e.g. sale of fixed assets at below/above market price)
  - Transactions where substance differs from form (e.g. exchange of assets)
  - Transactions processed in unusual manner (e.g. loans granted in absence of scheduled repayment terms)
  - Transactions, which have occurred but have not being given accounting recognition (e.g. receiving or providing any service free of cost).

#### **People within the entity who can have knowledge RPs or RPTs:**

- Those charged with governance;
- Personnel in a position to initiate, process, or record transactions that are both significant and outside the entity's normal course of business, and those who supervise or monitor such personnel;
- Internal auditors;
- In-house legal counsel; and
- The chief ethics officer or equivalent person.

#### **8.12 Indicators of dominant influence exerted by a RP include:**

- The related party has vetoed significant business decisions taken by management or those charged with governance.
- Significant transactions are referred to the related party for final approval.
- There is little or no debate among management and those charged with governance regarding business proposals initiated by the related party.
- Transactions involving the related party (or a close family member of the related party) are rarely independently reviewed and approved.
- Dominant influence may also exist in some cases if the related party has played a leading role in founding the entity and continues to play a leading role in managing the entity.

#### **8.13 Management Representation**



Where the applicable financial reporting framework establishes related party requirements, the auditor shall obtain written representation from management as per SA 580 and those charged with governance that

- They have disclosed to the auditor the identity of the entity's RPs and RPTs of which they are aware and
- They have appropriately accounted for and disclosed such relationships and transactions in accordance with the requirements of the financial reporting framework

#### 8.14 Assertions that relate to RPTs were done as per Arm's Length Transaction

Management is responsible for the substantiation of an assertion that a related party transaction was conducted on terms equivalent to those prevailing in an arm's length transaction.

There may be a risk that management's assertion that a related party transaction was conducted on terms equivalent to those prevailing in an arm's length transaction may be materially misstated.

Auditor can

- Compare terms of RPTs with similar transactions or known market terms
- Considering the appropriateness of management's process for supporting the assertion.
- Verifying the source of the internal or external data supporting the assertion, and testing the data to determine their accuracy, completeness and relevance.
- Evaluating the reasonableness of any significant assumptions on which the assertion is based.

#### 8.15 Communication

The auditor shall communicate with those charged with governance significant matters arising during the audit in connection with the entity's related parties as per SA 260.

#### 8.16 No sufficient appropriate audit evidence

- If the auditor is unable to obtain sufficient appropriate evidence or in his opinion disclosures are not adequate, he should **disclaimer of opinion or a modified** as necessary.



Before doing the same, the auditor shall communicate the same

give a **opinion,**

#### 8.17 Documentation

The auditor shall include in the audit documentation with respect to



- The name of the identified RPs and
- Nature of RP relationships and RPT
- Audit procedures used to identify and ensure disclosures

### 8.18 Questions

- 1) The nature of related party relationships and transactions may, in some circumstances, give rise to higher risks of material misstatement of the financial statements than transactions with unrelated parties. Explain with the help of at least three examples. [RTP-May 20]
- 2) There are specific accounting and disclosure requirements for related party relationships, transactions and balances to enable users of the financial statements to understand their nature and effects on the financial statements. Analyse and explain stating the responsibility of auditor in this regard. [RTP-May 19]
- 3) Write short note on: Identification of significant related party transaction outside business. [Nov. 13 (4 Marks)]
- 4) Discuss the following: With reference to SA 550 "Identification of significant related party transaction outside the entity's normal course of business. [May 16 (5 Marks)]
- 5)

## 9. SA 560 – Subsequent Events

### Contents

- Subsequent Events & Important Dates
- Auditor's Objective
- Events between FS date & Audit report date
- Events between Audit report date and FS Issue date

### 9.1 Important Dates

#### 9.1.1 Date of Financial Statements

The date of the end of the latest period covered by the financial statements.

#### 9.1.2 Date of approval of Financial Statements

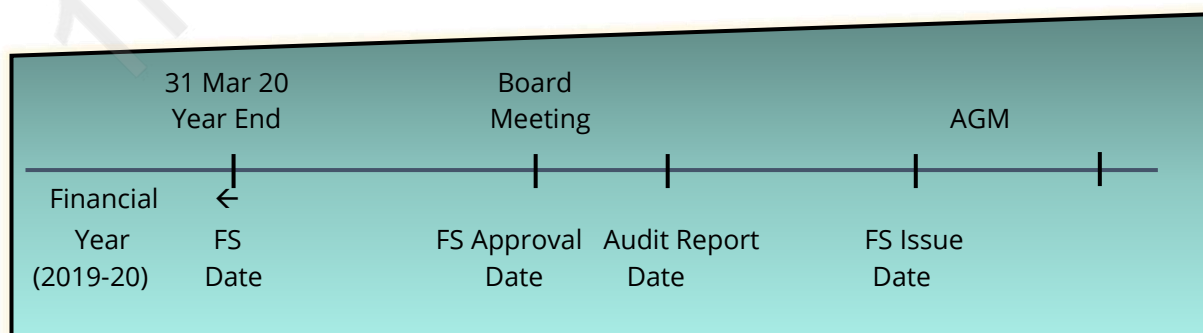
The date on which financial statements, including the related notes, have been prepared and those with the recognised authority have asserted that they have taken responsibility for those financial statements i.e. in case of a company the date board of directors sign and adopt the accounts.

#### 9.1.3 Date of the Auditor's Report

The date the auditor dates the report on the financial statements in accordance with SA 700(Revised).

#### 9.1.4 Date the Financial Statements are issue

The date that the auditor's report and audited financial statements are made available to third parties.

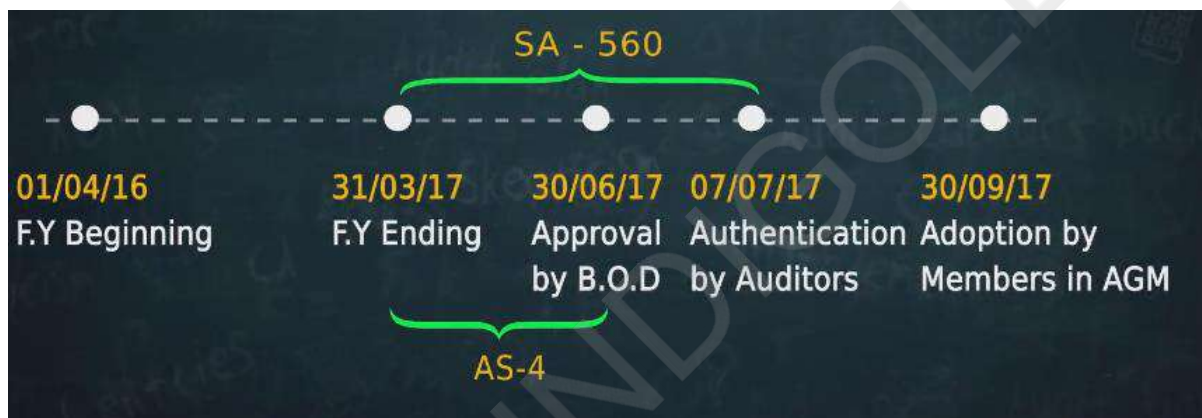


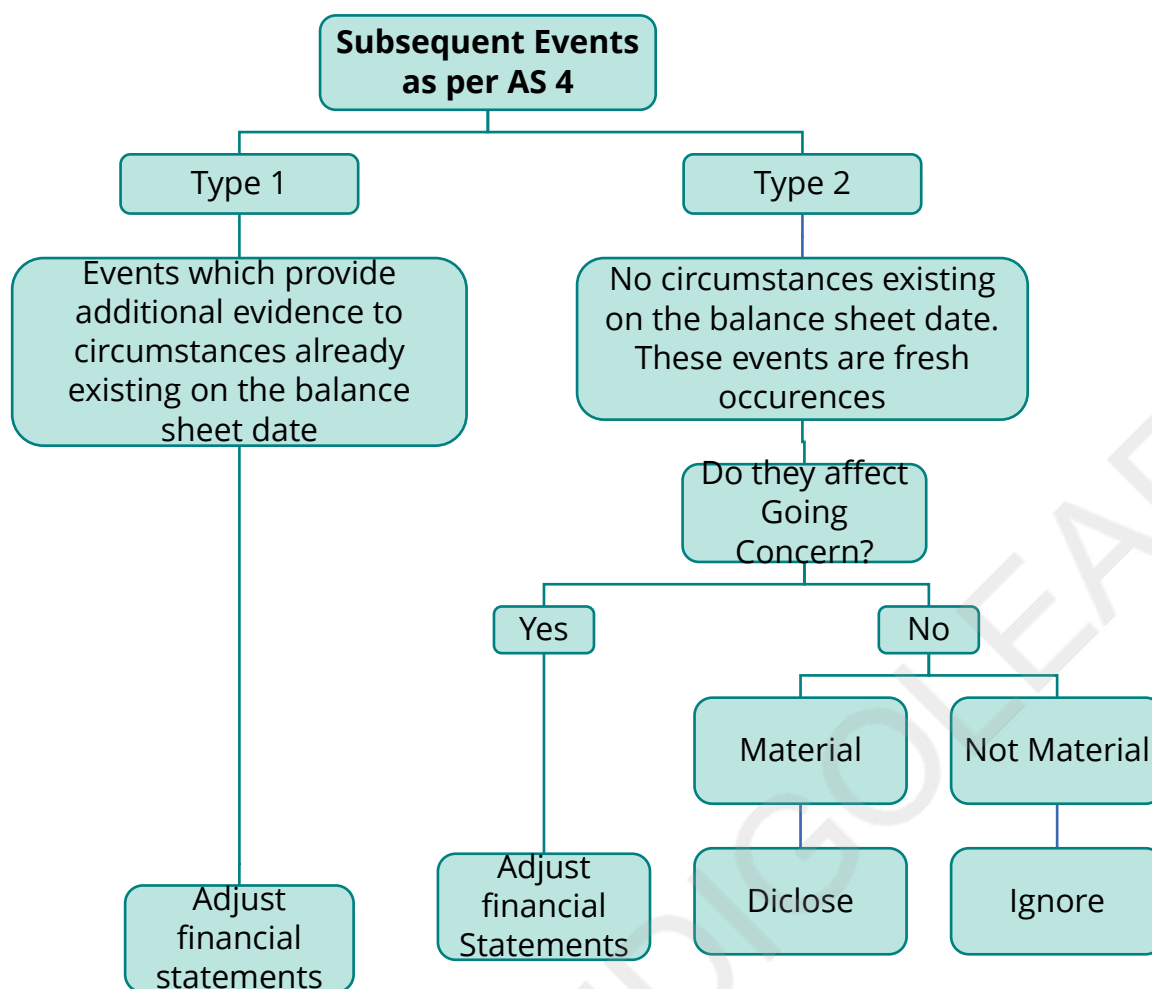
## 9.2 Subsequent events

Events occurring between the date of the financial statements and the date of the auditor's report, and facts that become known to the auditor after the date of the auditor's report.

Financial Statements are prepared for a particular period after the period ends and are issued to members for adoption at a later date and in between the management adopts them and auditor authenticates them.

Subsequent events are during the date of financial statements to date of authentication by the auditor. The subsequent events as per AS 4 is slightly different from that given under SA 560





### 9.2.1 Auditor's Objective

- Obtain sufficient appropriate audit evidence about subsequent events that require adjustment of, or disclosure in, the financial statements are appropriately reflected in those financial statements; and
- Respond appropriately to facts that become known to the auditor after the date of the auditor's report, that, had they been known to the auditor at that date, may have caused the auditor to amend the auditor's report.

The auditor is not expected to perform additional audit procedures on matters to which previously applied audit procedures have provided satisfactory

### 9.3 Auditor's Scope

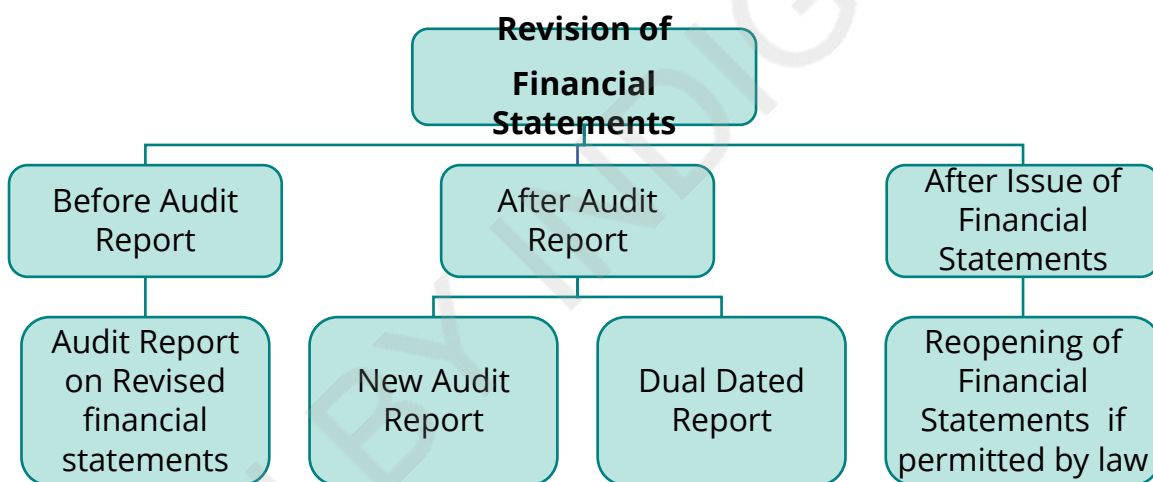
Financial reporting frameworks ordinarily identify two types of events:

- Those that provide evidence of conditions that existed at the date of the financial statements; and
- Those that provide evidence of conditions that arose after the date of the financial statements.

## 9.4 Audit Procedures

- Obtain an understanding of the procedures through which management has identified subsequent events.
- Inquiring of management as to occurrence of Subsequent events which affect the financial statements.
- Read minutes of management meetings that have been held after the date of the financial statements.
- Read the entity's latest subsequent interim financial statements, if any.
- If auditor identifies events that require adjustment or disclosure in the financial statements, the auditor should determine whether each such event is appropriately reflected in the financial statements.
- Obtain management Representation

## 9.5 Revision of Financial Statements by Management



## 9.6 Events between FS Date and Audit Report Date

### 9.6.1 Identification of Subsequent Events

- The auditor shall perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements have been identified.
- The auditor is not expected to perform additional audit procedures on matters to which previously applied audit procedures have provided satisfactory conclusions

### 9.6.2 Specific Procedures

- Understand the procedure for identification of Subsequent events
- Inquire with management regarding subsequent events
- Reading minutes of meetings of board and general meetings that have taken place after the balance sheet date
- Reading the entity's latest subsequent interim financial statements, if any.

### 9.6.3 Financial Statement Review

Review FS to ascertain events requiring adjustment or disclosures in accounts.

### 9.6.4 Management Representation

Written representation shall be obtained from management regarding appropriate identification and treatment of subsequent events

## 9.7 Facts which become known to the Auditor after Audit Report Date but before FS Issue date

### 9.7.1 Discussion with Management

If auditor comes to know of a fact after the the auditor's report but before the date the FS issued, and had it been known to the auditor date of the auditor's report, may have caused auditor to amend the auditor's report, then the shall



The auditor has no obligation to perform any audit procedures regarding the FS after the audit report date.

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auditor

- Discuss the matter with management and, where appropriate, those charged with governance.
- Determine whether the financial statements need amendment and
- If so, inquire how management intends to address the matter in the financial statements.

### 9.7.2 Amendment of FS and Issue of new audit report

If management amends the financial statements, the auditor shall

- Carry out the audit procedures necessary in the circumstances on the amendment.
- If amendment prohibited or not allowed or by law or regulation:
  - Extend the audit procedures referred to to the date of the new auditor's report; and
  - Provide a new auditor's report the amended financial statements.



The new auditor's report shall not be dated earlier than the date of approval of the

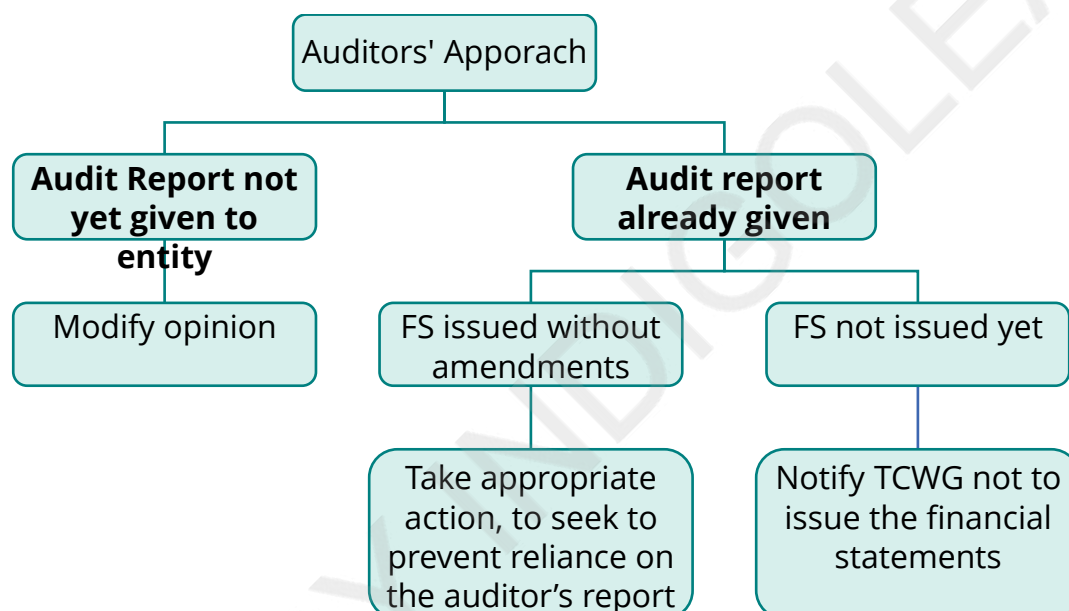
above  
on

### 9.7.3 Dual Dating of new para in audit report

When law, regulation or the financial reporting framework does not prohibit management from restricting the amendment of the financial statements to the effects of the subsequent events or events causing that amendments and those responsible for approving the financial statements are not prohibited from restricting their approval to that amendment i.e. amendment on account of subsequent events is permitted auditor's shall

- Amend the auditor's report to include an additional date restricted to that amendment  
E.g. "(Date of auditor's report), except as to Note Y, which is as of (date of revised report)";  
or
- Provide a new or amended auditor's report that includes a statement in an Emphasis of Matter paragraph or Other Matter

#### 9.7.4 Management doesn't amend as law does not provide but auditor believes they need to be amended



### 9.8 Facts, which become known to the Auditor after FS issue date

#### 9.8.1 Discussion with Management

When, after the financial statements have been issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report, the auditor shall

After the FS have been issued, the auditor has no obligation to perform any audit procedures.

- Discuss the matter with management and, where appropriate, those charged with governance
- Determine whether the financial statements need amendment and, if so,
- Inquire how management intends to address the matter in the financial statements.



### 9.8.2 Amendment to FS by management

- Carry out the audit procedures necessary in the circumstances on the amendment.
- Review the steps taken by management to ensure that anyone in receipt of the previously issued financial statements together with the auditor's report thereon is informed of the situation.
- Unless the Dual dating procedure applies:
  - Extend the audit procedures to the date of the new auditor's report, and the date the new auditor's report no earlier than the date of approval of the amended financial statements; and
  - Provide a new auditor's report on the amended financial statements.
- When the circumstances in Dual dating para apply, amend the auditor's report, or provide a new auditor's report.

### 9.8.3 Emphasis of Matter paragraph or Other Matter(s) paragraph

The auditor shall include in the new or amended auditor's report an Emphasis of Matter paragraph or Other Matter(s) paragraph referring to a note to the financial statements that more extensively discusses the reason for the amendment of the previously issued financial statements and to the earlier report provided by the auditor.

### 9.8.4 Special Control Action when Management not in agreement with Auditor

- If management does not take the necessary steps to ensure that anyone in receipt of the previously issued financial statements is informed of the situation and does not amend the financial statements in circumstances where the auditor believes they need to be amended, the auditor shall notify management and,
- If, despite such notification, management or TCWG do not take these necessary steps, the auditor shall take appropriate action to seek to prevent reliance on the auditor's report.

## 9.9 Written Representation

The auditor shall request the management or TCWG to provide a written representation that all events occurring subsequent to the date of the financial statements and requires adjustment or disclosure have been adjusted or disclosed.

## 9.10 Specific Inquiries

The auditor is required to obtain sufficient & appropriate audit evidence to ensure that events which require adjustments or disclosure in the financial statements have been identified.

For this purpose, auditor is required to inquire the management as to occurrence of Subsequent events which affect the financial statements.

Specific inquiries include the following:

- new commitments, borrowings or guarantees have been entered into.
- sales or acquisitions of assets have occurred or are planned.
- increases in capital or issuance of debt instruments, such as the issue of new shares or debentures, or an agreement to merge or liquidate has been made or is planned.
- assets appropriated by government or destroyed, for example, by fire or flood.
- any developments regarding contingencies.
- unusual accounting adjustments made or are contemplated.
- events occurred or are likely to occur that affect the
  - appropriateness of accounting policies used in the financial statements or
  - going concern assumption.
  - measurement of estimates or provisions made in the financial statements.
  - relevant to the recoverability of assets.

## 9.11 Questions

- 1) Explain the meaning of term “Subsequent Events” as used in SA 560. Should all types of subsequent events be considered by the auditor in attest functions. [May 12 (8 Marks)]
- 2) “The auditor should consider the effect of subsequent events on the financial statements and auditor’s report according to SA 560”. Comment. [MTP-Oct. 19]
- 3) The auditor shall perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor’s report that require adjustment of, or disclosure in, the financial statements have been identified. Explain. [RTP-May 19]
- 4) The auditor has no obligation to perform any audit procedures regarding the financial statements after the date of the auditor’s report. However, when, after the date of the auditor’s report but before the date the financial statements are issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor’s report, may have caused the auditor to amend the auditor’s report. Explain the auditor’s obligation in the above situation. [RTP-May 20]
- 5) Enquiry from management is helpful for auditor to evaluate subsequent events. Discuss specific enquiries in reference of SA 560, which might have effect on the financial statements. [Nov. 14 (5 Marks)]

- 6) In the context of SA 560 “Subsequent events”, state specific enquiries on matters by an auditor which may have effect on Financial Statements.  
[Nov. 17 (5 Marks)]

## 10. SA 570 – Going Concern

### Contents

- Going Concern Assumption
- Objective of Auditor
- Risk Assessment Procedures
- Auditor's responsibilities and Audit reports
- Indicators of going concern

### 10.1 Going Concern basis of Accounting

Under the going concern basis of accounting, the financial statements are prepared on the assumption that the entity is a going concern and will continue its operations for the foreseeable future.

As per AS-1 "Disclosure of Accounting Policies, financial statements are prepared on the basis of three assumptions

- Going Concern
- Consistency
- Accrual.

An entity's continuance as a going concern for a foreseeable future is assumed in the preparation of general purpose financial statements in the absence of information to the contrary.

Special purpose financial statements may or may not be prepared based on going concern basis of


When the use of the going concern basis of accounting is appropriate, assets and liabilities are recorded on the basis that the entity will be able to

- realize its assets and
  - discharge its liabilities
- in the normal course of business.

If this assumption is unjustified, the value of assets and liabilities may need adjustment.

#### 10.1.1 Responsibility of assessment for Going Concern Assumption

It is management's responsibility to assess the applicability and appropriateness of Going concern assumption to the entity and make appropriate disclosures, whether the financial reporting framework explicitly requires the management to do so or not.



Management's assessment of the entity's ability to continue as a going concern involves making a judgment

### 10.1.2 Factors relevant for the assessment

The following factors are relevant to that judgment:

- The degree of uncertainty associated with the outcome of an event or condition
- The size and complexity of the entity, the nature and condition of its business and the degree to which it is affected by external factors
- Information available at the time of the judgment

### 10.1.3 Auditor's Responsibilities

- Obtain sufficient appropriate audit evidence regarding the appropriateness of management's use of the going concern basis
- Conclude that no material uncertainty exists about the entity's ability to continue as a going concern.

The absence of any reference to a material uncertainty about the entity's ability to continue as a going concern in an auditor's report cannot be viewed as a guarantee as to the entity's ability to continue as a going concern.

## 10.2 Objectives of the Auditor

- Whether management has appropriately addressed going concern issue in financial statements?
- Is there any audit evidence to render going concern assumption inappropriate?
- Implications of going concern questionability on Auditors report

## 10.3 Risk Assessment Procedures

### 10.3.1 Events or Conditions affecting entity's ability to continue

Auditor shall review whether there are any events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.

Auditor can know about such events or conditions through the following:

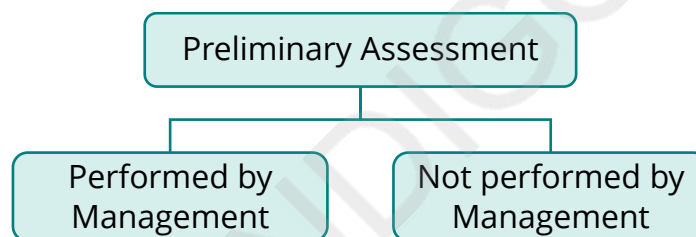
- Analysing and discussing cash flow, profit and other relevant forecasts with management.
- Analysing and discussing the entity's latest available interim financial statements.
- Reading the terms of debentures and loan agreements and determining whether any have been breached.
- Reading minutes of the meetings of shareholders, those charged with governance and

relevant committees for reference to financing difficulties.

- Inquiring of the entity's legal counsel regarding the existence of litigation and claims and the reasonableness of management's assessments of their outcome and the estimate of their financial implications.
- Confirming the existence, legality and enforceability of arrangements to provide or maintain financial support with related and third parties and assessing the financial ability of such parties to provide additional funds.
- Evaluating the entity's plans to deal with unfilled customer orders.
- Performing audit procedures regarding subsequent events to identify those that either mitigate or otherwise affect the entity's ability to continue as a going concern.
- Confirming the existence, terms and adequacy of borrowing facilities.
- Obtaining and reviewing reports of regulatory actions.
- Determining the adequacy of support for any planned disposals of assets

### 10.3.2 Preliminary Assessment

In doing the review, the auditor shall determine whether management has already performed a preliminary assessment of the ability to continue as a going concern



#### • Preliminary Assessment performed by management

- Discuss the assessment with management and
- Determine whether management has identified events or conditions that may cast significant doubts on the entity's ability to continue as a going concern.
- If so, understand management's plan to address them



Assessment should have been done for a minimum of 12 months from the date of financial

#### • Preliminary Assessment NOT performed by management

- Discuss with management the basis for the intended use of going concern assumption and
  - Inquire of management whether events or conditions exist that may cast significant doubt on the entity's ability to continue as a going concern
- The auditor shall remain alert throughout the audit for audit evidence of events or conditions that may cast significant doubt on the entity's ability to continue as a going

concern

### 10.3.3 Evaluation of management's assessment

- Assessment should have been done for a minimum of 12 months from the date of financial statements. If laws governing enterprise mandate a period in excess of 12 months, the same shall be verified.

If management is unwilling to make or extend its assessment when requested to do so by the auditor, the auditor shall consider the implications for the auditor's report.

- Auditor shall consider whether management's assessment includes all relevant information of which the auditor is aware as a result of the audit.

#### Period beyond management's assessment

The auditor shall inquire of management as to its knowledge of events or conditions beyond the period of management's assessment that may cast significant doubt on the entity's ability to continue as going concern

### 10.4 Additional Audit Procedures

Auditor shall perform additional audit procedures when events or conditions that may cast significant doubt on entity's ability to continue as going concern are identified

- Obtain sufficient appropriate audit evidence whether there is any material uncertainty
- Request management to make its assessment if not made yet
- Evaluate management's plans for future actions in relation to its going concern assessment, whether the plans are feasible
- Whether the entity has prepared cash flow forecast and, in that regard,
  - Evaluating the reliability of the underlying data generated to prepare the forecast
  - Determine whether there is adequate support for the assumptions underlying the forecast.
- Considering whether any additional facts or information have become available since the date on which management made its assessment.
- Request for management representation regarding future actions and the feasibility of such plans

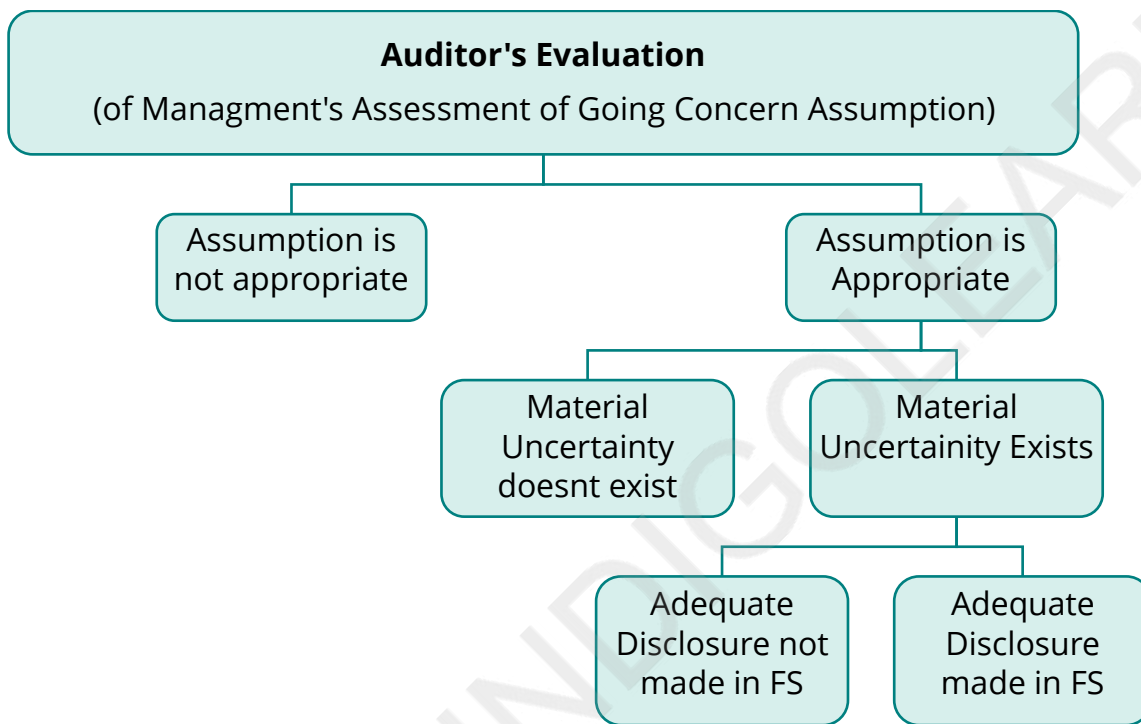
### 10.5 Auditor Conclusions



Auditor shall conclude whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern

If yes, and auditor believes that its potential impact and likelihood of occurrence is such that it requires appropriate disclosure of the nature and implications of the uncertainty to ensure:

- fair presentation of the financial statements, or
- financial statements not to be misleading.



## 10.6 Going Concern appropriate but material uncertainty exists

### 10.6.1 Auditor's Approach

When the auditor concludes that the use of the going concern assumption is appropriate in the circumstances, but a material uncertainty exists, the auditor shall determine whether the financial statements:

- Adequately describe
  - the principal events or conditions and
  - management's plans to deal with these events or conditions; and
- Disclose clearly that
  - there is a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and,
  - it may be unable to realize its assets and discharge its liabilities in the normal course of business.

## 10.6.2 Reporting Requirements

### • Adequate Disclosure made in FS

The auditor shall express an unmodified opinion and include an Emphasis of Matter paragraph in the auditor's report to:

- Highlight the existence of a material uncertainty relating to the event or condition that may cast significant doubt on the entity's ability to continue as a going concern; and
- Draw attention to the note in the financial statements

### • Adequate Disclosure not made in FS

- Express a **qualified or adverse opinion**, as appropriate, and
- State in his report that there is a material uncertainty that may cast significant doubt about the entity's ability to continue as a going concern

## 10.7 Going Concern Appropriate

If the financial statements have been prepared on a going concern basis but, in the auditor's judgment, management's use of the going concern assumption in the financial statements is inappropriate, the auditor shall express an **adverse opinion**.

## 10.8 Communication with TCWG

The auditor shall communicate with those charged with governance events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern.

Such communication shall include the following:

- Whether the events or conditions constitute a material uncertainty;
- Whether the use of the going concern assumption is appropriate in the preparation and presentation of the financial statements; and
- The adequacy of related disclosures in the financial statements

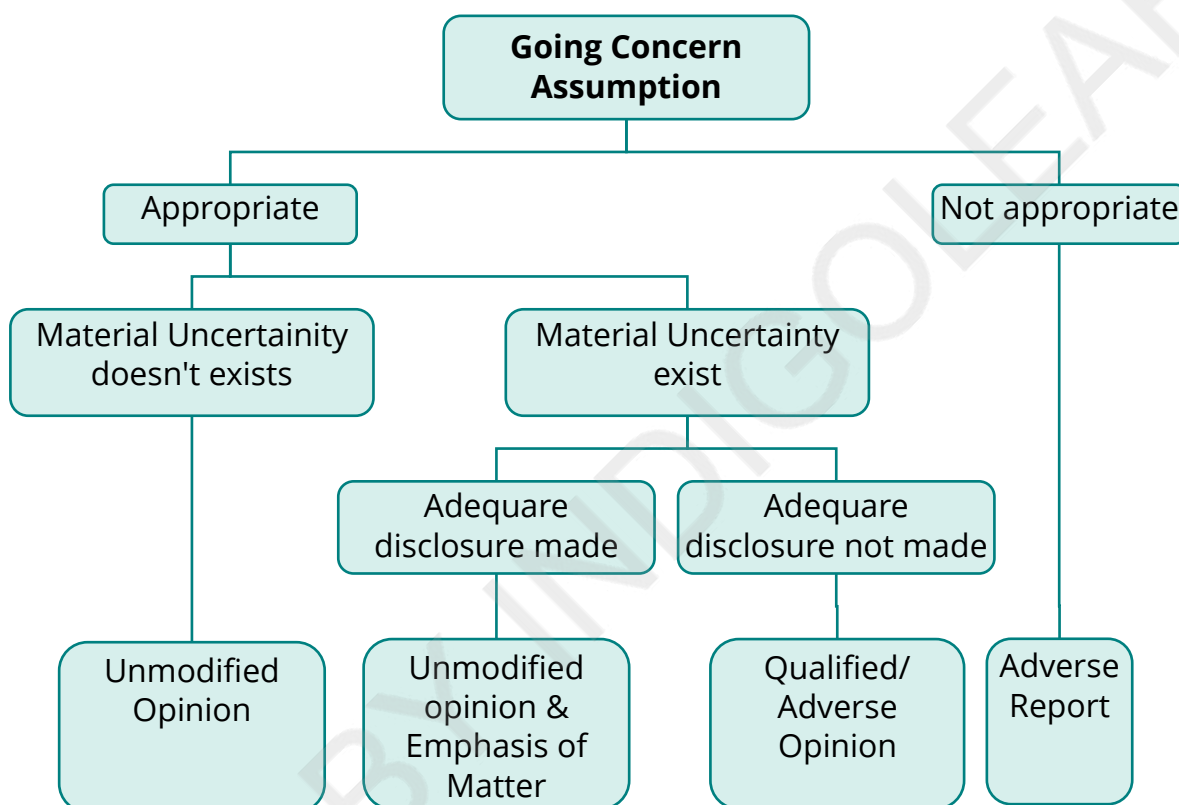
## 10.9 Significant Delay in the Approval of Financial Statements

When there is significant delay in the approval of the financial statements by management or those charged with governance after the date of the financial statements, the auditor shall

- inquire as to the reasons for the delay
- perform additional audit procedures necessary if the auditor believes delay could be due to events relating to the going concern assessment
- consider the effect on the auditor's conclusion regarding the existence of a material uncertainty.

ICAI has clarified vide general clarification that the auditor should comment on going concern of those companies who have not complied with the amended Sec 3 of the Companies Act 1956 regarding minimum paid up capital of Rs. 1Lakh for private and Rs.5 Lakhs for public companies

### 10.10 Implication on Audit reports in different scenarios



### 10.11 ICAI Clarification

ICAI has clarified vide general clarification that the auditor should comment on going concern of those companies who have not complied with the amended Sec.3 of the Companies Act 1956 regarding minimum paid up capital of Rs. 1Lakh for private and Rs.5 Lakhs for public companies

## 10.12 Indicators of potential Going concern problem

The entity's inability to continue as a going concern may be indicated by indicated by various factors. Some potential indicators

### 10.12.1 Financial Indicators

- Net liability or net current liability position.
- Fixed-term borrowings approaching maturity without realistic prospects of renewal
- Indications of withdrawal of financial support by creditors.
- Negative operating cash flows indicated by historical or prospective financials
- Adverse key financial ratios.
- Substantial operating losses or significant deterioration in the value of assets used to generate cash flows.
- Arrears or discontinuance of dividends.
- Inability to pay creditors on due dates.
- Inability to comply with the terms of loan agreements.
- Change from credit to cash-on-delivery transactions with suppliers.
- Inability to obtain financing for essential new product development.

### 10.12.2 Operating Indicators

- Management intentions to liquidate the entity or to cease operations.
- Loss of key management without replacement.
- Loss of a major market, key customer(s), franchise, license, or principal supplier(s).
- Labour difficulties.
- Shortages of important supplies.
- Emergence of a highly successful competitor.

### 10.12.3 Other Indicators

- Non-compliance with capital or other statutory requirements.
- Pending legal or regulatory proceedings against the entity that may, if successful, result in claims that the entity is unlikely to be able to satisfy.
- Changes in law or regulation or government policy expected to adversely affect the entity.
- Uninsured or underinsured catastrophes when they occur

## 10.13 Case Study

### • Case

A company has eroded its net worth and it also has high debts and received a waiver from bank for interest payments.

### • Management's Response

The banks have confidence in our ability as a going concern, hence the waiver. The banks certainly are not going to grant a waiver to a company it feels does not have ability to pay its debts.

- **Evaluation**

Though there is a risk of going concern for the organization, but if the banks weren't confident enough that the company will make profits and repay loan, they would not have sanctioned a waiver.

This is one of the examples of getting comfort over going concern risk mitigation.

## 10.14 Questions

- 1) On the basis of which assumption, the financial statements of a company are prepared. Explain. Also describe the objectives of the auditor regarding going concern. [RTP-May 19]
- 2) When the use of the going concern basis of accounting is appropriate, assets and liabilities are recorded on the basis that the entity will be able to realize its assets and discharge its liabilities in the normal course of business. Explain stating also the objective of the auditor regarding going concern. [RTP-Nov. 19]
- 3) Write short note on: Procedures to be performed by the auditor in expressing opinion on 'going concern' assumption. [Nov. 10 (4 Marks)]
- 4) Explain with reference to relevant SA: Appropriateness of going concern assumption.
- 5) Explain going concern assumption with reference to SA 570. State some financial events or conditions that may case doubt about going concern assumption. [May 12 (8 Marks)]
- 6) Discuss with reference to SAs: Operating conditions that may case doubt going concern assumption. [May 14 (5 Marks)]

# 11. SA 580 – Written Representations

## Contents

- Written Representations - Features
- Areas requiring written representations
- Auditor's Objective
- Relationship between Joint Auditors
- Reporting Responsibilities

### 11.1 Written Representation

Written statement by management provided to the auditor to confirm certain matters or to support other audit evidence.

Preparation and presentation of financial statements in accordance with applicable financial reporting framework is the responsibility of the management.

Written representations are necessary information that the auditor requires in connection with the audit, hence they are recognised as audit evidence as a response to inquiries.

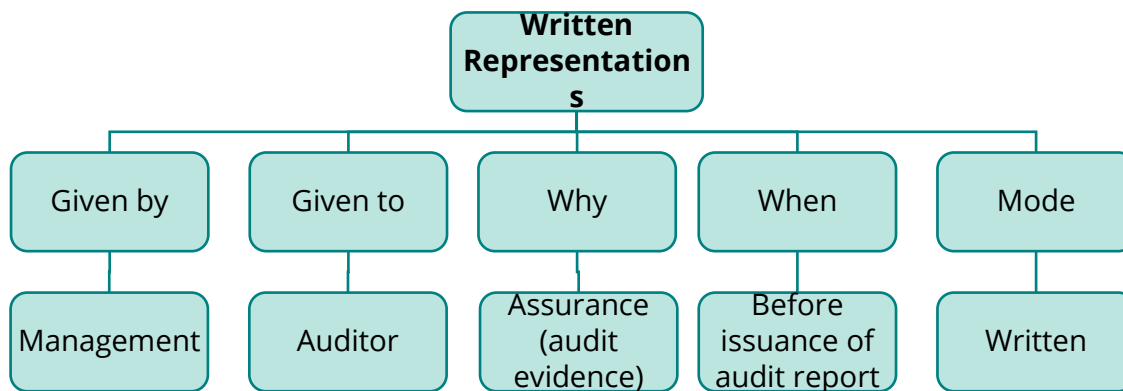
Although written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal.



Written representations in this context do not include financial statements, the assertions therein or supporting books and

Auditor requires the written representation from the management to support other audit evidence relevant to the Financial Statements. or specific assertions in the Financial Statements

### 11.1.1 Essential Features



## 11.2 Areas in which Written Representations are required

### 11.2.1 Management's Responsibility

- All transactions have been recorded and reflected in financial statements
- Financial statements are prepared as per relevant financial reporting framework
- Information in this regard given to auditor as per the engagement terms

Management's responsibilities shall be described in the written representations in the manner in which these responsibilities are described in the terms of the audit engagement.

### 11.2.2 As required by SAs

In various other standards, auditor is asked to obtain written representation from management as additional / corroborative audit evidence. They include:

- Selection and application of accounting policies are appropriate
- Recognition, measurement, presentation and disclosure of the following are in accordance with the financial reporting framework:
  - Plans or intentions that may affect the carrying value or classification of assets and liabilities;
  - Title to, or control over, assets, the liens or encumbrances on assets, and assets pledged as collateral
  - Accounting policies followed by client
  - Laws and regulations are duly complied with

If auditor opines that representation is required to provide additional audit evidence about any specific aspects, he may obtain the same

### 11.2.3 Deficiencies in Internal Control



The auditor may consider it necessary to request management to provide a written representation that it has communicated to the auditor all deficiencies in internal control of which management is aware.

### 11.3 Auditor's Objective

- To obtain written representations from management that management believes that it has fulfilled the fundamental responsibilities that constitute the premise on which an audit is conducted;
- To support other audit evidence relevant to the financial statements or specific assertions in the financial statements by means of written representations, if determined necessary by the auditor or required by other SAs; and
- To respond appropriately to written representations provided by management or if management does not provide the written representations requested by the auditor.

### 11.4 Date and period covered by written representation

#### 11.4.1 Date

The date of representation shall be as near as practicable to, but not after, the date of the auditor's report on the financial statements

#### 11.4.2 Period

The written representations shall be for all financial statements and periods referred to in the Auditor's Report.

### 11.5 Form of Written Representation

- It shall be addressed to the auditor
- If as per a law governing the enterprise, the management is required to make a written public statement of its responsibilities on financial statement that would have otherwise been taken from the management in the form of written representation; the auditor may rely on such statement as a part of audit evidence

The expression of management's responsibilities as required under any law or regulation is also not a substitute for the requested written representations.

### 11.6 Considerations w.r.t Written Representations

When obtaining evidence about, or evaluating, judgments and intentions, the auditor may consider one or more of the following:

- The entity's past history in carrying out its stated intentions.
- The entity's reasons for choosing a particular course of action.
- The entity's ability to pursue a specific course of action.

- The existence or lack of any other information that might have been obtained during the course of the audit that may be inconsistent with management's judgment or intent.

### 11.7 Unreliable written representations

- If the auditor has concerns about the competence, integrity, ethical values or diligence of management, or about its commitment to or enforcement of these, he shall determine the effect that such concerns may have on the reliability of representations (Oral / Written) and audit evidence in general.
- If inconsistencies remain unresolved, he shall determine the effect that such concerns may have on the reliability of representations (Oral / Written) and audit evidence in general



If written representations are inconsistent with other audit evidence, the auditor shall perform audit procedures to attempt to resolve them.

If auditor opines that audit evidence is unreliable, he shall determine its impact on the Auditor's report

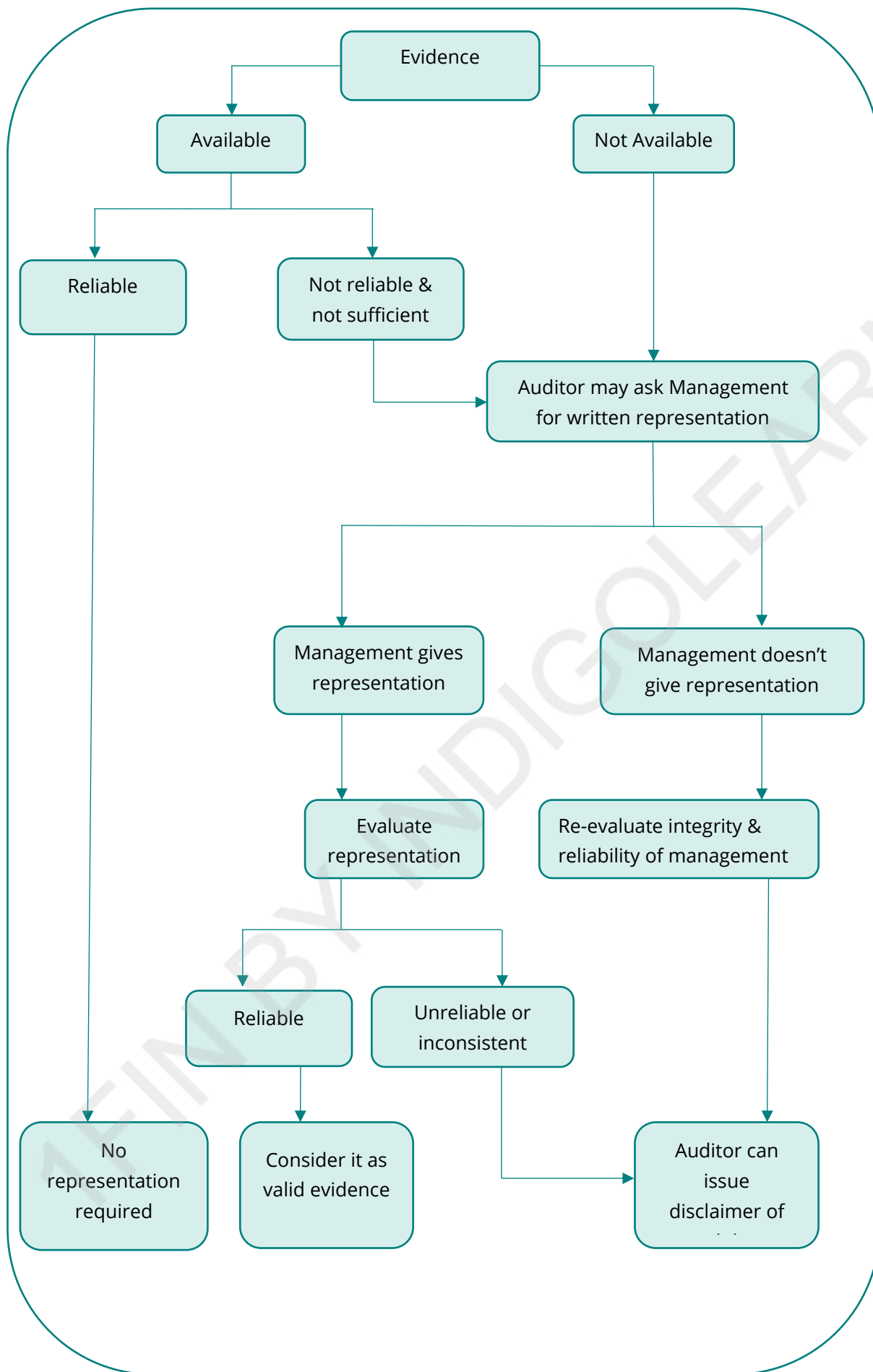
- The auditor shall disclaim an opinion on the financial statements in accordance with SA 705

### 11.8 Management doesn't provide Written Representation

If the management does not provide one or more of the requested written representation, the auditor shall:

- Discuss the matter with management and
- Re-evaluate the reliability and integrity of management.
- Take appropriate action including the determining the possible effect on the opinion.
- Under these circumstances the auditor shall issue a disclaimer of opinion.

### 11.9 Overall Auditor's Approach for written representations other than management's responsibilities



## 11.10 Sample

To

M/s RAMESH & Associates,  
Chartered Accountants,  
SECTOR-8,  
NOIDA

Dear Sirs,

### 1. Basis for Preparation of Financial Statements

The financial statements are prepared under the historical cost convention, on the accrual basis of accounting and in accordance with the Generally Accepted Accounting Principles ('GAAP') in India and comply with the accounting standards prescribed by the Companies (Accounting Standards) Rules, 2006, to the extent applicable and in accordance with the provisions of the Companies Act, 1956, as adopted consistently by the Company.

### 2. Share Capital

75% Share capital is owned by M/s ABC Co. Ltd., KOREA and 25% is owned by M/s XYZ PVT. Ltd.

### 3. Fixed Assets

Fixed assets are stated at cost less accumulated depreciation and impairment losses if any.

### 4. Depreciation

Tangible fixed assets are stated at the acquisition cost less accumulated depreciation and impairment loss, if any. Cost includes inward freight, duties, taxes, and incidental expenses related to acquisition and installation incurred in bringing the asset to its working condition for its intended use.

Depreciation on the tangible fixed assets is provided on the Written Down Value methods (WDV) at the rates specified in Schedule XIV of the Companies Act, 1956.

Tangible fixed assets costing less than Rs.5,000 per unit are fully depreciated in the year of purchase except Bins & Crates. In case of Bins & Crates, their life has been assumed to be 3 years and accordingly these are charged to depreciation on Straight Line Method (SLM) basis in 3 years.

Depreciation on additions/ deletion is provided on pro-rata basis from/ upto the date of such additions/ deletions.

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#### 5. Security Deposit

During the year the company has paid security deposit as follows: -

##### Unit 1: -

Electricity Deposit: - Rs. 1,000,000/-  
Rent: - Rs. 5,000,000/-

##### Unit 2: -

Rent: - Rs. 3,000,000/-  
Electricity Deposit: - Rs. 900,000/-

#### 6. Royalty

Payment of Royalty for using trademark of ABC Co., Ltd, Korea and XYZ Pvt. Ltd. is accounted for as per agreement executed between both these parties with A Z Z Pvt. Ltd. Total Payment of royalty during the period under audit is amounting to Rs. 1,000,000/-.

#### 7. Bank Balances

The company has bank account with Bank of India that has been reconciled up to March 31, 2013.

#### 8. Employee Benefits

The Company has a defined benefit gratuity and leave encashment scheme. The company has taken policy from LIC for both plants. In case liability on account of Gratuity will arise in future the same will be borne by LIC, in consideration of which LIC is charging premium on annual basis from the company. Therefore no provision has been made by the Company.

The earned leave liability arises on retirement, withdrawal, resignation and death of an employee.

#### 9. Loans & Advances

Short term working capital loan of Rs. 25,000,000/- has been taken during the year from Bank of India and is an Unsecured Loan.

Term Loans are secured against hypothecation of all plants and machineries and Corporate Guarantee of both co-ventures companies.

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## 11.8 Questions

- 1) Explain clearly meaning of Management Representation and objective of the auditor regarding written representation.
- 2) Explain clearly objective of the auditor regarding written representation. [RTP-Nov. 19]
- 3) Audit evidence is all the information used by the auditor in arriving at the conclusions on which the audit opinion is based. Written representations are necessary information that the auditor requires in connection with the audit of the entity's financial statements. Accordingly, similar to responses to inquiries, written representations are audit evidence. Explain stating clearly objectives of the auditor regarding written representation. [RTP-May 20]
- 4) "Although written representations provide necessary audit evidence yet they do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal". Discuss.
- 5) The auditor P of PAR and Co., a firm of Chartered Accountants is conducting audit of AB

Industries Ltd. The auditor requests management to provide Banker's certificate in support of Fixed deposits whereas management provides only written representation on the matter. Analyse how would you deal as an auditor. [RTP-May 18]

- 6) Discuss with reference to SAs: What do you mean by "Written Representations"? As an auditor, how would you deal if management does not provide requested written representations? [May 14 (5 Marks)]

# 1) SA 600 – Using the work of Another Auditor

## Contents

- Principal Auditor & Other Auditor
- Applicability of SA 600
- Principal Auditor's Procedures
- Co-ordination between Principal Auditor & Other Auditor

## 1.1 Introduction

As per SA 200, An auditor is entitled to rely on the work of others, provided he

- exercises adequate skill and care;
- is not aware of any reason for not relying on such work
- states the fact of reliance in the audit report



Principal auditor should determine how the work of the other auditor will affect the audit.

If so required, the principal auditor shall have power to visit the component and / or examine the books of accounts and other records, provided laws governing the enterprise provide for the same.

When planning to use the work of another auditor, the principal auditor should consider the professional competence of the other auditor in the context of specific assignment if the other auditor is not a member of the ICAI

## 1.2 Important Term

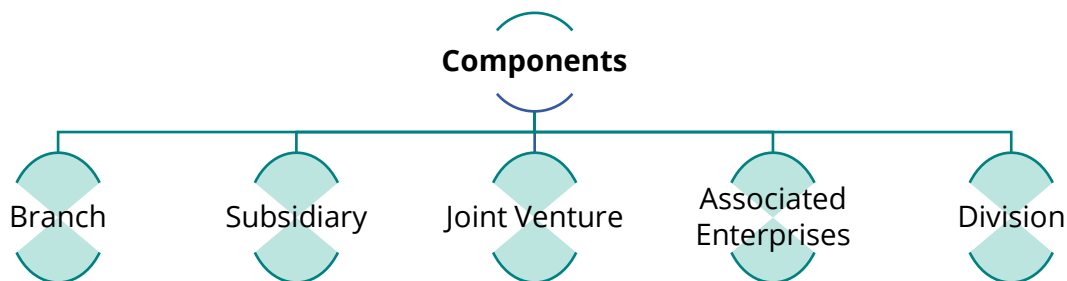
### 1.2.1 Principal Auditor

Auditor who is responsible for reporting on the financial information of an entity who has one or more components audited by another auditor.

### 1.2.2 Component

A division, branch, subsidiary, joint venture, associated enterprises, or other entity whose financial information is included in the financial information audited by principal auditor.





### 1.2.3 Other Auditor

The auditor responsible for reporting on the financial information of the component. (Another auditor is the auditor of component)

## 1.3 Applicability of SA

### 1.3.1 Applicable to

- Principal auditor uses work of another independent auditor ('Other Auditor') / Component Auditor

### 1.3.2 Non-Applicability

- Where two or more auditors are appointed as joint auditors, SA 299 deals with it;
- Auditor's relationship with a predecessor auditor; and
- Where the financial information of a component is immaterial, individually or aggregate

## 1.4 Considerations by Principal Auditor

The auditor should consider whether the auditor's own participation is sufficient to be able to act as the principal auditor. For that the principal auditor should consider:

- The **materiality** of the portion of the financial information which the principal auditor audits
- The principal auditor's **degree of knowledge** in the component's business
- The risk of material misstatements in the component's financial information
- The performance of additional procedures regarding the audited components audited which results in significant participation by principal auditor in such audit

## 1.5 Principal Auditor's Procedures

Where another auditor has been appointed for the component, the principal auditor would normally be entitled to rely upon the work of such auditor unless there are special circumstances to make it essential for him to visit the component and/or to examine the books of account and other records of the said component.

### 1.5.1 Professional Competence

The principal auditor should consider the professional competence of the other auditor in the context of specific assignment if the other auditor is not a member of the Institute of Chartered Accountants of India.

### 1.5.2 Sufficient Appropriate Audit Evidence

The principal auditor should perform procedures to obtain sufficient appropriate audit evidence, that the work of the other auditor is adequate for the principal auditor's purposes, in the context of the specific assignment.

### 1.5.3 Advise and Ascertain

- Advise the other auditor about the use to be made of his work and report
- Co-ordination between principal and component auditor at the planning stage
- Intimate the other auditor about areas requiring special consideration and time-table for completion of audit
- Advise the other auditor of the significant accounting, auditing and reporting requirements and obtain representation as to compliance with them
- Ascertain from the other auditor any limitation on the scope of his work
- Consider the significant audit findings of the other auditor

### 1.5.4 Discuss and Communicate

Unless the principal auditor concludes that sufficient appropriate audit evidence has been obtained that acceptable quality control policies and procedures are complied with in the conduct of other auditor's practice.

- Discuss with other auditor the audit procedures applied
- Review a written summary of the other auditor's
  - Audit procedures followed AND
  - Findings which may be in the form of a completed questionnaire or checklist



The principal auditor should consider the significant findings of the other auditor.

- Visit the other auditor

The nature, timing and extent of procedures will depend on the circumstances of the engagement and the principal auditor's knowledge of the professional competence of the other auditor.

### 1.5.5 Supplement Tests

Based on the discussions with component management on the findings of the other auditor, principal auditor may conduct supplement tests either directly or through another auditor.

The principal auditor can use work of rely on work of other auditor at his own discretion. However,

- Principal auditor has right to visit the component
- Principal auditor has right to examine books of account and other records of components.
- Check the professional competence of other auditor in case, he is auditor of foreign component, where such auditor is not member of ICAI

## 1.6 Documentation

The principal auditor should document in his working papers:

- Name of the components whose financial statements were audited by other auditors
- Names of the other auditors who audited those components;
- Significance of the financial statement of the components to the entity as a whole and if immaterial document the conclusions reached about the component;
- Details of procedures performed along with their conclusion;
- Manner of dealing with qualifications or adverse remarks contained in other auditor's report.

## 1.7 Coordination between Principal Auditor and Other Auditor

### 1.7.1 Role of Principal Auditor

- There should be sufficient liaison between the principal auditor and the other auditor
- The principal auditor should **issue written communication** to the other auditor and the latter should co-operate with the former.
- Both should immediately inform each other of any matter which come to their attention and have an important bearing on the work of the other.

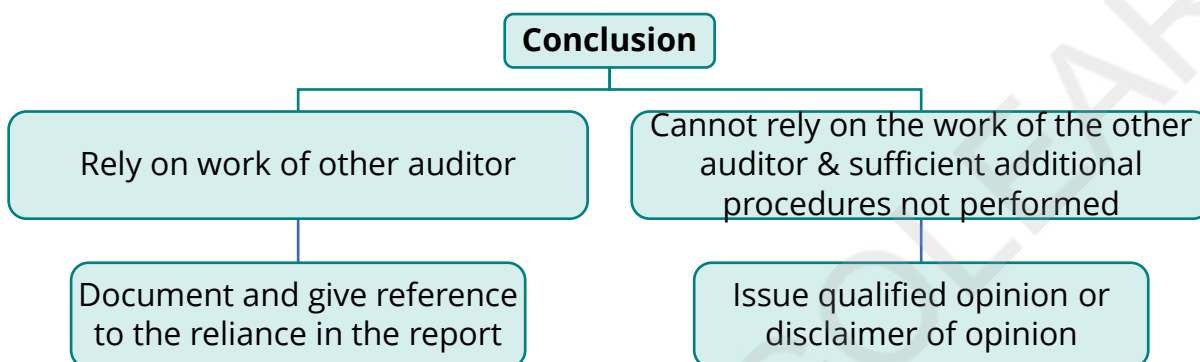
### 1.7.2 Role of Other Auditor

- The other auditor should co-ordinate with principal auditor and assist him regarding the component
- Bring to the attention of principal auditor any significant aspects
- Ensure compliance with relevant statutory requirements

### 1.7.3 Questionnaire

- Principal auditor, when considered necessary, may obtain from the other auditor, information required for the purpose of audit in the form of a questionnaire

## 1.8 Reporting Requirements



- If the principal auditor, on the basis of procedures mentioned above concludes that he cannot use the work of the other auditor, he should issue a qualified opinion or a disclaimer of opinion.



If the other auditor has issued a modified report, the principal auditor should assess the necessity of modifying his report

## 1.9 Responsibility of work of another auditor

The principal auditor usually is not responsible in respect of the work entrusted to other auditors.

- The introductory and scope paragraph of audit report should clearly indicate this fact.
- He should clearly mention in his report the extent to which the financial information of the component (s) audited by other auditor (s) has been included in the financial information of the entity.

This may be mentioned in terms of proportion of assets, revenue or income audited, for example, In the opinion paragraph of a standard unqualified report of B Ltd. It may be stated....

"We did not audit the financial statements of X Co. Ltd., a wholly owned subsidiary of B Ltd. These statements reflect total assets and revenues constituting sixteen percent and eighteen per cent respectively of the related consolidated totals. Those statements were audited by other auditors whose report has been furnished to us and our opinion, so far as it relates to the amounts included for B. Ltd. Is based solely on the report of the other auditors."

### 1.10 Case Study

- **Case**

XYZ Company has appointed PWC as the statutory auditors for FY24. During the audit of Internal Financial controls over Financial Reporting (IFCoFR), PWC has become aware that Deloitte was appointed as the management representative auditors for checking and taking action for the IFC. PWC was given a report of Control matrix with deficiencies and gaps.

- **Analysis**

As a statutory auditor the extent of reliance on the work of another auditor should be decided in line with SA 600.

Once PWC has performed necessary audit procedures to check the competence of Deloitte and reliance procedures on the work done by them, it can use the report to the extent required. But this will not reduce the responsibility of PWC in any way.

Principal auditor will be responsible for his opinion on the entity as a whole and should indicate division of responsibility with the other auditor.

### 1.11 Questions

- 1) "There should be sufficient liaison between a principal auditor and other auditors". Discuss the above statement and state in this context the reporting considerations, when the auditor uses the work performed by another auditor.
- 2) Describe the relevance of SA 600 while auditing consolidation of Financial Statements.
- 3) B Ltd is the Subsidiary company of A Ltd. ABC & Associates has been appointed as auditor of A Ltd. for the Financial Year 2014-15 and XYZ & Associates has been appointed as auditor of B Ltd for the year 2014-15. Explain the role of ABC & Associates and XYZ & Associates as auditors of the parent company and subsidiary respectively.

## 2) SA 610 – Using the Work of Internal Auditor

### Contents

- Internal Audit and Internal Auditor
- Internal Auditor vs External Auditor
- Using Work of Internal Auditor

### 2.1 Introduction

Internal audit function is a function of an entity that performs assurance & consulting activities designed to evaluate and improve the effectiveness of the entity's governance, risk management and internal control processes.

Internal Audit is an independent management function of examination of

- financial,
- operational and
- administrative aspects

The objectives and scope of an internal audit function, the nature of its responsibilities and its organizational status, including the function's authority and accountability, vary widely and depend on the size and structure of the entity and the requirements of management and, where applicable, those charged with governance.

#### 2.1.1 Objectives of Internal Audit

The objectives and scope of internal audit functions typically include assurance and consulting activities designed to evaluate and improve the effectiveness of the entity's governance processes, risk management and internal control

- Monitoring and evaluation of Internal Controls
- Review financial and operational information
- Review the efficiency of operational activities
- Review compliance with laws and regulations
- Facilitates risk management – identification

Objectives of internal audit and external audit are different, though scope and procedures of work

and

mitigation of significant exposures to risk and improve risk management and internal control including effectiveness of financial reporting process

- Assess overall governance process with respect to accomplishment of objectives on ethics and values, accountability and communication risk to appropriate areas of the organisation



### 2.1.2 Statutory Requirement of Internal Auditor

As per Section 138 of Companies, Act, 2013 such class or classes of companies as may be prescribed shall be required to appoint an internal auditor.

As per Rule 13 of Companies (Accounts) Rules, 2014, following companies must appoint Internal Auditor:

- Every **listed company**;
- Every **unlisted public company** having-
  - paid up share capital of 50 crore rupees or more during the preceding financial year; or
  - turnover of 200 crore rupees or more during the preceding financial year; or
  - outstanding loans or borrowings from banks or public financial institutions exceeding 100 crore rupees or more at any point of time during the preceding financial year; or
  - outstanding deposits of 25 crore rupees or more at any point of time during the preceding financial year; and
- Every **private company** having-
  - turnover of 200 crore rupees or more during the preceding financial year; or
  - outstanding loans or borrowings from banks or public financial institutions exceeding 100 crore rupees or more at any point of time during the preceding financial year.

### 2.1.3 Qualification of Internal Auditor

As per Sec. 138 of Companies Act, 2013 read with Rule 13 of Companies (Accounts) rules, 2014, internal auditor shall either be

- a chartered accountant (whether in practice or not) or
- a cost accountant, or
- such other professional

Internal Auditor may or may not be an employee of the company.

as may be decided by the Board to conduct internal audit of the functions and activities of the company.



## 2.2 Internal Auditor vs External Auditor

Internal Auditor	External Auditor
Objective – Review of controls and systems to facilitate management in better governance	Objective – Review and give an opinion on financial statements.
Internal auditor is not independent from the entity	External auditor is independent authority, separate from the entity.
Role, scope and responsibility determined by management or TCWG	Role, scope and responsibility determined by the engagement terms.
Auditor to ensure audit is conducted as per SAs & other ethical requirements	Auditor to ensure audit is conducted as per SAs & other ethical requirements

External auditor has sole responsibility for expression of an opinion on the financial statements and such responsibility is not reduced by external auditor relying on the work of internal auditor.

## 2.3 SA 315 vs SA 610

### 2.3.1 SA 315

SA 315 establishes that

- the external auditor can understand the entity and its environment and identification and assessment of risks of material misstatement from the knowledge and experience of the internal audit function
- effective communication between the internal and external auditors also creates an environment in which the external auditor can be informed of significant matters that may affect the external auditor's work

### 2.3.2 SA 600

SA 600 determines the external auditor's responsibilities

- if external auditor decides to rely on internal auditor's work based on the preliminary understanding of the internal audit function obtained as a result of procedures performed under SA 315

- if external auditor uses internal auditors to provide direct assistance under the direction, supervision and review of the external auditor.

## 2.4 Scope of SA

### 2.4.1 External Auditor's Responsibilities

External auditor's responsibilities when he determines that Internal auditors work is relevant for the audit and decides to rely on the work of internal auditor.

### 2.4.2 Situations not addressed

- If the entity does not have an internal audit function.
- The responsibilities and activities of the Internal Audit function are not relevant to the audit;
- The external auditor does not expect to use the work of Internal Auditor

## 2.5 Objectives of the External Auditor

- To determine whether the work of the internal audit function or direct assistance from internal auditors can be used, and if so, in which areas and to what extent; and
- If using the work of the internal audit function, to determine whether that work is adequate for purposes of the audit; and
- If using internal auditors to provide direct assistance, to appropriately direct, supervise and review their work.

## 2.6 Using work of Internal Auditor

<b>SCENARIO 1:</b> <b>Blindly trust</b> the Internal Auditor's work Stat Auditor <b>cannot</b> do this	<b>SCENARIO 2:</b> <b>Don't</b> rely on the Internal Auditor's work Stat Auditor <b>need not</b> do this	<b>SCENARIO 3:</b> Trust after <b>checking</b> Internal Auditor's work
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### 2.6.1 Evaluation of Internal Audit Function

Auditor shall determine whether the work of the internal auditor is adequate for the purpose of the audit. While doing so he shall consider

- Objectivity of the internal audit function
- Technical competence of the internal auditors
- Whether internal auditor exercised due professional care

- Effective communication between Internal and external auditor exists

The external auditor shall not use the work of the internal audit function if:

- lack of objectivity of internal auditors;
- function lacks sufficient competence; or
- function does not apply a systematic and disciplined approach, including quality control.

### 2.6.2 Determination of the nature and extent of work of Internal Audit Function that can be used

The external auditor shall consider

- the nature and scope of the work that has been performed, or is planned to be performed, by the internal audit function and
- its relevance to the external auditor's overall audit strategy and audit plan.

External auditor shall plan to use less of the work of the function and perform more of the work directly where

- more judgment is involved in like planning, evaluating audit evidence;
- there is high risk of material misstatement at the assertion level, especially for significant risks
- low objective status of the internal auditors; and
- low level of competence of the internal audit function.

The external auditor shall communicate with TCWG how the external auditor has planned to use the work of the internal audit function.

### 2.6.3 Using Work of the Internal Auditor

If the auditor determines that the work of the auditor is adequate and it can be used, auditor shall determine the planned effect of internal auditor's work on the nature, timing and extent of audit procedures to be conducted by the auditor.

For determining such effect, auditor shall consider

- Nature and scope of specific work performed by internal auditor
- Relevance of internal audit function for the audit strategy and audit plan
- Assessed risk of material misstatement at assertion level for particular class of transactions, account balances and disclosures
- Level of competence
- Degree of subjectivity involved in evaluating audit evidence gathered by internal auditor

Auditor shall carry out the following audit steps:

- Discuss the planned use of the work
- Read internal audit function reports
- perform sufficient audit procedures on the body of work of the internal audit function as a whole to ensure
  - work has been properly planned, performed, supervised, reviewed and documented
  - sufficient audit evidence has been obtained
  - exceptional items disclosed by internal auditor are resolved
  - conclusions reached are appropriate
  - reports are consistent with results

#### 2.6.4 Using Internal auditors to provide Direct Assistance

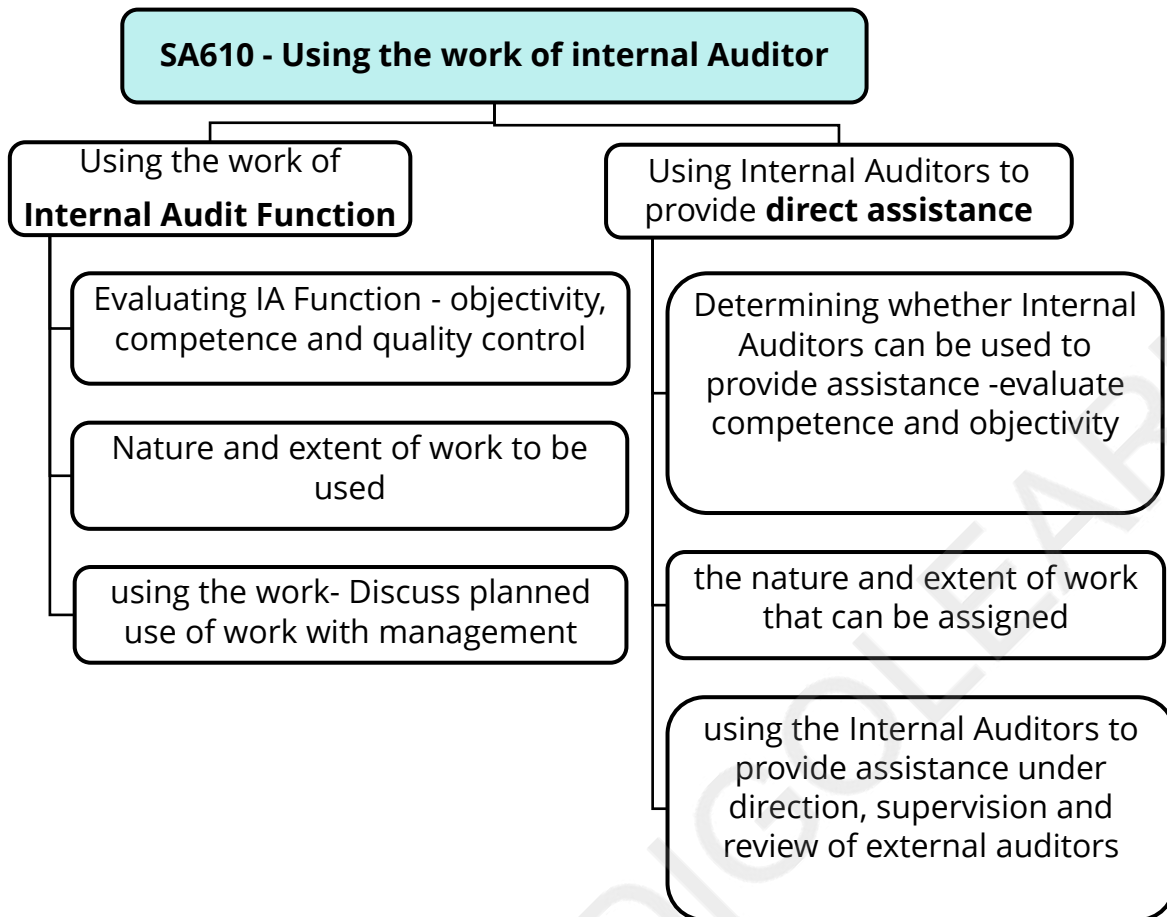
**Direct assistance** – The use of internal auditors to perform audit procedures under the direction, supervision and review of the external auditor.

The external auditor shall not use internal auditor for direct assistance if there are threats of objectivity or if the internal auditor lacks competence.

- the external auditor shall **evaluate**
  - the existence and significance of threats to objectivity and
  - the level of competence of the internal auditors who will be providing such assistance
- The external auditor **shall not use** internal auditors to provide direct assistance to perform procedures that:
  - Involve making significant judgments in the audit;
  - Relate to higher assessed risks of material misstatement where the judgment required is high
  - Relate to work with which the internal auditors have been involved and which has already been reported to management or TCWG by the internal audit function;
- Prior to using the direct assistance of internal audit function, the external auditor must obtain **written agreement** from
  - the entity stating that the internal auditor would be allowed to follow the instructions of external auditor.
  - The internal auditor regarding confidentiality & objectivity

The external auditor may be prohibited by law or regulation from obtaining direct assistance from internal auditors.

The external auditor shall direct, supervise and review the work performed by internal auditors on the engagement in accordance with SA 220.



## 2.7 Documentation

### 2.7.1 Use work of the Internal Auditor

When the external auditor uses work of the internal auditors, the external auditor shall document

- evaluation regarding objectivity of internal auditor, level of competence of the function and systematic and disciplined approach applied by the function
- nature and extent of the work used and the basis for that decision; and
- audit procedures performed by the external auditor to evaluate the adequacy of the work used.

### 2.7.2 Use internal auditor to provide Direct Assistance

When the external auditor uses work of the internal auditors as direct assistance, the external auditor shall document

- Nature & description of work assigned, basis for the decision regarding nature and extent of the work performed by internal auditor
- Associated risks and their mitigation
- conclusions regarding the evaluation of internal auditors for
  - adequacy of the work,
  - objectivity of the internal auditor
  - level of competence and
- Evidence collected by Internal Auditor
- the audit procedures (review) performed by the external auditor on that work
- written agreements
- working papers of the internal auditor
- Observations by the Internal Auditor and how they are dealt with

## 2.8 Factors to be considered by Auditor for evaluation

### 2.8.1 Objectivity

- The status of the internal audit function within the entity and the effect such status has on the ability of the internal auditors to be objective.
- Whether the internal audit function reports to those charged with governance or an officer with appropriate authority, and whether the
- internal auditors have direct access to those charged with governance.
- Whether the internal auditors are free of any conflicting responsibilities.
- Whether those charged with governance oversee employment decisions related to the internal audit function.
- Whether there are any constraints or restrictions placed on the internal audit function by management or those charged with governance.
- Whether, and to what extent, management acts on the recommendations of the internal audit function, and how such action is evidenced.

### 2.8.2 Technical Competence

- Whether the internal auditors are members of relevant professional bodies.
- Whether the internal auditors have adequate technical training and proficiency as internal auditors.
- Compliance with the mandatory/ recommendatory Standards on Internal Audit (SIAs) issued by Internal Audit Standards Board of the Institute of Chartered Accountants of India (ICAI).
- Whether there are established policies for hiring and training internal auditors.

### 2.8.3 Due Professional Care

- Whether activities of the internal audit function are properly planned, supervised, reviewed and documented.
- The existence and adequacy of audit manuals or other similar documents, work programs and internal audit documentation

### 2.8.4 Communication

- Meetings are held at appropriate intervals throughout the period;
- The external auditor is advised of and has access to relevant internal audit reports and is informed of any significant matters that come to the attention of the internal auditors when such matters may affect the work of the external auditor; and
- The external auditor informs the internal auditors of any significant matters that may affect the internal audit function

## 2.9 Matters to be agreed between Internal Auditor and External Auditor

- The timing of such work;
- The extent of audit coverage;
- Materiality for the financial statements as a whole (and, if applicable, materiality level or levels for particular classes of transactions, account balances or disclosures), and performance materiality;
- Proposed methods of item selection;
- Documentation of the work performed; and
- Review and reporting procedures

## 2.10 Questions

- 1) Explain the meaning, objectives and scope of internal audit functions as per SA 610. Also discuss who can be appointed as Internal Auditor? [RTP-May 19]
- 2) In the course of the statutory audit of Z Ltd, its statutory auditors, having determined that the work of internal auditor is likely to be adequate for the purpose of statutory audit, wanted to use the work of internal auditor in respect of physical verification of fixed assets. How an evaluation of this specific work done by the internal auditor can be done? (Nov-15)
- 3) CA. Amboj, a practicing-chartered accountant has been appointed as an internal auditor of Textile Ltd. He conducted the physical verification of the inventory at the year-end and handed over the report of such verification to CA. Kishor, the statutory auditor of the Company, for his view and reporting. Can CA. Kishor rely on such report?



### 3. SA 620 – Using the Work of an Auditor's Expert

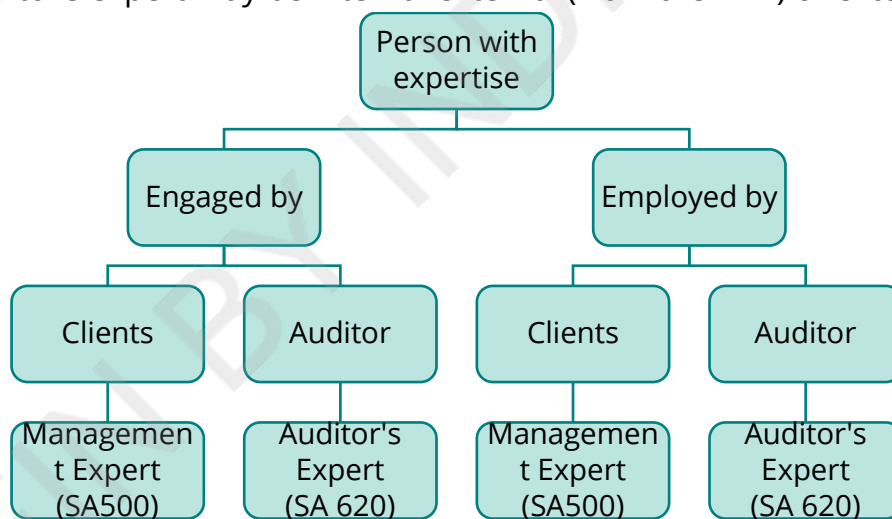
#### Contents

- Auditor's Expert

#### 3.1 Auditor's Expert

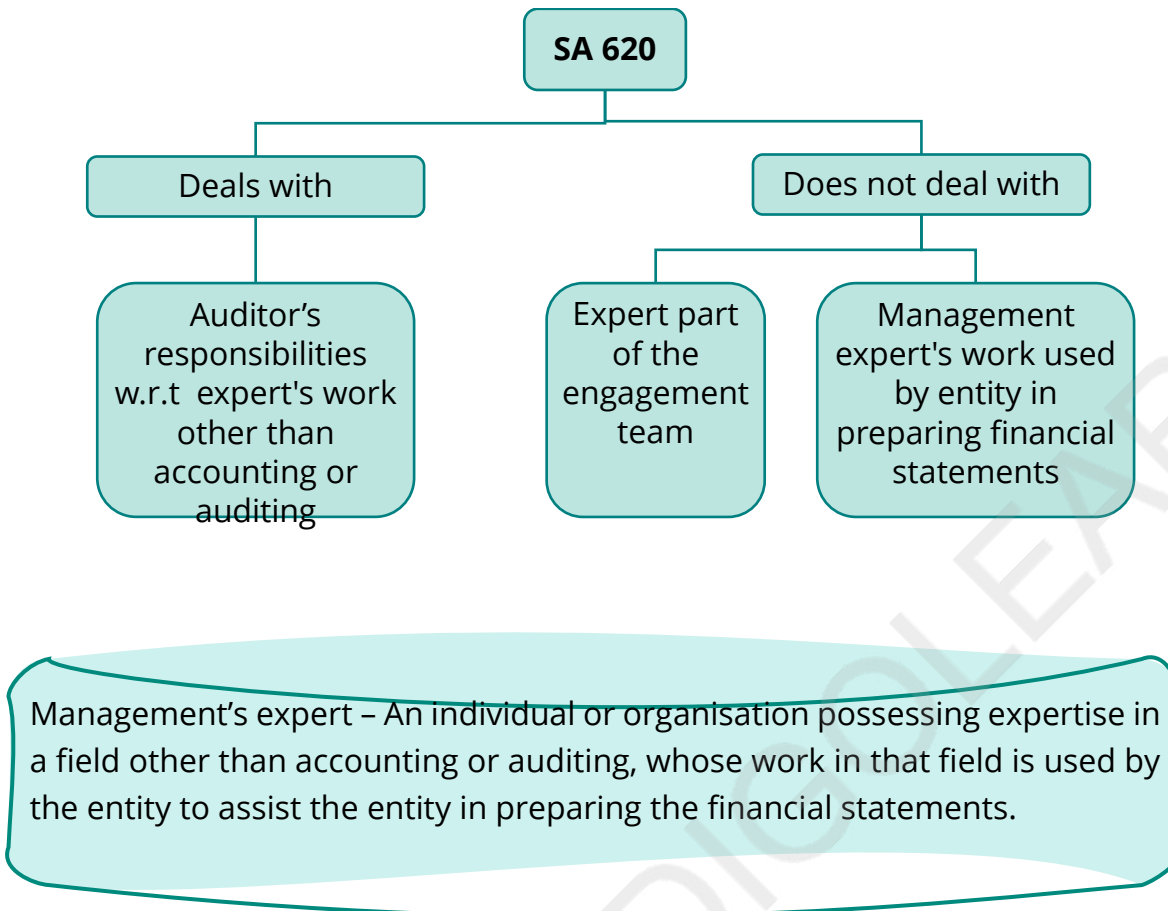
An individual or organisation possessing expertise in a field other than accounting or auditing, whose work in that field is used by the auditor to assist the auditor in obtaining sufficient appropriate audit evidence.

- Specialists or experts can be a person, firm or group of persons in a particular field. They can be engaged/ employed by the client or by the auditor.
- An auditor's expert may be internal external (from the firm) or external.



The auditor has sole responsibility for the audit opinion expressed, and that responsibility is not reduced by the auditor's use of the work of an auditor's expert. the auditor may accept that expert's findings or conclusions in the expert's field as appropriate audit evidence.

### 3.2 Scope of SA



### 3.3 Objectives of the Auditor

- To determine whether to use the work of an auditor's expert; and
- If using the work of an auditor's expert, to determine whether that work is adequate for the auditor's purposes.

### 3.4 Areas where Auditor's Expert is required

Although education and experience enable the auditor to be knowledgeable about business matters in general, the auditor is not expected to have detailed knowledge and experience of specialists in other disciplines.

Some of the areas for which the auditor may seek audit evidence from experts are-

- Valuation of assets such as land and building, precious stones, works of art and stock valuation (e.g. to identify obsolete inventory in case of valuation of a large inventory of microcomputers and computer parts by valuers, if no one in the audit firm is qualified to do so).
- Measurement of work done on long-term contracts.
- Legal interpretations of agreements, statute, etc.
- Legal opinions on the outcome of disputes and litigation.

- Actuarial advice in assessing cost of gratuity, pension plans, etc.

### 3.5 Using Work of an Expert

#### 3.5.1 Factors affecting the need to use the work of an Expert

- Materiality of, and likelihood of significant error in information being examined (example of microcomputers discussed above);
- Complexity of the information (e.g. valuation of work – in-progress in a case of long-term contracts); and
- Whether there are alternative sources of audit evidence (e.g. municipal authorities valued may have valued land for tax purposes. The need to get it valued by an approved valuer may not be there.)

#### 3.5.2 Qualities of Auditor's Expert

The auditor should consider the following qualities of the expert on whose work he is planning to rely on

- Skills and competence i.e. professional qualifications, experience and reputation of the expert;
- Objectivity i.e. unbiased and focused attitude.

In the case of an auditor's external expert, the evaluation of objectivity shall include inquiry regarding interests and relationships that may create a threat to that expert's objectivity.

#### 3.5.3 Understanding the field of expertise of Auditor's Expert

After considering qualities of the expert, the auditors should gain knowledge about following aspects to determine nature, scope, objective and adequacy of expert's work:

- Terms of expert's engagement;
- Objectives and scope and subject matter of his work;
- Clarification of the expert's relationship, if any, with the client;
- Degree of confidentiality of the expert's work to be maintained and confidentiality of the client's information.

#### 3.5.4 Written Agreement with the Auditor's Expert

- Nature, scope and objectives of that expert's work;
- Respective roles and responsibilities of the auditor and that expert;
- Communication between the auditor and that expert,
- Report to be issued; and
- Confidentiality requirements.

### 3.5.5 Evaluating the work of an Expert

The auditor should seek reasonable assurance that the expert's work constitutes appropriate audit evidence by considering the results of the work in the light both of overall knowledge of the business and of the results of audit procedures.

In particular, the auditor should consider the following:

- Appropriateness and accuracy of source data supplied by the management to the expert
  - In many cases, the client provides source data to the experts, for example, the management of insurance company would provide data on insurance policies in force to an actuary engaged to determine loss reserves and a financial institution might provide a real estate to collateralize a loan. Such an appraisal would ensure that collateralised value is not below loan amount. In order to do so, he should make enquiries of the expert about the source data and conduct audit procedures on the data.
- Relevance and reasonableness of expert's findings
- Conclusions arrived by expert and their consistency
- relevance and reasonableness of those assumptions and methods

### 3.5.6 Expert's Work not adequate

If the auditor determines that the work of the auditor's expert is not adequate for the auditor's purposes, the auditor shall:

- Agree with that expert on the nature and extent of further work to be performed by that expert; or
- Perform further audit procedures appropriate to the circumstances.

### 3.5.7 Conclusion

Normally, audit procedures mentioned above will provide reasonable assurance that the auditor has obtained appropriate audit evidence. Where the auditor has reservations regarding the evidence, discuss these with the client and specialist. In rare cases, he may seek a second opinion.

## 3.6 Reporting

In the following cases the auditor may need to express a qualified opinion, a disclaimer of opinion or an adverse opinion:

- the work of the expert is inconsistent with the information in financial statements; or
- the work of the expert does not constitute sufficient



The auditor shall not refer to the work of an auditor's expert in an auditor's report containing an unmodified opinion

If the auditor has expressed an opinion other than unqualified in his audit report, he may refer to or describe the work of the expert and may also disclose the identity of the expert, with his consent.

appropriate evidence.

### 3.7 Question

- 1) Write a brief note on auditor's responsibility when work of an expert is used with reference to SA 620.
- 2) Explain the responsibility of auditors, in case, report made by Mr. Y's actuary, later on, found faulty.

# STANDARDS ON AUDITING

## 700-799 Audit Conclusions and Reporting

### Contents

- SA 700 - Forming an Opinion and Reporting on Financial Statements
- SA 701 - Communicating Key Audit Matters in the Independent Auditor's Report
- SA 705 - Modifications to the Opinion in the Independent Auditor's Report
- SA 706 - Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report
- SA 710 - Comparative Information—Corresponding Figures and Comparative Financial Statements
- SA 720 - The Auditor's Responsibilities Relating to Other Information

# 1) SA 700 – Forming an Opinion and Reporting on Financial Statements

## Contents

- Scope of SA
- Financial Reporting Framework
- Opinion – Unmodified and Modified
- Consideration for forming an opinion
- Audit Report Elements

### 1.1 Introduction

An **Audit report** is an opinion drawn on the entity's financial statements to make sure that the records are true and fair representation of the transactions they claim to represent.

Management is responsible for preparation of Financial Statements. Auditor provides further confidence to intended users through Audit Report.

In order to form that opinion, the auditor shall conclude as to whether the auditor has **obtained reasonable assurance** about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error.

### 1.2 Scope of SA

- The auditor's responsibility to form an opinion on the financial statements to ensure financial statements reflect a true and fair representation
- The form and content of the auditor's report issued as a result of an audit of financial statements.

This SA applies to

- an audit of a complete set of general-purpose financial statements and is written in that context
- audits for which SA 800 or SA 805 apply.

General purpose financial statements – Financial statements prepared in accordance with a general-purpose framework.



This SA promotes consistency in the auditor's report, but recognizes the need for flexibility to accommodate particular circumstances of individual jurisdictions.

### 1.3 Objective of the Auditor

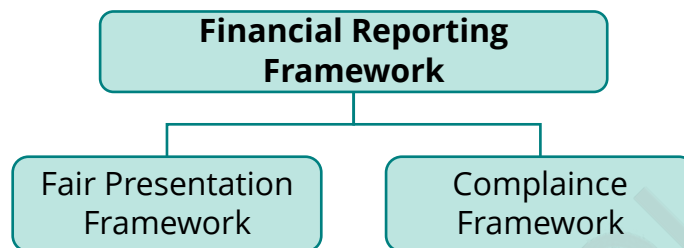
The objectives of the auditor are:

- To **form an opinion** on the financial statements based on an evaluation of the conclusions drawn from the audit evidence obtained; and
- To express clearly that opinion through a **written report**.



The auditor's report shall be in writing

### 1.4 Financial Reporting Framework



#### 1.4.1 Fair Presentation Framework

Fair presentation framework requires compliance with the requirements of the framework and to make financial statements not misleading, requiring management to

- provide additional disclosures or
- depart from any material requirement of the reporting framework (exceptional cases)

#### 1.4.2 Compliance Framework

Compliance framework refers to compliance of requirements to framework, without reference to additional disclosures and departures mentioned above.

### 1.5 Form an Opinion

Auditor's objective is to form an opinion on the financial statements after performing audit procedures. The auditor may express an unmodified opinion or a modified opinion

#### 1.5.1 Unmodified Opinion

**Unmodified opinion** – The opinion expressed by the auditor when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

Unmodified or unqualified opinion indicates that

- FS are prepared on generally accepted accounting principles and comply with relevant statutory requirements
- Adequate disclosures are made

### 1.5.2 Modified Opinion

Modified Opinion is given if the auditor

- concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement; or
- is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement, the auditor shall modify the opinion in the auditor's report in accordance with SA 705.

**Fair Presentation Framework** – If financial statements do not achieve fair presentation, auditor may, if necessary, give modified opinion after discussing with management

**Compliance Framework** – If financial statements are misleading, auditor shall determine how to communicate in the auditor's report after discussing with the management.

## 1.6 Considerations to form an opinion on Financial Statements

The auditor shall form an opinion on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

### 1.6.1 Preparation of Financial Statements

While ensuring that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework, auditor shall evaluate:

- Adequate disclosure of accounting policies, including notes to account are made
- Appropriateness of accounting policies
- Consistency in following accounting policies
- Reasonableness of accounting estimates made by management
- Information presented in the financial statements is relevant, reliable, comparable and understandable
- Effect of material transactions and events has been adequately disclosed
- Appropriate terminology is used
- Adequate reference to applicable financial reporting framework

When the financial statements are prepared in accordance with a fair presentation framework, evaluate whether the financial statements achieve fair presentation. procedures.

### 1.6.2 Reasonable Assurance

Obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement and in this regard shall consider:

- Whether sufficient appropriate evidence has been obtained.
- Whether uncorrected misstatements are material either individually or in aggregate.

## 1.7 Elements of Audit Report

The auditor's report includes the following basic elements:

### 1.7.1 Title

Audit Report should have a title clearly stating that it is a report of an independent auditor.

### 1.7.2 Addressee

Audit Report is normally addressed to those for whom Audit Report is prepared, i.e. shareholders or TCWG.

### 1.7.3 Opinion

This section states the auditor's opinion on true and fair view of financial statements. Opinion Section of the Auditor's Report shall also cover the following:

- Identify the entity whose FS have been audited.
- State that Financial Statements have been audited.
- Identify title of each statement that comprises F.S.
- Refer to the notes, including the summary of significant accounting policies; and
- Specify date of period covered by each Financial Statement.

### 1.7.4 Basis for Opinion

The auditor's report shall include a section, directly following the Opinion section, with the heading "Basis for Opinion", that:

- States that the audit was conducted in accordance with SA;
- Refers to the section of the auditor's report that describes the auditor's responsibilities under the SAs;
- Includes a statement that the auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit, and has fulfilled the auditor's other ethical responsibilities in accordance with these requirements. The statement shall refer to the Code of Ethics issued by ICAI
- States whether the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's opinion.

### 1.7.5 Going Concern

Where applicable, the auditor shall report in accordance with SA 570.

### 1.7.6 Key Audit Matters

The auditor shall communicate key audit matters in the auditor's report in accordance with SA 701

- for audits of complete sets of general-purpose financial statements of listed entities,
- for communications of key audit matters as per law or regulation

### 1.7.7 Other Information

Where applicable, auditor shall report in accordance with SA 720.

### 1.7.8 Responsibilities of Management for the Financial Statements

- Preparing the financial statements in accordance with applicable financial reporting framework.
- Such internal control as management determines necessary to enable the preparation of financial statements that are free from material misstatements and error.
- Assessing the ability of the entity to continue as a going concern.
- Whether the use of the going concern assumption is appropriate.



This section will also identify those responsible for governance i.e. Those Charged with Governance

For Fair presentation framework, the auditor's report with respect to management responsibilities shall refer to "the preparation and fair presentation of these financial statements" or "the preparation of financial statements that give a true and fair view,"

Auditor cannot conclude that management has provided with all relevant information agreed in the terms of the audit engagement agreement without confirming with management whether such information has been provided.



If those who signed engagement letter are no more in the entity, new people in management can give the representations with respect to going concern.

### 1.7.9 Auditor's Responsibility

It shall state the auditor's objectives to

- obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error; and
- Issue an auditor's report that includes the auditor's opinion.

This section also enumerates the auditor's responsibilities as prescribed under different Standards on Auditing.

The auditor shall also mention that assurance is a high level of assurance but is not a guarantee that an audit conducted in accordance with SAs will always detect a material misstatement when it exists.

- The auditor shall state that, as part of an audit in accordance with SAs, the auditor exercises professional judgment and maintains professional scepticism throughout the audit and
- Describe an audit by stating that the auditor's responsibilities are to

- Identify and assess risks of material misstatements
- Design and perform audit procedures responsive to such risks
- Obtain sufficient appropriate audit evidence
- Risk of not detecting material misstatement is higher for fraud than error
- Obtain understanding of internal control for designing audit procedures but not for forming opinion on their effectiveness
- Evaluate appropriateness of accounting policies and reasonableness of accounting estimates
- Conclude on appropriateness of management's use of going concern basis
- Evaluate overall presentation, structure and content of the financial statements for fair presentation framework
- The auditor shall describe the responsibilities in a group audit by stating the extent to which financial information of components have been audited by other auditors.
- The auditor shall also state the manner in which the auditor communicated with those charged with governance with respect to
  - Planned scope and timing of the audit
  - Significant audit findings
  - Significant deficiencies in internal controls.
- The matters communicated as Key Audit Matters are those matters which the auditor considers to be of most significance out of the matters which are communicated to those charged with governance.

### **Location of the Description of Auditor's Responsibilities**

The description of the auditor's responsibilities shall be included

- within the body of the auditor's report or
- within an appendix to the audit report (with reference to the same in the auditor's report) or
- on a website of an appropriate authority if law permits (with specific reference in the audit report).

### 1.7.10 Other Reporting Responsibilities

If the auditor addresses other reporting responsibilities in the auditor's report on the financial statements that are in addition to the auditor's responsibilities under the SAs, these other reporting responsibilities shall be addressed in a separate section in the auditor's report with a heading titled "Report on Other Legal and Regulatory Requirements"

### 1.7.11 Signature of the Auditor

Audit report to be signed in auditor's (engagement partner) personal name. Where firm appointed as auditor, report is signed in personal name of the auditor and in the name of audit firm.



The partner/proprietor signing the audit report also needs to mention the membership number assigned by

### 1.7.12 Place of Signature

It is ordinarily the city where audit report is signed i.e. the Corporate office of the entity.

### 1.7.13 Date of Auditor's Report

It should not be earlier than the date on which auditor has obtained sufficient appropriate audit evidence (on which auditor's opinion is based) that:

- financial statements, including the related notes, have been prepared; and
- those with authority have acknowledged that they have taken responsibility for those financial statements.

## 1.8 Audit Reports prescribed by Law

If the auditor is required by law or regulation to use a specific layout, or wording of the auditor's report, the auditor's report shall refer to Standards on Auditing only if the auditor's report includes, at a minimum, each of the following elements:

- Title
- Addressee
- Opinion
- Identification of entity's financial statements
- Statement on auditor's independence
- Going Concern issue, where applicable (SA 570)
- Key Audit Matters (SA 701)
- Auditor's Responsibilities (SA 720)
- Responsibilities of Management for preparation of Financial Statements (SA 700)
- Reference to SAs
- Auditor's Responsibilities
- Auditor's Signature
- Place & Date of Audit Report

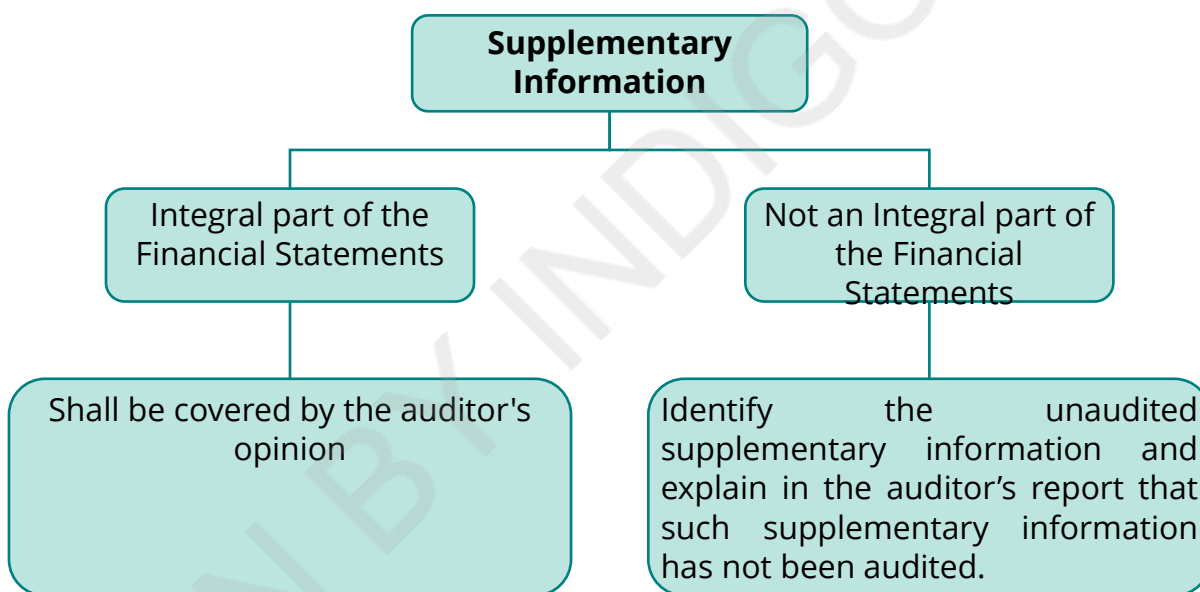
## 1.9 Audit Report for audits conducted in accordance with SAs issued by ICAI and International SAs

The auditor's report may refer to SAs in addition to the International SAs or auditing standards of such other jurisdiction only if:

- No conflict between SAs and ISAs leading to formation of different opinions or including Emphasis or Other Matters paragraph
- The auditor's report includes the minimum elements in the report.

When the auditor's report refers to both the ISAs and SAs issued by ICAI, the auditor's report shall clearly identify the same including the jurisdiction of origin of the other auditing standards.

### 1.10 Supplementary information presented with the Financial Information





## 1.11 Format of an Audit Report

*To the Members of ABC Company Limited*

### **Report on the Audit of the Standalone Financial Statements**

#### **Opinion**

*We have audited the standalone financial statements of ABC Company Limited ("the Company"), which comprise the balance sheet as at 31st March 20XX, and the statement of Profit and Loss, (statement of changes in equity)<sup>2</sup> and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies and other explanatory information [in which are included the Returns for the year ended on that date audited by the branch auditors of the Company's branches located at (location of branches)].*

*In our opinion and to the best of our information and according to the explanations given to us, the aforesaid standalone financial statements give the information required by the Act in the manner so required and give a true and fair view in*

*conformity with the accounting principles generally accepted in India, of the state of affairs of the Company as at March 31, 20XX, and profit/loss, (changes in equity)<sup>4</sup> and its cash flows for the year ended on that date.*

#### **Basis for Opinion**

*We conducted our audit in accordance with the Standards on Auditing (SAs) specified under section 143(10) of the Companies Act, 2013. Our responsibilities under those Standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the Company in accordance with the Code of Ethics issued by the Institute of Chartered*

*Accountants of India together with the ethical requirements that are relevant to our audit of the financial statements under the provisions of the Companies Act, 2013 and the Rules thereunder, and we have fulfilled our other ethical responsibilities in*

*accordance with these requirements and the Code of Ethics. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.*

### **Key Audit Matters**

*Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.*

*[Description of each key audit matter in accordance with SA 701.]*

### **Management's Responsibility for the Standalone Financial Statements**

*The Company's Board of Directors is responsible for the matters stated in section 134(5) of the Companies Act, 2013 ("the Act")<sup>4</sup> with respect to the preparation of these standalone financial statements that give a true and fair view of the financial position, financial performance, (changes in equity)<sup>5</sup> and cash flows of the Company in accordance with<sup>6</sup> the accounting principles generally accepted in India, including the accounting Standards specified under section 133 of the Act. This responsibility also includes maintenance of adequate accounting records in accordance with the provisions of the Act for safeguarding of the assets of the Company and for preventing and detecting frauds and other irregularities; selection and application of appropriate implementation and maintenance of accounting policies; making judgments and estimates that are reasonable and prudent; and design, implementation and maintenance of adequate internal financial controls, that were operating effectively for ensuring the accuracy and completeness of the accounting records, relevant to the preparation and presentation of the financial statement that give a true and fair view and are free from material misstatement, whether due to fraud or error.*

*In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.*

*Those Board of Directors are also responsible for overseeing the Company's financial reporting process.*

### **Auditor's Responsibilities for the Audit of the Financial Statements**

*Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with SAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.*

#### **Other Matter**

*We did not audit the financial statements/ information of \_\_ (number) branches included in the stand alone financial statements of the Company whose financial statements/financial information reflect total assets of Rs \_\_\_\_ as at 31st March 20XX and the total revenue of \_\_\_\_ for the year ended on that date, as considered in the standalone financial statements/information of these branches have been audited by the branch auditors whose reports have been furnished to us, and our opinion in so far as it relates to the amounts and disclosures included in respect of branches, is based solely on the report of such branch auditors.*

*Our opinion is not modified in respect of these matters.*

### **Report on Other Legal and Regulatory Requirements**

As required by the Companies (Auditor's Report) Order, 2016 ("the Order"), issued by the Central Government of India in terms of sub-section (11) of section 143 of the Companies Act, 2013, we give in the Annexure a statement on the matters specified in paragraphs 3 and 4 of the Order, to the extent applicable.

As required by Section 143(3) of the Act, we report that:

- (a) We have sought and obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purposes of our audit.
- (b) In our opinion, proper books of account as required by law have been kept by the Company so far as it appears from our examination of those books [and proper returns adequate for the purposes of our audit have been received from the branches not visited by us]
- (c) [The reports on the accounts of the branch offices of the Company audited under Section 143(8) of the Act by branch auditors have been sent to us and have been properly dealt with by us in preparing this report.]
- (d) The Balance Sheet, the Statement of Profit and Loss, and the Cash Flow Statement dealt with by this Report are in agreement with the books of account [and with the returns received from the branches not visited by us].
- (e) In our opinion, the aforesaid standalone financial statements comply with the Accounting Standards specified under Section 133 of the Act, read with Rule 7 of the Companies (Accounts) Rules, 2014.
- (f) On the basis of the written representations received from the directors as on 31st March, 20XX taken on record by the Board of Directors, none of the directors is disqualified as on 31st March, 20XX from being appointed as a director in terms of Section 164 (2) of the Act.
- (g) With respect to the adequacy of the internal financial controls over financial reporting of the Company and the operating effectiveness of such controls, refer to our separate Report in "Annexure A".

(h) With respect to the other matters to be included in the Auditor's Report in accordance with Rule 11 of the Companies (Audit and Auditors) Rules, 2014, in our opinion and to the best of our information and according to the explanations given to us:

(i) The Company has disclosed the impact of pending litigations on its financial position in its financial statements – Refer Note XX to the financial statements; [or the Company does not have any pending litigations which would impact its financial position]

(ii) The Company has made provision, as required under the applicable law or accounting standards, for material foreseeable losses, if any, on long- term contracts including derivative contracts – Refer Note XX to the financial statements; [or the Company did not have any long-term contracts including derivative contracts for which there were any material foreseeable losses.]

(iii) There has been no delay in transferring amounts, required to be transferred, to the Investor Education and Protection Fund by the Company {or, following are the instances of delay in transferring amounts, required to be transferred, to the Investor Education and Protection Fund by the Company or there were no amounts which were required to be transferred to the Investor Education and Protection Fund by the Company.

For XYZ & Co

Chartered Accountants (Firm's Registration No.)

Signature

(Name of the Member Signing the Audit Report)

(Designation)

(Membership No. XXXXX)

Place of Signature:

Date:

## 1.12 Questions

1) State correct or not

- Where the firm of appointed as an auditor of the entity the audit report is signed only in the name of audit firm. [May 19 (2 Marks)]
  - Any partner of an LLP, who is appointed as an auditor of a company, can sign the audit report. [Nov. 18 (2 Marks)]
- 2) In order to form the audit opinion as required by SA 700, the auditor shall conclude as to whether the auditor has obtained reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. Explain the conclusions that the auditor shall take into account. Also explain the objective of auditor as per SA 700. [MTP-Aug. 18]
  - 3) "An auditor is required to make specific evaluations while forming an opinion in an audit report." State them. [Nov. 18 (5 Marks)]
  - 4) The auditor's report shall include a section with a heading "Responsibilities of Management for the Financial Statements." SA 200 explains the premise, relating to the responsibilities of management and, where appropriate, those charged with governance, on which an audit in accordance with SAs is conducted. Explain. [RTP-Nov. 18, MTP-April 19]
  - 5) When does an auditor issue unqualified opinion and what does it indicate? [May 08 (4 Marks)]
  - 6) The Auditor is fully satisfied with the audit of an entity in respect of its systems and procedures and wants to issue a report without any hesitation. What type of opinion can be given and give reasoning? [MTP-April 19]
  - 7) State any six elements of the Auditor's Report. [Nov. 12 (6 Marks)]
  - 8) The auditor's report shall include a section, directly following the Opinion section, with the heading "Basis for Opinion". Explain what is included in this "Basis for Opinion" section. [RTP-Nov. 19]
  - 9) The first section of the auditor's report shall include the auditor's opinion, and shall have the heading "Opinion." The Opinion section of the auditor's report shall also Identify the entity whose financial statements have been audited. Apart from the above, explain the other relevant points to be included in opinion section. [RTP-May 20]

## 2) SA 701 – Communicating Key Audit Matters in the Independent Auditor's Report

### Contents

- Scope of SA
- Key Audit Matters
- Communication of KAM
- Reporting KAM
- Documentation

### 2.1 Introduction

This SA deals with the auditor's responsibility to communicate key audit matters in the auditor's report.

- It is intended to address both the auditor's judgment as to what to communicate in the auditor's report and the form and content of such communication.
- Communicating key audit matters provides additional information to intended users of the financial statements ("intended users") to assist them in understanding those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period.

#### 2.1.1 Objectives of Auditor under this SA

The objectives of the auditor are to determine key audit matters and, having formed an opinion on the financial statements, communicate those matters by describing them in the auditor's report.

#### 2.1.2 Applicability of SA

- This SA applies to audits of complete sets of general-purpose financial statements of listed entities and circumstances when the auditor otherwise decides to communicate KAM in the auditor's report.
- This SA also applies when the auditor is required by law or regulation to communicate KAM in the auditor's report.

SA 705 (Revised) prohibits the auditor from communicating KAM when the auditor disclaims an opinion on the financial statements, unless such reporting is required by law or regulation



## 2.2 Key Audit Matters (KAM)

**Key Audit Matters** - Those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance.

### 2.2.1 Determination of KAM

The auditor shall determine, from the matters communicated with TCWG, those matters that required significant auditor attention in performing the audit. In making this determination, the auditor shall consider the following:

- Areas of higher assessed RMM, or significant risks identified as per SA 315;
- Significant auditor judgments that involved significant management judgment, including accounting estimates that have been identified as having high estimation uncertainty.
- The effect on the audit of significant events or transactions that occurred during the period.

The auditor shall determine which of the matters so determined above were of most significance in the audit of the F.S. of the current period and therefore are the key audit matters.

## 2.3 Communication of Key Audit Matter

### 2.3.1 Audit Report

- Communicating KAM in the auditor's report is in the context of the auditor having formed an opinion on the financial statements as a whole (of the current period).



Key Audit Matters cannot be a substitute for expressing a Modified Opinion

### 2.3.2 Not a Substitute

- Communicating KAM in the auditor's report is not
  - A substitute for disclosures in the financial statements that the applicable financial reporting framework requires management to make, or that are otherwise necessary to achieve fair presentation;
  - A substitute for the auditor expressing a modified opinion when required by the circumstances of a specific audit engagement in accordance with SA 705 (Revised);
  - A substitute for reporting in accordance with SA 570 (Revised) when a material uncertainty exists relating to events or conditions that may cast significant doubt on an entity's ability to continue as a going concern; or



Modified opinion para comes before this para in audit report.

- A separate opinion on individual matters.

### 2.3.3 Individual Description & Reference to Related Disclosures

The auditor shall describe each key audit matter, using an appropriate subheading, in a

The description of each key audit matter in the KAM section of the auditor's report shall include a **reference to the related disclosure(s)**, if any, in the financial statements and shall address:

- Why the matter was considered to be one of most significance in the audit and therefore determined to be a key audit matter; and
- How the matter was addressed in the audit

separate section of the auditor's report under the heading "Key Audit Matters,"

### 2.3.4 Circumstances where KAM is not communicated

The auditor shall not describe a key audit matter in the auditor's report if:

- Law or regulation prevents public disclosure about the matter; or
- In extremely rare circumstances, the auditor determines that the matter should not be communicated in the auditor's report because its benefits are lesser than the possible damages. This shall not apply if the entity has publicly disclosed information about the matter. [auditors generally don't apply this]

## 2.4 Significant matters not reported under "Key Audit Matters" but as Other Elements in the Audit Report

A matter giving rise to a

- modified opinion in accordance with SA 705 (Revised), or
- matters raising going concern questions SA 570 (Revised), are by their nature key audit matters.

Are significant matters and can come under the description of KAM, however these matters shall not be described in the Key Audit Matters section of the auditor's report. Rather, the auditor shall:

- Report on these matter(s) in accordance with the applicable SA(s); and
- Include a reference to the Basis for Qualified (Adverse) Opinion or the Material Uncertainty Related to Going Concern section(s) in the Key Audit Matters section.

## 2.5 No Key Audit Matters to report

If the auditor determines, depending on

- the facts and circumstances of the entity and
- the audit,

that there are no key audit matters to communicate, the auditor shall include a statement to this effect in a separate section of the auditor's report under the heading "Key Audit Matters."



When there are no KAM to report, auditor shall state the fact in the report

In case of Disclaimer of Opinion, there wouldn't be any Key Audit Matters to report

## 2.6 Communication with Those Charged With Governance

The auditor shall communicate with those charged with governance:

- Those matters the auditor has determined to be the key audit matters; or
- The fact that there is no key audit matter to communicate in the auditor's report

## 2.7 Documentation

The auditor shall include in the audit documentation

- The matters that required significant auditor attention and whether it was considered as a key audit matter or not
- Reason for not considering KAM
- Reasons why matters were considered key audit matters and
  - why they were reported OR
  - not reported in the audit report

## 2.8 Questions

Communicating Key Audit Matter is not a substitute for disclosure in the Financial Statements rather Communicating key audit matters in the auditor's report is in the context of the Auditor having formed an opinion on the financial statements as a whole. Analyse. [RTP-May 18]

Explain clearly the purpose of communicating key audit matters. [RTP-Nov. 18]

Mr. A was appointed as statutory auditor of X Ltd. While doing audit, Mr. A is required to determine the key audit matters which are required to be mentioned in the audit report. You are required to advise Mr. A about the considerations which Mr. A shall take into account while determining key audit matters.

## 3. SA 705 – Modifications to the Opinion in the Independent's Auditor's Report

### Contents

- Modified Opinion
- Types – Qualified, Adverse, Disclaimer
- When to issue modified opinion

### 3.1 Scope

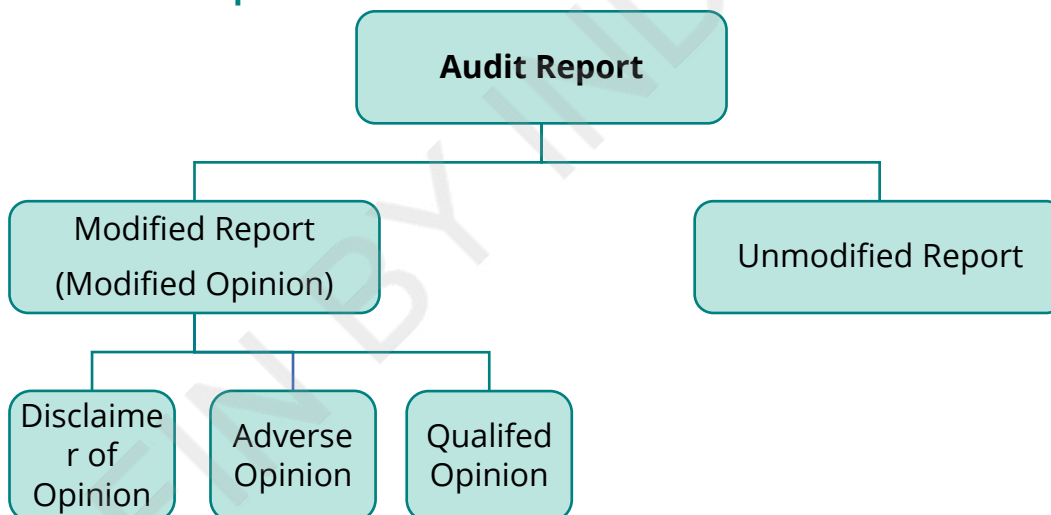
Auditor needs to follow this SA if a modification is required to the opinion. This SA also specifies the form and content

#### 3.1.1 Objectives of the Auditor

Express clearly a modified opinion when

- Financial statements are not free of material misstatement
- Auditor unable to obtain sufficient appropriate audit evidence to conclude financial statements are free from material misstatements

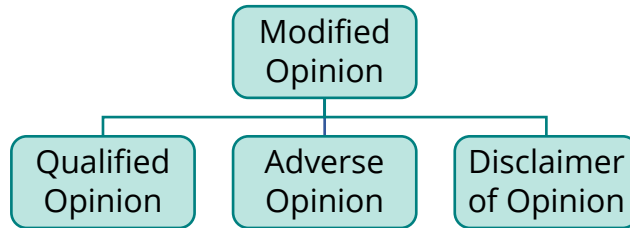
### 3.2 Audit Report



### 3.3 Modified opinion

A qualified opinion, an adverse opinion or a disclaimer of opinion on the financial statements is a Modified Opinion

#### 3.3.1 Types of Modified Opinion



Any opinion other than clean opinion is called modified – It could be Emphasis of matter as discussed in SA 706 or it could be Qualified, Adverse and Disclaimer as discussed in SA 705

#### 3.3.2 Factors affecting the opinion

The decision regarding which type of modified opinion is appropriate depends upon:

- The nature of the matter giving rise to the modification i.e.
  - the financial statements are materially misstated or,
  - no sufficient appropriate audit evidence leading to materially misstated financial statements
- The auditor's judgment about the pervasiveness of the effects or possible effects of the matter on the financial statements

#### 3.3.3 When to modify the opinion

- Auditor concludes that financial statements are not free of material misstatement
- Auditor unable to obtain sufficient appropriate audit evidence to conclude financial statements are free from material misstatements

### 3.4 Persuasive

A term used, in the context of misstatements, to describe the effects or the possible effects of misstatements (if any) on the financial statements as a whole that are undetected due to an inability to obtain sufficient appropriate audit evidence.

Persuasive effects are those that are:

- not confined to specific elements, accounts or items of the financial statements
- If so confined, represent or could represent a substantial proportion of the financial statements
- In relation to disclosures, such disclosures are fundamental to users' understanding of the financial statements

### 3.5 Modification in the Audit Report

Auditor determines the appropriate opinion depending on how material or pervasive the issues identified during the audit are to the reader's understanding of the financial statements

Nature of Matter Giving Rise to the Modification	Auditor's Judgment about the Pervasiveness of the effects or possible effects on the Financial Statements	
	Material but Not Pervasive	Material and Pervasive
Financial statements are materially misstated	Qualified opinion	Adverse opinion
Inability to obtain sufficient appropriate audit evidence	Qualified opinion	Disclaimer of opinion

### 3.6 Qualified Opinion

The auditor shall express a qualified opinion when:

a. The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements are material, individually or in the aggregate, but not pervasive, to the financial statements; or

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

Reasons for qualification to be mentioned in the

#### 3.6.1 When to Give a Qualified Opinion

- Limitation of Scope
  - Disagreement with management
    - Accounting policies or its application
    - Disclosure
    - Statutory Compliance
  - Significant uncertainty (Other than going concern)
    - If Material – Qualified report
    - If not material – Emphasis of matter para
  - Unable to obtain all information and explanations
  - Proper books not kept in accordance with law
- 
- Balance Sheet and profit and Loss statement not in agreement with Books of account
  - Information required by law not disclosed
  - Accounts do not give true and fair view

### 3.6.2 Quantification of Impact

- Quantify the impact that qualification would have on the Financial statements.
- If accurate quantification is not possible, the basis and management assumptions that went into quantification need to be indicated.



This information would be presented in Para preceding Qualification Opinion para.

## 3.7 Adverse Opinion

### 3.8

The auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements

#### 3.8.1 When to give an Adverse Opinions

- Scope of audit is restricted,
- The auditor may not have access to the books of accounts, e.g.: -
  - books of A/c's of the company seized by IT authorities,
  - Sometimes inventory verifications at locations outside the city bound the scope of duties of the auditor.



### 3.9 Disclaimer of Opinion

The auditor shall disclaim an opinion when

- the auditor is unable to obtain sufficient appropriate audit evidence and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could **be both material and pervasive**.
- If in case of **multiple uncertainties**, though sufficient appropriate audit evidence is obtained for each uncertainty individually, it is **not possible to form an opinion** on the financial statements due to the potential interaction of the uncertainties and their possible cumulative effect on the financial statements



In case of Disclaimer of Opinion, there wouldn't be any Key Audit Matters paragraph in the audit report

When the auditor disclaims an opinion due to an inability to obtain sufficient appropriate audit evidence, the auditor shall amend the introductory paragraph of the auditor's report.

The auditor shall also amend the description of the auditor's responsibility and the description of the scope of the audit to state only the following:

*"Our responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with Standards on Auditing issued by the Institute of Chartered Accountants of India. Because of the matter(s) described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion".*

### 3.10 Reasons for Misstatement

- The appropriateness of the selected accounting policies
- The application of the selected accounting policies
- The appropriateness or adequacy of disclosures in the financial statements.

### 3.11 Reasons for Inability to obtain sufficient and appropriate audit evidence

- Circumstances beyond the control of the entity
- Circumstances relating to the nature or timing of the auditor's work
- Limitations imposed by management
  - Auditor may resign from the audit in such case OR
  - Issue a Disclaimer of opinion explaining scope limitation
  - Communicate matters relating to resignation to regulatory authorities and members / owners, if required by laws governing the enterprise

### 3.12 Form and Content of the Auditor's Report for a Modified Opinion

- Include additional paragraph indicating basis / reason for modification to the report format discussed in SA 700
- Such para shall be placed just before opinion paragraph with an appropriate heading "Basis for Qualified Opinion", "Basis for Adverse Opinion", or "Basis for Disclaimer of Opinion"



For Opinion paragraph, indicate heading appropriately "Qualified Opinion", "Adverse Opinion", or "Disclaimer of

Quantify and indicate the impact of such modification on the financial statements. If it is impracticable to quantify the impact of modification, indicate the fact that the same couldn't be quantified.

- In short, Even if the auditor has expressed an adverse opinion or disclaimed an opinion on the financial statements, the auditor shall describe in the basis for modification paragraph the reasons for any other matters of which the auditor is aware that would have required a modification to the opinion, and the effects thereof

### 3.13 Communication with Those Charged with Governance

When the auditor expects to modify the opinion in the auditor's report, the auditor shall communicate with those charged with governance the circumstances that led to the expected modification and the proposed wording of the modification.

### 3.14 Questions

- 1) What is a qualified auditor report? Under what circumstances a qualified report is issued. [May 07 (8 Marks)]
- 2) What is clean audit report. Explain how it is different from qualified report affecting

Auditor's opinion. [Nov. 07 (8 Marks)]

- 3) State briefly the circumstances when an auditor issues a disclaimer of opinion. [Nov. 10 (4 Marks)]
- 4) Differentiate between 'Qualified Report' and 'Adverse Report'. [May 10 (5 Marks)]
- 5) State the circumstances which could lead to any of the following in an Auditor's Report:
  - (i) A modification of opinion
  - (ii) Disclaimer of opinion
  - (iii) Adverse opinion
  - (iv) Qualified opinion [May 13 (8 Marks)]
- 6) Discuss the following: The Auditor's Report is considered to be modified under certain circumstances. [May 15 (5 Marks)]
- 7) Write short note on: Qualified Opinion. [Nov. 15 (4 Marks)]

## 4) SA 706 - Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report

### Contents

- Emphasis of Matter
- Other Matters
- Emphasis of Matter vs Key Audit Matters

#### 4.1 Format for the paragraphs – Objective of the Auditor

Draw user's attention to

- matters presented or disclosed in the financial statements that are fundamental to users' understanding of the financial statements; or
- matters not presented or disclosed in the financial statements but are relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.

#### 4.2 Emphasis of Matter

A paragraph included in the auditor's report that refers to a matter appropriately **presented or disclosed** in the financial statements that, in the auditor's judgment, is of such importance that it is **fundamental to users' understanding** of the financial statements.

### 4.2.1 Factors affecting

The auditor shall include Emphasis of Matter only if

- It does not result in modified opinion
- It is not key audit matter

### 4.2.2 Reporting Aspects

- Include it immediately after opinion para of audit report
- Contain a heading “Emphasis of matter”
- Indicate clear reference to the disclosures of financial statements
- Indicate that the auditor’s opinion is not modified in respect to matter emphasized

### 4.2.3 Circumstances for Emphasis of Matter

- An uncertainty relating to the future outcome of an exceptional litigation or regulatory action.
- Early application (where permitted) of a new accounting standard that has a pervasive effect on the financial statements in advance of its effective date.
- A major catastrophe that has had, or continues to have, a significant effect on the entity’s financial position.



Inclusion of an Emphasis of Matter paragraph in the auditor’s report does not affect the auditor’s opinion.

## 4.3 Other Matters

A paragraph included in the auditor’s report that refers to a matter **other than those presented or disclosed** in the financial statements that, in the auditor’s judgment, is **relevant to users’ understanding** of the audit, the auditor’s responsibilities or the auditor’s report.

Include it immediately after opinion para of audit report or any Emphasis of matter

### 4.3.1 Factors affecting

The auditor shall include Emphasis of Matter only if

- It is not prohibited by law or regulation
- It is not key audit matter

## 4.4 Communicate with Those Charged with Governance

If the auditor expects to include an Emphasis of Matter or an Other Matter paragraph in the auditor’s report, the auditor shall communicate with those charged with governance regarding this expectation and the wording of this paragraph.

## 4.5 Emphasis of Matters (EM) vs Key Audit Matters (KAM)

The use of Emphasis of Matter paragraphs is not a substitute for a description of individual key audit matters.

There may be a matter that is not determined to be a key audit matter in accordance with SA 701 (i.e., because it did not require significant auditor attention), but which, in the auditor's judgment, is fundamental to users' understanding of the financial statements (e.g., a subsequent event).

If the auditor considers it necessary to draw users' attention to such a matter, the matter is included in an Emphasis of Matter paragraph in the auditor's report in accordance with this SA.

## 4.6 Requirement under SAs

### 4.6.1 Emphasis of Matters

- SA 210, Agreeing the Terms of Audit Engagements
- SA 560, Subsequent Events
- SA 800, Special Considerations—Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks

### 4.6.2 Other Matters

- SA 560, Subsequent Events
- SA 710, Comparative Information—Corresponding Figures and Comparative Financial Statements

## 4.7 Format

### 4.7.1 Emphasis of Matter

*We draw attention to Note X to the financial statements, which describe the uncertainty<sup>6</sup> related to the outcome of the lawsuit filed against the Company by XYZ Company. Our opinion is not qualified in respect of this matter.*

### 4.7.2 Other Matters

*We did not audit the financial statements of certain subsidiaries; whose financial statements reflect total assets (net) of Rs. XXXX as at March 31, 20XX, total revenues of Rs. XXXX and net cash outflows amounting to Rs. XXXX for the year then ended. These financial statements have been audited by other auditors whose reports have been furnished to us by the Management, and our opinion is based solely on the reports of the other auditors. Our opinion is not qualified in respect of this matter*

### 4.8 Questions

- 1) What is Emphasis of matter Paragraph? State the circumstances when EOM para can be included in Auditor's report
- 2) What is Modified Reports? Discuss disclosure pattern when the auditor includes an Emphasis of Matter Paragraph in the Auditor's Report. [May 14 (5 Marks)]
- 3) What is an Emphasis of Matter paragraph, when it is used and manner of its use in an audit report? [May 17 (4 Marks)]
- 4) Define emphasis of matter paragraph and how it should be disclosed in the independent auditor's report? [May 18 (5 Marks)]
- 5) Define Emphasis of Matter paragraph. When the auditor shall include an Emphasis of Matter paragraph in the auditor's report? Also explain how the auditor would include an Emphasis of Matter in the auditor's report? [RTP-May 19]

## 5) SA 710 - Comparative Information—Corresponding Figures and Comparative Financial Statements

### Contents

- Comparative Information
- Corresponding Figures
- Comparative Financial Statements
- Audit Procedures

### 5.1 Comparative Information

The amounts and disclosures included in the financial statements in respect of one or more prior periods in accordance with the applicable financial reporting framework.

#### 5.1.1 Corresponding figures

Comparative information where amounts and other disclosures for the prior period are included as an **integral part of the current period financial statements**, and are intended to be read only in relation to the amounts and other disclosures relating to the current period (referred to as “current period figures”).

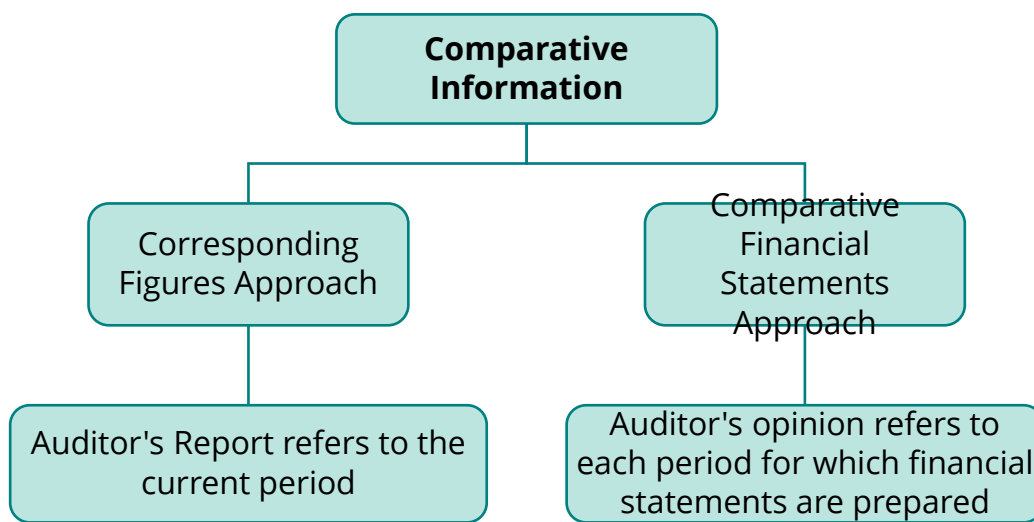
The level of detail presented in the corresponding amounts and disclosures is dictated primarily by its relevance to the current period figures

#### 5.1.2 Comparative Financial Statements

Comparative information where amounts and other disclosures for the prior period are included for comparison with the financial statements of the current period but, if audited, are referred to in the auditor’s opinion.

The level of information included in those comparative financial statements is comparable with that of the financial statements of the current period.





The approach to be adopted is often specified by law or regulation but may also be specified in the terms of engagement.

## 5.2 Objective of Auditor

- Obtain evidence to ensure comparative information presented as per applicable financial reporting framework
- Report in accordance with the auditor's reporting responsibilities

## 5.3 Audit Procedures

- Check whether comparative information agreed with the amounts and disclosures presented in the prior period
- Whether accounting policies are followed consistently and if there is a change, whether they have been disclosed by management as per AS 5
- If the auditor of current year becomes aware of any possible misstatement in the comparative information, he shall increase the extent of procedures or perform such additional audit procedures as are necessary in the circumstances to obtain sufficient appropriate audit evidence to determine whether a material misstatement exists.
- Also, obtain written representation from management that all comparative information is presented appropriately by them.



If the auditor of current year becomes aware of any possible misstatement in the comparative information, he shall increase the extent of procedures

## 5.4 Corresponding Figures

Auditor's report doesn't not refer to corresponding figures generally. Auditor only has to check whether previous year's financial statements have been recorded in the corresponding column of the current year's financial statements correctly.

But if the opinion on previous period is modified, then auditor has to additional procedures.

- **Modified Opinion**

If the auditor's report on the prior period, as previously issued, included a qualified opinion, a disclaimer of opinion, or an adverse opinion and the **matter which gave rise to the modification is unresolved**, the auditor shall modify the auditor's opinion on the current period's financial statements.

- **Basis for Modification paragraph**

In the Basis for Modification paragraph in the auditor's report, the auditor shall either

- Refer to both the current period's figures and the corresponding figures in the description of the matter giving rise to the modification when the effects or possible effects of the matter on the current period's figures are material;

Or

- In other cases, explain that the audit opinion has been modified because of the effects or possible effects of the unresolved matter on the comparability of the current period's figures and the corresponding figures.

- **Unqualified Opinion**

If the prior period's financials were unqualified but the **present auditor believes that it should have been modified** due to possible material misstatement existing and the same remains unresolved even in the current financial year, the auditor shall **express a qualified opinion or an adverse opinion** in the auditor's report on the current period financial statements, modified with respect to the corresponding figures included therein

#### **5.4.1 Previous Period's Financial Statements Audited by Different Auditor**

If the prior periods were audited by a different auditor, in the current year audit report, indicate under "Other matters paragraph",

- the fact that it was audited by another auditor together
- the type of opinion expressed by the predecessor auditor,
- if the opinion was modified, the reasons therefore and
- date of such opinion

#### **5.4.2 Previous Period's Financial Statements Not Audited**

The current year's auditor shall

- State in Other Matter paragraph in the auditor's report that the corresponding figures are unaudited.
- Request the management to disclose this fact on the face of the current period financial statements with respect to the corresponding figures

- Obtain sufficient appropriate audit evidence that the opening balances do not contain misstatements that materially affect the current period's financial statements.

## 5.5 Comparative Financial Statement Approach

When reporting on prior period financial statements in connection with the current period's audit, if the auditor's opinion on such prior period financial statements differs from the opinion the auditor previously expressed, the auditor shall disclose the substantive reasons for the different opinion in Other Matter paragraph in accordance with SA 706.



The auditor's opinion shall refer to each period for which financial statements are presented and on which an audit opinion is expressed

If misstatement in prior periods noticed by the current auditor were brought to the notice of management, and the same is revised and audit report too is revised by the predecessor auditor, the current auditor shall report only on the current period

### 5.5.1 Previous Period's Financial Statements Audited by Different Auditor

If the prior periods were audited by the predecessor auditor, in the current year audit report, indicate under "Other matters paragraph",

- the fact that it was audited by predecessor auditor
- the type of opinion expressed by the predecessor auditor,
- if the opinion was modified, the reasons therefore and
- date of such opinion

If the auditor concludes that Material Misstatement exists in prior period financial statements

- If predecessor audit report not modified → auditor shall communicate with management and TCWG
- If predecessor issues new report → auditor shall report on current period only

### 5.5.2 Previous Period's Financial Statements Not Audited

The current year's auditor shall

- State in Other Matter paragraph in the auditor's report that the corresponding figures are unaudited.
- Obtain sufficient appropriate audit evidence that the opening balances do not contain misstatements that materially affect the current period's financial statements.

## 5.6 Questions

- 1) The nature of the comparative information that is presented in an entity's financial statements depends on the requirements of the applicable financial reporting framework. There are two different broad approaches to the auditor's reporting responsibilities in respect of such comparative information: corresponding figures and comparative financial statements. Explain clearly stating the essential audit reporting differences between the approaches. Also define comparative information and audit procedures regarding comparative information. [RTP-May 19]
- 2) What are the auditor's responsibilities in respect of corresponding figures.
- 3) The extent of audit procedures performed on corresponding figures is less compared to audit of current period figure's reporting. Justify the statement with regard to auditor's duties for reporting of comparatives under SA 710. [May 10 (5 Marks)]
- 4) When corresponding figures are presented, the auditor's opinion shall not refer to the corresponding figures except in some circumstances. Explain those circumstances. [MTP-Aug. 18]
- 5) When corresponding figures are presented, the auditors' opinion shall not refer to the corresponding figures. Discuss the exceptions of the above statement when the prior period financial statements are audited. [Nov. 19 (4 Marks)]

## 6) SA 720 - The Auditor's Responsibilities Relating to Other Information

### Contents

- Scope
- Auditor's Objective
- Other Information
- Audit Procedures & Documentation

### 6.1 Scope of SA

- Annual reports that are issued to owners, containing Audited Financial statements and auditors' report thereon
- other documents containing audited financials

The auditor's opinion on the financial statements does not cover the other information, nor does this SA require the auditor to obtain audit evidence beyond that required to form an opinion on the financial statements.

#### 6.1.1 Applicability

This SA does not apply to

- Preliminary announcements of financial information; or
- Securities offering documents, including prospectuses.

### 6.2 Objective of Auditor

- Consider whether there is material inconsistency between
  - Other information and financial statements
  - Other information and audit evidence
- To respond appropriately when documents containing audited financial statements and the auditors' report thereon include other information that could undermine the credibility of those financials and auditors' report

## 6.3 Other Information

Financial and non- financial information which is included either by laws and regulations in a document containing audited financial statements and the auditors' report thereon.

Other Information includes

- Board Report
- Corporate Governance Report
- Reply from Management & TCWG
- Financial summaries & Highlights
- Financial Ratios
- Selected Quarterly Data
- Planned Capital Expenditure
- Summaries & Analysis

### 6.3.1 Audit Report

A document, or combination of documents, prepared annually by management or TCWG as per law, regulation or custom to provide owners or stakeholders with information through financial statements on

- the entity's operations and
- the entity's financial results and
- financial position.

An annual report contains (or accompanies)

- financial statements and
- the auditor's report thereon
- information about the entity's developments,
- its future outlook and risks and uncertainties,
- a statement by the entity's governing body, and
- reports covering governance matters.

## 6.4 Important Terms

### 6.4.1 Inconsistency

Inconsistency means when Other information that contradicts information contained in the financial statements.

### 6.4.2 Misstatement of Other Information

Other information that is unrelated to matters appearing in the audited financial statements that is incorrectly stated or otherwise misleading by omitting or obscuring necessary information for proper understanding.

A material misstatement of fact may undermine the credibility of the document containing audited financial statements.

Such material misstatements may also inappropriately influence the economic decisions of the users for whom the auditor's report is prepared.

## 6.5 Audit Procedures

- Discuss with management and know the elements of Annual report
- Obtain final version of annual report documents (prior to annual report date, if possible)
- Obtain written representation for documents not obtained till audit report date
- Read the Other Information and identify material inconsistencies by evaluation through comparison
- Conclude if any revision required for financial statements

## 6.6 Reading Other Information & Response

- The auditor shall read the other information to identify material inconsistencies, if any, with the audited financial statements
- If on reading the information, the auditor identifies a material inconsistency,
  - Discuss with management
  - Perform additional audit procedures

The auditor shall make appropriate arrangements with management or those charged with governance to obtain that other information **prior to the date of the auditor's report.**

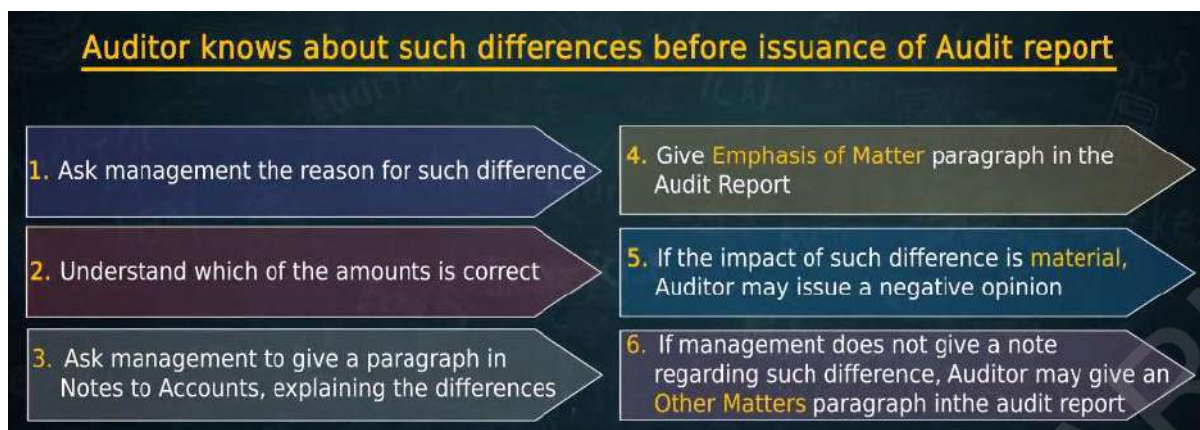
- If the auditor concludes that there is material misstatement of the other information inform management and TCWG and take appropriate action.

### 6.6.1 Misstatement Identified in Other Information before Audit Report Date

- Request the management to correct the other information
  - If management agrees and corrects → Auditor shall make note of it
  - If management refuses → Communicate the matter to TCWG and request for correction



- TCWG does not correct →
  - Address the same in audit report as per SA 705
  - If possible, under law, withdraw from engagement



### 6.6.2 Misstatement Identified in Other Information after Audit Report Date

- Follow the audit procedures as per SA 560 "Subsequent Events"
- Request the management to correct the other information
  - If management agrees and corrects → Auditor shall make note of it
  - If management refuses → Communicate the matter to TCWG and request for correction
- TCWG does not correct → seek to have the uncorrected material misstatement appropriately brought to the attention of users for whom the auditor's report is prepared.

### 6.7 Material Misstatement in Financial Statement Exists or Auditor's understanding needs to be updated

If the auditor concludes that a material misstatement in the financial statements exists or the auditor's understanding of the entity and its environment needs to be updated, the auditor shall respond appropriately in accordance with the other SAs.

### 6.8 Reporting

The auditor's report shall include a separate section with a heading "Other Information", or other appropriate heading, when, at the date of the auditor's report obtains other information for listed or unlisted

#### 6.8.1 Other Information para includes

- A statement that management is responsible for the other information;
- An identification of other information obtained or expected to be obtained
- A statement that the auditor's opinion does not cover the other information and the audit opinion or any form of assurance conclusion is not formed on such other information;
- A description of the auditor's responsibilities relating to reading, considering and reporting on other information as required by this SA; and

When other information has been obtained prior to the date of the auditor's report, either:

- A statement that the auditor has nothing to report; or
- a statement that describes the uncorrected material misstatement of the other information, if any material misstatement has been identified by auditor

If the auditor is required to refer to other information by a relevant law or regulation the auditor's report shall refer to SA only if the auditor's report includes,

- Identification of the other information obtained
- A description of the auditor's responsibilities for the other information; and

## 6.9 Documentation

- Documentation of the procedures performed under this SA; and
- The final version of the other information on which the auditor has performed the work required under this SA

## 6.10 Questions

- 1) Write short notes on "Other Information".
- 2) What are the auditor's responsibilities with respect to Other Information?

### 1. Powers and Duties of the Auditor –Sec 143

#### 1.1. Right of Access to books etc.: Sec 143(1)

- every auditor of a company shall have a right of access,
- at all times to the books of accounts and vouchers of the company
- whether kept at the registered office of the company or at any other place
- Auditor of holding co. will have right to access records of all its subsidiary & associate companies related to consolidation

#### Note:

- The phrase 'books, 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; memoranda books, e.g., inventory books, costing records and the like may also be inspected by the auditor.
- Similarly the term 'voucher' includes all or any of the correspondence which may in any way serve to vouch for the accuracy of the accounts.
- Thus, the right of access is not restricted to books of account alone and it is for the auditor to determine what record or document is necessary for the purpose of the audit.

#### 1.2. Right to obtain information and explanation from officers : Sec 143(1)

This right of the auditor to obtain from the officers of the company such information and explanations as he may think necessary for the performance of his duties as auditor is a wide and important power

#### Right of lien:

- Auditor can exercise lien on books and documents placed at his possession by the client for non-payment of fees, for work done on the books and documents.
- The Institute of Chartered Accountants in England and Wales has expressed a similar view on the following conditions:
  - Documents retained must belong to the client who owes the money.
  - Documents must have come into possession of the auditor on the authority of the client.
  - They must not have been received through irregular or illegal means. In case of a company client, they must be received on the authority of the Board of Directors.

- The auditor can retain the documents only if he has done work on the documents assigned to him.
- Such documents can be retained which are connected with the work on which fees have not been paid.

Note: it seems that though legally, auditor may exercise right of lien in cases of companies, it is mostly impracticable for legal and practicable constraints. His working papers being his own property, the question of lien, on them does not arise.

### **1.3. Sec 143 (1) : Duty to enquire on certain matters**

- a) Loans & advances made on security have been properly secured & whether terms on which they are made are prejudicial to interest of company or its members
- b) Transactions merely represented by book entries are prejudicial to interest of company.
- c) Where co. not being investment/banking Co. whether its assets consisting of shares, debentures & other securities sold at price < purchase price
- d) Whether loans & Advances shown as Deposits
- e) Whether personal expenses charged to revenue a/c
- f) Where shares of co. have been allotted for cash, whether cash has been actually received with respect to such allotment & if no cash received, position as per books & balance sheet is correct, regular & non misleading

Note: Auditor should report only when answer to any of matters is in adverse.

### **1.4. Duty to audit report: Sec 143(3) , the auditor's report shall also state-**

- a) whether he has sought and obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of his audit and if not, the details thereof and the effect of such information on the financial statements;
- b) whether, in his opinion, proper books of account as required by law have been kept by the company so far as appears from his examination of those books and proper returns adequate for the purposes of his audit have been received from branches not visited by him;
- c) whether the report on the accounts of any branch office of the company audited under sub- section (8) by a person other than the company's auditors has been sent to him under the proviso to that sub-section and the manner in which he has dealt with it in preparing his report;
- d) whether the company's balance sheet and profit and loss account dealt with in the report are in agreement with the books of account and returns;
- e) whether, in his opinion, the financial statements comply with the accounting standards;

- f) the observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company;
- g) whether any director is disqualified from being appointed as a director under sub-section (2) of the section 164;
- h) any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith;
- i) whether the company has adequate internal financial controls with reference to financial statements in place and the operating effectiveness of such controls;
- j) such other matters as may be prescribed.

**Rule 11 of the Companies (Audit and Auditors) Rules, 2014** prescribes the other matters to be included in auditor's report. The auditor's report shall also include their views and comments on the following matters, namely: -

- (1) whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statement;
- (2) whether the company has made provision, as required under any law or accounting standards, for material foreseeable losses, if any, on long term contracts including derivative contracts;
- (3) whether there has been any delay in transferring amounts, required to be transferred, to the Investor Education and Protection Fund by the company.
- (4) (i) Whether the management has represented that, to the best of its knowledge and belief, other than as disclosed in the notes to the accounts, no funds have been advanced or loaned or invested (either from borrowed funds or share premium or any other sources or kind of funds) by the company to or in any other person(s) or entity(ies), including foreign entities ("Intermediaries"), with the understanding, whether recorded in writing or otherwise, that the Intermediary shall, whether, directly or indirectly lend or invest in other persons or entities identified in any manner whatsoever by or on behalf of the company ("Ultimate Beneficiaries") or provide any guarantee, security or the like on behalf of the Ultimate Beneficiaries;
- (ii) Whether the management has represented, that, to the best of its knowledge and belief, other than as disclosed in the notes to the accounts, no funds have been received by the company from any person(s) or entity(ies), including foreign entities ("Funding Parties"), with the understanding, whether recorded in writing or otherwise, that the company shall, whether, directly or indirectly, lend or invest in other persons or entities identified in any manner whatsoever by or on behalf of the Funding Party ("Ultimate Beneficiaries") or provide any guarantee, security or the like on behalf of the Ultimate Beneficiaries; and
- (iii) Based on such audit procedures that the auditor has considered reasonable and appropriate in the circumstances, nothing has come to their notice that has caused them to believe that the representations under sub-clause (i) and (ii) contain any material mis-statement.

(5) Whether the dividend declared or paid during the year by the company is in compliance with section 123 of the Companies Act, 2013.

(6) Whether the company, in respect of financial years commencing on or after the 1st April, 2022, has used such accounting software for maintaining its books of account which has a feature of recording audit trail (edit log) facility and the same has been operated throughout the year for all transactions recorded in the software and the audit trail feature has not been tampered with and the audit trail has been preserved by the company as per the statutory requirements for record retention.

### **1.5. Sec143 (4): Duty to state Reason for qualification or negative report**

When an auditor qualifies their report or issues a negative opinion on the financial statements of a company, they are required to provide clear and specific reasons for their assessment. This requirement ensures transparency and accountability in financial reporting, helping stakeholders understand the basis for any adverse findings or reservations expressed by the auditor.

### **1.6. Sec143 (9) Auditor's duty to comply with Standards on Auditing**

Auditors are required to adhere to the Standards on Auditing issued by the Institute of Chartered Accountants of India (ICAI) while conducting audits.

### **1.7. Ceiling on number of audits:**

A person shall not be eligible for appointment as an auditor if he is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such person or partner is at the date of such appointment or reappointment,

- already holding appointment as auditor of more than twenty companies other
  - than one person companies,
  - dormant companies,
  - small companies and private companies having paid-up share capital less than Rs.100 crore (private company which has not committed a default in filing its financial statements under section 137 of the said Act or annual return under section 92 of the said Act with the Registrar).

**Note:** In the case of a firm of auditors, it has been further provided that 'specified number of companies' shall be construed as the number of companies specified for every partner of the firm who is not in full time employment elsewhere

### **1.8. Duty to Sign the Audit Report: Sec 145**

The person appointed as an auditor of the company shall sign the auditor's report or sign or certify any other document of the company, in accordance with the provisions of Sec 141(2)



and the qualifications, observations or comments on financial transactions or matters, which have any adverse effect on the functioning of the company mentioned in the auditors' report shall be read before the company in general meeting and shall be open to inspection by any member of the company

### **1.9. Auditor to attend General Meeting -Sec 146**

It is right of the auditor to

- receive notices and other communications relating to any general meeting
- be heard at such meeting, relating to the matter of his concern,

However, it is duty of the auditor to attend the same or through his authorised representative unless otherwise exempted.

### **1.10. Reporting of Fraud- Sec 143(12)**

If auditor has reason to believe that an offence of fraud involving amount of 1 Cr or above committed in company by its officers or employees -

- Auditor shall report to CG within such time & manner as prescribed

#### **Manner of Reporting fraud: Rule 13 of CAAR Rules, 2014**

- Report to Board or Audit Committee, immediately but not later than 2 days, seeking their reply within 45 days
- On receipt of reply, forward
  - His report
  - Reply or observation of Board or Audit Committee
  - Along With his comments
- to Central Government within 15 days of receipt of reply

If no reply received, then he shall forward only his report along with a note containing the details of his report forwarded to the AC or Board for which no reply has been received.

The report shall be sent to Secretary, MCA in sealed cover by Registered post with acknowledgment due (RPAD) or by speed post followed by e-mail.

#### **Report format -ADT 4**

The report shall be on the letter head of auditor with post address, e-mail, mobile no., & signed by auditor with seal and membership number

**If fraud amount is less than 1 Cr-** Report to Audit Committee or Board, within 2 days specifying following:

- Nature of fraud



- Amounted involved
- Parties involved

**The following details of each fraud reported to the Audit Committee of the Board during the year shall be disclosed in the Board's report:-**

- Nature of fraud with description
- Approximate amount involved
- Parties involved, if remedial actions not taken, and
- Remedial actions taken

Note: The provisions of this rule shall mutatis mutandis apply to cost auditor and secretarial auditor

#### **1.11. Audit of Branch office Accounts- Sec 143(8)**

- Sec 128 (1): Every Company shall keep at Registered office books of accounts & FS that give true & fair view & as per accrual basis and double entry system of accounting
- If kept at any other place, inform ROC within 7 days
- If Company has branch office, it can keep books of branch at that office & proper summarized returns shall be sent to Registered office periodically

#### **Sec 143 (8): Powers & duties of Company Auditor in relation to branch audit & branch auditor**

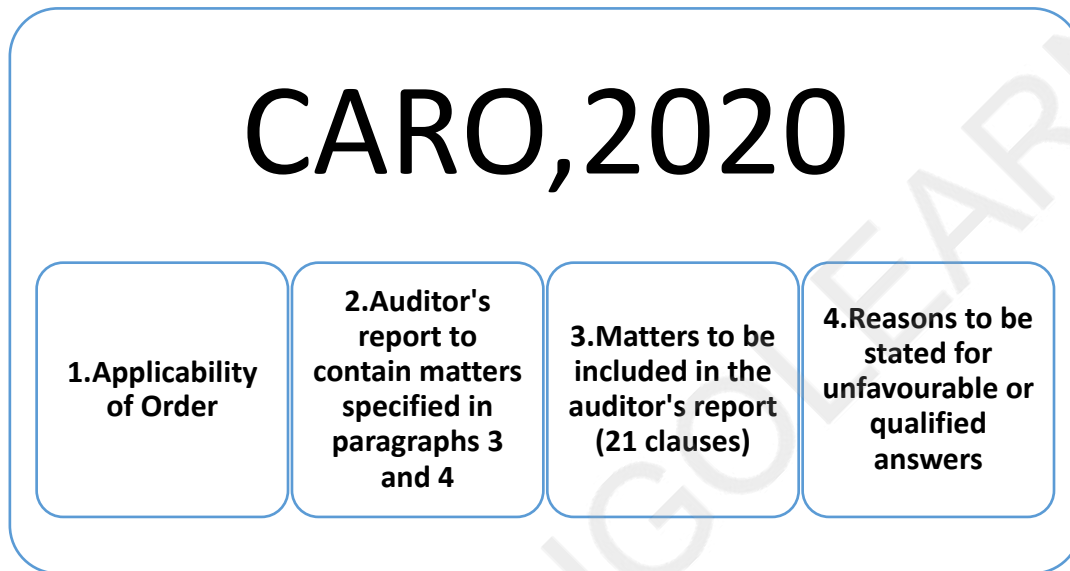
- Branch a/c can be audited by company auditor or any other qualified person
- If branch is situated outside India then audit shall be done by Company Auditor or by a person duly qualified to be appointed as auditor as per the laws of that country
- Branch auditor (if different) shall share his report with Company Auditor
- the Branch auditor shall prepare a report on the accounts of the branch examined by him and send it to the auditor of the company who shall deal with it in his report in such manner as he considers necessary

## 2. Reporting Under CARO, 2020

In exercise of the powers conferred by section 143(11) of the Companies Act, 2013, the Central Government, after consultation with the National Financial Reporting Authority constituted under section 132 of the Companies Act, 2013, has issued the Companies (Auditor's Report) Order, 2020, (CARO, 20) dated 25th February, 2020.

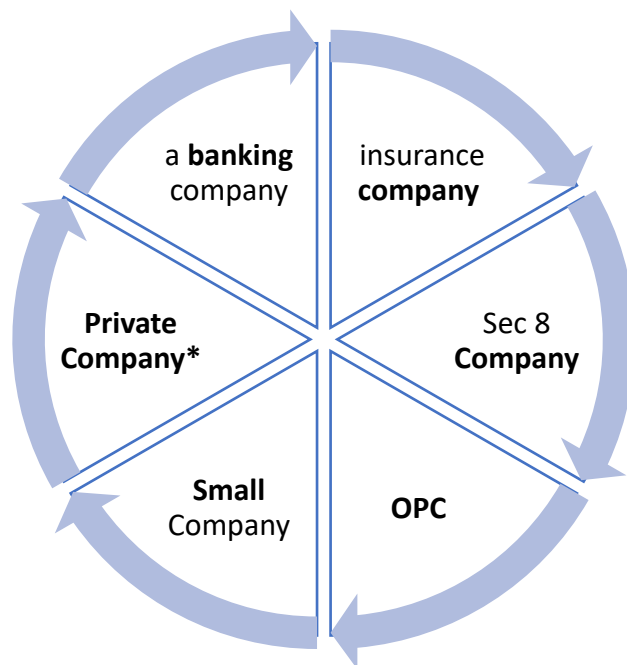
CARO is the additional reporting requirement under Sec 143(11) of the Companies Act 2013..

**The order contains four paragraphs:**



**1. Applicability of the Order:** The order applies to every company including a foreign company as defined in clause (42) of section 2 of the Companies Act, 2013. However, the Order specifically exempts the following classes of companies:

- (i) a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949 (10 of 1949);
- (ii) an insurance company as defined under the Insurance Act, 1938 (4 of 1938);
- (iii) a company licensed to operate under section 8 of the Companies Act;
- (iv) a One Person Company as defined under clause (62) of section 2 of the Companies Act and a small company as defined under clause (85) of section 2 of the Companies Act; and
- (v) a private limited company, not being a subsidiary or holding company of a public company, having a paid up capital and reserves and surplus not more than rupees one crore as on the balance sheet date and which does not have total borrowings exceeding rupees one crore from any bank or financial institution at any point of time during the financial year and which does not have a total revenue as disclosed in Scheduled III to the Companies Act, 2013 (including revenue from discontinuing operations) exceeding rupees ten crore during the financial year as per the financial statements.



### **\*Conditions for Private Company exemption**

Should not be holding/Subsidiary	Of a public company
Paid up capital & Reserves and Surplus	Less than 1 Crore as on BS date
Total Borrowings	Less than 1 Crore during any time during FY
Total Revenue	Less than 10 Crores during the FY

**2. Auditor's report to contain matters specified in paragraphs 3 and 4** - Every report made by the auditor under section 143 of the Companies Act, 2013 on the accounts of every company audited by him, to which this Order applies, for the financial year, shall in addition, contain the matters specified in paragraphs 3 and 4, as may be applicable.

**It may be noted that the Order shall not apply to the auditor's report on Consolidated Financial Statements except clause (xxi) of paragraph 3.**

**3. Matters to be included in the auditor's report:** The auditor's report on the accounts of a company to which this Order applies shall include a statement on the following matters, namely: -

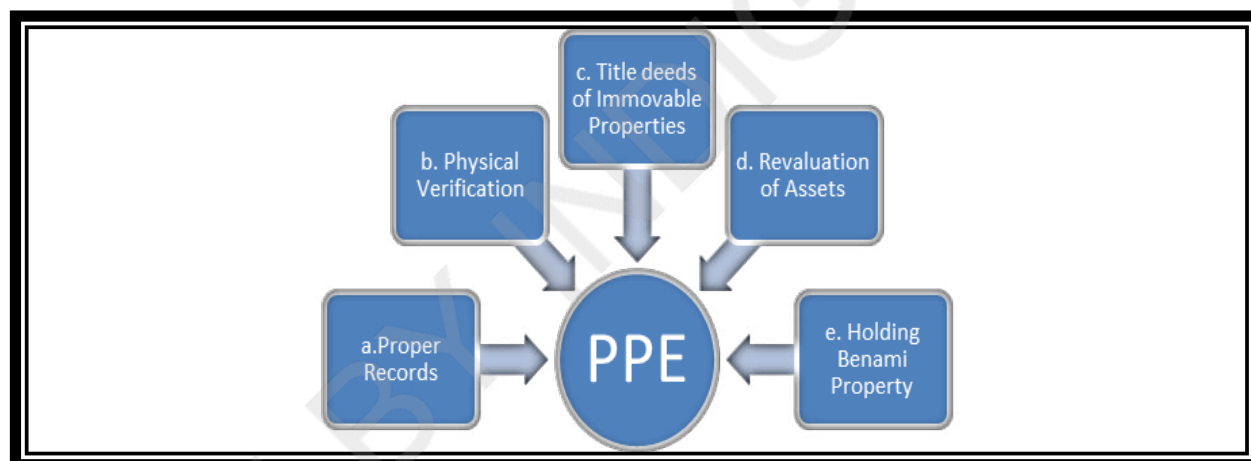
### **21 clauses (for quick revision)**

i.	Property, Plant and Equipment (including Intangible)
ii.	Inventory
iii.	Investments, Guarantee, Security, loans and Advances
iv.	Compliance with Sec 185 and Sec 186
v.	Public deposits
vi.	Cost records
vii.	Statutory Dues

viii.	Unrecorded Incomes
ix.	Repayment of Dues
x.	Application of money raised by public issue or Preferential allotment
xi.	Fraud
xii.	Nidhi Companies
xiii.	Transactions with related Parties
xiv.	Internal Audit System
xv.	Non cash transaction with directors
xvi.	Registration with RBI
xvii.	Cash losses
xviii.	Consideration of issues raised by Outgoing Auditor
xix.	Existence of Material Uncertainty as to company's ability to meet its liabilities
xx.	Transfer of unpaid CSR amount
xxi.	Qualifications or adverse remarks in CARO reports of group companies

### The 21 Clauses are as follows

#### (i) Property, Plant and Equipment



(a) (A) whether the company is maintaining **proper records** showing full particulars, including quantitative details and situation of Property, Plant and Equipment;

(B) whether the company is maintaining **proper records** showing full particulars of intangible assets;

(b) whether these Property, Plant and Equipment have been **physically verified** by the management at reasonable intervals; whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of account;

### Points to be noted:

- What constitutes a reasonable interval depends upon the circumstances of each case.
- The factors to be taken into consideration in this regard would include number of assets, nature of assets, relative value of the assets, difficulty in verification, situation and geographical spread of the location of the assets etc.
- The management may decide about the periodicity of physical verification of fixed assets considering the above factors.
- Sometimes it may be impractical to carry out the verification of all the assets. Even in such cases the verification program should be such that all the assets are verified at least once in every three years.
- If verification of all the assets has not been made during the year, it will be necessary for the auditor to report the fact. But if he's satisfied regarding the frequency of verification, he should also make a suitable comment to that effect.

(c) whether the **title deeds of all the immovable properties** (other than properties where the company is the lessee and the lease agreements are duly executed in favour of the lessee) disclosed in the financial statements are held in the name of the company, if not, provide the details thereof in the format below: -

Description of Property	Gross Carrying Value	Held in the name of	Whether promoter, director or their relative or employee	Period held – indicate range, where appropriate	Reason for not being held in name of company
					*Also indicate if in dispute

**Title deed:** The order is silent as to what constitutes a title deed. In general, title deed means a legal deed or document, constituting evidence of a right especially to the legal ownership of the immovable property.

**Title deed could be registered sale deed, Transfer deed, conveyance deed, etc. of land, land and building together etc. purchased, allotted, transferred by any person including any government, government authority, body, agency Corporation, etc, to the company.**

(d) whether the company has **revalued** its Property, Plant and Equipment (including Right of Use assets) or intangible assets or both during the year and, if so, whether the revaluation is

based on the valuation by a Registered Valuer; specify the amount of change, if change is 10% or more in the aggregate of the net carrying value of each class of Property, Plant and Equipment or intangible assets;

(e) whether any proceedings have been initiated or are pending against the company for holding any **benami property** under the Benami Transactions (Prohibition) Act, 1988 (45 of 1988) and rules made thereunder, if so, whether the company has appropriately disclosed the details in its financial statements;

## ii. Inventory

a) whether **physical verification** of inventory has been conducted at **reasonable intervals** by the management and whether, in the opinion of the auditor, the coverage and procedure of such verification by the management is appropriate; whether any discrepancies of **10% or more in the aggregate for each class of inventory** were noticed and if so, whether they have been properly dealt with in the books of account;

(b) whether during any point of time of the year, the company has been **sanctioned working capital limits in excess of five crore rupees**, in aggregate, from banks or financial institutions on the basis of security of current assets; whether the **quarterly returns or statements** filed by the company with such banks or financial institutions are in agreement with the books of account of the Company, if not, give details;

## iii. Investments, Guarantee, Security, Loans or advances

*whether during the year the company has made investments in, provided any guarantee or security or granted any loans or advances in the nature of loans, secured or unsecured, to companies, firms, Limited Liability Partnerships or any other parties, if so, -*

(a) whether during the year the company has provided loans or provided advances in the nature of loans, or stood guarantee, or provided security to any other entity [not applicable to companies whose principal business is to give loans], if so, indicate-

(A) the aggregate amount during the year, and balance outstanding at the balance sheet date with respect to such loans or advances and guarantees or security **to subsidiaries, joint ventures and associates;**

(B) the aggregate amount during the year, and balance outstanding at the balance sheet date with respect to such loans or advances and guarantees or security **to parties other than subsidiaries, joint ventures and associates;**

(b) whether the investments made, guarantees provided, security given and the terms and conditions of the grant of all loans and advances in the nature of loans and guarantees provided are not prejudicial to the company's interest;

(c) in respect of loans and advances in the nature of loans, whether the schedule of **repayment of principal and payment of interest** has been stipulated and whether the repayments or receipts are regular;

(d) if the amount is overdue, state the total amount **overdue for more than ninety days**, and whether reasonable steps have been taken by the company for recovery of the principal and interest;

(e) whether any loan or advance in the nature of loan granted which has fallen due during the year, has been **renewed or extended or fresh loans** granted to settle the overdues of existing loans given to the same parties, if so, specify the aggregate amount of such dues renewed or extended or settled by fresh loans and the percentage of the aggregate to the total loans or advances in the nature of loans granted during the year [not applicable to companies whose principal business is to give loans];

(f) whether the company has granted any loans or advances in the nature of loans either **repayable on demand or without specifying any terms** or period of repayment, if so, specify the aggregate amount, percentage thereof to the total loans granted, aggregate amount of loans granted to Promoters, related parties as defined in clause (76) of section 2 of the Companies Act, 2013;



#### iv. Compliance of provisions of Sec 185 and 186

In respect of loans, investments, guarantees, and security, whether provisions of sections 185 and 186 of the Companies Act have been complied with, if not, provide the details thereof



## v. Public Deposits

- in respect of deposits accepted by the company or amounts which are deemed to be deposits, whether the directives issued by the **Reserve Bank of India** and the provisions of **sections 73 to 76** or any other relevant provisions of the Companies Act and the rules made thereunder, where applicable, have been complied with, if not, the nature of such **contraventions** be stated;
- if an **order has been passed by Company Law Board or National Company Law Tribunal or Reserve Bank of India or any court or any other tribunal**, whether the same has been complied with or not

## vi. Cost Records

whether maintenance of cost records has been specified by the Central Government under sub-section (1) of section 148 of the Companies Act and whether such accounts and records have been so made and maintained

### Note

- The word **made** applies in respect of cost accounts, and the word **maintained** applies in respect of costs records relating to material, labour, overheads, etc.
- The order does not require a detailed examination of such records. The auditor should therefore, conduct a general review of the cost records to ensure that the records as prescribed are made and maintained. He should of course, make a reference to the records as necessary for the purpose of his audit.
- The auditor should also obtain a list of books and records made and maintained in this regard.
- It is necessary that the extent of examination made by the auditor is clearly brought out in his report. The following wordings are therefore suggested.
- “We have broadly reviewed the books of accounts maintained by the company pursuant to the order made by Central Government for the maintenance of cost records under Section 148 of the Act and are of the opinion that, *prima facie*, the prescribed accounts and the records have been made and maintain.

## vii. Statutory dues

- a. whether the company **is regular in depositing undisputed statutory** dues including Goods and Services Tax, provident fund, employees' state insurance, income-tax, sales-tax, service tax, duty of customs, duty of excise, value added tax, cess and any other statutory dues to the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as on the last day of the financial year concerned for **a period of more than six months from the date they became payable, shall be indicated;**

- b. (b) where statutory dues referred to in sub-clause (a) have not been deposited on account of **any dispute**, then the amounts involved and the forum where dispute is pending shall be mentioned (a mere representation to the concerned Department shall not be treated as a dispute);

Note: A mere representation to the concerned department will not be treated as dispute.

#### viii. Unrecorded Income

- whether any transactions not recorded in the books of account have been surrendered or disclosed as income during the year in the tax assessments under the Income Tax Act, 1961 (43 of 1961),
- if so, whether the previously unrecorded income has been properly recorded in the books of account during the year

#### ix. Repayment of Dues

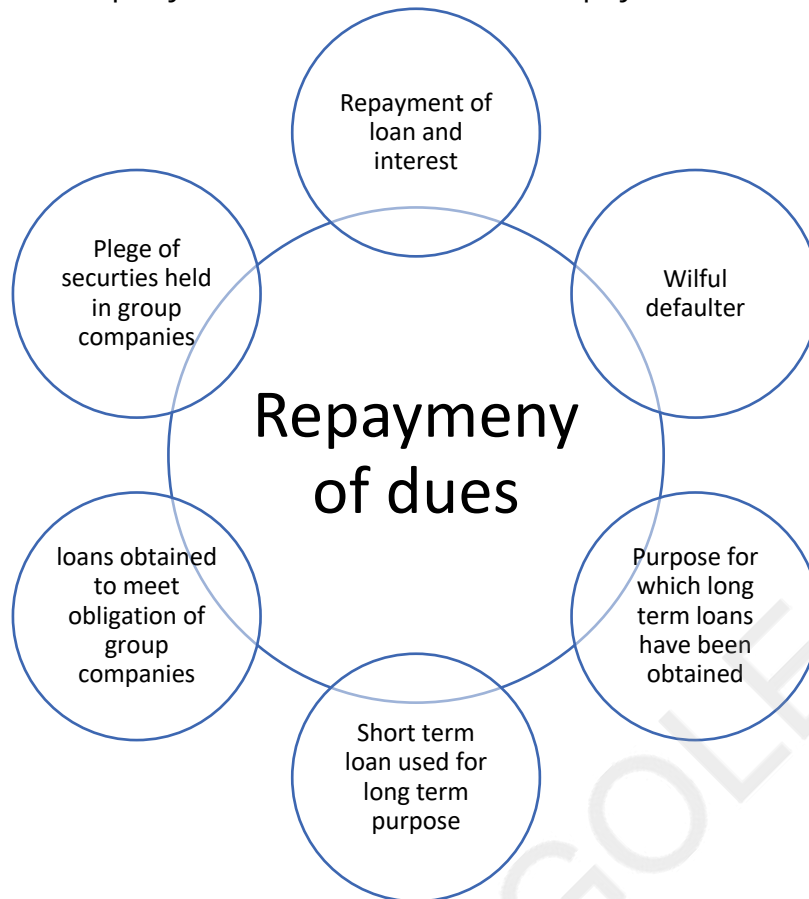
- (a) whether the company **has defaulted in repayment of loans** or other borrowings or in the **payment of interest** thereon to any lender, if yes, the period and the amount of default to be reported as per the format below: -

Nature of borrowing including debt securities	Name of Lender*	Amount not paid on due date	Whether principal or interest	No. of days delay or unpaid	Remarks, if any

\*Lender wise details to be provided in case of defaults to banks, financial institutions and Government.

- (b) whether the company is a declared **wilful defaulter** by any bank or financial institution or other lender;
- (c) whether term loans were applied for the **purpose** for which the loans were obtained; if not, the amount of loan so diverted and the purpose for which it is used may be reported;
- (d) whether funds raised on **short term basis have been utilised for long term purposes**, if yes, the nature and amount to be indicated;
- (e) whether the company has taken any funds from any entity or person on account of or to **meet the obligations of its subsidiaries, associates or joint ventures**, if so, details thereof with nature of such transactions and the amount in each case;
- (f) whether the company has raised loans during the year on **the pledge of securities** held in its subsidiaries, joint ventures or associate companies, if so, give details thereof and also

report if the company has defaulted in repayment of such loans raised;



#### x. Application of money raised by public offer and Preferential allotment

(a) whether moneys raised by way of **initial public offer** or **further public offer** (including debt instruments) during the year were applied for the purposes for which those are raised, if not, the details together with delays or default and subsequent rectification, if any, as may be applicable, be reported;

(b) whether the company has made **any preferential allotment or private placement** of shares or convertible debentures (fully, partially or optionally convertible) during the year and if so, whether the requirements of section 42 and section 62 of the Companies Act, 2013 have been complied with and the funds raised have been used for the purposes for which the funds were raised, if not, provide details in respect of amount involved and nature of non-compliance;

#### xi. Fraud

(a) whether any fraud by the company or any fraud on the company has been **noticed or reported** during the year, if yes, the nature and the amount involved is to be indicated;

(b) whether any report under sub-**section (12) of section 143** of the Companies Act has been filed by the auditors in Form ADT-4 as prescribed under rule 13 of Companies (Audit and Auditors) Rules, 2014 with the Central Government;

(c) whether the auditor has **considered whistle-blower complaints**, if any, received during the year by the company

#### xii. Nidhi Companies

(a) whether the Nidhi Company has complied with the Net Owned Funds to Deposits in the ratio of **1:20** to meet out the liability;

(b) whether the Nidhi Company is maintaining **10 % unencumbered term deposits** as specified in the Nidhi Rules, 2014 to meet out the liability;

(c) whether there has been any default in payment of interest on deposits or repayment thereof for any period and if so, the details thereof

### **xiii. Related Party Relations**

whether all transactions with the related parties are in compliance with **sections 177 and 188** of Companies Act where applicable and the details have been disclosed in the financial statements, etc., as required by the applicable accounting standards. (AS 18 and IND AS 24)

### **xiv. Internal Audit System**

(a) whether the company has an internal audit system **commensurate with the size and nature** of its business;

(b) whether the **reports of the Internal Auditors** for the period under audit were considered by the statutory auditor

### **xv. Non Cash Transactions**

whether the company has entered into any non-cash transactions with directors or persons connected with him and if so, whether the provisions of **section 192 of Companies Act** have been complied with

### **xvi. Registration with RBI**

(a) whether the company is required to be registered under section **45-IA of the Reserve Bank of India Act, 1934** and if so, whether the registration has been obtained;

(b) whether the company has conducted any Non-Banking Financial or Housing Finance activities without a **valid Certificate of Registration from the Reserve Bank of India** as per the Reserve Bank of India Act, 1934;

(c) whether the company is a **Core Investment Company (CIC)** as defined in the regulations made by the Reserve Bank of India, if so, whether it continues to fulfil the criteria of a CIC, and in case the company is an exempted or unregistered CIC, whether it continues to fulfil such criteria;

(d) whether the Group **has more than one CIC** as part of the Group, if yes, indicate the number of CICs which are part of the Group;

### **xvii. Cash losses**

whether the company has incurred **cash losses** in the financial year and in the **immediately preceding financial year**, if so, state the amount of cash losses;

### **xviii. Consideration of issues raised by outing auditor**

- whether there has been any **resignation of the statutory auditors** during the year, if so, whether the auditor has taken into consideration the issues, objections or concerns raised by the outgoing auditors

#### **xix. Uncertainties existing for entity's ability to continue as going concern**

- on the basis of the **financial ratios, ageing and expected dates** of realisation of financial assets and payment of financial liabilities, other information accompanying the financial statements,
- the **auditor's knowledge of the Board of Directors and management plans**,
- whether the auditor is of the opinion **that no material uncertainty exists** as on the date of the audit report that company is capable of meeting its liabilities existing at the date of balance sheet as and when they fall due within a period of one year from the balance sheet date

#### **xx. Unspent CSR amount**

- (a) whether, in respect of **other than ongoing projects**, the company has transferred unspent amount to a **Fund specified in Schedule VII** to the Companies Act within a period of six months of the expiry of the financial year in compliance with sec 135(5) of Companies Act
- (b) whether any amount remaining unspent under sub-section (5) of section 135 of the Companies Act, pursuant to any **ongoing project**, has been transferred to special account in compliance with the provision of **Sec 135(6) of the Act**.

#### **Xxi Qualification or Adverse Remark in CARO report of Group Companies**

- whether there have been any qualifications or adverse remarks by the respective auditors in the Companies (Auditor's Report) Order (CARO) reports of the companies included in the **consolidated financial statements**,
- if yes, indicate the **details of the companies and the paragraph numbers of the CARO report** containing the qualifications or adverse remarks

#### **Reasons to be stated for unfavourable or qualified answers-**

- (a) Where, in the auditor's report, the **answer to any of the questions** referred to in paragraph 3 is unfavourable or qualified, the auditor's report shall also **state the basis** for such unfavourable or qualified answer, as the case may be.
- (b) Where the auditor **is unable to express any opinion** on any specified matter, his report shall indicate **such fact together with the reasons** as to why it is not possible for him to give his opinion on the same.

# SA 800 SPECIAL CONSIDERATIONS-AUDITS OF FINANCIAL STATEMENTS PREPARED IN ACCORDANCE WITH SPECIAL PURPOSE FRAMEWORKS

## SCOPE OF THIS SA

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- A. This SA deals with special considerations in the application of the SAs (200 to 700 series) to an audit of Financial Statements prepared in accordance with a Special Purpose Framework
- B. This SA is relevant for complete set of Financial Statements prepared under Special Purpose Framework.
- C. This SA does not override other SAs.
- D. This SA may not deal with all special considerations that may be relevant in the circumstances of the engagement.

## OBJECTIVE

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The objective of the auditor is to address appropriately the special considerations that are relevant to:

- A. Acceptance of the engagement;
- B. Planning and Performance of that engagement; and
- C. Forming an opinion and reporting on the Financial Statements (but not for expressing an opinion on effectiveness of entity's IC).

## DEFINITIONS

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**Special purpose Financial Statements:** Financial Statements prepared in accordance with a SPF.

**General purpose framework:** A FINANCIAL REPORTING FRAMEWORK designed to meet the common financial information needs of a wide range of users.

**Special Purpose Framework (SPF):** A FINANCIAL REPORTING FRAMEWORK designed to meet the financial information needs of specific users.

The FINANCIAL REPORTING FRAMEWORK may be a fair presentation framework or a compliance framework.

### Examples:

- Cash receipts and disbursements basis of accounting for cash flow information that an entity may be requested to prepare for creditors;
- Financial reporting provisions established by a regulator to meet the requirements of that regulator; or
- Financial reporting provisions of a contract, such as a bond indenture, a loan agreement, or a project grant.

## CONSIDERATIONS WHEN ACCEPTING THE ENGAGEMENT

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### **HOW Acceptability of the Financial Reporting Framework is determined?**

- A. **Meeting the financial information needs of the intended users** are a key factor in determining the acceptability of the FRI) applied in the preparation of the Financial Statements.
- B. The **ACCEPTABLE FRFD** may encompass the financial reporting standards established by
  - i. **an authorised or recognised organisation;**
  - ii. Law(s) or regulation (s) which is to be used by management.

Then, in the absence of indications to the contrary, such FINANCIAL REPORTING FRAMEWORK is **presumed acceptable** special purpose Financial Statements prepared by such entity.

- C. if above **financial reporting standards are supplemented by legislative or regulatory requirements**, SA 210 requires the auditor to determine whether any conflicts between the financial reporting standards and the additional requirements exist, and prescribes action<sup>3</sup> to be taken by the auditor if such conflicts exist.

**The ACCEPTABLE FINANCIAL REPORTING FRAMEWORK may encompass the financial reporting provisions of a contract or sources other than those prescribed above**

In that case, the acceptability of FINANCIAL REPORTING FRAMEWORK in the circumstances of the engagement is determined by considering whether the framework exhibits attributes normally exhibited by ACCEPTABLE FINANCIAL REPORTING FRAMEWORK which is a matter of professional judgment



## B CONSIDERATIONS WHEN PLANNING AND PERFORMING THE AUDIT

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### SA 200 requires the auditor –

1. **To comply with:**

- ✓ Relevant ethical requirements, including those pertaining to independence.
- ✓ All SAS relevant to the audit.
- ✓ The auditor is required to comply with each requirement of an SA unless, the entire SA is not relevant or the requirement is not relevant because it is conditional and the condition does not exist.
- ✓ However, In exceptional circumstances, the auditor may depart from a relevant requirement in an SA by performing alternative audit procedures to achieve the aim of that requirement.

2. **Determine whether application of the SAs requires special consideration in the circumstances of the engagement**

- ✓ In SA 320, judgments about matters that are **material** to users of the Financial Statements are based on a consideration of the common financial information needs of users as a group. In the case of an audit of special purpose Financial Statements, however, those judgments are based on a consideration of the financial information needs of the intended users.
- ✓ In case special purpose Financial Statements are prepared in accordance with the requirements of a Contract, management may agree with the intended users on a **threshold** below which misstatements identified during the audit will not be corrected or otherwise adjusted. The existence of such a threshold does not relieve the auditor from the requirement to determine materiality in accordance with SA 320 for purposes of planning and performing the audit of the special purpose Financial Statements.
- ✓ SA 260 (Revised) requires auditor to determine the appropriate person(s) within the entity's governance structure with whom to communicate.

## C . Forming an opinion and Reporting Considerations

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The auditor shall **apply the requirements stated in SA 700** (Revised), when forming an opinion and reporting on special purpose Financial Statements.

### DESCRIPTION OF THE APPLICABLE FINANCIAL REPORTING FRAMEWORK

SA 700 (Revised) requires the auditor to:

- a. Evaluate whether the **Financial Statements adequately refer to or describe the ACCEPTABLE FINANCIAL REPORTING FRAMEWORK.**
- b. Describe in auditor's report the **purpose for which the Financial Statements are prepared** and, if necessary, **the intended users**, by giving a note.

- c. If management has a choice of FRF) in the preparation of such Financial Statements, refer the **explanation of management's responsibility for the Financial Statements for determining that the ACCEPTABLE FRFD is acceptable in the circumstances.**

## **ALERTING READERS THAT THE Financial Statements ARE PREPARED IN ACCORDANCE WITH SPF**

- i. The special purpose Financial Statements may be used for purposes other than those for which they were intended. For example, a regulator may require certain entities to place the special purpose Financial Statements on public record.
- ii. To avoid misunderstandings, auditor alerts users of the auditor's report that Financial Statements are prepared in accordance with a SPF and, therefore, may not be suitable for another purpose.

## **RESTRICTION ON DISTRIBUTION OR USE**

The auditor may restrict the **distribution or use** of auditor's report, depending on the law or regulation applicable.

In these circumstances, the paragraph alerting the readers may be expanded to include these other matters, and the heading modified accordingly.

# **SA 805 SPECIAL CONSIDERATIONS-AUDITS OF SINGLE FINANCIAL STATEMENT AND SPECIFIC ELEMENTS, ACCOUNTS OR ITEMS OF A FINANCIAL STATEMENT**

## **SCOPE OF THIS SA**

- This SA deals with special considerations in the application of SAs (200 to 700 series) to an audit of a single Financial Statements or of a specific element, account or item of a Financial Statements, which may be prepared as per general or special purpose framework.
- This SA does not apply to the report of a component auditor (SA 600)
- This SA does not override other SAS; nor does it deal with all special considerations that may be relevant in the circumstances of the engagement.

## **Objective**

The objective of the auditor is to address appropriately the special considerations that are relevant to:

- A. Acceptance of the engagement;
- B. Planning and Performance of that engagement; and
- C. Forming an opinion and reporting on the Financial Statements (but not for expressing an opinion on effectiveness of entity's IC).

## Definitions

**Element of a Financial Statements or element**": means an "element, account or item of a Financial Statements." For example, a cash flow statement is a single Financial Statements.

For example, trade receivables or cash and bank balances.

**Single Financial Statement**: A single Financial Statements is to be distinguished from a complete set of Financial Statements.

For example, a cash flow statement is a single Financial Statements.

A single Financial Statements or a specific element of Financial Statements include the related notes ordinarily comprising a summary of significant accounting policies and other explanatory information relevant to the Financial Statements or to the element.

## CONSIDERATIONS WHEN ACCEPTING THE ENGAGEMENT

### Application of Standards

- a. SA 200 requires the auditor to comply with
  - i. **Relevant ethical requirements**, including those pertaining to independence.
  - ii. **All SAs** relevant to the audit.

The auditor is required to comply with each requirement of on SA unless, the entire SA is not relevant or the requirement is not relevant because it is conditional and the condition does not exist.

However, in exceptional circumstances, the auditor may depart from a relevant requirement in an SA by performing alternative audit procedures to achieve the aim of that requirement.

- b. The auditor shall determine whether the audit of a single Financial Statements or of a specific element of those Financial Statements in accordance with SAs is practicable, if the auditor is not also engaged to audit the entity's complete set of Financial Statements.
- c. If auditor concludes that audit of a single Financial Statements or of a specific element of a Financial Statements in accordance with SAs may not be practicable, the auditor shall discuss with management whether another type of

engagement might be more practicable.

- d. Audit of single Financial Statements or of a specific element of Financial Statements is **not practicable** when:
  - i. Auditor is **not also engaged to audit the entity's complete set of Financial Statements**.
  - ii. Auditor **does not have understanding of the entity** and its environment, including its IC.
  - iii. Auditor **does not have the audit evidence** about the general quality of the accounting records or other accounting information of the entity.

### **Acceptability of the Financial Reporting Framework**

- i. SA 210 requires the auditor to determine the **acceptability of the FINANCIAL REPORTING FRAMEWORK** applied in the preparation of the Financial Statements,
- ii. In case of an audit of a single Financial Statements or of a specific element of a Financial Statements, this shall include whether application of the FREW will result in a presentation that **provides adequate disclosures to enable the intended users to understand the information conveyed** in the Financial Statements or the element, and the effect of material transactions and events on the information conveyed in the Financial Statements or the element.
- iii. A single Financial Statements or a specific element of a Financial Statements may be prepared as per ACCEPTABLE FINANCIAL REPORTING FRAMEWORK that is based on FINANCIAL REPORTING FRAMEWORK established by an authorised or recognised standards setting organisation for the preparation of a complete set of Financial Statements.

If this is the case, determination of the acceptability of the applicable framework may involve considering whether that framework includes all the requirements of the framework on which it is based that are relevant to the presentation of a single Financial Statements or of a specific element of a Financial Statements that provides adequate disclosures.

## CONSIDERATIONS ON PLANNING AND PERFORMING THE AUDIT

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- a. In planning and performing the audit of a single Financial Statements or of a specific element of a Financial Statements, the auditor shall adapt **all SAs** relevant to the audit as necessary in the circumstances of the engagement.
- b. When auditing a single Financial Statements or a specific element of a Financial Statements in conjunction with the audit of the entity's complete set of Financial Statements, auditor may be able to use audit evidence obtained as part of the audit of the entity's complete set of Financial Statements in the audit of the Financial Statements or the element. SAs require the auditor to plan and perform the audit of the Financial Statements or element to obtain **sufficient appropriate audit evidence** on which to base the opinion on the Financial Statements or on the element.
- c. While performing audit of single Financial Statements or of a specific element of Financial Statements, auditor may need to perform **procedures in relation to the interrelated items** to meet the objectives of the audit.
- d. The materiality determined for a single Financial Statements or for a specific element of a Financial Statements may be lower than the **materiality determined** for the entity's complete set of Financial Statements. This will affect the nature, timing and extent of the audit procedures and the evaluation of uncorrected misstatements.

## FORM OF OPINION

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- a. SA 210 requires that the **agreed terms** of the audit engagement include the expected form of any reports to be issued by the auditor.
- b. Form of opinion to be expressed by the auditor depends on the ACCEPTABLE FINANCIAL REPORTING FRAMEWORK and applicable laws or regulations. In accordance with Revised SA 700:
  - i. When expressing unmodified opinion on a complete set of Financial Statements prepared in accordance with **fair presentation framework**, the auditor's opinion, unless otherwise required by law or regulation, uses one of the following phrases:
    - Financial Statements present fairly, in all material respects, in accordance with the ACCEPTABLE FINANCIAL REPORTING FRAMEWORK; or
    - Financial Statements give a true and fair view in accordance with the ACCEPTABLE FRF); and

- ii. When expressing an unmodified opinion on a complete set of Financial Statements prepared in accordance with **compliance framework**, the auditor's opinion states that the Financial Statements are prepared, in all material respects, in accordance with the ACCEPTABLE FINANCIAL REPORTING FRAMEWORK.
- c. In case of a single Financial Statements or of a specific element of a Financial Statements. the **ACCEPTABLE Financial Reporting Framework may not explicitly address the presentation** of the Financial Statements or of the element.
- d. In such case, the auditor shall consider whether the expected form of opinion is appropriate in the light of the ACCEPTABLE FINANCIAL REPORTING FRAMEWORK.

**Factors that may affect the auditor's considerations to whether to use the phrases 'presents fairly, in all material respects', or "gives a true and fair view" in the auditor 's opinion include.**

- i. Whether ACCEPTABLE FINANCIAL REPORTING FRAMEWORK is **explicitly or implicitly restricted** to the preparation of a complete set of Financial Statements.
- ii. Whether single Financial Statements or the specific element of a Financial Statements will:
  - **Comply fully** with each of those requirements of the framework relevant to the particular Financial Statements or the particular element, and the presentation of the Financial Statements or the specific element include the related notes and disclosures.
  - If necessary to achieve fair presentation, **provide disclosures beyond those specifically required by the framework** or, in exceptional circumstances, depart from a requirement of the framework.
- e. Auditor's decision as to the expected form of opinion is a matter of professional judgment. It may be affected by whether use of the phrases "presents fairly, in all material respects", or gives a true and fair view" in the auditor's opinion on a single Financial Statements or on a specific element of a Financial Statements prepared in accordance with a fair presentation framework is generally accepted in the particular jurisdiction.

## FORMING AN OPINION AND REPORTING CONSIDERATIONS

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- a. The auditor shall apply the requirements in SA 700 (Revised), adapted as necessary in the circumstances of the engagement.
- b. It is important that the Financial Statements or the element, including the related notes, in view of the requirements of the ACCEPTABLE FINANCIAL REPORTING FRAMEWORK, provides adequate disclosures to enable the intended users to understand the information conveyed in the Financial Statements or the element, and the effect of material transactions and events on the information conveyed in the Financial Statements or the element.

### Reporting on the Entity's Complete Set of Financial Statements and on a Single Financial Statement or on a Specific Element of Those Financial Statements

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1. If the auditor undertakes an engagement to report on a single Financial Statement or on a specific element of a Financial Statement in conjunction with an engagement to audit the entity's complete set of Financial Statements, the auditor shall express **a separate opinion for each engagement**.
2. An audited single Financial Statement or on audited specific element of a Financial Statement may be published together with the entity's audited complete set of Financial Statements.
3. **If auditor concludes that presentation of single Financial Statement or of the specific element of a Financial Statement is:**
  - **Clearly differentiated from complete set of Financial Statements - No further procedure**
  - **If not clearly differentiated from complete set of FS- Ask the management to rectify the same, If management agrees- no further procedure. If management does not agree- Shall not issue auditor's report until satisfied With the differentiation**

**Modified opinion, Emphasis of Matter (EOM) Paragraph or Other Matter (OM) Paragraph in the Auditor's Report on the Entity's Complete Set of Financial Statements.**

- If the opinion in the auditor's report on an entity's **complete set of Financial Statements is modified, or includes an EOM paragraph or OM paragraph,**



**The auditor shall consider its effect on his report**



↓

**The auditor shall modify his opinion or include an EOM /OM paragraph in the report, when deemed appropriate.**

- **Adverse opinion or disclaim an opinion on the entity's complete set of Financial Statements as a whole**, SA 705(Revised) **restricts** the auditor to include in the same auditor's report an unmodified opinion on a single Financial Statements or on a specific element that forms part of those Financial Statements, as it would **contradict the adverse opinion or disclaimer of opinion on the entity's complete set of Financial Statements as a whole**.
- Adverse opinion or disclaim an opinion on the entity's complete set of Financial Statements as a whole but, an unmodified opinion on that specific element that is included in those Financial Statements, the auditor shall only do so if (conditions):
  - a. The auditor is **not prohibited by law or regulation** from doing so;
  - b. That opinion is expressed in an auditor's report that is **not published together** with the auditor 's report containing the adverse opinion or disclaimer of opinion, and
  - c. The specific element **does not constitute a major portion** of the entity's complete set of Financial Statements.
- Auditor shall not express an unmodified opinion on a single Financial Statements, if he has expressed an adverse opinion or disclaimed an opinion on the complete set of Financial Statements as a whole, **even if the auditor s report on the single Financial Statements is not published together with the auditor's report containing the adverse opinion or disclaimer of opinion**.

**This is because a single financial statement is deemed to constitute a major portion of those Financial Statements.**

#### **Examples of Specific Elements, Accounts or items of a Financial Statements are**

1. Accounts receivable, allowance for doubtful accounts receivable, inventory, the liability for accrued benefits of a private pension plan, the recorded value of identified intangible assets, or the liability for "incurred but not reported" claims in an insurance portfolio, including related notes.
2. A schedule of externally managed assets and income of a private pension plan, including related notes.
3. A schedule of net tangible assets, including related notes.
4. A schedule of disbursements in relation to a lease property, including explanatory notes.

# SA 810- ENGAGEMENTS TO REPORT ON SUMMARY FINANCIAL STATEMENT

<b>A</b>	Engagement acceptance	<b>F</b>	Restriction on Distribution or Use or Alerting Readers to the Basis of Accounting
<b>B</b>	Nature of Procedures	<b>G</b>	Comparatives
<b>C</b>	Form of Opinion	<b>H</b>	Unaudited Supplementary Information Presented with Summary Financial statements
<b>D</b>	Timing of Work and Events Subsequent to the Date of the Auditor's Report on the Audited Financial Statements	<b>I</b>	Other Information in Documents Containing Summary Financial Statements
<b>E</b>	Auditor's Report on Summary Financial Statements	<b>J</b>	Auditor Association

## SCOPE OF THIS STANDARD

The auditor's responsibilities when undertaking an engagement to report on summary Financial Statements derived from Financial Statements audited in accordance with SAs by that same auditor.

## DEFINITIONS

**Applied criteria:** The criteria applied by management in the preparation of the summary Financial Statements.

**Audited Financial Statements:** Financial Statements audited by the auditor in accordance with SAs, and from which the summary Financial Statements are derived.

**Summary Financial Statements:** Historical financial information that is **derived from the Financial Statements** but that **contains less detail** than the complete set of Financial Statements.

## REQUIREMENTS

### A. Engagement acceptance

1. **Auditor of complete Financial Statements and summary Financial Statements shall be the same:**
  - I. The auditor shall, ordinarily, accept an engagement to report on summary Financial Statements only when the auditor has been engaged to conduct an audit in accordance with SAS of the Financial Statements from which the summary Financial Statements are derived.

- II. This provides the auditor with the necessary knowledge to discharge his responsibilities in relation to summary Financial Statements.
- III. Application of this SA will not provide sufficient appropriate evidence on which to base the opinion on the summary Financial Statements if the auditor has not also audited Financial Statements from which the summary Financial Statements are derived.

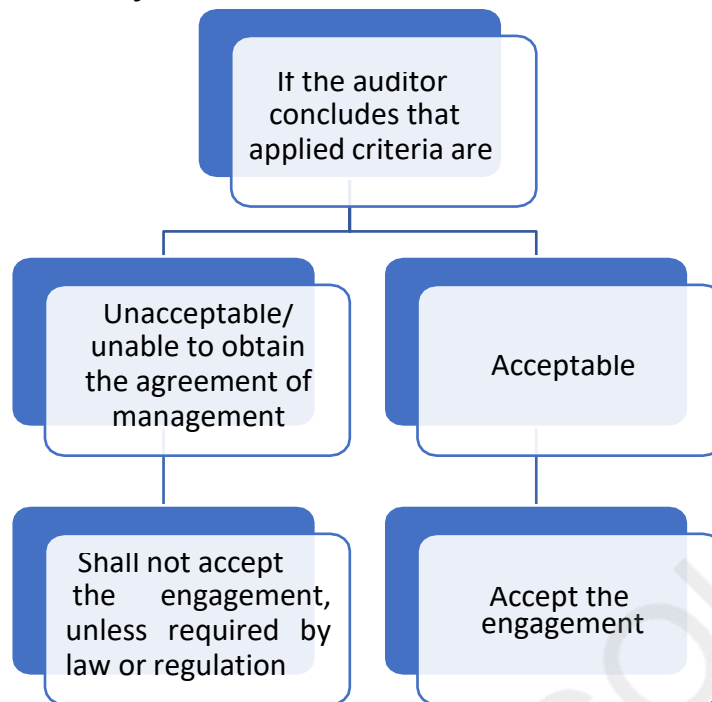
## 2. **Pre-conditions for acceptance of an engagement:**

Before accepting an engagement to report on summary Financial Statements, the auditor shall:

- i. Determine whether the **applied criteria are acceptable**,
  - a. Management is responsible to determine the information that needs to be reflected in the summary Financial Statements that are consistent, in all material respects, with or represent a fair summary of audited Financial Statements.  
However, there is an increased risk that summary Financial Statements may not contain sufficient information, and may mislead the intended users. This risk increases when established criteria for the preparation of summary Financial Statements do not exist.
  - b. Factors to determine acceptability of the criteria
    - Nature of the entity
    - Purpose of the summary Financial Statements
    - information needs of the intended users
    - Whether the applied criteria is not misleading in the circumstances
  - c. Where the criteria is established by an authorised or recognised standards setting organisation or by law or regulation, the auditor may presume that such criteria is acceptable.
  - d. Where the established criteria do not exist, criteria may be developed by management, for example, based on practice in a particular industry.
- ii. **Obtain the agreement (i.e. written acceptance) of management** that it acknowledges and understands its responsibility:
  - a. For the **preparation of the summary Financial Statements** in accordance with the applied criteria,
  - b. To **make the audited Financial Statements available to the intended users** of the summary Financial Statements without undue difficulty.

(Note: if law or regulation provides that audited **Financial Statements need not to be made available to the intended users and establishes the criteria** for the preparation of the summary Financial Statements, then, **describe** that law or regulation in the summary Financial Statements)

- c. To include the auditor's report on the summary Financial Statements.
- iii. Agree with management the form of opinion to be expressed on the summary Financial Statements.



## B Nature of Procedures

The auditor shall perform the following procedures, as the basis for his opinion on the summary Financial Statements:

- a. Evaluate whether the summary Financial Statements adequately disclose their summarized nature and identify the audited Financial Statements.
- b. When summary Financial Statements are not accompanied by the audited Financial Statements, evaluate whether they describe clearly:
  - i. From whom or where the audited Financial Statements are available; or
  - ii. The law or regulation that specifies that the audited Financial Statements need not be made available to the intended users and establishes the criteria for the preparation of the summary Financial Statements.
- c. Evaluate whether the summary Financial Statements adequately disclose the applied criteria.
- d. Compare the summary Financial Statements with the related information in the audited Financial Statements to determine whether it agrees with or can be recalculated from the related information in the audited Financial Statements.
- e. Evaluate whether the summary Financial Statements are prepared in accordance with the applied criteria.
- f. Evaluate whether summary Financial Statements contains the necessary information and are at an appropriate level of aggregation, so as not to be misleading in the circumstances.
- g. Evaluate whether the audited Financial Statements are available to the intended users of the summary Financial Statements without undue difficulty, unless

otherwise provided by law or regulation.

For the purpose of evaluation, the auditor shall consider the following factors:

- The summary Financial Statements describe clearly from whom or where the audited Financial Statements are available
- The audited Financial Statements are on public record; or
- Management has established a process by which the intended users can obtain ready access to the audited Financial Statements.

### C. Form of Opinion

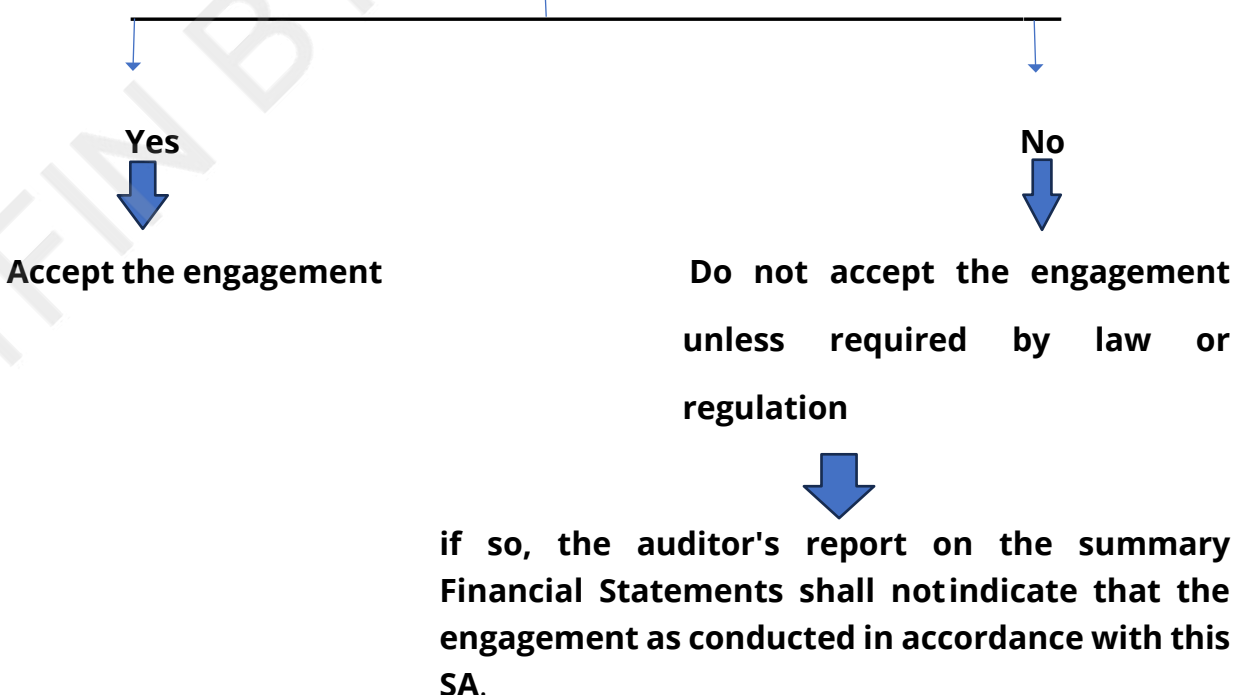
When the auditor has concluded that an **unmodified opinion** on the summary Financial Statements is appropriate, the auditor's opinion shall, unless otherwise required by law or regulation, use one of the following phrases:

1. The summary Financial Statements are consistent, in all material respects, with the audited Financial Statements, in accordance with (the applied criterion); or
2. The summary Financial Statements are a fair summary of the audited Financial Statements, in accordance with (the applied criteria).

If law or regulation prescribes different wording from above, the auditor shall:

- I. In addition to nature of procedures prescribed, perform any **further procedures** necessary to enable him to express the prescribed opinion; and
- II. Evaluate Whether the intended users might misunderstand the auditor's opinion and, if so, whether **additional explanation** in the auditor's report on the summary Financial Statements can mitigate possible misunderstanding

**If additional explanation mitigates the possible misunderstanding**



## D Timing of Work and Events Subsequent to the Date of the Auditor's Report on the Audited Financial Statements

- 1. Events occurred subsequent to the date of the auditor's report on the audited Financial Statements:** The auditor's report on the summary Financial Statements may be dated later than the date of the auditor's report on the audited Financial Statements.

In such cases, the auditor's report on the summary Financial Statements shall state that the summary Financial Statements and audited Financial Statements do not reflect the effects of events that occurred subsequent to the date of the auditor's report on the audited Financial Statements that may require adjustment of, or disclosure in the audited Financial Statements.

## F Auditor's Report on Summary Financial Statements

### 1. Elements of the Auditor's Report

The auditor's report on summary Financial Statements shall include the following elements:

#### a. Title

- Independent Auditor's Report or Report of the Independent Auditor

#### b. Addressee

- As required by circumstances of the engagement i.e. appointing authority.
- If different than auditor's report on audited Financial Statements, evaluate its appropriateness.

#### c. Introductory paragraph

- identifies the summary Financial Statements, including title of each statement included therein.
- identifies the audited Financial Statements, date of that report & in cases other than where audited Financial Statements contain modified opinion, emphasis of matter paragraph and other matter paragraph, the fact that an unmodified opinion is expressed on the audited Financial Statements.
- If the date of the auditor's report on the summary Financial Statements is later than the date of the auditor's report on the audited Financial Statements, states that the summary Financial Statements and the audited Financial Statements do not reflect the effects of events that occurred subsequent to the date of the auditor's report on the audited Financial Statements; and
- A statement indicating that the summary Financial Statements do not contain all the disclosures required by the FINANCIAL REPORTING FRAMEWORK applied in the preparation of the audited Financial Statements, and that reading the summary Financial Statements is not a substitute for reading the audited Financial Statements.

**d. Management's Responsibility**

Management is responsible for the preparation of the summary Financial Statements in accordance with the applied criteria

**e. Auditor's Responsibility**

- A statement that the auditor is responsible for expressing an opinion on the summary Financial Statements based on the procedures required by this SA.

**f. Opinion paragraph**

**g. Signature**

- Auditor's signature
- Firm Registration Number
- ICAI Membership number

- UDIAN

**h. Date of the report**

*Earlier of:*

- Date on which the auditor has obtained sufficient appropriate evidence on which to base the opinion, including evidence that the summary Financial Statements have been prepared and those with the recognised authority have asserted that they have taken responsibility for them; and
- Date of auditor's report on audited Financial Statements

**i. Place of signature**

2. Modifications to the Opinion, Emphasis of Matter Paragraph or Other Matter Paragraph in the Auditor 's Report on the Audited Financial Statements



If audited financial statements contain

**Qualified opinion, EOM paragraph or OM paragraph**

but auditor is satisfied that summary FS are consistent, in all material respects, with audited FS as per applied criteria

Auditor's report on summary FS shall

a. State that the auditor's report on the audited financial statements contains a qualified opinion, EOM paragraph, or OM paragraph

b. Describe

(i) That qualified opinion, EOM paragraph or OM paragraph

(ii) Basis for such opinion

(iii) Effect thereof on summary FS, if any

**Adverse opinion/Disclaimer of Opinion**

(a) State that auditor's report on audited FS contain adverse opinion or disclaimer of opinion

(b) Describe the basis for such opinion

(c) State that, due to such opinion, it is inappropriate to express an opinion on summary FS

**This is In addition to the elements of auditor's report**

### **Modified opinion on the Summary Financial Statements**

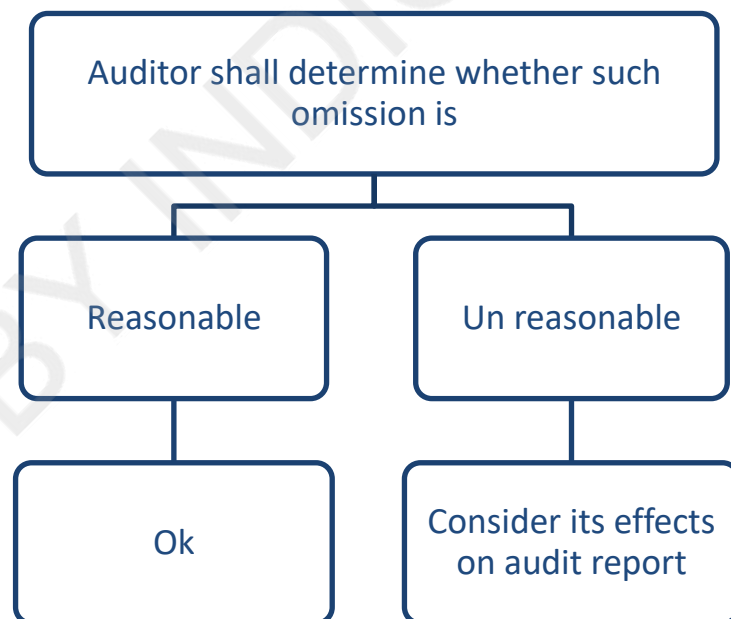
**If summary Financial Statements are not consistent with audited Financial Statement and Management does not agree to make necessary changes, then, the auditor shall express an adverse opinion on summary FS**

### **F Restriction on Distribution or Use or Alerting Readers to the Basis of Accounting**

The auditor shall include a similar restriction or alert in the auditor's report on the summary Financial Statements as provided in auditor's report on audited Financial Statements.

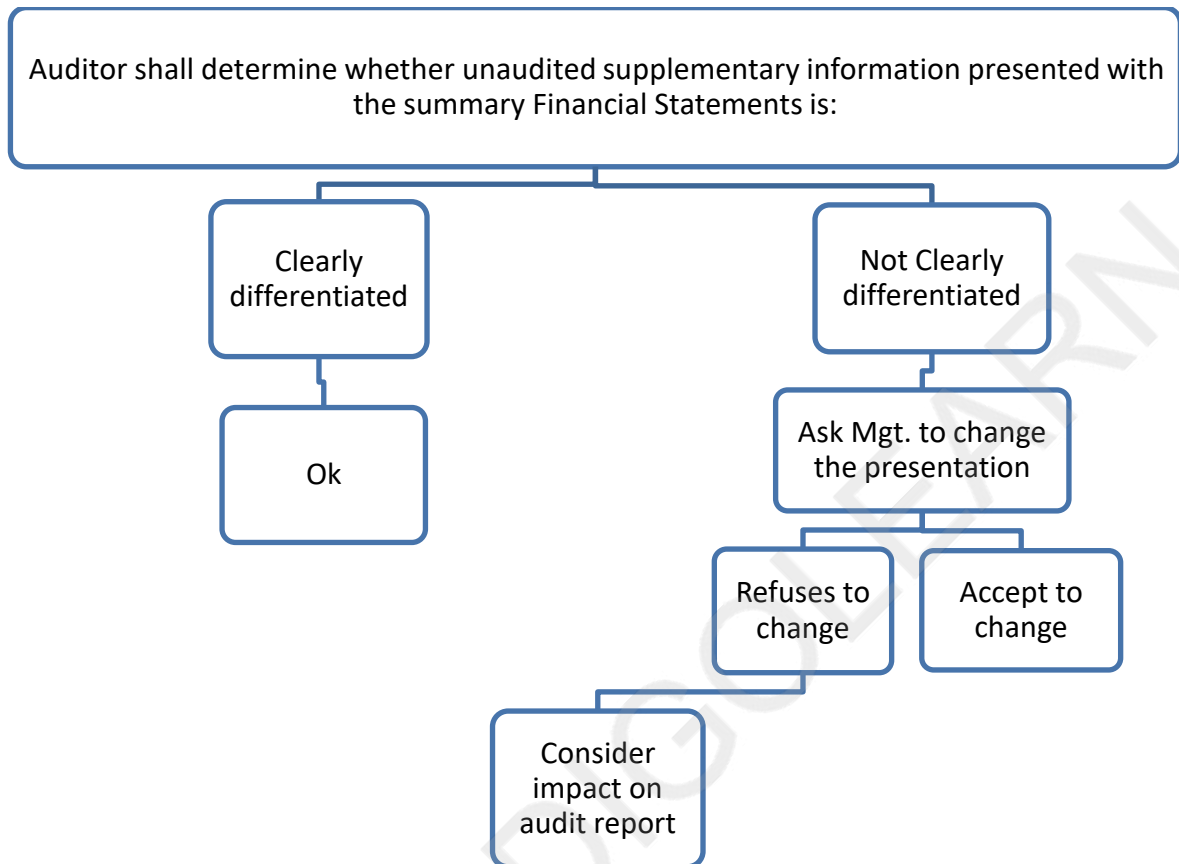
### **G. Comparatives**

- a. Where audited Financial Statements contains comparative (i.e. corresponding figures or comparative financial information) and, summary Financial Statements omits such disclosure, then,

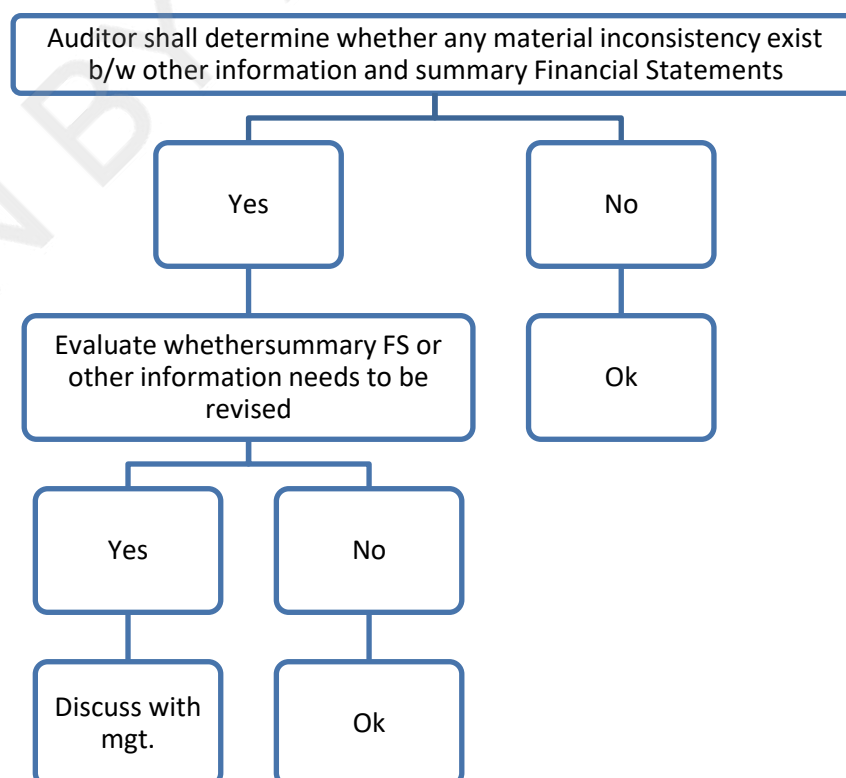


- b. If summary Financial Statements contain comparatives that were reported on by another auditor, the auditor's report on the summary Financial Statements shall also contain the matters that SA 710 requires the auditor to include in the auditor's report on the audited Financial Statements.

## H. Unaudited Supplementary Formation Presented with Summary Financial Statements

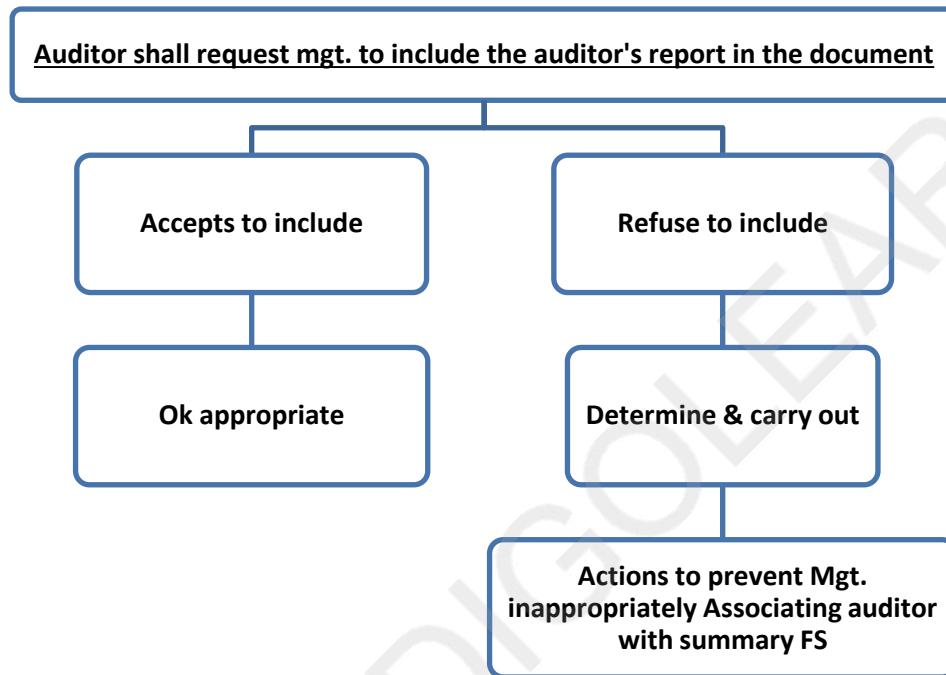


## I Other Information in Documents Containing Summary Financial Statements



**Case -A**

**Entity plans to state that auditor reported on summary Financial Statements but does not include the related auditor's report in a document containing summary Financial Statements**



**Case-B**

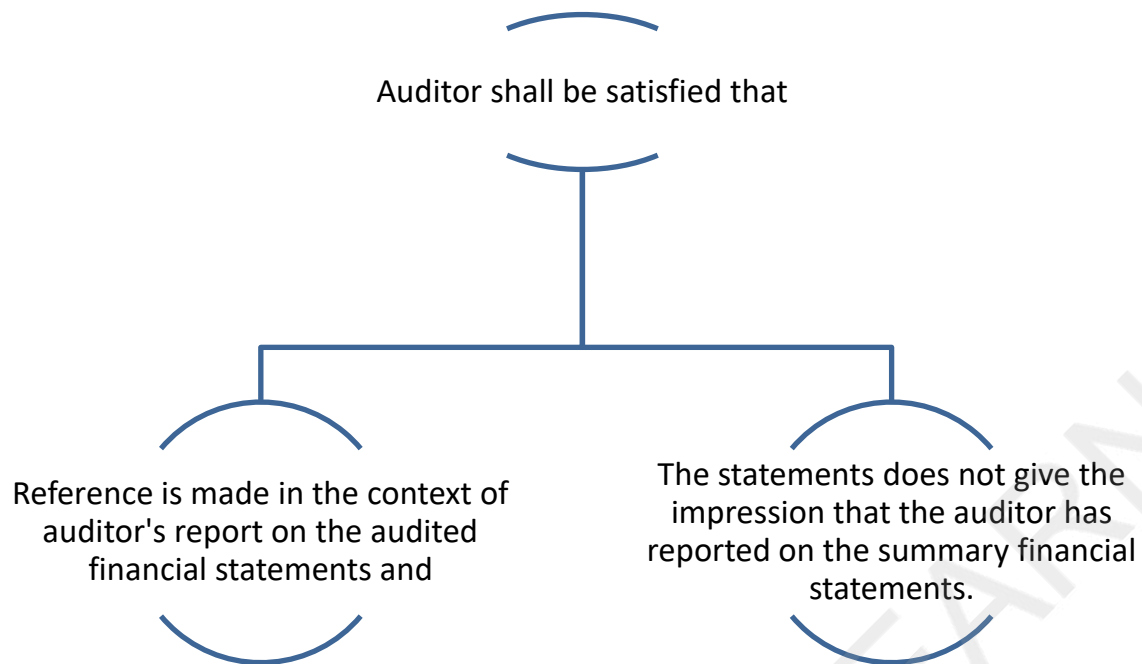


**Auditor engaged to report on audited Financial Statements but not on the summary Financial Statements**



**Entity plans to make a statement that refers auditor and the fact that summary Financial Statements are derived from audited Financial Statements audited by the auditor.**





If (a) or (b) are not met, the auditor shall request management to change the statement to meet them, or not to refer to the auditor in the document

Accepts to change



Ok

Refuse to change



- (a) Advise management that the auditor disagrees with the reference to the auditor
- (b) Determine & carry out appropriate actions to Prevent Mgt. inappropriately referring to the auditor.

# SRE 2400: ENGAGEMENTS TO REVIEW HISTORICAL FINANCIAL STATEMENTS

## Scope

This Standard on Review Engagements (SRE) deals with:

1. The practitioner's responsibilities to **perform review of historical financial statements**, when he is **not the auditor** of entity's financial statements; and
2. The **form and content** of the report.

## Purpose

In review, the practitioner expresses a conclusion that is designed to **enhance the degree of confidence of intended users** regarding the preparation of an entity's financial statements in accordance with an applicable financial reporting framework.

## Opinion

Practitioner's conclusion is based on the **limited assurance obtained**.

## Procedure

Practitioner **performs inquiry and analytical procedures to obtain sufficient appropriate evidence** as the basis for a conclusion on the financial statements as a whole.

## Misstatement

If the **practitioner becomes aware** of a matter that **financial statements may be materially misstated**, the **design and perform additional procedures**, as necessary in the circumstances, to be able to conclude on the financial statements.

## Objectives

**obtain limited assurance**, primarily by making **an inquiry and performing analytical procedures**, about whether the **financial statements as a whole is free from material misstatement**, thereby enabling the practitioner to **express a conclusion** on whether anything has come to his attention that causes him to believe the financial statements are not prepared, in all material respects, in accordance with on A-FRE); and

**Report on the financial statements as a whole and communicate**, as required by this SRE. In cases, when limited assurance cannot be obtained express a modified conclusion, or disclaim a conclusion in the report or, where appropriate, withdraw.

## Limited Assurance

The level of assurance obtained where engagement risk is reduced to a level that is acceptable in the circumstances of the engagement, but where that risk is greater than for a reasonable assurance engagement, as the basis for expressing a conclusion.

### A limited assurance engagement:

- provides **lower level of assurance** than audit
- involves **fewer procedures**

- gathers sufficient and appropriate **evidence on basis of which limited conclusions** are drawn.

### Compliance with Ethical Requirements and Engagement level quality control

The practitioner shall comply with relevant ethical requirements, including independence; and

the engagement partner is responsible for overall quality of each review engagement.

### Refuse to Accept

**a. The practitioner is not satisfied:**

- i. **That there is a rationale purpose for the engagement.**

**It may be unlikely that there is a rational purpose for the engagement if, for example:**

- There is a **significant limitation** on scope of work;
- Practitioner **suspects association of the practitioner's name** in an **inappropriate manner**, or
- The engagement is intended to meet compliance requirements of relevant **law or regulation and such law or regulation requires the financial statements to be audited.**

- ii. **That a review engagement would not be appropriate in the circumstances;**  
Practitioner may consider recommending that another type of engagement be undertaken, for instance, audit engagement, or a compilation engagement or other accounting services engagement, as appropriate

- b. . The practitioner has reason to believe that relevant **ethical requirements**, including independence, **will not be satisfied.**
- c. The practitioner's preliminary understanding of the engagement circumstances indicates that **information needed** to perform the review engagement **is likely to be unavailable or unreliable;**
- d. The practitioner has cause **to doubt management's integrity** such that it is likely to affect proper performance of the review; or
- e. **Management or TCWG impose a limitation on scope** of the practitioner's work such that the practitioner believes the limitation will result in the practitioner **disclaiming conclusion** on the financial statements.

### PRECONDITIONS FOR ACCEPTING A REVIEW

1. Acceptability of FRFW applied in preparation of financial statements.
2. Agreement of management in acknowledging and understanding its responsibility for preparation of financial statements and IC.
3. Providing access to all information to the practitioner for the purpose of review and unrestricted access to persons within the entity.

If the practitioner is not satisfied with any of the pre-conditions



-Evaluate whether management or TCWG accepts to change. If agrees, accept the engagement. If they refuse,

- The practitioner shall not accept the proposed engagement unless required by law or regulation.
- If accepted due to law or regulation, the practitioner shall not include any reference within his report that review has been conducted accordance with his SRE.
- If it is discovered, after the engagement has been accepted that the practitioner is not satisfied with any of the above preconditions, the practitioner shall discuss the matter with management or TCWG and shall determine
  - (a) Whether the matter can be resolved.
  - (b) Whether it is appropriate to continue with engagement; and
  - (c) Whether and, if so, how to communicate the matter in the practitioner's report.

### AGREEING TO THE TERMS OF ENGAGEMENT

Agree the terms of the engagement with management or TCWG, prior to performing	→	The agreed terms of engagement shall be recorded in an engagement letter or another required format.
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### Recurring Engagements

1. Evaluate whether circumstances, including changes in the engagement acceptance considerations,
  - **require the terms of engagement to be revised; and**
  - **Whether there is a need to remind management or TCWG, as appropriate, of the existing terms of engagement**
2. Practitioner shall **not agree to a change** in the terms of the engagement where **there is no reasonable justification for doing so.**
3. If, prior to completing the review engagement, **practitioner is requested to change** the engagement to an engagement for which no assurance is obtained, determine whether there is reasonable justification for doing so.
4. **If terms of engagement are changed** during the course of the engagement, the practitioner and management or TCWG, as appropriate, **shall agree on and record** the new terms of engagement in an engagement letter or any other written agreement.

### Performing the review engagement in accordance with SRE 2400

Determine materiality for financial statements as a whole.
--

Obtain understanding of entity and applicable financial reporting framework to identify areas of possible material misstatements
--

Design and perform "inquiry" and "Analytical procedures"

Perform procedures to address specific circumstances

Perform other procedures, if necessary, in circumstances.

## Materiality in a review of financial statements

- Determine materiality for the financial statements as a whole, for designing procedures and in evaluating results.
- Practitioner's judgment **about materiality** in relation to financial statements as a whole is **same regardless of the level of assurance obtained**.
- Practitioner shall revise materiality for the financial statements as a whole in the event of becoming aware of information during the review that would have caused the practitioner to have determined a different amount initially.

## Obtaining Understanding of the Entity

The practitioner shall obtain an understanding of the **entity** and its **environment**, and **applicable financial reporting framework**.

## Designing and Performing Procedures

- I. In obtaining **sufficient appropriate evidence** as the basis for a conclusion on the financial statements as a whole, the practitioner shall design and perform **inquiry** and **analytical procedures**:
  - a) To address all **material items** in the financial statements, including disclosures, and
  - b) **To focus on addressing areas** in the financial statements where material misstatements are **likely to arise**.
- II. There may be circumstances where practitioner may consider to design and perform **other procedures**.

For example, if in the course of obtaining an understanding of the entity, practitioner becomes aware of a significant contract the practitioner may choose to read the contract.
- III. Practitioner may consider, **reviewing the accounting records** with a view to identifying significant or unusual transactions that may require specific attention in the review.

## Practitioner's Procedures

### Inquiry:

- Inquiry includes seeking information from management and other persons within the entity.
- Inquiries include matters such as: **(Estimates, RP, EARD, GC, E or C-SD, Frauds, Inconsistencies, non-financial data, etc.)**
  - making of **accounting estimates**,
  - identification of **related parties**, about significant, complex or unusual transactions,

- existence of any actual, suspected or alleged **fraud**,
  - **events occurring between the date** of financial statements and practitioner's report,
  - basis for management's assessment of entity's ability to continue as **a going concern**,
  - **events or conditions that appear to cast doubt** on the entity's ability to continue as a going concern,
  - material **commitments**,
  - contractual obligations or contingencies **that have affected or may affect the entity's financial statements** including disclosures and material non-monetary transactions or transactions for no consideration in the financial reporting period under consideration.
- Practitioner may also extend inquiries to obtain **non-financial** data if appropriate.
- **Evaluating responses** provided by management is integral to inquiry process.
- Depending on engagement circumstances, inquiries may also include **inquiries about**:
- Actions taken at meeting of owners, TCWG and committees thereof, and proceeding at other meeting, if any, that affect the information and disclosures contained in financial statements.
- ↓
- Communications the entity has received, or expects to receive or obtain, from regulatory agencies.
- ↓
- Matters arising in the course of applying other procedures.
- When performing further inquiries in relation **to identified inconsistencies**, the practitioner considers:
- **Reasonableness and consistency of management's responses** in light of the results obtained from other procedures,
  - **Practitioner's knowledge and understanding of the entity** and the industry in which it operates.

### Analytical procedures:

- In designing analytical procedures, practitioner shall consider whether data from the entity's accounting system and accounting records are adequate for the purpose of performing analytical procedure

#### **Why "Inquiry and "Analytical procedures" are important in Review?**

1. Evidence obtained through **inquiry is the principal source of evidence** about management intent
2. However, information available **to support management's intent** may be limited.  
In that case, **understanding**:

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

may provide relevant information to corroborate evidence obtained through inquiry.

3. **Professional skepticism** helps in evaluating management responses.
4. **Inquiry procedures assists** practitioner **in obtaining or updating** the practitioner's **understanding of the entity and its environment**, to be able to identify areas where material misstatements are likely to arise in the financial statements.
5. In a review of financial statements, performing **analytical procedures** assists the practitioner in:
  - **obtaining understanding of entity and its environment**, including to be able to **identify areas where material misstatements** are likely to arise in the financial statements.
  - identifying **inconsistencies or variances** from expected trends, values or norms in financial statements such as the level of congruence of financial statements with key data, including key performance indicators.
  - Providing **corroborative evidence** in relation to other inquiries or analytical procedures already performed.
  - Serving **additional procedures** when the practitioner becomes aware of matters that cause the practitioner to believe that financial statements may be materially misstated.
6. **Example** of additional procedure is a comparative analysis of monthly revenue and cost figures across profit centres, branches or other components of the entity, to provide evidence about financial information contained in line items or disclosures made in the financial statements.

## Procedures to Address Specific Circumstances

### Related party:

- During review, practitioner **shall remain alert** for arrangements or information that may indicate existence of related party relationships or transactions that **management has not previously identified** or disclosed to the practitioner.
- If practitioner identifies significant **transactions outside the entity's normal course of business**, practitioner shall inquire with management about
  - i. **Nature of those transactions**,
  - ii. **Possible involvement of related parties**
  - iii. **Business rationale** (or lack thereof) of those transactions.

### Fraud and non-compliance with laws or regulations:

- When there is an **indication** that fraud or non-compliance with laws or regulations, or suspected fraud or non-compliance with laws or regulations, has occurred in the entity, practitioner **shall communicate that matter to the appropriate level of senior management or TCWG** as appropriate and request management's assessment of the effects, if any, on the financial statements.

- Practitioner has to **consider the effect, if any, of management's assessment** of the effects of fraud or non-compliance with laws or regulations communicated to him on his conclusion on the financial statements and **on his report**.
- Practitioner shall determine **whether there is a responsibility to report the occurrence or suspicion of fraud or illegal acts** to a party outside entity.

### Going concern:

- Review of financial statements includes consideration of **entity's ability to continue as a going concern**.
- If, during performance of review, practitioner becomes aware of events or conditions that may cast **significant doubt** about **the entity's ability** to continue as a going concern, the practitioner shall:

#### (a) **Inquire management about:**

- plans for **future actions affecting the entity's ability** to continue as a going concern.
- **feasibility of those plans,**
- whether management believes that the outcome of those plans will improve the situation.

#### (b) Evaluate results of those inquiries, to consider whether management's responses provide a sufficient basis to:

- i. Continue to present the financial statements on the going concern basis if the acceptable financial reporting framework includes assumption of an entity's continuance as a going concern: or
- ii. Conclude whether the financial statements are materially misstated, or are otherwise misleading regarding entity's ability to continue as a going concern; and

#### (c) **Consider management's responses** in light of all relevant information of which practitioner is aware as a result of review.

### Use of work performed by others:

- During review, it may be necessary for practitioner to **use work performed by other practitioners**, or work of an individual or organisation possessing **expertise in a field** other than accounting or assurance.
- If practitioner uses work performed by another practitioner or an expert in course of review, **he shall take appropriate steps to be satisfied that the work performed is adequate for his purposes**.

### Review of Group's financial statements:

When practitioner is engaged to review the **financial statements of group of entities**, the planned nature, timing and extent of procedures for the review are directed at achieving the practitioner's objectives for the review engagement in accordance with this standard but in the context of the group financial statements.

## Additional Procedures when the practitioner becomes aware that the financial statements may be materially misstated

1. Design and perform **additional procedures** sufficient to **enable the practitioner to:**
  - (a) Conclude that the matter(s) **is not likely** to cause the financial statements as a whole to be **materially misstated**; or
  - (b) Determine that the matter(s) **causes the financial statements** as a whole to **be materially misstated**.
2. Practitioner's response will vary, depending on the circumstances, and is a matter for the practitioner's **professional judgment**.
3. **Some of the additional procedures are:**
  - **Additional inquiry or analytical procedures,**
  - **Other types of procedures,** for example, substantive test of details or external confirmations.

### Example explaining when additional procedures may be necessary in review:

While performing inquiry and analytical procedures, analysis of accounts receivable shows a **material amount of past due accounts receivable**, for which there **is no allowance for bad or doubtful debts**. This causes the practitioner to believe that accounts receivable balance in the financial statements may be materially misstated.



Then, practitioner shall inquire management whether there are **uncollectible accounts receivable** that would need to be shown as being impaired.



### Depending on management's response, practitioner's evaluation of the response may:

- a. Enable the practitioner to **conclude** that accounts receivable balance is **not likely required. to be materially misstated**. In that case, no further procedures are required.
- b. **Enable the practitioner to determine** that the matter causes the financial statements to **be materially misstated**. No further procedures are required, and practitioner would form the conclusion that financial statements as a whole are materially misstated.
- c. Lead the practitioner to continue to believe that accounts receivable balance is **likely to be materially misstated**, while not providing sufficient appropriate evidence.

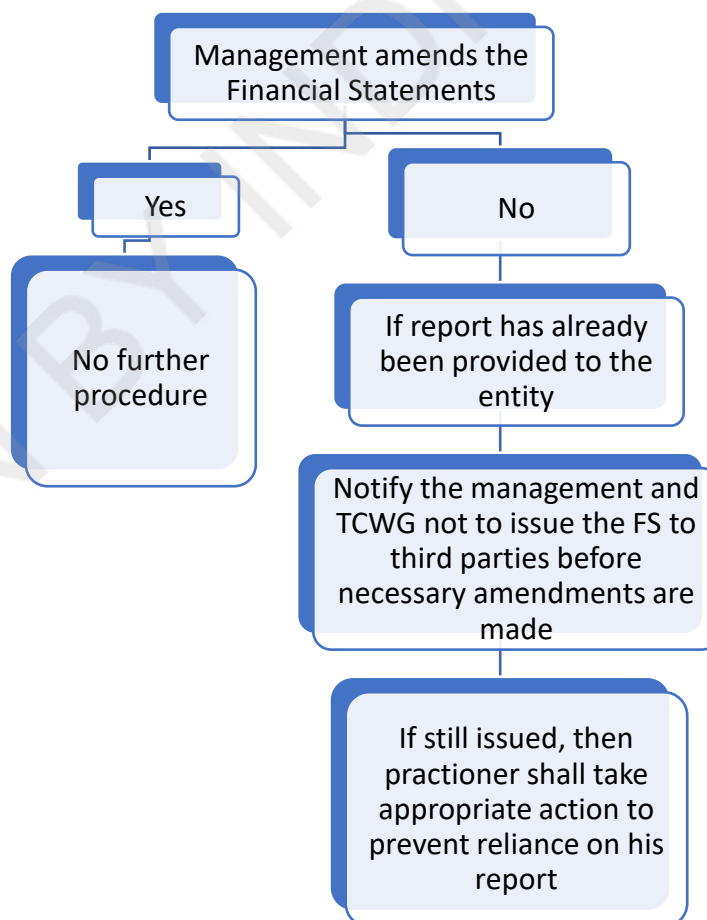
### If not, the practitioner is required to:

- i. **Continue performing additional procedures** until practitioner reaches either (a) or (b) above; or

- ii. If practitioner is **not able to conclude** then a **scope limitation exists** and the practitioner is **not able to form an unmodified conclusion on the financial statements**.

## SUBSEQUENT EVENTS

1. If the **practitioner becomes aware** of events occurring between the date of the financial statements and the date of the practitioner's report **that require adjustment of, or disclosure** in, the financial statements, the practitioner shall **request management** to correct those misstatements.
2. **If after the date of the practitioner's report** but before the date financial statements are issued, a fact becomes known to the practitioner that, had it been known to him at the date of his report, may have caused him to amend the report, **he shall:**
  - (a) Discuss the **matter with management or TCWG**, as appropriate,
  - (b) **Determine whether the financial statements need amendment; and**
  - (c) If so, **inquire how management intends to address** the matter in the financial statements.
  - (d) **Evaluate whether management amended the financial statements:**

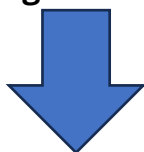


## Written Representations



1. Request management to provide a written representation that **management has fulfilled its responsibilities** described in the agreed terms of engagement.
  - a. Management has fulfilled its responsibility for the **preparation of financial statements in accordance with Acceptable Financial Reporting Framework**, including where relevant their fair presentation, and has provided the practitioner with all relevant information and access to information as agreed in the terms of the engagement; and
  - b. All transactions have been **recorded and are reflected in the financial statements**.
2. If law or regulation requires **management to make written public statements** about its responsibilities, and the practitioner determines that such statements provide some or all of the representations required above, the matters covered by such statements **need not be included in the written representation**.
3. Practitioner **may request other written representations about the financial statements**, for example, to complete the practitioner's evidence w.r.t certain items or disclosures reflected in the financial statements where such representations to be important in forming a conclusion on the financial statements on either a modified or unmodified basis.
4. **Practitioner shall also request management's written representations that management has disclosed to him:**
  - **Identity of the entity's related parties** and all related party **relationships and transactions** of which management is aware;
  - Significant facts relating to any **frauds or suspected frauds** known to management that may have affected the entity;
  - Known actual or possible **non-compliance with laws and regulations** for which the effects of non-compliance affect the entity's financial statements;
  - All information relevant to use of the **going concern assumption** in the financial statements;
  - That all events occurring **subsequent to the date of the financial statements** and for which the applicable financial reporting framework requires adjustment or disclosure, have been adjusted or disclosed;
  - **Material commitments**, contractual obligations or contingencies that have affected or may affect the entity's financial statements, including disclosures; and
  - **Material non-monetary transactions** or transactions for no consideration undertaken by the entity in the financial reporting period under consideration.
5. If management ***does not provide one or more of the requested written representations, the practitioner shall:***

**Discuss the matter with management and TCWG, as appropriate;**



**Re-evaluate the integrity** of management, and evaluate the effect that this may have on the reliability of representations (oral or written) and evidence in general; and



**Take appropriate** actions, including determining the possible effect on the conclusion in the practitioner's report.

6. The practitioner shall **disclaim a conclusion on the financial statements, or withdraw** from the engagement if withdrawal is possible under applicable law or regulation, as appropriate, if:
  - a. There **is sufficient doubt about the integrity of management** such that written representations are not reliable or
  - b. Management **does not provide the required representations**.

#### **7. Evaluating evidence obtained from the procedures performed**

1. The practitioner **shall evaluate whether sufficient appropriate evidence has been obtained**, if not, perform other procedures.
2. In some circumstances, practitioner considers that the **evidence obtained** from procedures performed is **not sufficient and appropriate** to be able to form a conclusion on the financial statements.

**The practitioner may:**

- **Extend the work performed;** or
  - **Perform other procedures** as necessary in the circumstances.
3. If the practitioner is **not able to obtain sufficient appropriate evidence** to form a conclusion, then in such case, **practitioner shall discuss with management and TCWG**, as appropriate, the effects such limitations have on the scope of the review.

#### **8. Forming the practitioner's conclusion on the financial statements**

1. **The practitioner shall consider the impact of:**
  - i. **Uncorrected misstatements identified during the review, and in the previous year's review** of the entity's financial statements, on the financial statements as a whole; and
  - ii. **Qualitative aspects** of the entity's accounting practice, including indicators of possible bias in management's judgments.
2. If the financial statements are prepared using a **fair presentation framework**, the practitioner's consideration shall also include:
  - i. **The overall presentation**, structure and content of the financial statements in accordance with the applicable framework; and
  - ii. Whether the financial statements, including the **related notes**, appear to represent the underlying transactions and events in a manner that achieves fair

presentation or gives a true and fair view, as appropriate, in the context of the financial statements as a whole.

## FORM OF THE CONCLUSION

The practitioner's conclusion on the financial statements, whether unmodified or modified, shall be expressed in the appropriate form in the context of the FRFW applied in the financial statements.

Basis	Unmodified Opinion	Modified opinion	financial statements are materially misstated	
when to express	When practitioner has obtained <b>limited assurance</b> to be able to conclude that nothing has come to the practitioner's attention that causes him to believe that the financial statements are not prepared, in all material respects, in accordance with A-FREW.	When A Practitioner determines, based on procedures performed and evidence obtained, that the <b>financial statements are materially misstated</b> , or b) Practitioner is <b>unable to obtain sufficient and appropriate evidence</b> in relation to one or more items in the financial statements that are material in relation to the financial statements as a whole.	The practitioner shall express:  A ) <b>A qualified conclusion</b> , when practitioner concludes that the effects of the matter(s) giving rise to the modification are material, but not pervasive to the financial statements; or	b) <b>An adverse conclusion</b> , when the effects of the matter(s) giving rise to the modification are both material and pervasive to the financial statements.
<b>Presentation</b>	Practitioner shall, unless required by	The practitioner shall:	When the practitioner expresses a	When the practitioner expresses an

	<p>law or regulation, use one of the <b>following phrases</b>, as appropriate:</p> <p>(a) "Based on our review, nothing has Come to our attention that causes us to believe that the financial statements do not give a true and fair view (or do not present fairly, in all material respects), in accordance with the A-FREW (for financial statements prepared using a fair presentation framework); or (b) <b>"Based On our review,</b> nothing has Come to our attention that causes us to believe that the financial statements are not prepared, in all material respects, in</p>	<p>A) Use the heading <b>"Qualified Conclusion," "Adverse Conclusion" or "Disclaimer of Conclusion,"</b> as appropriate, for the conclusion paragraph in the practitioner's report; and (b) Provide a description of the matter giving rise to the modification, under an appropriate heading (for example, <b>"Basis for Qualified Conclusion," "Basis for Adverse Conclusion" "Basis for Disclaimer of Conclusion,"</b> as appropriate) in a separate paragraph in the practitioner's report immediately before the conclusion</p>	<p><b>qualified conclusion,</b> practitioner shall, unless otherwise required by law or regulation, use one of the following phrases, as appropriate:</p> <p>A) Based on our review, except for the effects of the matter(s) described in the <b>Basis for Qualified Conclusion</b> paragraph, nothing has come to our attention that causes us to believe that the fs do not give a true and fair view (or do not view present fairly, in all material respects), material respects), the A-FRFW) (for financial statements prepared using a fair presentation framework); or <b>b ) "Based on our review,</b> expect for the effects of the matter(s) described in the Basics for Qualified Conclusion paragraph, nothing has come to our attention that causes us to believe that the financial statements are not prepared, in all</p>	<p><b>adverse conclusion</b> on the financial statements, practitioner shall, unless otherwise required by law or regulation, use one of the following phrases, as appropriate:</p> <p>A) "Based on our review, due to the significance of the matter(s) described in the <b>Basis for Adverse Conclusion Paragraph, the fs</b> do not give a true and fair view (or do not present fairly, in all material respects). In accordance with the applicable financial reporting framework (for financial statements prepared using a fair presentation framework); or <b>B ) "Based on our review</b> due to the significance of the matter(s) described in the Basis for Adverse conclusion paragraph, the</p>
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		paragraph (referred to as the basis for conclusion paragraph).	material respects, in accordance with the applicable financial reporting framework (for financial statements prepared using a compliance framework)	financial statements are not prepared, in all material respects, in accordance with the applicable financial reporting framework (for financial statements prepared using a compliance framework).
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### Basis for Conclusion Para

Qualified Conclusion	Disclaiming a conclusion
<p>When the practitioner expresses a qualified conclusion on the financial statements <b>due to inability to obtain sufficient and appropriate evidence</b>, the practitioner shall, unless otherwise required by law or regulation, use one of the following phrases, as appropriate:</p> <p>(a) <b>"Based on our review</b>, except for the possible effects of the matter(s) described in the Basis for Qualified conclusion paragraph, nothing has come to our attention that causes us to believe that the financial statements do not give a true and fair view (or do not present fairly, in all material respects) in accordance with the applicable financial reporting framework (for financial statements prepared using a fair presentation framework);</p> <p><b>Or</b></p> <p>(b) <b>"Based on our review</b>, except for the possible effects of the matter(s) described in the Basis for Qualified Conclusion paragraph, nothing has come to our attention that causes us to believe that the financial</p>	<p>(a) Due to the significance of the matter(s) described in the <b>Basis for Disclaimer of Conclusion</b> paragraph, the practitioner is unable to obtain sufficient appropriate evidence to form a conclusion on the financial statements; and</p> <p>(b) Accordingly, the practitioner <b>does not express a conclusion on the financial statements</b>,</p>

statements are not prepared, in all material respects, in accordance with the applicable financial reporting framework (for financial statements prepared using a compliance framework).	
In the basis for conclusion paragraph, in relation to either the qualified conclusion due to inability of obtaining sufficient and appropriate evidence or when the practitioner disclaims a conclusion, the practitioner <b>shall include the reason(s)</b> for the inability to obtain sufficient and appropriate evidence.	

## The practitioner's report

The practitioner's report shall be in writing, and shall contain the following elements:

- **Title**, clearly indicating that it is the report of an independent practitioner for a review engagement;
- **Addressee(s)**, as required by the circumstances of the engagement;
- **Introductory paragraph that:**
  - i. identifies the financial statements reviewed. including identification of the title of each of the statements contained in the set of financial statements and the date and period covered by each financial statement;
  - ii. Refers to the summary of significant accounting policies and other explanatory information; and
- Description of **the responsibility of management** for the preparation of the financial statements, including an explanation that management is responsible for:
  - i. Their preparation in accordance with the applicable financial reporting framework including, where relevant, their fair presentation;
  - ii. Such IC as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error;
- **If the financial statements are special purpose financial statements:**
  - i. A description of the purpose for which the financial statements are prepared and, if necessary, the intended users, or reference to a note in the Special Purpose financial statements that contains that information; and
  - ii. If management has a choice of FRFW in the preparation of such financial statements, a reference within the explanation of management's responsibility for the financial statements to management's responsibility for determining that the applicable financial reporting framework is acceptable in the circumstances;
- Description of the **practitioner's responsibility** to express a conclusion on the financial statements including reference to this SRE and, where relevant, applicable law or regulation;
- Description of a review of financial statements and its limitations, and the following statements:

- i. A review engagement under this SRE OS a limited assurance engagement;
- ii. The practitioner performs procedures, primarily consisting of making inquiries of management and others within the entity, as appropriate, and applying analytical procedures, and evaluates the evidence obtained; and
- iii. The **procedures performed in a review are substantially less** than those performed in an audit conducted in accordance with Standards on Auditing (SAs), O2d. accordingly, the practitioner **does not express an audit opinion on the financial statements**;
- A paragraph under the heading "Conclusion" that contains:
  - i. The practitioner's conclusion on the financial statements as a whole as appropriate; and
  - ii. A reference to the applicable financial reporting framework used to prepare the financial statements.
- When the practitioner's conclusion on the financial statements is modified:
  - i. A paragraph under the appropriate heading that contains the practitioner's modified conclusion, as appropriate; and
  - ii. A paragraph, under an appropriate heading, that provides a description of the matter(s) giving rise to the modification;
- Reference to the practitioner's obligation under this **SRE to comply with relevant ethical requirements**;
- **Date of practitioner's report**:

**Not earlier than** the date on which practitioner has obtained sufficient appropriate evidence as the basis for conclusion on the financial statements, including being satisfied that:

- i. All statements that comprise the financial statements under the applicable financial reporting framework, including the related notes where applicable, have been prepared and
- ii. Those with the recognised authority have asserted that they have taken responsibility for those financial statements.
- Practitioner's **signature**; and
- **Place** of signature.

## EMPHASIS OF MATTER (EOM) AND OTHER MATTER (OM) PARAGRAPHS IN THE PRACTITIONER'S REPORT

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EOM Paragraph	OM Paragraph
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<ul style="list-style-type: none"> <li>• Practitioner may consider it necessary to draw users' attention to a matter presented or disclosed in the financial statements that, in the practitioner's judgment, is of such importance that it is <b>fundamental to users' understanding of the financial statements</b>.</li> <li>• In such cases, practitioner shall include an EOM paragraph in his report, provided sufficient appropriate evidence have been obtained to conclude that the matter is not likely to be materially misstated as presented in the financial statements. Such paragraph shall refer only to the information presented or disclosed in the financial statements.</li> <li>• Practitioner shall include an EOM paragraph immediately after the paragraph that contains conclusion on the financial statements under the heading "Emphasis of Matter," or other appropriate heading.</li> </ul>	<ul style="list-style-type: none"> <li>• If the practitioner considers it necessary to communicate a matter other than those that are presented or disclosed in the financial statements that, in his judgment, is relevant to users understanding of the review, his responsibilities or report and this is not prohibited by law or regulation, the practitioner shall do so in a paragraph in his report with the heading "other Matter" or other appropriate heading.</li> </ul>
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## OTHER REPORTING Responsibilities

- a. A practitioner may be requested to address other reporting responsibilities in his report on the financial statements that **are in addition to his responsibilities under this SRE**.
- b. In such situations, those other reporting responsibilities shall be addressed by the practitioner in a separate section in his report headed **Report on Other Legal and Regulatory Requirements**," or otherwise as appropriate to the context of the section, following the section of the report headed "Report on the financial statements."

## DOCUMENTATION

1. The practitioner shall document the **following aspects of the engagement in a timely manner, sufficient to enable an experienced practitioner, to understand:**
  - a. **Nature, timing, and extent of procedures** performed and applicable legal and regulatory requirements;
  - b. **Results obtained** from procedures, and conclusions formed on the basis of those results; and
  - c. **Significant matters** arising during the engagement, conclusions reached thereon, and significant professional judgments made in reaching those conclusions.

2. While documenting the nature, timing and extent of procedures performed, the practitioner shall record:
  - a. **Who performed the work** and the date such work was completed, and
  - b. **Who reviewed the work** performed for the purpose of quality control for the engagement, and the period and extent of the review.
3. Practitioner shall **also document discussions with management, TCWG, and others as relevant to the performance of the review of significant matters arising during the engagement, including nature of those matters.**
4. If, in the course of the engagement, practitioner identified information that is inconsistent with his findings regarding significant matters affecting the Fs, he shall document how the inconsistency was addressed.

## AUDIT VS., REVIEW

<u>Audit</u>	<u>Review</u>
Audit is a type of reasonable assurance engagement providing reasonable level of assurance	Review is a type of limited assurance engagement providing a lower level of assurance than reasonable assurance engagement.
it performs elaborate and extensive procedures including tests of controls and substantive procedure	It performs fewer procedures primarily focusing on inquiry and analytical procedures.
it draws reasonable conclusions on the basis of sufficient appropriate evidence.	It draws limited conclusions on the basis of sufficient appropriate evidence.
It provides an assurance conclusion; The language of assurance conclusion is positively worded.	It provides an assurance conclusion. The language of assurance conclusion is negatively worded.

## SRE- 2410: REVIEW OF INTERIM FINANCIAL INFORMATION PERFORMED BY THE INDEPENDENT AUDITOR OF THE ENTITY

### SCOPE OF THIS SRE

SRE 2410 applies when review of interim Financial Information (Interim Financial Information) is performed by the independent auditor of the financial statements of the entity.

## MEANING OF INTERIM FINANCIAL INFORMATION (Interim Financial Information)

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Interim Financial Information is financial information that is:

- Prepared and presented in accordance with applicable Financial Reporting Framework
- Comprises either complete or condensed set of FS
- For a period that is shorter than the entity's FY.

Interim Financial Information may relate to FS of a quarter of FY.

## Objective of an engagement to review Interim Financial Information

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1. The objective is to enable the auditor to **express a conclusion** whether, on the basis of the review, anything has come to the auditor's attention that causes the auditor to believe that the **Interim Financial Information is not prepared, in all material respects, in accordance with an applicable financial reporting framework.**
2. Auditor shall make **inquiries**, and performs **analytical & other review procedures** to reduce the risk of expressing an inappropriate conclusion to a moderate level when Interim Financial Information is materially misstated.
3. Auditor shall **reduce the risk of expressing an inappropriate conclusion to a moderate level** by making inquiries, and performing analytical & other review procedures when Interim Financial Information is materially misstated.
4. How objective of review differs significantly from objective of audit?

**A review of Interim Financial Information:**

- a) Does not provide a basis for **expressing an opinion**
- b) **Is not designed to obtain reasonable assurance** that Interim Financial Information is free from material misstatement.
- c) Consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying **analytical and other review procedures.**
- d) **May bring significant matters** affecting Interim Financial Information **to the auditor's attention**, but it does not provide all evidence that would be required in an audit.

## AGREEING THE TERMS OF THE ENGAGEMENT

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1. Auditor and client should agree on the terms of the engagement.
2. Agreed terms of the engagement are ordinarily recorded in an **engagement letter.**
3. Engagement letter helps to **avoid misunderstandings** regarding:
  - a) Nature of engagement
  - b) objective and Scope of the review
  - c) Management's responsibilities
  - d) Auditor's responsibilities
  - e) Assurance obtained

## UNDERSTANDING THE ENTITY AND ITS ENVIRONMENT INCLUDING ITS INTERNAL CONTROL

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1. Understanding **the Entity and its Environment, including its IC** sufficient to plan and conduct the engagement so as to be able to:
  - i. **identify the types of potential material misstatement** and consider the likelihood of their occurrence; and
  - ii. **Select the inquiries, analytical and other review procedures** that will provide the auditor with a basis for reporting.
2. Auditor shall update his understanding obtained during the audit of entity's annual financial statements.
3. Auditor shall also **obtain sufficient understanding of IC** related to preparation of Interim Financial Information as it may differ from the IC related to annual financial information.
4. **Procedures performed by the auditor to update the understanding of the entity and its environment, including its IC, ordinarily include the following:**
  - a) **Reading the documentation**, as necessary, of the **preceding year's audit and reviews of prior interim period(s)** of the current year and corresponding interim period(s) of the prior year, to enable the auditor to **identify matters that may affect the current-period Interim Financial Information**
  - b) Considering any **significant risks**, including the risk of management override of controls, that were identified in the audit of the prior year's financial statements.
  - c) Reading the **most recent annual and comparable prior period IF**.
  - d) **Considering materiality** with reference to the applicable financial reporting framework as it relates to Interim Financial Information to assist in determining the **nature and extent of the procedures** to be performed and evaluating the effect of misstatements.
  - e) Considering the **nature of any corrected material misstatements** and any identified **uncorrected immaterial misstatements in the prior year's financial statements**.
  - f) Considering significant financial accounting and reporting matters that may be of continuing significance such as **material weaknesses** in IC.
  - g) Considering the **results of any audit procedures performed** with respect to the **current year's financial statements**.
  - h) Considering the results of any **internal audit** performed and the subsequent actions taken by management.
  - i) Inquiring of management about the results of **management's assessment** of the risk that the Interim Financial Information may be materially misstated as a result of fraud.
  - j) Inquiring of management about the effect of **changes** in the entity's **business activities**.
  - k) Inquiring of management about any **significant changes** in IC and the potential effect of any such changes on the preparation of Interim Financial Information.

- l) Inquiring of management of the **process by which the Interim Financial Information has been prepared** and the reliability of the **underlying accounting records** to which the Interim Financial Information is agreed or reconciled.
5. Auditor determines the nature of the **review procedures**, if any, to be performed for **components** and, where applicable, **communicates these matters** to other auditors involved in the review.
6. **Auditor who has not yet performed an audit of the annual financial statements as per SAs** should obtain an understanding of the entity and its environment, including its IC, as it relates to preparation of both annual and Interim Financial Information.

## INQUIRIES, ANALYTICAL AND OTHER REVIEW PROCEDURES

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- 1) The auditor should make **inquiries** and perform **analytical** and **other review procedures**.
- 2) A review ordinarily **does not require tests of the accounting records** through Complex Transaction FV inspection, observation or confirmation.
- 3) **Factors affecting nature and extent of the inquiries made, and analytical and other review procedures applied:**
  - a) Understanding of the **entity and its environment, including its Internal Control**.
  - b) Results of the **risk assessments** relating to the preceding audit.
  - c) **Materiality** level determined.
4. Auditor ordinarily performs the following **procedures (Read minutes, modifications of PY, mgt. inquiries, component auditors, Analytical procedure on unusual item, FRFW):**
  - a) **Reading minutes** of the meetings of shareholders, TCWG, and other appropriate committees to identify matters that may affect Interim Financial Information, and inquiring about matters dealt with at meetings for which minutes are not available that may affect the Interim Financial Information.
  - b) Considering the effect, if any, of matters giving rise to a **modification of the audit or review report**, accounting adjustments or unadjusted misstatements, at the time of the previous audit or review.
  - c) **Communicating**, where appropriate, **with other auditors** who are performing a review of the Interim Financial Information of the reporting **entity's significant components**.
  - d) **Inquiring management** and others about the following:
    - Whether IFI has been **prepared and presented as per applicable financial reporting framework**.
    - Whether there have been any changes in accounting principles or in the methods of applying them.
    - Whether any new transactions have necessitated the application of a new accounting principle.
    - Whether the IFI contains any known **uncorrected misstatements**.

- **Unusual or complex situations** that may have affected IEI, Such as a business combination or disposal of a segment of the business.
  - Significant assumptions that are relevant to the fair value measurement or disclosures and management's intention and ability to carry out specific courses of action on behalf of the entity.
  - Whether **related party transactions** have been appropriately accounted for and disclosed in the IFI.
  - Significant changes in commitments and contractual obligations.
  - significant changes in contingent liabilities including litigation or claims.
  - Compliance with **debt covenants**.
  - Matters about which questions have arisen in the course of applying the review procedures.
  - Significant **transactions occurring in the last several days of the interim period** or the first **several days of the next interim period**.
  - Knowledge of any **fraud or suspected fraud** affecting the entity involving:
    - Management;
    - Employees who have significant roles in IC, or
    - Others where the fraud could have a material effect on the IFI.
  - Knowledge of any allegations of fraud, or suspected fraud, affecting the entity communicated by employees, former employees, analysts, regulators, others:
  - Knowledge of any actual or possible non-compliance with laws and regulations that could have a material effect on the Interim Financial Information.
- e.) Applying analytical procedures to Interim Financial Information designed to identify **relationships and individual items** that **appear to be unusual** and that may reflect a material misstatement in Interim Financial Information.

f). Reading Interim Financial Information and considering whether anything has come to the auditor's attention that causes the auditor to believe that Interim Financial Information is not prepared, in all material respects, in **accordance with applicable financial reporting framework**.

5. Auditor may perform many of the review procedures before or simultaneously with the entity's preparation of the Interim Financial Information.
6. A review of Interim Financial Information ordinarily **does not require corroborating** the inquiries about litigation or claims.

## COLLECTION OF EVIDENCE

- Auditor may obtain evidence that **Interim Financial Information agrees or reconciles with the underlying accounting records by tracing Interim Financial Information to:**
  - a) **Accounting records**, such as general ledger, or a consolidating schedule that agrees or reconciles with the accounting records; and
  - b) **Other supporting data** in the entity's records as necessary.



- Auditor should inquire whether management has identified **all events up to the date of the review report** that may require adjustment to or disclosure in Interim Financial Information.
- (i) Auditor should inquire whether management has changed its assessment of the entity's ability to continue as a going concern.
  - (ii) When, as a result of this inquiry or other review procedures, auditor becomes aware of events or conditions that may cast **significant doubt on the entity's ability to continue as a going concern**, the auditor should:
    - I. **Inquire management** about its plans for future actions based on its going concern assessment, feasibility of these plans, and whether the outcome of these plans will improve the situation; and
    - II. **Consider the adequacy of the disclosure** about such matters in IFI.
- When a matter comes to the auditor's attention that leads the auditor to question whether a **material adjustment should be made** for Interim Financial Information to be prepared, in all material respects, in accordance with applicable financial reporting framework, **auditor should make additional inquiries or perform other procedures to enable the auditor to express a conclusion in the review report.**

## EVALUATION OF MISSTATEMENTS

1. Auditor should evaluate, individually and in the aggregate, whether **uncorrected misstatements** that have come to the auditor's attention are material to the Interim Financial Information.
2. Auditor exercises **professional judgment in evaluating materiality** of any misstatements that the entity has not corrected.

Auditor should obtain **written representation** from management that:

1. It **acknowledges its responsibility** for the design and implementation of IC to prevent and detect fraud and error.
2. IFI **is prepared and presented in accordance with applicable financial reporting framework.**
3. It believes the **effect of those uncorrected misstatements** aggregated by the auditor during the review are immaterial, both individually and in the aggregate, to the Interim Financial Information taken as a whole. A summary of such items is included in or attached to the written representations.
4. It has **disclosed to the auditor all significant facts** relating to any frauds or suspected frauds known to management that may have affected the entity.
5. It has **disclosed to the auditor the results of its assessment of the risks** that Interim Financial Information may be materially misstated as a result of fraud.
6. It has **disclosed to the auditor all known actual or possible non-compliance** with laws and regulations whose effects are to be considered when preparing Interim Financial Information; and



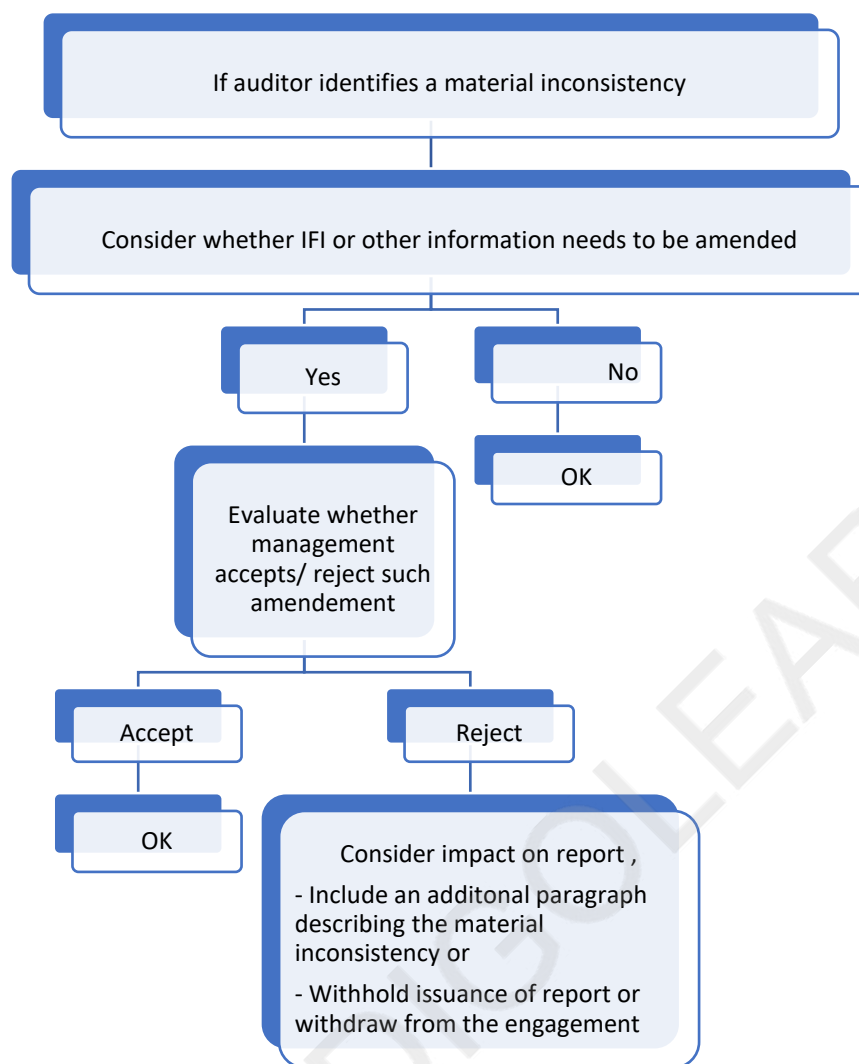
7. It has **disclosed to the auditor all significant events that have occurred subsequent to the balance sheet date** and through to the date of the review report that may require adjustment to or disclosure in Interim Financial Information.

#### **AUDITOR'S RESPONSIBILITY FOR ACCOMPANYING INFORMATION**

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1. Auditor should read other information that accompanies Interim Financial Information to consider whether any such information is materially inconsistent with IFI.

2.



3. If a matter comes to the auditor's attention that causes him to believe that other information appears to include a material misstatement of fact, he should discuss the matter with the entity's management.

### Communication

1. When a matter comes to auditor's attention that requires material adjustment to the IF1, he should communicate this matter to the **appropriate level of management**.
2. When, **management does not respond appropriately** within a reasonable period of time, he should **inform TCWG** (either orally" or in writing).

If information is communicated orally, auditor documents the communication.

3. When, in the auditor's judgment, **TCWG do not respond appropriately** within a reasonable period, he should consider.:
  - a) Whether to **modify** the report; or
  - b) Possibility of **withdrawing** from the engagement; and
  - c) Possibility of resigning from the appointment to **audit the annual financial statements**.
4. When a matter comes to the auditor's attention that causes him to believe in the existence of fraud or **non-compliance by the entity with las and regulations**, he should communicate the matter to the **appropriate level of management**. Auditor

should also consider the need to report such matters to TCWG and considers the **implication for the review**.

5. Auditor should communicate **relevant matters of governance interest** arising from the review of Interim Financial Information **with TCWG**.

## **REPORTING THE NATURE, EXTENT AND RESULTS OF THE REVIEW OF Interim Financial Information**

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**Auditor should issue a written report that contains the following**

- A) **Title**
- B) **Addressee**, as required by the circumstances of engagement
- C) **Identifications of Interim Financial Information reviewed**, including identification of the title of each of the statements contained in the complete or condensed set of financial statements and the date and period covered by Interim Financial Information.
- D) If **Interim Financial Information comprises a complete set of general-purpose financial statements prepared in accordance with a FRF) designed to achieve fair presentation, a statement that management is responsible for the preparation and fair presentation of Interim Financial Information in accordance with applicable financial reporting framework.**
- E) **Management's responsibility** for the preparation and presentation of IFI in accordance with applicable financial reporting framework.
- F) **Auditor's Responsibility** for expressing a conclusion on Interim Financial Information based on the review.
- G) **Statement that review of Interim Financial Information was conducted** in accordance with Standard on Review Engagements (SRE) 2410, "Review of Interim Financial Information Performed by the Independent Auditor of the Entity," and **a statement that such a review consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures.**
- H) Statement that **a review is substantially less in scope** than an audit conducted in accordance with Standards on Auditing and consequently **does not enable the auditor to obtain assurance** that the auditor would become aware of all significant matters that might be identified in an audit and that **accordingly no audit opinion is expressed.**
- I) If **Interim Financial Information comprises a complete set of general-purpose financial statements prepared in accordance with a FRFW** designed to achieve fair presentation, a conclusion as to whether anything has come to the auditor's attention that causes the auditor to believe that **Interim Financial Information does not give a true and fair view**, or does not present fairly, in all material respects, in accordance with Acceptable Financial Reporting Framework).
- J) A conclusion as to whether anything has come to the auditor's attention that **causes him to believe that IFI is not prepared**, in all material respects, in accordance with applicable financial reporting framework.

- K) **Date** of the report.
- L) **Place** of Signature
- M) Auditor's **signature** and **Membership number** assigned by the institute of Chartered Accountants of India (ICAI)
- N) **Fim's Registration Number**, wherever applicable
- O) **UDIN**

## DEPARTURE FROM THE APPLICABLE FINANCIAL REPORTING FRAMEWORK

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1. Auditor should express **qualified or adverse conclusion** when a matter has come to his attention that causes him to believe that a material adjustment should be made to IFI for it to be prepared, in all material respects, in accordance with A-FRF. Interim Financial Information for it to be prepared, in all material respects. in accordance with applicable financial reporting framework.
  - Ask the management to rectify such misstatement
    - Agrees- Continue
    - Refuses- Modify the report- Include an explanation paragraph in report and qualify the conclusion
2. When the effect of the departure is so **material and pervasive** that the auditor concludes a qualified conclusion is not adequate to disclose the misleading or incomplete nature of Interim Financial Information, he should express an **adverse conclusion**.

## LIMITATION ON SCOPE

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1. A limitation on scope ordinarily **prevents the auditor from completing review**.
2. When auditor is unable to complete the review, he should communicate, in **writing, to the appropriate level of management and to TCWG** the reason why the review cannot be completed and **consider whether it is appropriate to issue a report**.

### Limitation on scope:

#### a. Imposed by Management

- BEFORE acceptance – Do not accept the engagement
- After Acceptance- Request management to remove such limitation.
  - i. If management agrees- Continue
  - ii. If refuses- and auditor is unable to complete the review and express conclusion- Communicate in writing to Management and TCWG with reasons for non-completion of review.
- If law and regulation requires auditor to issue report, he should disclaim a conclusion, and also provide reason for non-completion of review.

#### b. Other Limitations

- Other than those imposed by Management
- Auditor unable to complete the review and express qualifying conclusion

## GOING CONCERN AND SIGNIFICANT UNCERTAINTIES

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1. If, as a result of inquiries or other review procedures, a material uncertainty relating to an event or condition comes to the auditor's attention that may cast **significant doubt on the entity's ability to continue as a going concern, and adequate disclosure is made** in Interim Financial Information the auditor modifies the review report by adding an Emphasis of Matter (EOM) paragraph.
2. If **material uncertainty still exists and adequate disclosure is made in IFI**, the auditor **modifies the review report on the current Interim Financial Information by adding a paragraph** to highlight the continued material uncertainty.
3. If a material uncertainty is **not adequately disclosed in Interim Financial Information**, the auditor should express a **qualified or adverse conclusion**, as appropriate. The report should include specific reference to the fact that there is such a material uncertainty.

## OTHER CONSIDERATIONS

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IFI, if reviewed and reported by the auditor, and expressed

- Unmodified opinion- Management to include report if it mentions that IFI has been reviewed
- Modified opinion- Report to be included by management with IFI

## DOCUMENTATION

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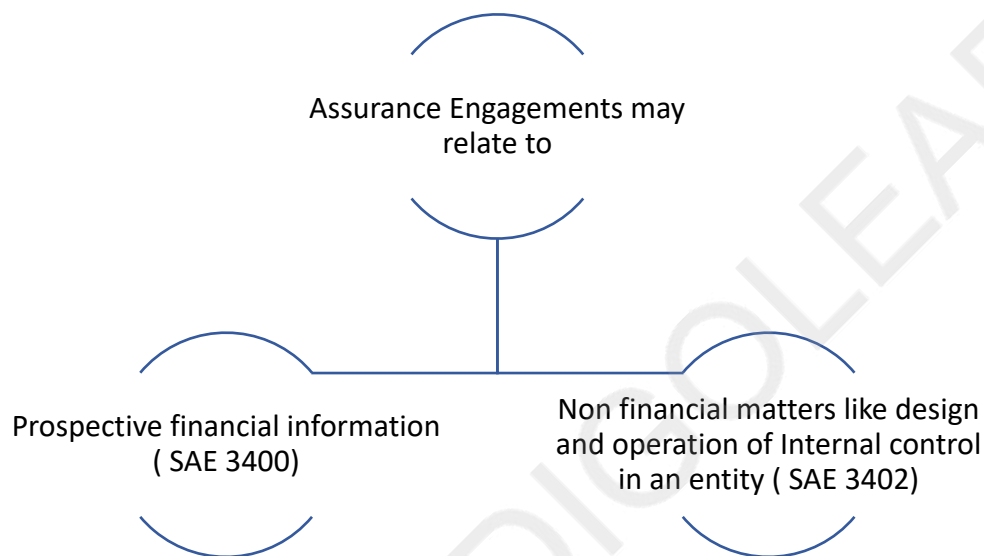
Auditor should prepare review documentation that is **sufficient and appropriate to provide a basis for the auditor's conclusion** and to provide evidence that the review was performed in **accordance with this SRE and applicable legal and regulatory requirements**.

# PROSPECTIVE FINANCIAL INFORMATION AND OTHER ASSURANCE SERVICES

## SAE 3400 THE EXAMINATION OF PROSPECTIVE FINANCIAL INFORMATION

### Introduction

Prospective Financial Statements (PFS) - PFS means future oriented financial statements



### Meaning of terms used in the standard

#### Prospective Financial information (PFI):

Financial information based on:

- Assumptions about events that may occur in the future and
- Possible actions by an entity.

It is highly subjective in nature and its preparation requires exercise of considerable judgment.

#### Prospective financial information can be in the form of:

- Forecast,
- Projection,
- Or combination of both (for example a 1-year, forecast plus a 5-year, projection.)

Forecast	Projection
<p><b>It means PFI prepared on the basis of:</b></p> <ul style="list-style-type: none"> <li>➤ Assumptions as to future events which <b>management expects to take place; and</b></li> <li>➤ The actions management expects to take as of the date the information is prepared.</li> </ul> <p><b>Example,</b> In present market conditions, supply availability, historical buying patterns and seasonal trends, CFO of X Ltd. expects sales to increase by 5% over the next quarter. Therefore, a 5% sales increase is his financial forecast for the period</p>	<p><b>PFI prepared on the basis of:</b></p> <ul style="list-style-type: none"> <li>➤ Hypothetical assumptions about future events and management actions <b>which are not necessarily expected to take place</b>, such as when some entities are in a start-up phase or are considering a major change in the nature of operations, or</li> <li>➤ A <b>mixture of best-estimate and hypothetical</b> assumptions (imagined or suggested)</li> </ul> <p><b>Best estimate assumptions:</b> An assumption that reflects anticipated experience, with no provision for risk of adverse deviation.</p> <p><b>Examples:</b></p> <ol style="list-style-type: none"> <li>1. X Ltd. may project a course of action to take when one or more hypothetical situations arise, such as creating a new product to meet the demand of expected market growth. As a result of assuming the possibility of different events occurring, financial projections serve as an outline for evaluating the desired outcomes X Ltd. expects to see, including its financial, cash flow and operational outcomes.</li> <li>2. A company plans to raise funds from a prospective equity investor and has asked a firm of Chartered Accountants to examine the profit forecast for placing it before prospective equity investor.</li> <li>3. A company is in the process of setting up a new plant. It needs financial assistance from bank in shape of term loan and working capital credit facilities. The company has prepared a projection of its profits, cash flows for next seven years along with its underlying assumptions.</li> </ol>

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## SCOPE OF SAE 3400

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- The purpose of this SAE 0s to establish standards and provide guidance on engagements to **examine and report on PFI** including examination procedures for **best-estimate and hypothetical assumptions**.
- **Non-applicability:** This SAE does not apply to examination of PFI expressed in general or narrative terms, such as that found in management's discussion and analysis in an entity's annual report.
- The term "**auditor**" is used throughout this SAE when describing services involving examination of PFI. Such reference is **not intended to imply** that a member performing such services need necessarily be the **statutory auditor of the entity's FS**.

## AUDITOR'S DUTY/NATURE OF ASSURANCE REGARDING PFI

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- Auditor may be required to examine and report on PFI to enhance its credibility.
- PFI relates to **events and actions that have not yet occurred and might** not occur.
- Evidences are **future- oriented and speculative in nature**,
- Therefore, an **opinion** as to whether the results shown in the PROSPECTIVE FINANCIAL INFORMATION will be achieved cannot **be expressed**.
- Auditor can only provide moderate level of assurance (**Negative assurance**)

## MANAGEMENT'S RESPONSIBILITY

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Management is responsible for the preparation and presentation of PFI including:

- identification and disclosure of PFI;
- Explaining the basis of forecast;
- Underlying assumptions.

## CAN PROFESSIONAL ACCOUNTANTS BE ASSOCIATED WITH PFI?

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- Various stakeholders like banks, financial institutions and prospective investors place greater reliance on reports of projected cash flow and profitability statements examined and signed by Chartered accountants.
- **clause 3 of the Second Schedule to the Chartered Accountants Act, 1949** states that a chartered accountant in practice shall be deemed to be guilty of professional misconduct, if he permits his name or the name of his firm to be used in connection with an estimate of earnings contingent upon future transactions in a manner which may lead to the belief that he vouches for the accuracy of the forecast.
- However, **above clause does not preclude** Chartered accountant from associating his name with PFI. **A chartered accountant can participate** in the preparation of profit or financial forecasts and can review them, **provided he indicates clearly in his report:**
  - **sources** of information,
  - **basis** of forecasts
  - **major assumptions** made in arriving at forecasts and so long as he **does not vouch for the accuracy of the forecasts**.

- Same also applies to projections made on the basis of hypothetical assumptions about future events and management actions which are not necessarily expected to take place so long as vouching for the accuracy of the projection is not made.

## DUTIES OF MEMBER WHO IS EXAMINING THE PFI

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In an engagement to examine PFI, auditor should obtain **sufficient appropriate evidence** as to whether:

- management 's (best-estimate assumptions on which PFI is based are not unreasonable and, in case of hypothetical **assumptions, such assumptions are consistent with the purpose of the information;**
- PFI is **properly prepared on the basis of assumptions;**
- PFI is **properly presented and all material assumptions are adequately disclosed, including a clear indication as to whether they are best-estimate assumptions or hypothetical assumptions; and**
- PFI is prepared on a **consistent basis** with historical financial statements, using **appropriate accounting principles.**

**Note- While examining PFI, principles laid down in other Standards on Auditing should be applied to the extent practicable.**

## ACCEPTANCE OF ENGAGEMENT

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Before accepting an engagement to examine PFI, **auditor would consider**, amongst other things:

- **Intended use** of the information:
- Whether the information will be for **general or limited distribution;**
- **nature of the assumptions**, that is, whether they are best **estimates or hypothetical**
- **elements to be included** in the information; and
- period covered by the information.

***When the assumptions are clearly unrealistic or when the auditor believes that PFI will be inappropriate for its intended use, he should not accept the engagement or should withdraw from the engagement.***

## EXAMINATION PROCEDURES

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1. when determining the **nature, timing and extent of examination procedures**, the following matters should be considered such as (**Prior Exp, Mgt. Competence, likelihood of MM Extent of Judgement, Data Source, Business Stability, Team's experience**)
  - **knowledge** obtained during previous engagements
  - management's **competence** regarding preparation of PFI
  - likelihood of **material** misstatement
  - **extent** to which PFI is affected by the management's judgment

- **sources** of information considered by the management for the purpose, their adequacy, reliability of the underlying data, including data derived from third parties such as industry statistics, to support the assumptions.
- **stability** of entity's business; and
- engagement team 's experience with the business and the industry in which entity operates and with reporting on PFI.

2. (i) While performing **procedures, source and reliability** of the evidence supporting **management's best-estimate assumptions** needs to be assessed.

2. (ii) Such **evidence** may be available from varied sources like entity's budgets, debt agreements, industry publications etc.

3. When **hypothetical** assumptions are used, all significant **implications** of such assumptions should have been taken into consideration.

## PRESENTATION AND DISCLOSURE

When assessing the presentation and disclosure of PFI and the underlying assumptions, it needs to consider whether:

- presentation of PFI is **informative and not misleading**
- **accounting policies are clearly disclosed** in the notes to PFI;
- **assumptions are adequately disclosed** in the notes to PFI.

(Specify, assumptions represent management's best estimates or are hypothetical and, uncertainty and resulting sensitivity of results needs to be adequately disclosed whether uncertainty is high)

- **Date as of which PFI is prepared** is disclosed. (Management needs to confirm that the assumptions are appropriate as of this date)
- **Basis of establishing points in a range** is clearly indicated (Range is, not biased or misleading) when results shown are expressed in terms of a range and
- if there is any **change in the accounting policy** from the most recent historical is, whether reason and effect of such change has been adequately disclosed.

## REPORT ON EXAMINATION OF PFI

It should contain the following:

a. Title
<b>b. Addressee</b>
<b>c. Identification of PFI</b>
<b>d.</b> Reference to the <b>Standards</b> on Auditing applicable to the examination of PROSPECTIVE FINANCIAL INFORMATION.
<b>e.</b> Statement that <b>management is responsible</b> for PFI including the underlying assumptions.
<b>f.</b> When applicable, a reference to <b>the purpose and/or restricted distribution of PFI</b>

<b>g.</b> Statement that <b>examination procedures included</b> examination, on a test basis, of evidence supporting the assumptions, amounts and other disclosures in the forecast or projection
<b>h.</b> Statement of <b>negative assurance</b> as to whether the assumptions provide a reasonable basis for PFI.
<b>i.</b> <b>Opinion</b> as to whether PFI is properly prepared on the basis of the assumptions and is presented in accordance with the relevant FRFW.
<b>j.</b> Appropriate <b>caveats concerning the achievability of the results indicated by PROSPECTIVE FINANCIAL INFORMATION</b>
<b>k.</b> <b>Date</b> of report (which should be the date procedures have been completed)
<b>l.</b> <b>Place</b> of signature
<b>m.</b> <b>Signature</b>

## SUCH A REPORT WOULD

- State whether, anything has come to attention, that the **assumptions do not provide a reasonable basis** for PROSPECTIVE FINANCIAL INFORMATION.
- **Express an opinion as** to whether PFI is **properly prepared** on the basis of the assumptions and is presented in accordance with the **relevant FRFW**)
- **State that: -**
  - **Actual results are likely to be different** from PFI since anticipated events frequently do not occur as expected and the variation could be material.
  - **Likewise, when PFI is expressed as a range**, it would be stated that there can be no assurance that actual results will fall within the range: and
  - In **case of projection**, PROSPECTIVE FINANCIAL INFORMATION has been prepared for (intended use), using a set of assumptions that include **hypothetical assumptions** about future events and management's actions **that are not necessarily expected to occur.**

Consequently, readers are **cautioned that PFI should not be used for purposes other than the above-mentioned intended use.**

## REPORTING

- **Presentation and disclosure of PFI is not adequate:**  
When auditor believes that the presentation and disclosure of PFI is not adequate, a **qualified or adverse opinion** in the report on PROSPECTIVE FINANCIAL INFORMATION should be expressed or withdrawal from engagement should be made as appropriate.
- **Assumptions do not provide a reasonable basis:**  
When auditor believes that one or more significant assumptions do not provide a reasonable basis for PROSPECTIVE FINANCIAL INFORMATION prepared on the basis of best-estimate assumptions or that one or more significant assumptions do not provide a reasonable basis for PEL given the hypothetical assumptions, **an adverse opinion setting out reasons should be expressed, or withdrawal from engagement should be made.**

➤ Conditions precluding application of one or more procedures:

When examination is affected by the conditions that **preclude application of one or more procedures** considered **necessary** in the circumstances, auditor should **either withdraw** from the engagement or **disclaim the opinion and describe the scope limitation in the report on PFI**.

## DOCUMENTATION

Matters, which are important in providing evidence to support report on examination of PROSPECTIVE FINANCIAL INFORMATION, and evidence that such examination was carried out in accordance with this SAE should be documented.

## SAE 3402 ASSURANCE REPORTS ON CONTROLS AT A SERVICE ORGANIZATION

### SCOPE OF THIS SAE

- This SAE deals with **assurance engagements** undertaken by a professional accountant in public practice to provide a report for use by user entities and their auditors.
- It **complements SA 402**, in that reports prepared in accordance with this SAE are capable of providing appropriate evidence under SA 402.
- This SAE applies only when the **service organisation is responsible for**, or otherwise able to make an **assertion about, the suitable design of controls**.
- **Non-Applicability: It does not deal with assurance engagements:**
  - To **report only on whether controls at a service organisation operated as described; or**
  - To **report only on controls at a service organisation** other than those relevant to user entities' IC (for example, controls that affect user entities' production or quality control).

### Meaning of certain terms

#### Service Organisation

It refers to a **third-party organisation** (or segment of a third-party organisation) **that provides services to user entities** that are likely to be relevant to user entities IC as it relates to financial reporting.

#### User entity

It refers to an **entity that uses a service organisation**.

#### User auditor

It refers to an auditor **who audits and reports on the FS of a user entity**

## Service auditor.

It refers to a **professional accountant in public practice** who, at the request of the service organisation, provides **an assurance report on controls at a service organisation**.

### Controls of a service organisation are important to a user entity's ICs relating to financial reporting

1. Service organization's operations and compliance controls may affect user entity's financial reporting & related controls.
2. Such controls may pertain to assertions in FS of user entity to evidence that user auditor uses in applying auditing procedures.
3. **"Controls at service organization" includes** aspects of
  - **user entities' information systems maintained by** the service organization.
  - one or more of the **other** components of internal control at a **service organization**.
4. Auditor shall exercise **professional judgment** when determining **whether controls at service organization are relevant to user entities' internal control**.

### OBJECTIVES OF SERVICE AUDITOR

- a. To **obtain reasonable assurance** about whether, in all material respects, **based on suitable criteria**
  - Service organization's **description of its system fairly presents** the system as designed and implemented throughout the specified period (or in the case of a type I report, as at a specified date)
  - Controls related to the **control objectives** stated in the service organization's description of its system were **suitably designed** throughout the specified period (or in the case of a type I report, as at a specified date)
  - **Control objectives** stated in the service organization's description of its system **were achieved** throughout the specified period.
- b. To report on the matters in (a) above in accordance with the findings.

### Type 1 Report & Type 2 Report

<u>Type 1 report is a report that comprises:</u>	<u>Type 2 report is a report that comprises:</u>
<ol style="list-style-type: none"><li>1. Service organisation's <b>description of its system</b>;</li><li>2. A written assertion by the service organisation that, in all material respects, and based on suitable criteria:<ul style="list-style-type: none"><li>➤ <b>Description fairly presents</b> the service organisation's system as designed and <b>implemented at the specific date</b>;</li></ul></li></ol>	<ol style="list-style-type: none"><li>1. Service organisation's description of its system;</li><li>2. A written assertion by the service organisation that, in all material respects, and based on suitable criteria:<ul style="list-style-type: none"><li>➤ Description <b>fairly presents</b> the service organisation's system as designed and implemented <b>throughout the specified period</b>;</li><li>➤ Controls related to the control objectives stated in the service</li></ul></li></ol>



<p>➤ <b>Controls related to the control objectives</b> stated in the service organisation's description of its system were <b>suitably designed</b> as at the specified date.</p> <p>3. A service auditor's assurance report that conveys <b>reasonable assurance about the matters referred to in (2)</b></p>	<p>organisation's description of its system were <b>suitably designed throughout the specified period; and</b></p> <p>➤ Controls related to the control objectives stated in the service organisation's description of its system <b>operated effectively throughout the specified period.</b></p> <p>3. A service auditor's assurance report that:</p> <p>➤ Conveys <b>reasonable assurance</b> about the matters in (2) and</p> <p>➤ Includes a <b>description of the tests of controls and the results thereof.</b></p>
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- **Type 1** report is a report on the description and design of controls at a service organisation whereas
- **Type 2** report is a report on the description, design and operating effectiveness of controls at a service organisation

## ENGAGEMENT PROCEDURES

### 1. Compliance with ethical requirements:

Service auditor shall **comply with relevant ethical requirements**, including those pertaining to **independence**, relating to assurance engagements.

### 2. Determination of Management and TCWG and communication with them:

The service auditor shall inquire of, request representations from, communicate with, or interact with the service organisation wherever required. The service auditor shall **determine the appropriate persons within the service organisation's management or governance structure with whom to interact.**

### 3. Acceptance and changes in terms of engagement:

Before accepting such an engagement, service auditor should ensure that:

- He is **capable and competent to perform** the engagement.
- **criteria to be applied by the service organisation** to prepare the description of its system will **be suitable and available to user** entities and their auditors; and
- The scope **of the engagement** and the service organisation's description of its system will not be so limited that they are unlikely to be useful to user entities and their auditors.
- If the service organisation **requests a change** in the scope of the engagement before the completion of the engagement, service auditor shall be **satisfied that there is a reasonable justification for the change.**

### 4. Assessing of suitability of the Criteria:

Service auditor shall assess whether the service organisation has used suitable criteria in:

- Preparing the **description of its system**,
- Evaluating whether controls are **suitably designed**, and



- Evaluating whether controls are **operating effectively (in case of type 2 reports)**

#### 5. Determination of Materiality:

When planning and performing the engagement, the service auditor shall consider materiality with respect to:

- **Fair presentation of the description,**
- **suitability of the design** of controls and,
- **operating effectiveness** of controls (in the case of a type 2 report)

#### 6. obtaining an understanding of the Service organisation's system:

Service Auditor shall obtain an understanding of the service organisation 's system, including controls that are included in the scope of engagement.

#### 7. Obtaining evidence regarding

- **Description:** Service auditor shall obtain and read the service organisation's description of its system and evaluate whether those aspects of the description included in the scope of engagement are **fairly presented**.
- **Design of controls:** Service auditor shall determine which of the controls at the service organisation are necessary to achieve the control objectives stated in the service organisation's description of its system and shall assess whether those controls were **suitably designed**.
- **Operating effectiveness of controls:** When providing a type 2 report, service auditor shall **test those controls** that the service auditor has determined are necessary to achieve the control objectives stated in the service organisation's description of its system, and **assess their operating effectiveness throughout the period**.

#### 8. Understanding the internal audit function:

If the service organisation has an internal audit function, service auditor shall obtain an understanding of:

- **Nature of responsibilities of the internal audit function**
- **Activities performed** in order to **determine** whether the internal audit function is likely to be **relevant to the engagement** in order for the service auditor to use specific work of the internal auditors.

#### 9. Asking for Written Representation:

Service auditor shall request the service organisation to provide written representations.

Asking Written representation from service organisation

- That reaffirm the assertion accompanying the description of the system
- That it has provided the service auditor with all relevant information and access agreed to and
- That it has disclosed to the service auditor any of the following of which it is aware
  - Non-compliance with laws and regulation, fraud or uncorrected deviations attributable to the service organisation that may affect one or more user entities
  - Design deficiencies in controls

- Instances where controls have not operated as described and
- Any events and subsequent to the period covered by the service organisation's description of its system up to its system up to the date of service auditor's assurance report that could have a significant effect on the service auditor's assurance report

**10.Subsequent Events:** Service auditor shall inquire whether service organisation is aware of any events subsequent to the period covered by the service organisation's description of its system up to the date of the service auditor's assurance report that could have a significant effect on the service auditor's assurance report.

## Reporting

**Service auditor's assurance report shall include the** following basic elements:

- Title **clearly indicating that report is an independent service auditor 's assurance report.**
- Addressee
- Identification of:
  - i. Service organization's description of its system, and **service organization's assertion, which includes the matters for a type 2 report, or for a type I report.**
  - ii. Those parts of the service organization's description of its system, if any, that are not covered by the service auditor's opinion.
  - iii. **If the description refers to the need for** complementary user entity controls, a statement that the service auditor has not evaluated **the suitability of design or operating effectiveness of complementary user entity controls, and that the control objectives stated in the service organization's description of its system can be achieved only if complementary user entity controls are suitably designed or operating effectively, along with the controls at the service organization.**
  - iv. If services are performed by a subservice organization, the nature of activities performed by the subservice organization as described in the service organization's description of its system
- Identification of the criteria, and the party specifying the control objectives.
- Statement that the report and, the description of tests of controls (in the case of a type 2 report) are intended only for user entities and their auditors.
- Statement that the service organization is responsible for:
  - i. Preparing description of its system, and accompanying assertion, including the completeness, accuracy and method of presentation of that description and that assertion;
  - ii. Providing the services covered by the service organization's description of its system;

- iii. Stating the control objectives (where not identified by law or regulation, or another party, for example, a user group or a professional body); and
  - iv. Designing and implementing controls to achieve the control objectives stated in the service organisation's description of its system
- statement that the service auditor's responsibility is to express an opinion on the service organization's description, on the design of controls related to the control objectives stated in that description and, on the operating effectiveness of those controls (in the case of a type 2 report) based on the service auditor's procedures.
  - Statement that the engagement was performed in accordance with SAE 3402.
  - Summary of the service auditor's procedures to obtain reasonable assurance and a statement of the service auditor's belief that the evidence obtained is sufficient and appropriate to provide a basis for the service auditor's opinion, and, in the case of a type 1 report, a statement that the service auditor has not performed any procedures regarding the operating effectiveness of controls and therefore no opinion is expressed thereon.
  - Statement of the limitations of controls and, of the risk of projecting to future periods any evaluation of the operating effectiveness of controls (in the case of a type 2 report)
  - service auditor's opinion, expressed in the positive form, on whether, in all material respects, based on suitable criteria.

<b><u>In the case of a type 2 report</u></b>	<b><u>In the case of a type I report</u></b>
	<ul style="list-style-type: none"> <li>a. Description fairly presents the service organisation's system that had been designed and implemented as at the specified date; and</li> <li>b. Controls related to the control objectives stated in the service organisation's description of its system were suitably designed as at the specified date.</li> </ul>

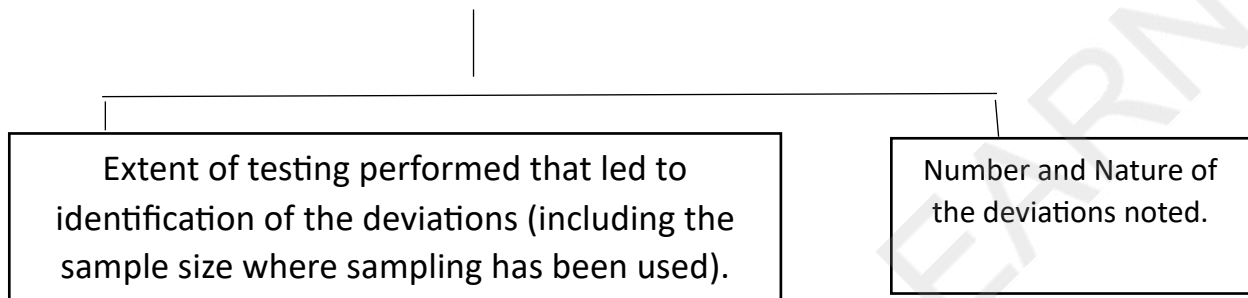
- Date of the service auditor's assurance report,  
Not earlier than-
  - Date on which the service auditor has obtained sufficient appropriate evidence on which to base the opinion.
- Signature-report should be signed by the practitioner.
- Place of signature where report is signed.

### **ADDITIONAL MATTERS REQUIRING REPORTING IN TYPE 2 REPORT**

1. A separate section after the opinion, or an attachment, describing the tests of controls that were performed and results of those tests.

In describing the tests of controls, service auditor shall clearly state:

- Controls that were tested;
  - Identify whether the items tested represent all or a selection of the items in the population;
  - Indicate the nature of the tests in sufficient detail to enable user auditors to determine the effect of such tests on their risk assessments.
2. If deviations have been identified, service auditor shall include:



3. Service auditor shall report deviations even if he has concluded that the related control objective was achieved

### Modified options

If service auditor concludes that:

Service organisation's description does not fairly present in all material respects, the system as designed and implemented	Controls related to the control objectives stated in the description were not suitably designed, in all material respects;	In case of type 2 report, the controls tested, which were necessary to provide reasonable assurance that the control objectives stated in the service organization's description of its system were achieved, did not operate effectively, in all material respects; or	Service auditor is unable to obtain sufficient appropriate evidence, the service auditor's opinion shall be modified, and shall contain a clear description of all the reasons for modification.
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### DOCUMENTATION

Service auditor shall prepare documentation that is sufficient to enable an experienced service auditor, having no previous connection with the engagement, to understand:

- a. Nature, timing, and extent of the procedures performed to comply with this SAE and applicable legal and regulatory requirements.
- b. Results of the procedures performed, and the evidence obtained: and

- c. Significant matters arising during the engagement, conclusions reached thereon and significant professional judgments made in reaching those conclusions.

## SAE: 3420- Assurance Engagement to report on the compilation of Pro forma Financial information included in a prospectus

### SCOPE OF THIS SAE

- This SAE deals with reasonable assurance engagements undertaken by a practitioner to report on the responsible party's compilation of pro forma financial information included in a prospectus.
- Applicability:
  - Where such reporting is required by securities law or regulation of the security exchange in the jurisdiction in which the prospectus is to be issued.
  - This reporting is generally accepted practice in such jurisdiction.

### Meaning of Pro forma financial information

- **Meaning:** It refers to financial information shown together with adjustments to illustrate the impact of an event or transaction on unadjusted financial information as if the event had occurred or the transaction had been undertaken at an earlier date selected for purposes of the illustration.
- **Usage:** It is, normally, used in the offer documents to demonstrate the effect of a transaction on the FS of a company as if those transactions had occurred at an earlier date.
- **Form:** The Pro forma financial information may take the form of Statement of Profit and Loss and Balance Sheet to illustrate how the transactions might have affected the assets, liabilities and earnings of the issuer. They also include:
  - Notes in relation to the significant aspects of the transactions.
  - Assumptions used
  - Adjustments made
- **Purpose:**
  - To illustrate the impact of a significant event or transaction on unadjusted financial information of the entity as if the event had occurred or the transaction had been undertaken at an earlier date selected for purposes of the illustration.
  - This is achieved by applying pro forma adjustments to the unadjusted financial information.
- **Exclusions:** it does not represent the entity's actual financial position, financial performance, or cash flows.

### Applied criteria

"Applicable criteria" are criteria used by the responsible party when compiling the pro forma financial information.

Criteria may be established by:

- An authorized or recognized standard-setting organisation; or
  - By law or regulation.
- Where established criteria do not exist, they will be developed by the responsible party.

## OBJECTIVES

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- To obtain reasonable assurance about whether the pro forma financial information has been compiled, in all material respects, by the responsible party on the basis of the applicable criteria, and
- To report in accordance with the practitioner's findings.

## COMPILATION OF PRO FORMA FINANCIAL INFORMATION

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It involves the responsible party gathering, classifying, summarising and presenting financial information that illustrates the impact of a significant event or transaction on the unadjusted financial information of the entity as if the event had occurred or the transaction had been undertaken at the selected date.

### Steps involved in this process are:

- Identifying the source of unadjusted financial information to be used in compiling the proforma financial information, and extracting unadjusted financial information from that source.
- Making pro forma adjustments to the unadjusted financial information for the purpose for which pro forma financial information is presented; and
- Presenting the resulting pro forma financial information with accompanying disclosures.

## Nature of the Practitioner's Responsibility

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- Practitioner has no responsibility to compile the pro forma financial information for the entity; such responsibility rests with the responsible party.
- Practitioner 's sole responsibility is to report on whether the pro forma financial information has been compiled, in all material respects, by the responsible party on the basis of the applicable criteria.
- it is a reasonable assurance engagement to report on the;
  - Compilation of pro forma financial information
  - Involving performing the procedures
  - To assess whether the applicable criteria used by the responsible party in the compilation provide a reasonable basis
  - For presenting the significant effects directly attributable to the event or transaction.

## Steps involved in such an engagement

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### **a. Engagement acceptance**

- b. Planning and performing the engagement**
- c. Written representations**
- d. Forming the opinion**
- e. Preparing the assurance report**



## **A. ENGAGEMENT ACCEPTANCE**

Before agreeing to accept an engagement, the practitioner shall:

- Determine that the practitioner has the capabilities and competence to perform the engagement
- Determine that the applicable criteria are suitable and that it is unlikely that the pro forma financial information will be misleading for the purpose for which it is intended.
- Evaluate the wording of the opinion prescribed by the relevant law or regulation, if any, to determine that the practitioner will likely be able to express the opinion so prescribed based on performing the procedures specified in this SAE.
- where the sources from which the unadjusted financial information and any acquiree or dives tee financial information have been extracted have been audited or reviewed and a modified audit opinion or revie conclusion has been expressed, or the report contains an Emphasis of Matter paragraph, consider whether or not the relevant law or regulation permits the use of, or reference in the practitioner's report to, the modified audit opinion or review conclusion or the report containing the Emphasis of Matter paragraph with respect to such sources.
- If the entity's historical financial information has never been audited or reviewed, consider whether the practitioner can obtain a sufficient understanding of the entity and its accounting and financial reporting practices to perform the engagement.
- If the event or transaction includes an acquisition and the acquiree's historical financial information has never been audited or reviewed, consider whether the practitioner can obtain a sufficient understanding of the acquiree and its accounting and financial reporting practices to perform the engagement; and
- obtain agreement of the responsible party that it acknowledges and understands its responsibility for:

### **Agreement with the Responsible Party:**

- i. Adequately disclosing and describing the applicable criteria to the intended users if these are not publicly



- ii. Compiling the pro forma financial information on the basis of the applicable criteria; and
- iii. Providing the practitioner with:
  - a. Access to all information (Including, when needed for purposes of the engagement, information of the acquiree(s) in a business combination), such as records, documentation and other material, relevant to evaluating whether the pro forma financial information has been compiled, in all material respects, on the basis of the applicable criteria
  - b. Additional information that the practitioner may request from the responsible party for the purpose of the engagement
  - c. Access to those within the entity and the entity's advisors from whom the practitioner determines it necessary to obtain evidence relating to evaluating whether the pro forma financial information has been compiled, in all material respects, on the basis of the applicable criteria; and
  - d. When needed for purposes of the engagement, access to appropriate individuals within the acquiree(s) in a business combination.

### Planning and Performing the engagement

1. Practitioner shall assess whether the applicable criteria are suitable, as required by the Framework for Assurance Engagements.
2. When planning and performing the engagement, practitioner shall consider materiality with respect to evaluating whether the pro forma financial information has been compiled, in all material respects, on the basis of the applicable criteria.
3. An understanding of how the responsible party has compiled the pro forma financial Information and other engagement circumstances.
4. Practitioner shall obtain evidence about the appropriateness of the source from which the unadjusted financial information has been extracted.
5. If there is no audit or review report on the source from which the unadjusted financial information has been extracted, the practitioner shall perform procedures to be satisfied that the source is appropriate.
6. Practitioner shall determine whether the responsible party has appropriately extracted the unadjusted financial information from the source.
7. Practitioner shall obtain evidence about the appropriateness of the pro forma adjustments.

In relation to unadjusted financial information, Pro forma adjustments include:

- a. Adjustments to unadjusted financial information that illustrate the impact of a significant event or transaction as if the event had occurred or the transaction had been undertaken at an earlier date selected for purposes of the illustration; and
  - b. Adjustments to unadjusted financial information that are necessary for the pro forma financial information to be compiled on a basis consistent with the AFRFW of the reporting entity and its accounting policies under that framework.
8. Practitioner shall evaluate the presentation of pro forma financial information.

9. Practitioner shall read the other information included in the Prospectus containing the pro forma financial information to identify material inconsistencies, if any, with pro forma financial information.

## Opinion

**Unmodified opinion:** When practitioner concludes that the pro forma financial information has been compiled, in all material respects, by the responsible party on the basis of the applicable criteria.

### Modified Opinion

a.

- i. where relevant law or regulation precludes publication of a prospectus that contains a modified opinion with regard to whether the pro forma financial information has been compiled, in all material respects, on the basis of the applicable criteria
- ii. Practitioner concludes that a modified opinion is nevertheless appropriate in accordance with the Framework for Assurance Engagements, Practitioner shall discuss the matter with the responsible party.

If the responsible party does not agree to make the necessary changes, the practitioner shall:

- Withdraw from the engagement; or
  - Consider seeking legal advice.
- a. where relevant law or regulation may not preclude publication of a prospectus that contains a modified opinion with regard to whether the pro forma financial information has been compiled, in all material respects, on the basis of the applicable criteria and
- Practitioner determines that a modified opinion is appropriate in accordance with the Framework for Assurance Engagements, Practitioner shall apply the requirements in the Framework for Assurance Engagements regarding modified opinions.

### Emphasis of Matter paragraph

- a. In some circumstances, practitioner may consider it necessary to draw the user's attention to a matter present ed or disclosed in the pro forma financial information or the ac companying explanatory notes.
- b. This would be the case when, in the practitioner's opinion, the matter is of such importance that it is fundamental to the user's understanding of whether the pro forma financial information has been compiled, in all material respects, on the basis of the applicable criteria.
- c. n such circumstances, practitioner shall include an Emphasis of Matter paragraph in his report provided that he has obtained sufficient appropriate evidence that the

matter does not affect whether the pro forma financial information has been compiled, in all material respects, on the basis of the applicable criteria.

- d.** Such a paragraph shall refer only to information presented or disclosed in the pro forma financial Information or the accompanying explanatory notes.

## Preparing the assurance report

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Practitioner's report shall include the following basic elements:

- Title clearly indicating that the report is an independent assurance report.
- Addressee(s), as agreed in the terms of engagement.
- Introductory paragraphs that identify:
  - i.** Pro forma financial information
  - ii.** Source from which the unadjusted financial information has been extracted and Whether or not an audit or review report on such a source has been published.
  - iii.** Period covered by, or the date of, the pro forma financial information, and
  - iv.** A reference to the applicable criteria on the basis of which the responsible party has performed the compilation of the pro forma financial information, and the source of the criteria
- Statement that the responsible party is responsible for compiling the pro forma financial information on the basis of the applicable criteria.
- Description of the practitioner's responsibilities, including statements that:
  - i.** Practitioner's responsibility is to express an opinion about whether the pro forma financial information has been compiled, in all material respects, by the responsible party on the basis of the applicable criteria.
  - ii.** For purposes of this engagement, the practitioner is not responsible for updating or reissuing any reports or opinions on any historical financial information used in compiling the pro forma financial information, nor has the practitioner, in the course of this engagement, performed an audit or review of the financial information used in compiling the pro forma financial information; and
  - iii.** The purpose of pro forma financial information included in a prospectus is solely to illustrate the impact of a significant event or transaction on unadjusted financial information of the entity as if the event had occurred or the transaction had been undertaken at an earlier date selected for purposes of the illustration. Accordingly, the practitioner does not provide any assurance that the actual outcome of the event or transaction at that date would have been as presented.
- A statement that the engagement was performed in accordance with SAE 3420, 'Assurance Engagements to Report on the Compilation of Pro Forma Financial Information Included in a Prospectus', which requires that the practitioner comply with ethical requirements and plan and perform procedures to obtain reasonable assurance about whether the responsible party has compiled, in all material respects, the pro forma financial information on the basis of the applicable criteria;
- Statements that:

- i. A reasonable assurance engagement to report on whether the pro forma financial information has been compiled, in all material respects, on the basis of the applicable criteria involves performing procedures to assess whether the applicable criteria used by the responsible party in the compilation of the pro forma financial information provide a reasonable basis for presenting the significant effects directly attributable to the event or transaction and to obtain sufficient appropriate evidence about whether:
    - The related pro forma adjustments give those appropriate effect to those criteria; and
    - The pro forma financial information reflects the proper application of those adjustments to the unadjusted financial information
  - ii. Procedures selected depend on the practitioner's judgment, having regard to the practitioner's understanding of the nature of the entity, the event or transaction in respect of which the pro forma financial information has been compiled, and other relevant engagement circumstances; and
  - iii. Engagement also involves evaluating the overall presentation of the pro forma financial information.
- Unless otherwise required by law or regulation, the practitioner's opinion using one of the following phrases, which are regarded as being equivalent:
    - i. The pro forma financial information has been compiled, in all material respects, on the basis of the applicable criteria; or
    - ii. The pro forma financial information reflects the proper application of those adjustments to the unadjusted financial information. The pro forma financial information has been properly compiled on the basis stated.
  - Practitioner's signature
  - Date of the report
  - Place of signature

## Documentation

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As in case of all assurance engagements, documentation has to be ensured by the practitioner while performing engagement under SAE 3420.

## RELATED SERVICES

### SRS-4400 : ENGAGEMENTS TO PERFORM AGREED-UPON PROCEDURES REGARDING FINANCIAL INFORMATION

#### INTRODUCTION

##### Meaning of Agreed upon Procedures

- In an engagement to perform AGREED UPON PROCEDURES, auditor is engaged by the client to issue a **report of factual findings, based on specified procedures performed on specified subject matter** of specified elements, accounts or items of a FS.
- **For example**, an engagement to perform AUP may require the auditor to perform certain procedures concerning individual items of financial data, say, accounts payable, accounts receivable, purchases from related parties and sales and profits of a segment of an entity, or a FS, say, a balance sheet or even a complete set of FS.
- However, a person performing related services **need not necessarily be the auditor** of the entity's FS.

#### OBJECTIVE

1. **To carry out procedures of an audit nature** to which the auditor and the entity and any appropriate third parties **have agreed** and to **report on factual findings. No assurance is provided in such a report.** Such engagements are non-assurance engagements.
2. Report is usually restricted to those parties that have agreed to the procedures to be performed.

<u>Basis</u>	<u>Audit</u>	<u>AGREED UPON PROCEDURES</u>
Opinion	An audit expresses an opinion	AGREED UPON PROCEDURES does not provide an opinion. Only a report of the factual findings of AGREED UPON PROCEDURES is provided
Assurance	Audit provides assurance to users.	No assurance is given to users. Users draw their own conclusions based on factual findings stated in the report.

### **For example, Agreed upon procedures engagement procedures to evaluate validity of accounts payable**

- Comparing of names of major suppliers and amounts outstanding as on a date to the related names and amounts in the trial balance
- Obtaining suppliers statements or confirmations from suppliers to confirm balances outstanding on a date.
- Comparison of such statements or confirmations to the amounts in trial balance.
- Further, actual findings like variation in balances reflected in Trial Balance and statements or confirmations are given. The actual findings are reported as such without providing an assurance.

### **General Principles of an Agreed upon Engagement**

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1. Auditor should **comply with the Code of Ethics** issued by ICAI.
2. **Ethical principles** include:
  - Integrity
  - Objectivity
  - Professional competence and due care
  - Confidentiality
  - Professional conduct and technical standards

**Note:**

- Independence is not a requirement for Agreed upon procedures engagement.
- If terms require the auditor to comply with the independence requirements, if the auditor is not independent, a statement to that effect should be made in the report.



## DEFINING THE TERMS OF THE ENGAGEMENT

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1. Auditor should ensure with representatives of the entity and, other specified parties that there is a clear understanding regarding the Agreed upon procedures and the conditions of the engagement.

### Matters to be agreed include the following:

- **Nature of engagement** including the fact that the **procedures performed will not constitute an audit or a review** and that accordingly no assurance will be expressed.
- **Stated purpose** for the engagement.
- **identification of the financial information** to which the Agreed upon procedures will be applied.
- **Nature, timing and extent of the specific procedures** to be applied
- **Limitations on distribution of the report of factual findings. When such limitation would be in conflict with the legal requirements, if any, the auditor would not accept the engagement.**

2. Auditor shall **send an engagement letter documenting the key terms** of the appointment. Matters to be included in engagement letter.
  - A listing of the procedures to be performed as agreed-upon between the parties.
  - **A statement that the distribution of the report of factual findings would be restricted to the specified parties who have agreed to the procedures to be performed**

## PLANNING

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Auditor should plan the work so that an effective engagement will be performed.

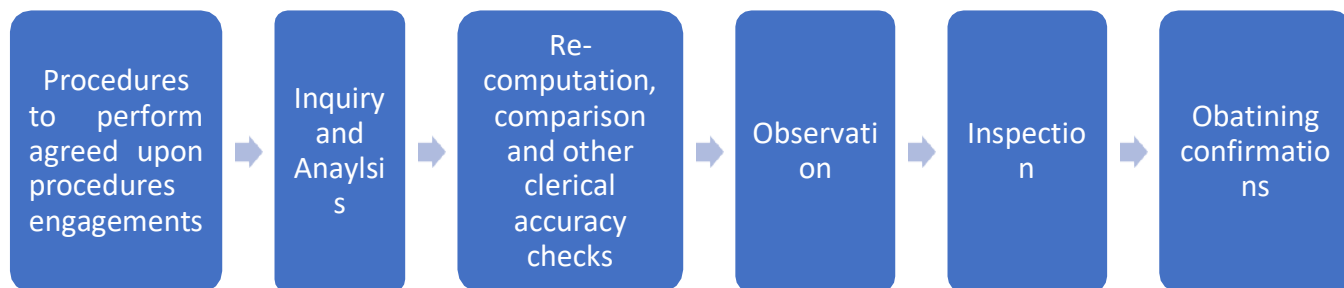
## PROCEDURES AND EVIDENCE

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Auditor should **carry out the procedures agreed-upon and use the evidence** obtained as the **basis for the report** of factual findings.

### **Procedures include:**

- Inquiry and analysis
- Re-computation, comparison and other clerical **accuracy checks**
- Observation
- Inspection
- Obtaining confirmations



## REPORTING

**The report of factual findings should contain:**

<b>a.</b> Title
<b>b.</b> Addressee (ordinarily, the appointing authority)
<b>c.</b> identification of specific financial or non-financial <b>information</b> to which the Agreed upon procedures have been applied.
<b>d.</b> Statement that the <b>procedures performed were those agreed-upon</b> with the recipient.
<b>e.</b> Statement that the engagement was performed in accordance with the Standard on Related Services applicable to Agreed upon procedures engagements.
<b>f.</b> Identification of the purpose for which the Agreed upon procedures were performed.
<b>g.</b> A listing of the specific procedures performed.
<b>h.</b> Description of the auditor's factual Findings including sufficient details of errors and exceptions found.
<b>i.</b> Statement that the procedures performed does not constitute either an audit or a review and, as such, no assurance is expressed.
<b>j.</b> Statement that had the auditor performed additional procedures, an audit or a review, other matters might have come to light that would have been reported.
<b>k.</b> Statement that the report is restricted to those parties that have agreed to the procedures to be performed.
<b>l.</b> Statement (when applicable) that the report relates only to the elements, accounts, items or financial and non-financial information specified and that it does not extend to the entity's FS taken as a whole.
<b>m.</b> Date of the report
<b>n.</b> Place of signature
<b>o.</b> Auditor's signature

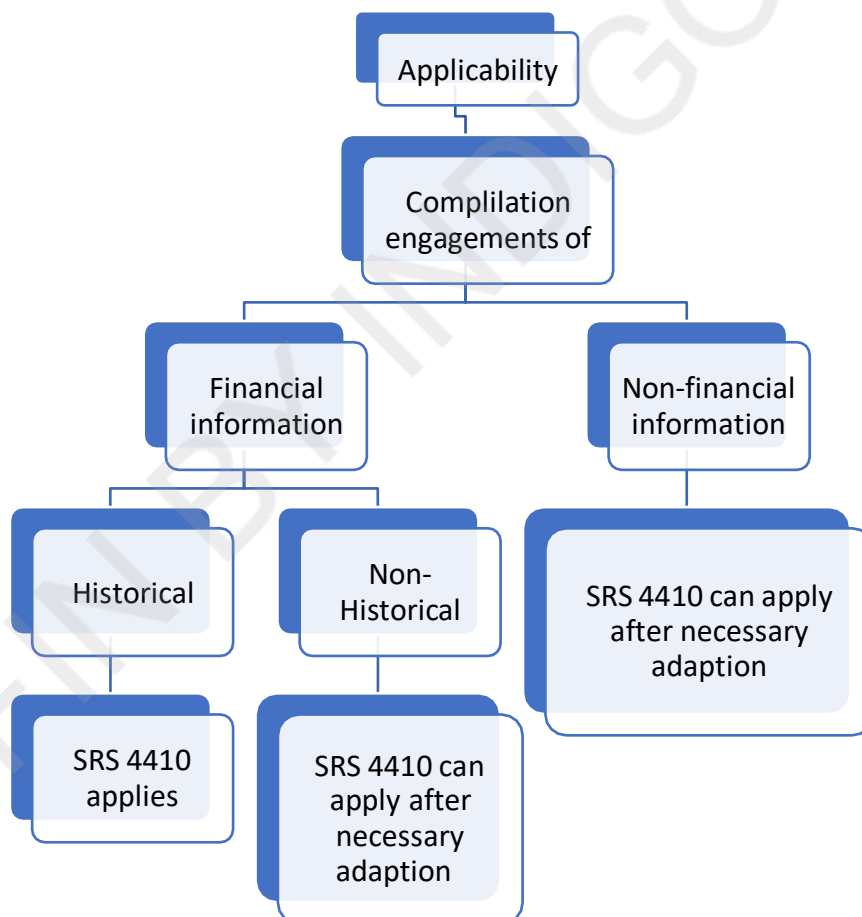
## DOCUMENTATION

Auditor should document **matters which are important in providing evidence to support the report of** factual findings, and evidence that **the engagement was carried out in accordance with this SRS and the terms of the engagement.**

## SRS 4410: COMPILATION ENGAGEMENTS

### SCOPE OF THIS SRS

1. It deals with **practitioner's responsibilities** when engaged to **assist management with the preparation and presentation of historical financial information without obtaining any assurance** on that information, and to report on the engagement in without accordance with this SRS.
2. SQC I also apply to firms in respect of firm's compilation engagements



## Meaning of Compilation engagement

1. Compilation engagement is an engagement in which a **practitioner applies accounting and financial reporting expertise to assist management in the preparation and presentation of financial information** of an entity in accordance with an Acceptable Financial Reporting Framework and issues a report.
2. **Management may request a professional accountant** in public practice to assist with the preparation and presentation of financial information of an entity.

Financial information that is the subject of a compilation engagement may be required for various purposes including:

- **To comply with mandatory periodic financial reporting** requirements established in law or regulation, if any; or
- For purposes **unrelated to mandatory financial reporting** under relevant law or regulation, including for example:
  - For management or TCWG, prepared on a basis appropriate for their particular purposes (such as preparation of financial information for internal use).
  - For periodic financial reporting undertaken for external parties under a contract or other form of agreement (such as financial information provided to a funding body to support provision or continuation of a grant)
  - For transactional purposes, for example, to support a transaction involving changes to the entity's ownership or financial structure (such as for a merger or acquisition)
- A compilation engagement is **not an assurance engagement**.
- A compilation engagement does not require the practitioner to verify the accuracy or completeness of the information provided by management for the compilation, or otherwise to gather evidence to express an audit opinion or a review conclusion on the preparation of the financial information.

## OBJECTIVES

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The practitioner's objectives in a compilation engagement under this SRS are to:

1. **Apply accounting and financial reporting expertise** to assist management in the preparation and presentation of financial information in accordance with an A-FREW based on information provided by management; and
2. **Report** in accordance with the requirements of this SRS.

## SCOPE OF COMPILATION ENGAGEMENTS

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1. It involves **assisting management in the preparation and presentation of the entity's financial information** in accordance with the FRFW, based on information provided by management.
2. **Management retains responsibility for the financial information** and the basis on which it is prepared and presented.
3. **Different FRFW can be used to prepare and present financial information**, ranging from a simple entity-specific basis of accounting to established financial reporting standards. The FRFW adopted by management to prepare and present the financial information will **depend on the nature of the entity and the intended use of the information**.

## ETHICAL REQUIREMENTS

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1. Practitioner shall **comply with relevant ethical requirements**.
2. **Any threats** to the practitioner's compliance with relevant ethical requirements are **required to be identified and appropriately addressed**
3. Being in nature of non-assurance engagement, **independence requirements do not apply to compilation engagements**. However, laws or regulations may specify requirements or disclosure rules pertaining to independence.

## A . ENGAGEMENT ACCEPTANCE AND CONTINUANCE

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Practitioner **shall not accept the engagement unless** the practitioner **has agreed the terms of engagement** with management, and the engaging party if different, including:

1. **intended use and distribution** of the financial information, and **any restrictions on either its** use or its distribution where applicable.
2. **identification of the A-FRF)**
3. **Objective and scope** of the compilation engagement
4. **Responsibilities of the practitioner**, including the requirement to comply with relevant ethical requirements
5. **Management's Responsibility for:**
  - The **financial information**, and for the preparation and presentation thereof, in **accordance with a FRFD** that is acceptable in view of the intended use of the financial information and the intended users.
  - **Design, implementation and maintenance** of such IC as management determines is necessary to enable the preparation of FS that are free from material misstatement, whether due to fraud or error.
  - The **accuracy and completeness of the records, documents, explanations** and **other** information provided by management for the compilation engagement; and
  - **Judgments** needed in the preparation and presentation of the financial information, including those for which the practitioner may require assistance in the course of the compilation engagement.
6. Expected **form and content** of the practitioner's report.
  - The practitioner shall record the agreed terms of engagement in an engagement letter or other suitable form of written agreement, prior to performing the engagement.
  - **Recurring compilation engagements:**

On recurring compilation engagements, the practitioner shall **evaluate whether** circumstances, **including changes in the engagement acceptance considerations, require the terms of engagement to be revised and whether there is need to remind management of the existing terms of engagement.**

## **B. PERFORMING THE ENGAGEMENT**

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- Practitioner shall **obtain an understanding** of the following matters sufficient to be able to perform the compilation engagement:

- a. The entity's business and operations, including the entity's accounting system and accounting records; and
  - b. The **applicable financial reporting framework**, including its application in the entity's industry.
- Practitioner shall **compile the financial information** using the records, documents, explanations and other information, including significant judgments, provided by management.
  - Practitioner shall **discuss with management** or TCWG as appropriate, those significant judgments, for which the practitioner has provided assistance in the course of compiling the financial information.
  - Prior to completion of the compilation engagement, the practitioner shall **read the compiled financial information in light of the practitioner's understanding of the entity's business and operations, and of the Applicable Financial Reporting Framework.**
  - If, in the course of the compilation engagement, the **practitioner becomes aware that the records, documents, explanations or other information, including significant judgments**, provided by management for the compilation engagement are incomplete, inaccurate or otherwise unsatisfactory, the practitioner **shall bring that to the attention of management** and request the additional or **corrected information.**
  - If the practitioner is **unable to complete the engagement because management has failed to provide records, documents, explanations or other information, including significant judgments**, as requested, the practitioner shall **withdraw from the engagement and inform management and TCRG** of the reasons for withdrawing.
  - If the **practitioner becomes aware** during the course of the engagement that:
    - a) The compiled financial information does not adequately refer to or describe the Acceptable Financial Reporting Framework.
    - b) Amendments to the compiled financial information are required **for the financial information not to be materially misstated; or**
    - c) The compiled financial information is otherwise misleading,
 the practitioner shall **propose the appropriate amendments to management.**
  - **If management declines, or does not permit** the practitioner to make the **proposed amendments** to the compiled financial information, the practitioner shall **withdraw from the engagement and inform management and TCWG** of the reasons for withdrawing.



- If **withdrawal** from the engagement is **not possible**, the practitioner shall determine the **Professional and legal responsibilities applicable** in the circumstances.
- The practitioner shall **obtain an acknowledgement from management or TCWG**, as appropriate, **that they have taken responsibility for the final version of the compiled financial information**.

## COMMUNICATION WITH MANAGEMENT AND TCWG

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Practitioner shall communicate with management or TCWG, as appropriate, **on a timely basis** during the course of the compilation engagement, **all matters concerning the compilation engagement** that, in his professional judgment, are of **sufficient importance** to merit the attention of management or TCWG, as appropriate.

## C. PRACTITIONER'S REPORT

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The practitioner's report shall be in writing, and shall **include** the following elements:

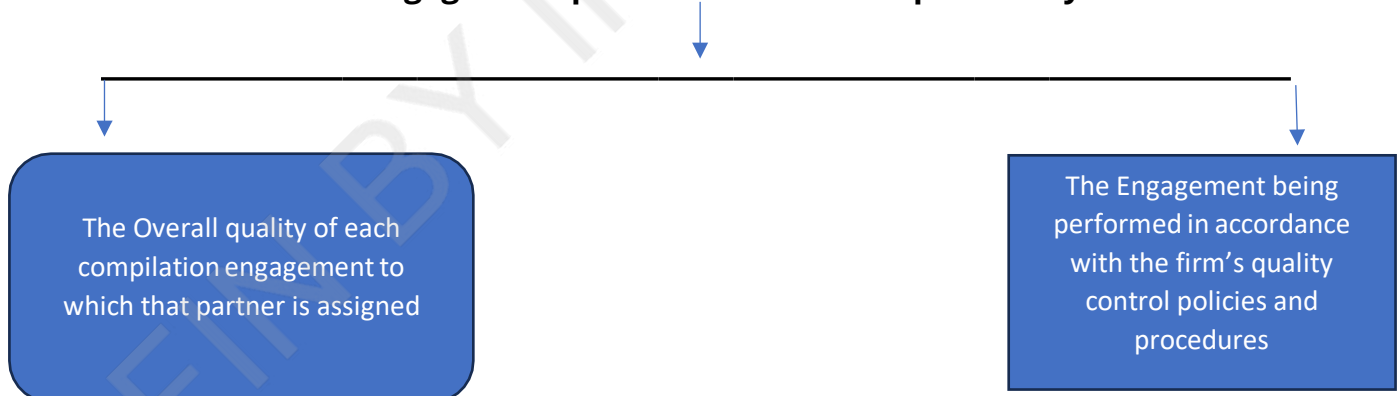
- Report title
- Addressee(s), as required by the terms of the engagement.
- Statement that the practitioner has compiled the financial information based on information provided by management.
- Description of the **responsibilities of management**, or TCWG as appropriate, in relation to the compilation engagement, and in relation to the financial information.
- identification of the A-FRFD and, if a special purpose FRFW is used, a description or reference to the description of that special purpose FRFW in the financial information.
- **identification of the financial information**, including the title of each element of the financial information if it comprises more than one element, and the date of the financial information or the period to which it relates.
- Description of the practitioner's responsibilities in compiling the financial information including that the engagement was performed in accordance with this SRS, and that the practitioner has complied with relevant ethical requirements.

- **Description of what a compilation engagement** entails in accordance with this SRS.
  - **Explanations that:**

Since a compilation engagement is not an assurance engagement, the practitioner is not required to verify the accuracy or completeness of the information provided by management for the compilation; and
  - Accordingly, the **practitioner does Not express an audit opinion or a review Conclusion** on whether the financial information is prepared in accordance with the Acceptable Financial Reporting Framework.
- If the financial information is prepared using a **special purpose Framework**, an explanatory paragraph that:
- Describes the **purpose for which the financial information is prepared** and, if necessary, the intended users, or contains a **reference to a note** in the financial information that discloses this information; and
  - **Draws the attention of readers of the report** to the fact that the financial information is prepared in accordance with a **special purpose framework** and that, as a result, the information may **not be suitable for other purpose**.
  - **Date of the report**
  - **Signature**
  - **Place of signature**

## ENGAGEMENT LEVEL QUALITY CONTROL

The engagement partner shall take responsibility for:



## DOCUMENTATION

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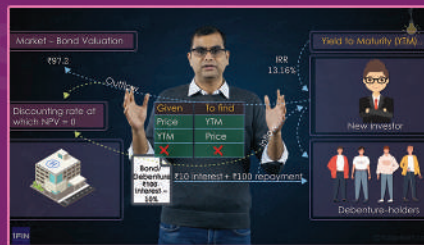
The practitioner shall include in the engagement documentation:

1. **Significant matters** arising during the compilation engagement and how those matters were addressed by the practitioner;
2. **A record of how the compiled financial information reconciles with the underlying records, documents, explanations and other information**, provided by management; and
3. **A copy of the final version of the compiled financial information**, for which management or TCWG, as appropriate, has acknowledged their responsibility, and the **practitioner's report**. The practitioner may also consider including in the engagement documentation **a copy of the entity's Trial Balance, summary of significant accounting records or other information** that he used to perform the compilation.

## Our Approach

We go to great lengths to ensure that we deliver a quality learning experience to our students. Right from pedagogy design to faculty selection, video recording and animation, at every stage our goal is to ensure that the final output is the BEST and it meets the requirements of the learners. It is our laser sharp focus on maintaining HIGH QUALITY and setting new benchmarks in the CA education domain, that make our efforts stand out and help our students to succeed in their examinations.

## A Glimpse of our e-learning modules

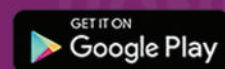


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