

# NATURE OBJECTIVE AND SCOPE OF AUDIT

## Meaning and Nature of Audit

- An audit is an Independent Examination of Financial information of Any Entity
- Whether Profit Oriented or not Irrespective of its size or legal form
- When Such Examination is Conducted with view to express an Opinion Thereon

## Purpose of Audit

- The Purpose of External Audit engagement is to enhance the degree of confidence of Indented user of FS
- This engagement is also known as Reasonable Assurance Engagement
- It is done by independent Auditor to express an opinion on whether the FS present T&F view of Entity's affairs.

## Auditor's Task that FS would not mislead anybody & it should satisfy himself that

- A/c's have been drawn up with reference to the Entries In BOA
- Entries in BOA are adequately supported by SAAE
- None of the entries in the BOA has been Omitted in the process of Compilation
- Nothing which is not in BOA has found place in the FS
- Information Conveyed by the FS is clear and Unambiguous
- FS amounts are properly Classified, Described and Disclosed in conformity with AS
- Statement of A/c present T&F picture of the Operational Results of Assets and Liabilities

## Overall Objectives of the Auditor as per SA 200

- To obtain **Reasonable Assurance** About Whether the FS as whole are free from MMs; and
- To **Report** On the FS and Communicate as required by the SA's In accordance with the Auditor's Findings

## Summary

- Obtaining **Reasonable Assurance** about Whether the FS as whole are free from MMs due to fraud or Error.
- Gaining a Reasonable Assurance leads to formation of Opinion Whether FS are **Prepared in all Material Aspects** in accordance with AFRFW
- To **Report** on the FS & **Reporting of Opinion** as per the Auditor's Findings
- **Communication** of Reporting
- Reporting and Communication in accordance with SA

## SCOPE OF AUDIT: WHAT IT INCLUDES

- Coverage to all aspects of entity relevant to the FS being audited
- Reliability and Sufficiency of Financial Info.
- Proper disclosure of Financial Info.
- Expression of Opinion on Financial Info

## SCOPE OF AUDIT: WHAT WON'T INCLUDES

- Responsibility of Preparation and Presentation of FS
- Duties outside scope of Competence of Auditor
- Expertise in authentication of Documents
- Investigation

## Inherent Limitations of Audit

The Auditor is not expected to, and Cannot, Reduce Audit Risk to Zero & therefore can't obtain absolute assurance that the FS free from MMs Due to fraud or Error

Most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being persuasive rather than conclusive.

1. The Nature of Financial Reporting
2. The Nature of Audit procedures
3. Audit is not investigation
4. Timeliness of financial reporting and decrease in relevance of information over time
5. Future Events

## The Nature of Audit procedures

- Preparation of FS involves making **many judgments by Mgmt.**
- These judgments may involve **subjective decisions or a degree of uncertainty**. Therefore, auditor may not be able to obtain absolute assurance

## The Nature of Financial Reporting

- There are **practical and legal limitations on ability of auditor to obtain audit evidence**. For example, an auditor does not test all transactions and balances.
- Management **may not provide complete information as requested by auditor**. There is no way by which auditor can force management to provide complete information as may be requested by auditor
- The **management may consist of dishonest and unscrupulous people** and may be, itself, involved in fraud. It may be engaged in concealing **fraud by designing sophisticated and carefully organized schemes** which may be hard to detect by the auditor.
- An **auditor is not an expert in authentication of documents**. Therefore, he may be led to accept invalid audit evidence on the basis of unauthentic documents

**Audit is not investigation** - Audit is not an official investigation. Hence, auditor cannot obtain absolute assurance that financial statements are free from material misstatements due to frauds or errors

**Timeliness of Financial Reporting and the Balance between Benefit and Cost:** The relevance of information decreases over time and auditor cannot verify each and every matter. Therefore, a balance has to be struck between reliability of information and cost of obtaining it

**Future events:** Future events or conditions may affect an entity adversely. **The business may cease to exist in future** due to change in market conditions, emergence of new business models or products or due to onset of some adverse events.

## Advantages of Audit of Financial Statement

- It **protects the financial interests of people not involved in managing the entity**
- It **deters employees** from committing theft or fraud
- Audited FS are useful for **calculating taxes, securing loans**, and determining the value of a business in a sale
- They can also **resolve disputes** related to wages, bonuses, or property damage
- Audits find and suggest solutions for losses caused by **inadequate Internal Controls**.
- Audits check if records are maintained properly and help clients correct any deficiencies
- Audits review organizational controls, **highlighting weaknesses** or shortcomings
- Audited accounts simplify **settling financial matters** when a partner joins or leaves
- The **government may require audited statements** before granting assistance

## Audit Mandatory or Voluntary

**Audit required under law:** The organisations which require audit under law are the following: e.g., companies governed by the Companies Act; banking companies

**Voluntary category** are the audits of the accounts of proprietary entities, partnership firms, Hindu undivided families, etc. In respect of such accounts, there is no basic legal requirement of audit.

**Engagement:** it means a formal agreement between auditor and client under which auditor agrees to provide auditing services. It takes the shape of engagement letter.

#### **External audit engagements:**

- External audit engagements aim to boost the confidence of financial statement users.
- These engagements provide reasonable assurance.
- In India, companies must have their annual accounts audited by an external auditor
- Non-corporate entities can also opt for external audits due to their associated benefits

#### **To whom audit report is submitted by an auditor**

- The report is given to the person who appoints the auditor.
- In companies, this is the shareholders, and in firms, it's the partners

#### **Meaning of Assurance Engagement**

- Assurance engagement involves a practitioner providing a conclusion.
- The conclusion aims to increase the confidence of users (other than responsible party) in the evaluation or measurement of a subject matter against criteria.
- The practitioner offers an opinion on specific information.
- This helps information on which users make confident decisions with reduced risk of inaccuracies

#### **Elements of an Assurance Engagement**

1. Three Party relationship
  - a. **A practitioner is a person who provides the Assurance**
  - b. **A responsible party is the party responsible for preparation of subject matter**
  - c. **Intended users are the persons for whom an assurance report is prepared.**
2. An appropriate subject matter
3. Suitable Criteria
4. Sufficient appropriate evidence
5. Written assurance report in appropriate form

#### **Audit vs. Review**

- Audit is a reasonable assurance engagement.
- It offers reasonable assurance.
- Review is a limited assurance engagement.
- It provides less assurance compared to an audit.
- Reviews involve fewer procedures and gather sufficient evidence for limited conclusions.
- Both audit and review pertain to financial statements based on historical financial data

#### **Reasonable Assurance vs. Limited Assurance**

##### **Reasonable assurance engagement**

- It Provides High Level Assurance
- It performs elaborate and extensive procedures to obtain SAAE
- It draws reasonable conclusions on the basis of SAAE
- E.g. Audit Engagement

##### **Limited assurance engagement**

- It Provides lower Level Assurance than Reasonable Assurance Engagement
- It performs fewer procedures compared to Reasonable Assurance Engagement
- It involves obtaining SAAE to draw limited conclusions
- E.g. Review Engagement.

#### **Prospective vs. Historical financial Information**

Prospective financial information" means financial information based on assumptions about events that may occur in the future and possible actions by an entity. It can be in the form of a forecast or projection or combination of both

Historical financial information" means information expressed in financial terms in relation to a particular entity, derived primarily from that entity's accounting system, about economic events occurring in past time periods or about economic conditions or circumstances at points in time in the past

### **Standards on Auditing:**

- Standards on Auditing apply to independent audits of financial statements.
- They specifically pertain to historical information
- These standards set high-quality benchmarks for auditors.
- Auditors must follow these standards during financial statement audits.
- Standards cover various auditing topics, including objectives, documentation, planning, risk assessment, sampling, evidence, and reporting.
- They encompass all key aspects of financial statement audits

### **Standards on Review engagements:**

- Standards on review engagements apply to the review of financial statements.
- A review is a limited assurance engagement and offers less assurance than an audit.
- Reviews involve fewer procedures than audits.
- Despite being a limited assurance engagement, reviews still require obtaining sufficient appropriate evidence.
- An example of a review is when an auditor reviews interim financial information for an entity.

### **Standards on Assurance Engagements:**

- Apply to assurance engagements dealing with subjects other than historical financial information.
- These engagements do not involve auditing or reviewing historical financial data.
- An example is an assurance engagement for examining prospective financial information.
- These standards cover various assurance tasks, including those related to non-financial matters like the design and operation of internal controls in an entity.

### **Standards on Quality Control:**

- Standards on Quality Control (SQC) are guidelines for firms to maintain quality control in their audit, review, and assurance engagements.
- SQC 1 is one of these standards and requires auditors/practitioners to establish a quality control system.
- The system ensures compliance with professional standards, legal requirements, and the issuance of appropriate reports.
- The main goal is to have a quality control system in firms to ensure compliance with professional standards and legal requirements when providing services covered by engagement standards.

### **Why are Standards required?**

- Standards ensure carrying out of audit against established benchmarks at par with global practices.
- Standards improve quality of financial reporting thereby helping users to make diligent decisions.
- Standards promote uniformity as audit of financial statements is carried out following these Standards.
- Standards equip professional accountants with professional knowledge and skill. 5. Standards ensure audit quality

### **Duties in relation to Standards**

- Professional accountants have a responsibility to follow accounting standards in their work.
- They must adhere to these standards in most cases, but there can be situations where following a standard isn't effective for a specific job.
- In such cases, accountants should document the alternative procedures they used and explain why they departed from the standard unless it's obvious
- Their report should also highlight any departures from the standards.
- Just disclosing a departure in the report doesn't excuse the accountant from following the standards.

## 2. AUDIT STRATEGY, AUDIT PLANNING AND AUDIT PROGRAMME

Planning an audit involves establishing the overall audit strategy for the engagement and developing an audit plan

### **Benefits of Planning**

- Appropriate Attention To Important areas
- Identify and Resolve the potential Problems
- To Conduct Efficient and Effective Audit
- Selection of Team Members
- Direction and Supervision of Team & Review of Work
- Coordination with Other Auditors and Experts

### **Planning is a CONTINUOUS process**

Planning is not a discrete phase of an audit, but rather a continual and iterative process that often begins shortly after (or in connection with) the completion of the previous audit and continues until the completion of the current audit engagement

Planning, however, includes consideration of the timing of certain activities and audit procedures that need to be completed prior to the performance of further audit procedures. Such as

- **Analytical procedures** to be applied as risk assessment procedures.
- Obtaining a general understanding of the **legal and regulatory framework** applicable to the entity and how the entity is complying with that framework.
- The determination of **materiality**.
- The involvement of **experts**.
- The performance of other **risk assessment procedures**

### **Involvement of key engagement team members in planning audit**

The involvement of the engagement partner and other key members of the engagement team in planning the audit draws on their experience and insight, thereby enhancing the effectiveness and efficiency of the planning process

### **Discussion of elements of planning with entity's management**

The auditor may decide to discuss elements of planning with the entity's management to facilitate the conduct and management of the audit engagement. When discussing matters included in the overall audit strategy or audit plan, care is required in order not to compromise the effectiveness of the audit.

### **Planning Process- Elements of Planning**

The elements of planning can be categorized as under:

- Preliminary engagement activities
- Planning activities

**Preliminary engagement activities:** It assists the auditor in identifying and evaluation events or Circumstances that may affect auditor's ability to plan and perform the audit engagement

1. **Performing procedures regarding the continuance of the client relationship;** Acceptance and Continuance of Client Relationships and Audit Engagements

- Ensure that appropriate procedures regarding the acceptance and continuance of client relationships
- Integrity of principal owners and key Mgmt.
- Competence of engagement team to perform the audit engagement
- Implications of matters that have arisen during current and previous audit engagement may need to be considered

## **2. Evaluating compliance with ethical requirements, including independence. Auditor Shall**

- Continuously evaluate compliance with ethical requirements including independence
- remain alert, for evidence of non-compliance of Ethics by Engagement Team members
- Obtain relevant information from the firm to identify and evaluate circumstances and relationships that create threats to independence
- Take appropriate action to eliminate such threats or reduce them to an acceptable level by applying safeguards
- The engagement partner shall promptly report to the firm any inability to resolve the matter for appropriate action

## **3. Establishing an understanding of terms of engagement**

It is in the interests of both the entity and the auditor that the auditor sends an audit. Engagement letter before the commencement of the audit to help avoid misunderstandings with respect to the audit. It ensures that there is no confusion with the client regarding terms of the engagement

### **Establishing the overall audit strategy:**

Overall Audit Strategy sets the scope, Timing and Direction of the audit and Guides the development of more detailed Audit Plan.

In establishing the overall audit strategy, the auditor shall:

- Identify the characteristics of the engagement that define its scope
- Ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required
- Consider the factors that, in the auditor's professional judgment, are significant in directing the engagement team's efforts
- Consider the results of preliminary engagement activities
- Ascertain the nature, timing and extent of resources necessary to perform the engagement

The process of establishing the overall audit strategy assists the auditor to determine, subject to the completion of the auditor's risk assessment procedures such matters as

- The resources to deploy for specific audit areas
- The amount of resources to allocate to specific audit areas
- When these resources are to be deployed, such as whether at an interim audit stage or at key cut-off dates
- How such resources are managed, directed and supervised.

### **Audit Plan**

Once the overall audit strategy has been established, an audit plan can be developed to address the various matters identified in the overall audit strategy, taking into account the need to achieve the audit objectives through the efficient use of the auditor's resources

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

- The nature, timing and extent of planned risk assessment procedures
- The nature, timing and extent of planned further audit procedures at assertion level
- Other planned audit procedures that are required to be carried out so that the engagement complies with SAs

### **Relation between Strategy and Plan**

- Audit strategy sets the broad overall approach to the audit whereas audit plan addresses the various matters identified in the overall audit strategy
- Audit strategy determines scope, timing and direction of audit.
- Audit plan describes how strategy is going to be implemented
- The audit plan is more detailed than the overall audit strategy that includes the nature, timing and extent of audit procedures to be performed by engagement team members
- These are Closely Inter related

### ***Changes to Planning during the course of Audit***

The auditor shall update and change the overall audit strategy and the audit plan as necessary during the course of the audit as a result of:

- Unexpected events
- Change in conditions
- Audit evidence obtained

### ***Direction Supervision and Review work of Team members***

The nature, timing and extent of the direction and supervision of engagement team members and review of their work vary depending on many factors, including:

- The size and complexity of the entity.
- The area of the audit.
- The assessed risks of material misstatement
- Capability and competence of team members

### ***Documentation***

The documentation of the overall audit strategy is a record of the key decisions considered necessary to properly plan the audit and to communicate significant matters to the engagement team.

The documentation of the audit plan is a record of the planned nature, timing and extent of risk assessment procedures and further audit procedures at the assertion level in response to the assessed risks

The auditor shall document:

- The overall audit strategy
- The audit plan
- Any significant changes made during the audit engagement to the overall audit strategy or the audit plan, and the reasons for such changes

### ***Meaning of Audit Programme***

An audit programme is a detailed plan of applying the audit procedures to obtain sufficient evidence to enable the auditor to express an informed opinion on a company's financial statements and accounts

It consists of a series of verification procedures to be applied in the given circumstances.

The purpose of the audit programme is to accomplish the audit objectives

### ***General Points of Audit Programme***

Evolving One Audit Programme – Not Practicable for All Businesses: Businesses vary in nature, size and composition; work which is suitable to one business may not be suitable to others.

Assistant should be instructed to note and report significant matters coming to his notice, to his seniors or to the partners or proprietor of the firm engaged for doing the audit

There should be periodic review of the audit programme to assess whether the same continues to be adequate for obtaining requisite knowledge and evidence about the transactions

### ***Constructing an Audit Programme – keep in mind the following points***

- Stay within the scope and limitation of the assignment
- Prepare a written audit program
- Determine the Evidence reasonably available and identify the best evidence
- Apply only those steps and procedures which are useful in accomplishing the verification purpose
- Include the audit Objective of Each Area
- Consider all possibilities of error
- Co-ordinate the procedures to be applied to related items

### ***Advantages of Audit Programme***

1. Provides the assistant carrying out the audit with clear instructions of the work to be done
2. Provide a total perspective of work to be performed
3. Selection of assistants for the jobs on the basis of capability becomes easier when the work is rationally planned, defined and segregated
4. Prevents danger of ignoring or overlooking certain books and records
5. The assistants accept responsibility for the work carried out by them
6. Principal can control the progress of the various audits in hand by examining initiated programmes
7. Serves as a guide for audits to be carried out in the succeeding year
8. Serves as evidence in the event of any charge of negligence being brought against the auditor

### ***Dis-Advantages of Audit Programme***

1. Work may become mechanical
2. Parts of the programme may be carried out without understanding of the objective
3. Programme may become rigid and inflexible
4. Business may change, but the old programme may still be carried on
5. Changes in staff or internal control may require precaution in different points than originally planned
6. Inefficient assistants may take shelter behind the programme
7. Hard and fast audit programme may kill initiative of efficient and enterprising assistants



### 3. RISK ASSESSMENT AND INTERNAL CONTROL PART - 1

#### **Audit Risk (AR)**

It is the risk that the auditor gives an inappropriate audit opinion when the financial statements are materially misstated. Thus, it is the risk that the auditor may fail to express an appropriate opinion in an audit assignment

$AR = \text{Risk of Material Misstatement (ROMM)} \times \text{Detection Risk (DR)}$

$ROMM = \text{Inherent Risk} \times \text{Control Risk}$

#### **Risk of Material Misstatement**

It is the risk that the financial statements are materially misstated prior to audit. It simply means that there is a probability of frauds or errors in financial statements before audit.

The risks of material misstatement may exist at two levels

1. The overall financial statement level- ROMM that relate pervasively to FS and Potentially affect Many assertions
2. The assertion level for classes of transactions, account balances, and disclosures in order to determine the nature, timing, and extent of further audit procedures to obtain SAAE

#### **Inherent Risk (IR)**

The susceptibility of an assertion about a COT, A/c Bal. 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 factors are considered while designing tests of controls and substantive procedures

#### **Control Risk (CR)**

The risk that a misstatement that could occur in an assertion about a COT, A/c Bal. or disclosure 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**

**Control risk is a function of the:**

- Effectiveness of the design,
- Implementation and
- Maintenance of internal control by management

Internal control can only reduce but not eliminate risks of material misstatement

#### **Detection Risk (DR)**

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.

Detection risk may be reduced by increasing area of checking, testing larger samples and by including competent and experienced persons in the engagement team

Detection risk comprises sampling and non-sampling risk

**Sampling risk** is the risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure

**Non-sampling** risk is the risk that the auditor reaches an erroneous conclusion for any reason not related to sampling risk

### ***Not an Audit Risk***

- Audit risk does not include the risk that the auditor might express an opinion that the financial statements are materially misstated when they are not.
- It does not refer to the auditor's business risks such as loss from litigation, adverse publicity, or other events arising in connection with the audit of financial statements

### ***Not an Audit Risk***

- Audit risk does not include the risk that the auditor might express an opinion that the financial statements are materially misstated when they are not.
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### ***Combined assessment of ROMM***

The auditor may make combined assessments of IR & CR depending on preferred audit techniques or methodologies

The assessment of the ROMM may be expressed in quantitative terms, such as in percentages, or in non-quantitative terms

### ***Significant Risk – The Auditor Shall Consider***

- Whether Such risk is a **risk of fraud**
- Risk is related to recent **significant economic, accounting** or other important development
- **Complexity** of transactions
- Risk involves significant transaction with **related parties**
- Risk related to financial item where there is **high degree of subjectivity in measurement**
- Risk related to **significant transactions outside the normal course of business**

### ***Significant risks often relate to significant non-routine transactions or judgmental matters***

*ROMMs may be greater for significant non-routine transactions – Arise from the following*

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

*ROMMs may be greater for significant Judgmental Matters*

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

### ***Assessment of risks- A matter of professional Judgment***

The assessment of risks is a matter of professional judgment, rather than a matter capable of precise measurement. The distinguishing feature of the professional judgment expected of an auditor is that **it is exercised by an auditor whose training, knowledge and experience have assisted in developing the necessary competencies to achieve reasonable judgments**

### ***Objective of SA 315***

- Identify and assess the risks of material misstatement,
- Whether due to fraud or error,
- At the financial statement and assertion levels,
- Through understanding the entity and its environment, including the entity's internal control.

## ***Risk Assessment Procedure***

### **The audit procedures performed to obtain:**

- An understanding of the entity and its environment,
- Including the entity's internal control,
- To identify and assess the risks of material misstatement, whether due to fraud or error,
- At the financial statement and assertion levels

### ***The risk assessment procedures shall include***

- Inquiries of Management and Others within the Entity
- Analytical Procedures
- Observation and inspection

### **Inquiries of Management and Others within the Entity**

The auditor obtains information about the entity and its environment through inquiry of management, individuals responsible for financial reporting, and other personnel within the entity

Depending on the circumstances, the auditor might make inquiries of:

- Inquiries directed toward TCWG
- Inquiries directed toward Internal audit personnel about internal audit procedures relating to the design and effectiveness of the entity's internal control
- Inquiries directed toward Employees involved in accounting initiating, authorizing, processing, or recording complex transactions
- Inquiries directed toward In-house legal counsel about litigation, compliance with laws and regulations
- Inquiries directed toward Production, marketing, sales, and other personnel
- Inquiries directed to information systems personnel information about system changes, system or control failures.

## ***Analytical Procedure***

- The auditing standards require the use of analytical procedures during the audit planning phase
- The auditor can gain insight into the entity and its environment and identify areas that may pose significant risks relevant to the audit.
- Analytical procedures are effective in detecting unusual transactions or events
- The results of high-level analytical procedures are only an initial indication of whether there may be a significant misstatement.

## ***Observation and inspection***

- Observation of entity activities and operations.
- Inspection of documents (e.g., business plans and strategies), records, and internal control manuals.
- Read reports prepared by management, those charged with governance, and internal audit.
- Visits to the entity's premises and plant facilities.
- Tracing transactions through the information system relevant to financial reporting

## ***Information obtained by performing RAP - Used as audit evidence***

Information obtained by performing risk assessment procedures and related activities may be used by the auditor as audit evidence to support assessments of the risks of material misstatement

### ***Understanding of Entity***

- *Understanding of industry:* Relevant industry, regulatory, and other external factors including the AFRFW
- *Understand the entity:* The nature of the entity, including:
  - its operations;
  - its ownership and governance structures
  - The types of investments that the entity is making and plans to make, including investments in special-purpose entities; and
  - The way that the entity is structured and how it is financed
- *Understanding of accounting system:* The entity's selection and application of accounting policies, including the reasons for changes
- *Understanding of financial reporting framework*
- *Understanding entity's objective, strategies and business model*
- *The measurement and review of the entity's financial performance*
  - Key performance indicators (financial and non-financial) and key ratios,
  - Trends and operating statistics.
  - Period-on-period financial performance analyses.
  - Budgets, forecasts, variance analyses, and departmental or other level performance reports.
  - Credit rating agency reports

### ***Understanding the entity and its environment is significant***

- It helps the auditor in planning the audit and in identifying areas requiring special attention.
- Gaining knowledge about client's business is one of the important principles in developing an overall audit plan.
- In fact, without adequate knowledge of client's business, a proper audit is not possible.

### ***Understanding of the entity – a continuous process***

- 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.
- This helps them to plan the audit and make professional judgments throughout the process.
  - Assessing ROMM of the FS
  - Determining materiality in accordance with SA 320
  - Considering the appropriateness of the selection and application of accounting policies
  - Identify areas that may need extra attention, such as transactions involving related parties, checking if the management's use of the going concern assumption is suitable or not.
  - Developing expectations for use when performing analytical procedures
  - Evaluating the sufficiency and appropriateness of audit evidence obtained

### 3. RISK ASSESSMENT AND INTERNAL CONTROL PART - 2

#### **Internal Control**

The internal control may be defined as the process is Designed, Implemented and Maintained by those charged with governance, management and other personnel to provide reasonable assurance about the achievement of an entity's objectives with regards to

- Reliability of financial reporting,
- Effectiveness and efficiency of operations,
- Safeguarding of assets, and
- Compliance with applicable laws and regulations

#### **Benefits of Understanding of Internal Control**

An understanding of internal control assists the auditor in:

- Identifying types of potential misstatements
- Identifying factors that affect the risks of material misstatement
- Designing the nature, timing, and extent of further audit procedures

#### **Components of Internal Control (CT ICM)**

- Control Environment
- The Entity's Risk Assessment Process
- Information system and communication
- Control activities
- Monitoring

**Control Environment:** the auditor shall evaluate whether Management has created and maintained a culture of honesty and ethical behaviour.

It Includes

- The governance and Mgmt. functions and
- The attitudes, awareness, and actions of TCWG & Mgmt.
- The control environment sets the tone of an organization

#### **Elements of Control Environment:**

- Communication and enforcement of integrity and ethical values
- Commitment to competence
- Participation by those charged with governance
- Management's philosophy and operating style
- Organisational structure
- Assignment of authority and responsibility
- Human resource policies and practices

#### **The Entity's Risk Assessment Process:**

The entity's risk assessment process forms the basis for the risks to be managed. If that process is appropriate, it would assist the auditor in identifying risks of material misstatement

- Identifying business risks relevant to financial reporting objectives
- Estimating the significance of the risks
- Assessing the likelihood of their occurrence
- Deciding about actions to address those risks

#### **Information System and Communication**

The information system refers to all of the business processes relevant to financial reporting and communication. It includes the procedures within both information technology and manual systems

The auditor shall obtain an understanding of the information system including in the following areas

- Identify COT significant to the FS
- The procedure by which transaction initiated, recorded, processed, corrected as necessary transferred to general ledger & FS.
- Related A/c records, supporting info. & specific accounts in the FS that are used to initiate, record, process and report transactions.
- How IS captures information relevant to FS.
- The process used to prepare FS

### ***Control Activities***

Control Activities are the policies and procedures that help ensure management directives are carried out. During an audit, the auditor assesses the risk and considers only the relevant control activities related to a significant COT, A/c Bal., and disclosure

Specific control activities include those relating to audit are the following:

- Authorisation
- Performance reviews
- Information processing
- Physical controls
- Segregation of duties

### ***Monitoring Of Controls***

Monitoring of controls is a process to assess the effectiveness of internal control performance over time

Assessing the effectiveness of controls on a timely basis & taking necessary remedial actions..

Management accomplishes monitoring of controls through ongoing activities, separate evaluations, or a combination of the two

Ongoing monitoring activities are often built into the normal recurring activities of an entity

### ***Factors relevant to the auditor's judgment about Internal Control***

- Materiality.
- The significance of the related risk.
- The size of the entity.
- The nature of the entity's business, including its organisation and ownership characteristics.
- The diversity and complexity of the entity's operations.
- Applicable legal and regulatory requirements.
- The circumstances and the applicable component of internal control.
- The nature and complexity of the systems that are part of the entity's internal control, including the use of service organisations

### ***Nature and Extent of the Understanding of Relevant Controls***

Implementation of a control means that the control exists and that the entity is using it.

An improperly designed control may represent a significant deficiency in internal control. Risk assessment procedures to obtain audit evidence about the design and implementation of relevant controls may include

- Inquiring of entity personnel.
- Observing the application of specific controls.
- Inspecting documents and reports.
- Tracing transactions through the information system relevant to financial reporting

### ***Evaluation of Internal Control***

**1. Narrative Record** -written description of a system found in operation by the auditor. Actual testing and observation needed before creating it. Recommended for small businesses with no formal control system

Disadvantages

- Difficult to comprehend the system in operation
- Hard to identify weaknesses or gaps

**2. Checklist** - This is a series of instructions and/or questions which a member of the auditing staff must follow and/or answer. Answers to the check list instructions are usually Yes, No or Not Applicable. This is again an on-the-job requirement and instructions are framed having regard to the desirable elements of control

**3. Internal Control Questionnaire**

- It is comprehensive questions for internal control evaluation& Most widely used method for collecting information
- Review internal control system annually and record in detail
- Yes = satisfactory, No = weakness (with explanation option)
- Generally, issued to client for filling by concerned executives and employees
- Report of deficiencies and recommendations for improvement prepared

#### **4. Flow Chart**

- Graphic presentation of company's internal control system
- Most concise way of recording auditor's review
- Minimizes narrative explanation
- Provides bird's eye view of system and flow of transactions
- Helps in spotting documentation gaps and suggesting improvements

#### ***Benefits of evaluation of internal controls***

- Adequacy of internal control system
- Identify likelihood of errors and frauds
- Effectiveness of internal auditing department
- Administrative control impact on audit work
- Safeguarding assets
- Recording function discharge by management
- Reliability of reports, records, and certificates
- Extent and depth of examination
- Appropriate audit technique and procedure
- Weak or excessive control areas
- Suggestions for improving control system

#### ***Formulate Audit Programme after understanding Internal control***

- The auditor must comprehend the internal control systems and how they work before creating the audit plan
- If the auditor neglects this understanding, the audit plan might become too complex
- It's crucial for the auditor to verify if the system is actively functioning
- Sometimes, systems are installed but not properly monitored, leading the auditor to assume they are operational when they might not be working fully.
- The auditor can formulate his entire audit programme only after he has had a satisfactory understanding of the internal control systems and their actual operation.

### 3. RISK ASSESSMENT AND INTERNAL CONTROL PART 3

#### Meaning of Automated Environment

Automated environment basically refers to a business environment where the:

- Processes,
- Operations,
- Accounting and
- Even decisions are carried out by using computer systems

#### Key Features of an Automated Environment

- Enables faster business operation
- Accuracy in data processing and computation
- Ability to process large volume of transactions
- Integration amongst business operations
- Better security and controls
- Less prone to human errors
- Provides latest information
- Connectivity and networking capability

#### Understanding and documenting automated environment

- Information systems being used
- Their purpose
- Location of IT systems
- Architecture
- Version
- Interfaces within systems
- In-house vs. Packaged.
- Outsourced activities
- Key persons

#### Types of Controls in an Automated Environment

- General IT Controls
- Application Controls
- IT-Dependent Controls

#### Risks from the use of IT systems Information

- Inaccurate processing of data, processing inaccurate data, or both.
- Unauthorized access to data
- Direct data changes (backend changes).
- Excessive access / Privileged access (super users)
- Lack of adequate segregation of duties.
- Unauthorized changes to systems or programs
- Failure to make necessary changes to systems or programs.
- Loss of data

#### Impact of IT risks on Substantive Audit, Controls and Reporting

##### Impact on substantive checking

- It may lead to non-reliance of data obtained from systems.
- In such a case, all information, data, and reports would have to be tested thoroughly for their completeness and accuracy

##### Impact on controls

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

##### Impact on reporting

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

#### General IT Controls

- "General IT controls are policies and procedures that relate to many applications and support the effective functioning of application controls. They apply to mainframe, miniframe, and end-user environments



**General IT-controls that maintain the integrity of information and security of data commonly include controls over the following**

**Data centre and network operations** - The objective of controls over Data centre and network operations is to ensure that production systems are processed to meet financial reporting objectives

**Program Change** - The objective of program change controls is to ensure that modified systems continue to meet financial reporting objectives

**Access Security** - The objective of controls over access security is to ensure that access to programs and data is authenticated and authorized to meet financial reporting objectives.

**Application system acquisition, development and maintenance** - The objective of such controls is to ensure that systems are developed, configured and implemented to meet financial reporting objectives

**Application Controls**

Automated Application controls are embedded into IT applications viz., ERPs and help in ensuring the completeness, accuracy and integrity of data in those systems. Application controls include both automated and manual controls that operate at a business process level

**IT dependent Controls**

IT dependent controls are basically manual controls that make use of some form of data or information or report produced from IT systems and applications

Due to the inherent dependency on IT, the effectiveness and reliability of automated application controls and IT dependent controls require the General IT controls to be effective

**General IT Controls Vs. Application Controls**

- Application controls and General IT Controls are interrelated.
- General IT Controls are necessary to support the functioning of application controls.
- Both types of controls are required for accurate information processing through IT systems.

**Testing Methods**-Inquiry, observation, inspection and Re-performance. Inquiry is the most efficient audit test but it also gives the least audit evidence. Re-performance is most effective as an audit test and gives the best audit evidence.

- Observe how a user processes transactions under different scenarios.
- Inspect the configuration defined in an application.
- Inspect technical manual / user manual of systems and applications.
- Carry out a test check (negative testing) and observe the error message displayed by the application

**Manual elements vs. automated elements in entity's internal control**

*Manual elements are may be more suitable where judgment and discretion are required.*

- Large, unusual or non-recurring transactions.
- Circumstances where errors are difficult to define, anticipate or predict.
- In changing circumstances that require a control response outside the scope of an existing automated control.
- In monitoring the effectiveness of automated controls

*Manual control elements may be less suitable for the following circumstances*

- High volume or recurring transactions, or in situations where errors that can be anticipated or predicted can be prevented, or detected and corrected, by control parameters that are automated.
- Control activities where the specific ways to perform the control can be adequately designed and automated.

## Data Analytics for Audit

The combination of processes, tools and techniques that are used to tap vast amounts of electronic data to obtain meaningful information is called data analytics

The tools and techniques that auditors use in applying the principles of data analytics are known as Computer Assisted Auditing Techniques or CAATs

Data analytics can be used in testing of electronic records and data residing in IT systems.

- Check completeness of data and population that is used in either test of controls or substantive audit tests.
- Selection of audit samples – random sampling, systematic sampling.
- Re-computation of balances – reconstruction of trial balance from transaction data.
- Re-performance of mathematical calculations – depreciation, bank interest calculation.
- Analysis of journal entries
- Fraud investigation.
- Evaluating impact of control deficiencies

## Documenting the Risk – The Auditor shall document

- The discussion among the engagement team and the significant decisions reached
- Key elements of the understanding obtained regarding each of the aspects of the entity and its environment
- The identified and assessed ROMM at the FS level and at the assertion level
- The risks identified, and related controls about which the auditor has obtained an understanding.

## Objective of SA 330

- The auditor shall design and implement overall responses to address the assessed ROMM at the FS level.
- The auditor shall design and perform further audit procedures whose nature, timing and extent are based on and are responsive to the assessed ROMM at the assertion level.

## Digital Audit

- Entities are adopting digitization to keep up with changing times and revamp their business models through the use of new technologies.
- Companies are restructuring their business models with technology at the forefront, and automation plays a key role in the digitization process.
- Auditors are integrating digital technology into their processes, from planning to provide the final opinion on financial statements.
- Auditors are incorporating artificial intelligence, data analytics, and other cutting-edge technologies to gain a deeper understanding of business processes.
- The use of digital tools enables auditors to conduct more effective audits, focusing on areas that require greater attention and improving risk identification through technology

## Internal financial control as per Financial Reporting

The term Internal Financial Controls (IFC) basically refers to the policies and procedures put in place by companies for ensuring:

- Reliability of financial reporting
- Effectiveness and efficiency of operations
- Compliance with applicable laws and regulations
- Safeguarding of assets
- Prevention and detection of frauds

Section 134 (5) (e) -In case of listed Companies, the Directors' responsibility statement shall state that the Directors had laid down Internal financial controls & Operate Effectively

Section 143(3) (i) - The auditor's report shall state whether the company has adequate Internal financial controls system in place and also on the operating effectiveness of such controls

## Test of Controls (TOC)

- The TOC is an audit procedure performed by auditors to evaluate the effectiveness of a company's IC in preventing, or detecting and correcting MMs at the assertion level
- The auditor shall design and perform tests of controls to obtain SAAE as to the operating effectiveness of relevant controls when
- The auditor expects the controls to be operating effectively at the assertion level as part of their assessment of ROMM and plans to rely on them to determine the nature, timing, and extent of substantive procedures.
- Substantive procedures alone cannot provide enough suitable audit evidence at the assertion level.

## Test of controls may include

- **Inspection** of documents supporting transactions and other events to gain audit evidence that internal controls have operated properly
- Inquiries about, and observation of, internal controls which leave no audit trail.
- Re-performance involves the auditor's independent execution of procedures or controls that were originally performed as part of the entity's internal control
- Testing of internal control operating on specific computerised applications

## Matters the auditor may consider in determining the extent of test of controls

- 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.

## 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

## Evaluating the Operating Effectiveness of Controls

When evaluating the operating effectiveness of relevant controls, the auditor shall evaluate whether misstatements that have been detected by substantive procedures indicate that controls are not operating effectively. The absence of misstatements detected by substantive procedures, however, does not provide audit evidence that controls related to the assertion being tested are effective

## Specific inquiries when deviations from controls 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 are necessary; or
- The potential risks of misstatement need to be addressed using substantive procedures

Irrespective of the assessed risks of material misstatement, the auditor shall design and perform substantive procedures for each material class of transactions, account balance, and disclosure

## Substantive Procedure

Substantive procedures are audit procedures designed to detect material misstatements at the assertion level. Substantive procedures comprise: 1. Tests of details (of classes of transactions, account balances, and disclosures), and 2. Substantive analytical procedures. The extent of substantive procedures may need to be increased when the results from test of controls are unsatisfactory

## **Test of Details**

Tests of details are further classified into:

1. Tests of transactions i.e., vouching
2. Tests of balances i.e., verification

## **Substantive analytical procedures**

The term “analytical procedures” means evaluations of financial information through analysis of plausible relationships among both financial and non-financial data

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

### 3. RISK ASSESSMENT AND INTERNAL CONTROL PART 4 - SA 320

#### Scope of This Standard

This SA deals with the auditor's responsibility to apply the concept of materiality in planning & performing an audit of financial statements

#### Definition - Performance materiality

It 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.

#### Use of Benchmarks

- Determining materiality involves exercise of professional judgement
- A percentage is often applied to a chosen benchmark as a starting point in determining materiality for the financial statements as a whole
- Examples of benchmarks: Profit before tax, total revenue, gross profit, total expenses

#### Documentation of:

- Materiality for the financial statements as a whole.
- The materiality level or levels for particular COT, account balances or disclosures.
- Performance materiality.
- Any revision as the audit progressed

#### Limitation of Internal Control (Addnl.)

- i. Reasonable Assurance only
- ii. Human Judgment
- iii. Lack of understanding the purpose of IC
- iv. Collusion among People
- v. Judgment by MGMT
- vi. Not useful in Small Entity

#### Objective

To apply the concept of materiality appropriately in planning and performing an audit

#### Determining Materiality & Performance Materiality

- The auditor shall determine the materiality for the financial statements as a whole.
- If there is one or more particular classes of transactions, account balances or disclosures for which misstatements of lesser amounts than the materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements, the auditor shall also determine the materiality level or levels to be applied to those particular classes of transactions, account balances or disclosures.
- The auditor shall determine performance materiality for purposes of assessing the ROMM and determining the nature, timing & extent of further audit procedures.

#### Revision as the Audit progresses:

- 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, new information, or a change in the auditor's understanding of the entity and its operations as a result of performing further audit procedures.
- If the auditor concludes that a lower materiality for the financial statements as a whole than that initially determined is appropriate, the auditor shall determine whether it is necessary to revise performance materiality, and whether the nature, timing and extent of the further audit procedures remain appropriate

## 4. AUDIT EVIDENCE PART 1 - SA 500

### Meaning of Audit Evidence

Audit evidence may be defined as the 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
- Other information ( E.g. Minutes of the meetings)

### Types of audit evidence

#### *Depending upon nature:*

- Visual
- Oral
- Documentary

#### *Depending upon source*

- **Internal:** Evidence which originates within the organisation being audited is internal evidence
- **External:** The evidence that originates outside the client's organization is external evidence

The Reliability of evidence is influenced by its nature, source, and circumstances. The Reliability is increased when

- Evidence obtained from an **independent external source is more reliable** than client generated evidence
- **Evidence obtained directly by the auditor is more reliable**
- **Written evidence is more reliable than oral evidence**
- **Original documents are more reliable than copies**
- **The reliability of audit evidence generated internally is increased when the related controls of the entity are effective**

### Auditor's procedure for audit evidence

- Risk assessment procedures
- Further audit procedures, which comprise
  - Test 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.

### Sufficient and appropriate audit evidence (SAAE)

Sufficiency is the measure of the quantity of audit evidence. Auditor's judgment as to sufficiency may be affected by the factors such as:

- Materiality
- Risk of material misstatement
- Size and characteristics of the population

Appropriateness is the measure of the quality of audit evidence that is its **relevance** and its **reliability** in providing support for the conclusions on which the auditor's opinion is based

### Relevance:

Relevance means the evidence relates to the FS assertions being tested. Relevance deals with the logical connection or relation with the purpose of audit procedure

## Type of audit procedures

- **Inspection** - involves examining of Records or documents, which provides audit evidence of varying degrees of reliability
- **Observation:** looking at a process or procedure being performed by others
- **External Confirmation** : obtaining a direct response (usually written) from an external, third party
- **Recalculation:** manually or electronically checking the arithmetical accuracy of documents, records, or the client's calculations
- **Reperformance:** The auditor's independent execution of procedures or controls that were originally performed as part of the entity's IC system.
- **Analytical procedures:** analysis of plausible relationships between both financial and non-financial data
- **Inquiry:** seeking information from knowledgeable persons, both financial and nonfinancial, within the entity or outside

## Inconsistency in or Doubts over Reliability of Audit Evidence

If

1. Audit evidence obtained from one source is inconsistent with that obtained from another (or)
2. The auditor has doubts over the reliability of information to be used as audit evidence, the auditor shall determine what modifications or additions to audit procedures are necessary to resolve the matter, and shall consider the effect of the matter, if any, on other aspects of the audit.

## Selecting Items for Testing to Obtain Audit Evidence

When designing TOC and TOD, the auditor shall determine means of selecting items for testing that are effective in meeting the purpose of the AP

**Selecting All Items** - 100% examination may be appropriate when

- 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

**Selecting Specific Items** - The auditor may decide to select specific items from a population

**Specific items selected** may include –

- High value or key items
- All items over a certain amount - large proportion of the total Amount COT & A/c Bal.
- Items to obtain information about nature of the entity & Transaction

## 4. AUDIT EVIDENCE PART 1 - SA 501

### Objective of SA 501

The auditor should obtain sufficient appropriate evidence regarding:

- Existence and condition of *inventory*
- Completeness of *litigation and claims* involving the entity
- Presentation and disclosure of *Segment Information*

### Purpose of physical verification of inventory

Attend the physical inventory count, if inventory is material to the FS, then obtain SAAE regarding existence and condition of inventory by:

Attending physical inventory count to: -

- Evaluate management's instructions and procedures for the inventory count.
- Observe the performance of the count.
- Inspect the inventory.
- Perform test counts.

### Matters relevant in Planning Physical Verification

- Nature of inventory.
- Stages of completion of WIP
- The timing of physical inventory counting.
- The nature of the IC related to inventory.
- The ROMM related to inventory
- The locations at which inventory is held
- Whether the entity maintains a perpetual inventory system
- Whether proper instructions issued for physical inventory counting.

### Physical Verification Counting at Other Date

**Conducted other than at the Date of the FS:** The auditor 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.

**Auditor is unable to Attend due to Unforeseen Circumstances:** The auditor shall make or observe some physical counts (PIC) on an alternative date, and perform audit procedures on intervening transactions

**Attendance at PIC Impracticable:** The Auditor Perform alternative APs to obtain SAAE If not possible, issue modified report as per SA 705

**Inventory under custody or control of third party location:** Request confirmation from the third party & Perform inspection or other audit procedures appropriate

### Auditor's procedure for Litigation & claims which give rise to ROMM

- Inquiry of management including in-house legal counsel
- Reviewing minutes of meetings of TCWG & correspondence between the entity and its external legal counsel
- Reviewing legal expense account



**Communication with External Legal Counsel** - If the auditor assesses ROMMs regarding litigation or claims that have been identified

- The auditor shall, seek direct communication with the entity's external legal counsel
- If law and regulation prohibit such direct communication, perform alternate procedures

### **Segment Information**

Segment Information refers to information about different types of products and services of an enterprise and its operations in different geographical areas

### **Obtaining sufficient appropriate audit evidence**

- Obtaining 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 AFRFW
- Testing application of the method

### **Meeting with legal counsel**

- The auditor determines that the matter is a significant risk.
- The matter is complex.
- There is disagreement between management and the entity's external legal counsel. Ordinarily, such meetings require management's permission and are held with a representative of management in attendance.

**Further if:** management refuses to give the auditor permission to communicate or meet with the entity's external legal counsel, the auditor unable to obtain SAAE Auditor shall modify the opinion

### **Auditor's Responsibility**

The auditor's responsibility regarding the presentation and disclosure of segment information is in relation to the financial statements taken as a whole. Accordingly, the auditor is not required to perform audit procedures that would be necessary to express an opinion on the segment information presented on a standalone basis

## 4. AUDIT EVIDENCE PART 1 – SA 505

### Meaning of External Confirmation (EC)

External confirmation may be defined as 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 medium

### Important Terms

- **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
- **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
- **Non-response** – A **failure of** the confirming party to **respond, or fully respond**, to a positive confirmation request, or a **confirmation request returned undelivered**
- **Exception** - Difference between the information requested and information provided by the confirming party

### Audit procedures for External Confirmations

- Determining the information to be confirmed or requested
- Selecting the appropriate confirming party
- Designing the confirmation requests including that requests are properly addressed and contain return information
- Sending the requests, including follow-up requests

### Factors to consider when designing confirmation requests include

- Assertions being addressed.
- ROMM including fraud risks
- Layout and presentation of the confirmation request
- Prior experience on the audit or similar engagements
- Method of communication
- Management's authorisation or encouragement to the confirming parties to respond to the auditor
- The ability of the intended confirming party to confirm

### Management Refusal to send confirmation requests

- Inquire as to management's reasons for the refusal, and seek audit evidence as to their validity and reasonableness
- Evaluate the implications of management's refusal on the auditor's assessment of the relevant ROMM
- Perform alternative audit procedures designed to obtain relevant and reliable audit evidence

### If management refusal is unreasonable or auditor is unable to obtain relevant and reliable audit evidence from alternate procedure:

- Communicate with those charged with governance
- Determine implication for the audit and auditor's report as per SA 705

**The auditor is required to seek audit evidence as to the validity and reasonableness of the reasons because of the risk that management may be attempting to deny the auditor access to audit evidence that may reveal fraud or error**

**Negative Confirmations: Negative confirmations provide less persuasive (Convincing) audit evidence than positive confirmations**

Accordingly, the auditor shall not use negative confirmation requests as the sole substantive audit procedure to address an assessed ROMM at the assertion level unless all of the following are present

- The auditor has assessed the ROMM as low and has obtained SAAE regarding the operating effectiveness of IC relevant to the assertion
- The population of items subject to negative confirmation procedures are homogeneous, small size.
- A very low exception rate is expected

**Evaluating the Evidence Obtained**

The auditor shall evaluate whether the results of the external confirmation procedures provide relevant and reliable audit evidence

- A response by the appropriate confirming party indicating agreement with the information provided in the confirmation request
- A response deemed unreliable
- A non-response
- A response indicating an exception

## 4. AUDIT EVIDENCE PART 2 – SA 510

### Meaning of Initial audit engagement

Initial audit engagement is an engagement in which either:

- The FS for the prior period were not audited or
- The FS for the prior period were audited by a predecessor auditor

### Objective of SA 510

In conducting an initial audit engagement, the objective of the auditor with respect to Op. Bal. is to obtain SAAE about whether

- Opening balances contain misstatements that materially affect the current period's FS
- Appropriate accounting policies reflected in the opening balances have been consistently applied in the current period's FS or changes made are appropriately accounted for, presented and disclosed as per AFRFW

### Audit procedures for Opening balances

- The auditor should read the most recent FS and the predecessor auditor's report regarding the Opening balance
- Obtain SAAE to confirm
  - Brought forward of prior period's Closing balance
  - opening balances reflect application of appropriate A/c Policy
  - Perform specific audit procedures to obtain evidence on opening balances
- If prior period's audit report was modified, the auditor shall evaluate its effect on the assessment of Risk of Material Misstatement

### Misstatement in Opening Balances

The auditor obtains audit evidence that the opening balances contain misstatements that could materially affect the current period's FS:

- The auditor shall perform such additional audit procedures as are appropriate in the circumstances to determine the effect on the current period's FS.
- If the auditor concludes that such misstatements exist in the current period's FS, the auditor shall communicate the misstatements with the appropriate level of Mgmt. and TCWG

### Procedures adopted to Obtain Audit Evidence

**Inventory:** In the case of inventories, however, 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

- 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

**Non-current assets and liabilities:** Such as 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 & through confirmation with third parties

### Audit reporting

If the auditor is unable to obtain SAAE or concludes that the opening balances contain a misstatement that materially affects the current period's FS the auditor shall express a qualified opinion or an adverse opinion, as appropriate, in accordance with SA 705.

## 4. AUDIT EVIDENCE PART 2 - SA 520

The term “**Analytical procedures**” means: evaluations of financial information through analysis of plausible relationships among both financial and non-financial data and

Investigation of identified fluctuations, inconsistent relationships or amounts that differ from expected values by a significant amount

### Objective of SA 520

#### The Objective of the auditor are:

- To obtain relevant and reliable audit evidence when using substantive analytical procedures
- 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 FS are consistent with the auditor’s understanding of the entity

### Timing of Analytical Procedure

Analytical procedures are required in Planning, Testing as well as Completion phase. SA 315 requires the auditor to perform analytical procedures as a risk assessment procedure

#### In planning Stage analytical procedures assist the auditor in:

- Identify aspects of the entity of which the auditor was unaware.
- Assist in assessing the ROMM
- Assist in the identification of unusual transactions or events, as well as amounts, ratios, and trends that could potentially impact an audit.
- Help identify ROMM due to fraud

SA 500 requires the auditor to use analytical procedures at the **completion stage of the audit when forming an overall conclusion** as to whether the FS are consistent with the auditor’s understanding of the entity

### Factors to be considered for Analytical Procedures (SAD PIN)

- **Source:** The reliability of data depends on the source from which information is received. Some classes of transactions tend to be more predictable because they similar nature. The non-routine and estimation of SCOTs more difficult to predict
- **Availability of Data:** The availability of reliable and relevant data will facilitate effective procedures.
- **Account Type:** Income statement accounts tend to be more predictable because they reflect accumulated transactions over a period, whereas balance sheet accounts represent the net effect of transactions at a point in time
- **Disaggregation:** The degree of disaggregation (Breakdown) in available data can directly help in detecting misstatements
- **Predictability:** Substantive analytical procedures are more appropriate when an account balance or relationships between items of data are predictable
- **Inherent Risk:** When IR in any area is high, only analytical procedures won’t solve purpose. We should design TOD to address high IR.
- **Nature of Assertion:** It more effective in providing evidence for some assertions than for others. It using data analytics can be used to address completeness, valuation/measurement and occurrence

## Types of Analytical Procedure

- **Trend analysis** – It is a technique used to comparing current data with the prior period balance or with a trend in two or more prior period balances
- **Ratio analysis** - Ratio analysis is useful for analysing asset and liability accounts as well as revenue and expense accounts. It can also be compared over time or to the ratios of separate entities within the group
- **Reasonableness tests** - This analytical procedure does not rely on events of prior periods, but upon non-financial data for the audit period under consideration
- **Structural modelling** - A modelling tool constructs a statistical model from financial and/or non-financial data of prior accounting periods to predict current account balances

**Analytical Procedures as Substantive test:** When designing and performing substantive analytical procedures, either alone or in combination with TOD the auditor shall:

- Determine the suitability of particular substantive analytical procedures for given assertions, taking account of the assessed ROMM
- Assess the reliability of the data from which the expectation of recorded amount or ratio is developed
- Determine an expectation of recorded amounts or ratios
- Determine the amount of any difference of recorded amounts from expected values that is acceptable without further investigation

## Suitability of particular analytical procedures for given assertions

- It is generally more applicable to large volumes of transactions that tend to be predictable over time
- It is based on the expectation that relationships among data exist
- Suitability of a particular analytical procedure will **depend upon the auditor's assessment of how effective it will be in detecting a misstatement** to the FS.
- In some cases, even an unsophisticated predictive model may be effective as an analytical procedure

## Extent of Reliance on reliability of Data Analytical Procedures

- Source of the information available
- Comparability of the information available
- Nature and relevance of the information available
- Controls over the preparation of the information that are designed to ensure its completeness, accuracy and validity.
- When The controls are effective, the auditor generally has greater confidence in the reliability of the information

**Evaluation whether expectation is sufficiently Precise** - Factors that auditor shall consider when determining whether an expectation can be established with sufficient precision to identify ROMM

- The accuracy with which the expected results of substantive analytical procedures can be predicted
- The degree to which information can be disaggregated
- The availability of the information, both financial and non-financial

**Investigating results of Analytical Procedures-If there is Fluctuations with Expected values**

**Inquiring of management and obtaining appropriate audit evidence** relevant to management's responses evaluating those responses taking into account the auditor's understanding of the entity and its environment & with other audit evidence obtained during the course of the audit

**Performing other audit procedures** as necessary in the circumstances when, management is unable to provide an explanation or Mgmt.'s Response to the audit evidence obtained is not considered adequate

# AUDIT EVIDENCE PART 3 – SA 530

## Meaning of Audit Sampling

Application of audit procedures to Less than 100% population where each unit has an equal chance of selection such that conclusion on population is based on the conclusion on sample

**The two major stages in the audit examination during which sampling is used are:**

- Studying and evaluating the client's internal control
- Conducting substantive procedures

**Sample must be representative:** This means that it must be closely similar to the whole population although not necessarily exactly the same.

**Sampling Unit:** The individual items that make up the population are known as sampling units.

## Objective of SA 530

The objective of the auditor when using audit sampling is to provide a reasonable basis for the auditor to draw conclusions about the population from which the sample is selected

**Meaning of Population:** Population refers to the entire set of data from which a sample is selected and about which the auditor wishes to draw conclusions

## Characteristics of Population

**Appropriateness:** Determine that the population from which the sample is drawn is appropriate for the specific audit objective.

**Completeness:** The population also needs to be complete, which means that the population needs to include all relevant items from throughout the entire period.

**Reliable:** The information upon which the audit sampling is performed is sufficiently complete and accurate.

## Statistical Sampling

- Random selection of the sample items.
- Use of probability theory Measurement of sampling risk
- More scientific

## Non-statistical Sampling

- Sample size determined as per personal experience
- Traditional approach
- Neither objective, nor subjective
- Less time consuming

## Statistical Sampling

- Random selection of the sample items.
- Use of probability theory Measurement of sampling risk
- More scientific

## Non-statistical Sampling

- Sample size determined as per personal experience
- Traditional approach
- Neither objective, nor subjective
- Less time consuming

The decision whether to use a statistical or non-statistical sampling approach is a matter for the auditor's judgment, however, sample size is not a valid criterion to distinguish between statistical and non-statistical approaches

## Advantage of Statistical Sampling

- The amount of testing does not increase in proportion to the increase in the size of the area tested
- The sample selection is more objective
- It provides a means of estimating the min. sample size associated with a specified risk and precision
- It provides a means for deriving a "calculated risk"
- It provides Better description for large data



### Disadvantage with Non- Statistical Sampling

- It is neither objective nor scientific
- Risk of personal bias in selection of sample items
- Sample are not been selected in accordance with the mathematically based statistical techniques

### Sampling Risk

- Risk that auditor's conclusion based on sample May be different If APs were applied to entire population
- Two types of erroneous conclusion will occur

#### Type 1

- TOC -Controls more effective than actually are
- TOD-MS does not exist when in fact it does
- Affects-Audit effectiveness
- Results-Inappropriate audit opinion

#### Type 2

- TOC-Controls less effective than actually are
- TOD-MS exists when in fact it does not
- Affects-Audit efficiency
- Results Additional workload

**Non-Sampling Risk** The risk that the auditor reaches an erroneous conclusion for any reason not related to sampling risk

**Extent on checking on Sampling Plan** - The factors that should be considered for deciding upon the extent of checking on a sampling plan are following

- **Size of the organisation under audit.**
- **State of the internal control.**
- **Adequacy and reliability of books and records.**
- **Tolerable error range.**
- **Degree of the desired confidence**

### Selection of items for testing

- **Equal Chance of Selection**
- **Statistical Sampling:** Based on known probabilities.
- **Non-Statistical Sampling:** judgment to select sample items.
- **Purpose of Sampling:** Sampling is done to draw reliable conclusions about the entire population.

**Stratification** - Entire population divided into stratum or sub-populations having identifying characteristics.

- The objective of stratification is to reduce the variability of items
- When Perform TOD the population is often stratified by monetary value. This allows greater audit effort to be directed to the larger value items as these items may contain the greatest potential misstatement
- If a COT or A/c Bal. has been divided into strata, the misstatement is projected for each stratum separately and then combined when considering the misstatement on COT or A/c BAL.

### Sample Design When designing an audit sample, the auditor shall consider

Purpose of the audit procedures and the characteristics of the population from which the sample will be drawn

- **Nature of Audit Evidence sought & possible deviation or misstatement conditions** that will assist auditor in defining what population to use for Sampling
- **Specific Purpose to be achieved & Combination of audit procedures likely to best achieve that purpose**
- **Expected rate of deviation is considered to design audit sample in case of TOC**

### Important Terms

**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.

**Tolerable rate of deviation** – A rate of deviation from prescribed internal control procedures set 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.

**Tolerable error** is the maximum error in the population that auditor is ready to accept in a given sample size. Smaller the tolerable error, larger will be the sample size

## Methods of Sample Selection

### Simple Random Sampling

- Each unit has equal chance of selection
- Items chosen using random number generators
- Simple, easy and unbiased
- Appropriate for similar units in population

### Stratified Random Sampling

- Dividing population into strata
- Taking random sample from each strata
- Appropriate for diversified population

### Haphazard Sampling

- Selecting sample without structured technique
- Auditor should avoid conscious bias

### Interval / Systematic Sampling

- Determination of an interval
- Dividing number of sampling units by sample size
- Determine that sampling units are not in a structured pattern

### Monetary Unit Sampling

- Type of value-weighted selection
- Sample size in monetary amounts

### Block Sampling

- Selection of block of contiguous items
- Suitable for heterogeneous sampling units

## Evaluating Results from Audit Sampling

### The auditor shall evaluate:

1. The results of the sample and
2. Whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested

## Nature and causes of Deviation and misstatements

- The auditor shall investigate the nature and causes 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
- The auditor shall obtain a high degree of certainty that misstatement or deviation is not representative of the population
- The auditor shall obtain this degree of certainty by performing additional audit procedures to obtain SAAE that the misstatement
- **Anomaly may be defined as a misstatement or deviation that is demonstrably not representative of misstatements or deviations in a population**

## Projecting Misstatements

### **Anomaly : Deviations and MS identified - Evaluate whether it represent the population or not**

When a misstatement has been established as an anomaly, it may be excluded when projecting misstatements to the population. However, the effect of any such misstatement, if uncorrected, still needs to be considered in addition to the projection of the non-anomalous misstatements

For tests of details, the auditor shall project misstatements found in the sample to the population whereas 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

## 4. AUDIT EVIDENCE PART: 4 - SA 550

### Meaning of Related Parties (RP)

Related party as defined in the AFRFW or where the AFRFW establishes minimal or no related party requirements

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

Another entity that is under common control with the reporting entity through having:

- Common controlling ownership
- Owners who are close family members
- Common key management

**Entities under common control by Government are not considered related unless they share resources or transactions significantly**

### Nature of Related Party Transactions

Many related party transactions are in the normal course of business. In such circumstances, they may carry no higher ROMM of the FS than similar transactions with unrelated parties.

However, the nature of related party relationships and transactions may, in some circumstances, give rise to higher ROMM of the FS than transactions with unrelated parties

### Understanding the entity's related party relationships & transactions

The auditor shall inquire of management regarding:

- The identity of the entity's related parties, including changes from the prior period
- The nature of the relationships between the entity & these RP
- Whether the entity entered into any transactions with these RP during the period and, if so, the type and purpose of the transactions.

The auditor shall inquire of management and others within the entity, and perform **other RAP** considered appropriate, to obtain an understanding of the controls

- **Identify, account for & disclose** related party relationships and transactions in accordance with the AFRFW
- **Authorise and approve** significant transactions and arrangements with related parties
- Authorise and approve significant transactions and arrangements **outside the normal course of business**

**Auditor verify the existence of related party relationships and transactions** - Inspect the following documents

- Income tax returns
- Shareholder registers – Principal SH
- Information supplied by the entity to regulatory authorities
- Internal Audit report
- Statement of conflict from Mgmt. & TCWG
- Contracts not in ordinary Course of Business
- Records of the entity's investments and those of its pension plans
- Documents associated with the entity's filings with a securities regulators

## 4. AUDIT EVIDENCE PART: 4 - SA 610

### Scope of the SA 610

This SA deals with external auditor's responsibilities if using the work of internal auditors. This includes:

- Using the work of internal audit function in obtaining audit evidence.
- Using the internal auditors to provide direct assistance under the direction, supervision and review of external auditor

### External auditor's responsibility for the Audit

The External Auditor has the sole responsibility for the audit opinion expressed, and that responsibility is not reduced by the external auditor's use of the work of the internal audit function or internal auditors to provide direct assistance on the engagement

### 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 having made that determination
- If using the work of the internal audit function, to determine whether that work is adequate for the purposes of audit; and
- If using internal auditors to provide direct assistance, to appropriately direct, supervise and review their work

### Using the work of Internal Audit Function

External auditor shall determine whether the work of the Internal Audit function can be used for the audit by evaluating:

- The objectivity of the internal auditors.
- Level of competence of the internal audit function.
- Approach of Internal Audit function including quality control

External auditor shall determine the nature and extent of work of Internal Audit function that can be used by:

- Considering the nature and scope of work of Internal Audit function and its relevance to the external auditor's overall audit strategy and plan.
- Making all significant judgements and preventing undue use of the internal audit function.
- Being sufficiently involved in the audit.
- Communicating to TCWG, as to how they have planned to use the work of the internal audit function. The external auditor shall document the above.

### Using Internal Auditors to provide direct assistance

External auditor shall determine whether Internal Auditors can be used to provide Direct Assistance by evaluating:

- The existence and significance of threats to objectivity and
- The level of competence of the internal auditors.

External auditors shall determine the nature and extent of work that can be assigned to Internal Auditors providing Direct Assistance by considering:

- The amount of judgement involved.
- The assessed risk of material misstatements.
- The evaluation as mentioned above.

The external auditor shall be sufficiently involved in the audit and shall communicate to TCWG, the nature and extent of the planned use of internal auditors to provide direct assistance.

## **When using the work or direct assistance**

*Using the work of Internal Audit Function the External Auditor shall:*

- Discuss the planned use of the Internal Audit function.
- Read the report of the Internal Audit function.
- perform sufficient audit procedures to evaluate the internal audit function

*Using the Internal Auditors to provide Direct Assistance: The External Auditor shall:*

- Obtain written agreement from the entity.
- Obtain written agreement from the internal auditors.
- Direct, supervise and review the work performed by the Internal Auditors

# 6. AUDIT DOCUMENTATION

## Audit documentation

It refers to the record of:

- Audit procedures performed
- Relevant audit evidence obtained
- Conclusions the auditor reached. ( "work papers" are also sometimes used in reference to audit documentation)

## Benefit of audit documentation Audit documentation provides:

- Evidence of the auditor's basis for conclusion on their report.
- Evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements

## Purpose/Importance of Audit documentation

- Assists the engagement team to plan and perform the audit
- Assists members of the engagement team for direct, supervise and review the audit work
- Enables the engagement team to be accountable for its work
- Retains a record of matters which is significance to future audits
- Enables the quality control reviews and inspections to be performed
- Enables the external quality inspections to be performed

## Form content and extent of audit documentation.

Documentation should be sufficient to enable an experienced auditor, with no previous connection to the audit, to understand:

1. The NTE of audit procedures performed.
  - The identifying characteristics of the matters tested
  - Who perform the audit work and when it completed
  - Who reviewed the audit
2. The results of the procedures performed and the evidence obtained.
3. The significant matters arising during the course of the audit and the conclusions reached thereon.

## Factors of Form content and extent of audit documentation.

- Size and complexity of the entity.
- Identified risks of material misstatement.
- Nature of the audit procedures to be performed.
- Significance of the audit evidence obtained.
- Nature and extent of exceptions identified.
- Audit methodology and tools used
- Need to document a conclusion or the basis for a conclusion that isn't clear from the audit evidence

**Audit File:** Audit file may be defined as one or more folders or other storage media, in physical or electronic form, containing the records that comprise the audit documentation for a specific engagement

## Documentation of Significant matters and Judgements

- Matters that give rise to significant risks. (SA 315)
- Results of audit procedures indicating
  - That the FS could be materially misstated or
  - The auditor needs to change their previous assessment of the ROMM
- If the auditor faces challenges while performing necessary audit procedures or
- If they find something that could change the audit opinion

### Completion Memorandum (Audit Summary)

- It describes:
  - The significant matters identified during the audit and
  - How they were addressed.
- It helps in reviewing and inspecting audit documentation, especially useful for large and complex audits
- Preparing a summary can help the auditor focus on significant matters
- The summary can help identify whether any SA objective can be achieved or not

### Ownership of Audit documentation

- Audit documentation is the property of the auditor.
- He may at his discretion, make available portions of, or extracts from, audit documentation to clients.

### Assembly of Audit file

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

The time limit for complete the assembly of the final audit file is 60 days from the date of Auditor's Report

The completion of the assembly of the final audit file after the date of the auditor's report is an ***administrative process that does not involve the performance of new audit procedures or the drawing of new conclusions***

Changes may, however, be made to the audit documentation during the final assembly process, if they are administrative in nature

- Deleting or discarding superseded documentation.
- Sorting, collating and cross-referencing working papers.
- Signing off on completion checklists relating to the file assembly process
- Documenting audit evidence that the auditor has obtained, discussed and agreed with the relevant members of the engagement team

The auditor shall not delete or discard audit documentation of any nature before the end of its **retention period**. The retention period for audit engagements ordinarily is no shorter than **7 years** from the date of the auditor's report

## 7. COMPLETION AND REVIEW - SA 580

Written statement provided by Management to auditor to confirm certain matters or support Audit Evidence

Audit Evidence is all the Information obtained by the auditor for arriving at conclusion on which audit report is based

Written representation are audit evidence requested from those responsible for preparation & presentation of financial statements

Written Representations do not provide sufficient appropriate audit evidence on their own about any of the matters

Written Representation does not affect Nature or Extent of other Audit Evidence auditor has to obtain about fulfilment of management responsibilities or specific assertions

**If management does not provide one or more of the Requested Written Representations, the Auditor shall:**

- Discuss the matter with management
- Re-evaluate the integrity of management and evaluate the effect ,that this may have on the reliability of representations (oral or written) and audit evidence in general &
- Take appropriate actions, including determining the possible effect on the opinion in the auditor's report in accordance with SA 705

### Objectives of Auditor Regarding Written Representation

- **To Respond Appropriately** - To written representations provided by management or if Management does not provide written representations requested by auditor
- **To Obtain Written Representation** - Management has fulfilled its responsibility for preparation & has provided complete Information to auditor
- **To Support Other Evidence** Relevant to financial statements or specific assertions

### Management from Whom Written Representations Requested

Management may also ask others who have specialized knowledge relating to matters about which representations are requested

- Internal Counsel about Provisions for Legal claims
- Actuary Responsible for actuarially determined accounting measurement
- Staff Engineers about environment liability Measurements

Management may include qualifying language to the best of knowledge & belief, it is allowed if made by those with appropriate responsibilities and knowledge of matters in representation



# 7. COMPLETION AND REVIEW – SA 560

Events occurring after the Balance Sheet date & before date of auditor's report and facts that become known to auditor after date of auditor's report

## *Objectives*

- Obtain Sufficient Appropriate Evidence that events occurring after B/S Date & before date of auditor's report require adjustment or disclosure in financial statements are appropriately reflected in those financial statements
- Respond appropriately to facts that become known to auditor after the date of auditors report, had he known before would have caused him to amend the auditor's report

## **Audit Procedures Regarding Events occurring After B/S Date & before Date of auditors report**

- Obtain understanding of any procedures has established to ensure
- Inquiring of management & where appropriate TCWG, as to whether any subsequent events have occurred which affect financial statements
- Reading minutes of meetings of owners & TCWG that have been held after Date of Financial Statements & inquiring about matters discussed for which minutes are not available
- Read the entity's latest subsequent interim financial statements, if any. If auditor knows there is adjusting event, he shall see whether adjustments are appropriately made in the financial statements or disclosures as required that are identified

## **Auditor's Obligations Regarding Subsequent Events**

- Facts which become known to Auditor after date of auditors report but before the date when Financial Statements are issued to Members or
- After Financial Statements are Issued to Members
- Auditor has no obligation to perform any audit procedures. However if Auditor feels had he known this before, it would have amended his report. He shall
  - Discuss matter with Management & where appropriate TCWG
  - Determine whether financial statements need amendments
  - Inquire How Management intends to address the matter In Financial Statements

## 7. COMPLETION AND REVIEW - SA 570

### *Auditor's Responsibility Regarding Going Concern*

- Auditor has to obtain Sufficient Appropriate Audit Evidence regarding & conclude on management's going concern assumption & see if material uncertainty exists as regards to Going Concern
- However there can be inherent limitations on auditor's ability to detect material misstatements for future events or conditions
- Auditor cannot predict future events or conditions, so absence of any reference to a material uncertainty about going concern cannot guarantee entity's ability to continue as going concern

### *Additional Audit Procedures when events or conditions are identified Auditor shall perform following procedures:*

- Where Management has not yet performed assessment, request management to make assessment on entity's ability to continue as going concern
- Evaluate Management's plans for future actions in relation to Going Concern assessment
- Where entity has prepared a cash flow forecast & analysis of the forecast is a significant factor
- Consider whether any additional facts or information have become available since date on which management has made its assessment
- Requesting written representation from management regarding future plans & feasibility of these plans

### *Events or Conditions that may cast Significant Doubt on Auditor's Ability to Continue as Going Concern:*

#### **Financial**

- Net liability or net current liability position
- Negative operating cash flows indicated by historical or prospective financial statements
- Fixed term borrowings approaching maturity without realistic prospects of renewal or repayment or excessive dependent on short term borrowings
- Indications of withdrawal of financial support by creditors
- Adverse key financial ratios

#### **Operating Indicators**

- Management intentions to liquidate the entity or cease operations
- Loss of key management without replacement
- Loss of major market, key customer, franchise, license or principal supplier
- Labour difficulties
- Shortages of important supplies
- Emergence of highly successful competitor

#### **Other indicators**

- Non-compliance with capital or other statutory or regulatory requirements such as solvency or liquidity requirements for financial institutions
- Pending legal cases, if successful will result in claims entity can't satisfy
- Changes in law or regulation or government policy expected to adversely affect the entity"
- Uninsured or underinsured catastrophes when they occur

### *Use of Going Concern Basis Accounting is Inappropriate*

- If Management has prepared FS as per Going Concern But according to auditor the going concern is not valid , then auditor shall express adverse opinion as it will affect all accounts
- If Management prepared FS on liquidation basis the auditor shall express unmodified opinion but may express emphasis of matter paragraph In accordance with SA 706 to draw user's attention to alternate method of accounting

### *Use of Going Concern Basis Accounting, But Material Uncertainty exists*

- If adequate disclosure about material uncertainty is made in the FS auditor shall express UNQUALIFIED OPINION
- But in Auditor's Report shall include separate section with heading "Material Uncertainty related to Going Concern
- If adequate disclosure is not made in the FS auditor shall express QUALIFIED or ADVERSE OPINION
- In Basis of Opinion Write Material Uncertainty exists in going concerns and same matter is not disclosed in FS

## 7. COMPLETION AND REVIEW - SA 260

### *Objectives of Auditor (SA 260-Significance Of Communication With Those Charged With Governance)*

- Communicate Clearly with TCWG the responsibilities of auditor in relation to financial statements & overview of planned scope & timings of audit
- Obtain from TCWG information relevant to Audit
- To communicate TCWG, about observations which are significant & relevant to their responsibility to oversee financial reporting process
- Promote effective & 2 way communication between Auditor & TCWG

### Matters to be communicated by auditor

#### Auditor's Responsibility in relation to Financial Statement Audit

- Auditor is responsible for forming opinion on FS
- Planned Scope, Timing of Audit - Includes communicating about Significant risks identified by the entity
- Significant Findings from Audit - Accounting Practices, Policies if inconsistent with Applicable FRF, Significant Difficulties in Audit, Circumstances that may affect form & content of Audit report, any other significant matter, that are relevant in oversight of financial reporting process

In case of listed companies, we have to communicate whether Partner, Team & Network firms have complied with Independence

### Communication Process

- Auditor shall communicate with TCWG form, timing & expected general content of communications
- Auditor shall communicate in writing Significant Findings from Audit, if auditor feels written communication is not enough
- We need to communicate in writing about Independence, in case of Listed Entities
- If communication is not proper, we will evaluate its effect on ROMM & audit evidence
- Always retain copy of documentation, in those matters communicated in writing and those orally, include them in Audit Documentation, as to when & to whom they were communicated

## 7. COMPLETION AND REVIEW - SA 265

Auditor is required to obtain Understanding of Internal Control in identifying & assessing ROMM

**Objective of Auditor:**

- Communicate to Management & TCWG those Deficiencies in Internal Control that are of sufficient Importance

***Difference between Deficiency & Significant Deficiency in Internal Control***

- Deficiency-Exists when Control is missing, or is unable to prevent or detect & correct misstatement
- Significant Deficiency- Significant Deficiency are those that in auditors judgement are of utmost importance or whose Probability & Impact is High

***Determination of Significant Deficiencies***

- We shall determine, whether there are 1 or more deficiencies in Internal Control
- Based on that, auditor shall determine whether individually or in combination they constitute significant deficiencies

***Communication of Significant Deficiencies in Internal Control to TCWG***

- Auditor shall communicate in writing about Significant Deficiencies in Internal Control to TCWG
- Auditor shall also communicate with Management
- In writing, significant deficiencies communicated to TCWG or intends to communicate
- Other Deficiencies in Internal Control that are of sufficient importance to merit management's attention

***Auditor shall Include Written Communication of Significant Deficiencies-***

- A description of deficiency & their possible effects
- Sufficient information to enable TCWG to understand context of communication

Our main aim is to do Audit, while doing Audit these were identified, our report is on FS as a whole

# 7. COMPLETION AND REVIEW - SA 450

## *SA 450 Evaluation of Misstatements Identified During Audit*

### *Objective of the Auditor is to Evaluate*

- Effect of Misstatements Identified in Audit
- Effect of Uncorrected Misstatements, if any on the financial Statements

Auditor shall accumulate all misstatements identified during audit, unless they are immaterial

Auditor shall determine whether over-all Audit Strategy & Plan need to be revised if

1. If circumstances indicate other misstatements may exist
  2. Aggregate of the Misstatements accumulated during Audit could be Material.
- Auditor may request management to examine class of transactions, account balance or disclosures to understand cause of misstatement perform procedures to know actual amount of misstatement & make appropriate adjustments in the Financial Statements
  - If Management has corrected misstatements, Auditor shall perform other procedures to determine any other Misstatements remain

### *Communication & Correction of Misstatements*

- Auditor shall communicate all the Misstatements to appropriate level of Management
- Auditor shall request Management to correct those Misstatements
- If Management refuses to correct, auditor shall obtain understanding of managements reasons for not making corrections & shall take into account, when evaluation whether FS are free from Misstatements

### *Effect of Uncorrected Misstatements*

- Prior to Evaluation effect of uncorrected. Misstatements, Auditor should see Materiality is appropriate as per Entity's actual financial results.
- While seeing effect of Uncorrected Misstatements, Auditor shall evaluate-
  1. Size & Nature of Misstatements, in context individually for particular class of transaction, ac balance or disclosures and financial statements as a whole & circumstances of their occurrence (If unintentional - ignore)
  2. Effect of Uncorrected Misstatements related to prior period on CAD & Financial Statements as a whole

### *Communicate with Those Charged With Governance*

- The auditor shall request uncorrected misstatements to be corrected
- If TCWG doesn't, Auditor shall communicate effect it may have in Auditor's report
- Auditor shall also communicate effect on uncorrected misstatements related to prior period on relevant class of transactions, ac balances or disclosure

### *Written Representation Regards Effects of Uncorrected Misstatements*

Auditor shall request Written Representation from Management or where applicable TCWG, whether they believe, effects of misstatements are immaterial individually and in relation to FS as a whole

### *Documentation Regarding Misstatements Identified During Audit*

- Amount below which Misstatements are immaterial (Threshold limit - usually 5 % of materiality)
- All misstatements Identified during Audit & whether they are corrected
- Auditor conclusion whether uncorrected misstatement are material individually or in relation

## 8. AUDIT REPORT - SA 700

### Objective of SA 700 -“Forming an Opinion and Reporting on Financial Statements” are:

- To form an opinion on the financial statements based on an evaluation of the conclusions drawn from the audit evidence obtained &
- To express clearly that opinion through a written report

### Financial Reporting Framework (FRF)

**General Purpose Framework:** A FRF designed to meet the common financial information needs of a wide range of users. The FRF may be a fair presentation framework or a compliance framework

#### Fair presentation framework

- Compliance with FRF to achieve fair presentation
- Disclosures other than those required by FRF may be made to achieve fair presentation
- May depart from FRF requirement to achieve fair presentation

#### Compliance Framework

FRF that requires compliance with FRF requirement only. No additional disclosures and departures

**Forming 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

#### That conclusion shall take into account

- Whether SAAE has been obtained
- Whether uncorrected MS are material
- The evaluation of
  - Qualitative aspects of entity’s accounting practices
  - whether FS prepared as per applicable FRF
  - Specific requirements as per SA

#### Evaluation of Qualitative aspects of accounting

Management makes a number of judgments about the amounts and disclosures in the FS

The auditor may become aware of possible bias in management’s judgments

The auditor may conclude that lack of neutrality together with uncorrected misstatements causes the FS to be MMS

- The selective correction of misstatements brought to management’s attention during the audit.
- Possible management bias in the making of accounting estimate

### Requirement of Specific evaluations by auditor as per SA 700

- FS adequately discloses significant accounting policies applied
- Accounting policies applied are consistent with applicable FRF
- Accounting estimates made are reasonable
- Information presented in FS is relevant, reliable and comparable
- FS provide adequate disclosures of significant transactions and events
- Terminology used in FS is appropriate

## ***Elements of Audit Report***

- **Title** - Independent Auditor's Report
- **Addressee** - To those for whom the report is prepared, often either to the shareholders or TCWG
- **Auditor's opinion**
  - Identify the Name of the entity whose FS audited
  - Identify the Title of each FS
  - Reference to the Notes
  - State the FS is Audited
  - Specify the Period or date covered by the audit
- **Basis for opinion**
  - State the audit was conducted in accordance with SA
  - Reference to the auditor's Responsibilities section
  - Statement that the auditor is follow up Independent and ethical requirement
  - State whether SAAE has obtained or not
- **Going concern**
  - Auditor shall report as per SA 570
- **Key audit matters**
  - For complete set of FS of Listed entities
  - If required by any law or regulation
  - Auditor to report KAM as per SA 701
- **Management Responsibilities for financial statements**
  - State the responsibilities of management or TCWG (if management and TCWG is different)
  - Preparing the financial statements as per FRF
  - Design, implementation and maintenance of IC
  - Assessing the entity's ability to continue as a going concern
- **Auditor's responsibilities for audit of FS**
  - To maintain attitude of Professional Skepticism and Professional Judgement
  - To identify and Assess RMMS
  - To obtain understanding the Internal Control
  - To check the Accounting Policies and Estimates
  - To check the Ability to continue as Going Concern
  - To Check the Structure & Presentation of contents of FS
  - To determine matters communicated with TCWG
- **Other Reporting Responsibilities**
  - Any reporting requirement other than that specified in SAs
  - Reporting as per Section 143(3) of Companies Act,2013 (in case of companies)
  - Reporting under CARO, 2020 (if applicable)

- **Signature of the Auditor**
  - Individual auditor -Signature of engagement partner in his personal name
  - Firm Auditor - Signature of engagement partner in his personal name and in the firm's name
  - Proprietor/Partner's Membership number assigned by ICAI to be mentioned
  - In case of firm, firm registration number to be mentioned
- **Auditor's Address**
  - Name of city where audit report is signed
- **Date of Auditor's report**
  - Date of signing audit report
  - Should not be date earlier than date of obtaining SAAE on which opinion is based
  - This date informs the users that the auditor has considered the effect of events and transactions of which he became aware and that occurred up to that date
- **Location of description of auditor's responsibilities**
  - Body of the auditor's report
  - Within an appendix to the auditor's report
  - By a specific reference within the auditor's report to the location of such a description on a website of an appropriate authority, if permitted by law or regulation
- **UDIN – Unique Document Identification Number**
  - Auditor is required to mention the UDIN with respect to each audit report being signed by him, along with his membership number while signing an audit report



## 8. AUDIT REPORT – SA 701

### **Key Audit Matter Meaning**

- Matters which in auditor's professional judgment
- were of most significance in audit of FS of current period
- out of all matters communicated with TCWG

### **Objective of SA 701 - The objectives of the auditor are to:**

- Determine key audit matters and, having formed an opinion on the FS
- Communicate those matters by describing them in the auditor's report

### **Applicability**

- Listed entities
- Other circumstances where auditor decides to communicate
- KAM Where Law or regulation requires communication of KAM

### **Purpose of Communicating KAM**

- To enhance communicative value of the auditor's report
- Assist intended users in understanding the areas of significant management judgment in the audited FS
- Provides additional information to intended users

### **Determining Key Audit Matters**

- Areas of higher assessed RMM
- Significant auditor judgments relating to areas in the FS that involved significant management judgment
- Effect of significant events or transactions

### **Communicating Key Audit Matters**

- The auditor shall describe each key audit matter, using an appropriate subheading, in a separate section of the auditor's report under the heading "Key Audit Matters". It shall state that: - These matters were addressed in the context of the audit of the FS as a whole, and in forming the auditor's opinion thereon, and the auditor does not provide a separate opinion on these matters

### **Communicating Key Audit Matters is not**

- Substitute for disclosures in the FS
- Substitute for reporting as per SA 570 regarding material uncertainty of Going Concern approach
- Substitute for a modified opinion as per SA 705
- Separate opinion on individual matters

### **Circumstances in which KAM is not communicated in Audit report**

- When Law or regulation precludes public disclosure of such matters
- If adverse consequences of the communication would outweigh the public interest benefit

### **Communication with TCWG**

Auditor shall communicate the following with TCWG:

- Matters determined as KAM by the auditor
- If no KAM determined, communicate auditor's determination that there are no KAM

### **Audit Documentation**

- Matters that required significant attention for determination of KAM
- If no KAM determined, auditor's rationale for the same
- If KAM not communicated, auditor's rationale for not communicating the same

## 8. AUDIT REPORT - SA 705

### **Objective of SA 705 - Modifications to the Opinion in the Independent Auditor's Report**

- To express clearly an appropriately modified opinion on the FS that is necessary when
- The auditor concludes, based on AE obtained that FS as whole are not free from MMS
- The auditor is unable to obtain SAAE to conclude that the FS as a whole are free from MMS

### **Circumstances when modification is required**

When auditor concludes that FS are not free from MMS, may be due to:

- Inappropriate accounting policies
- Inappropriate application of Accounting policies
- Inappropriate or inadequate disclosures

When auditor unable to obtain SAAE to form a conclusion on the FS, may be due to:

- Limitations imposed by management
- Circumstances beyond control (e.g., records destroyed due to fire)
- Circumstances relating to NET of auditor's work

### **Two factors determining the type of Modified opinion**

**Materiality of matter** - Relatively significance of the matter for decision making of users

**Pervasiveness of matter** - Are not confined (Restricted to certain extent) to specific elements of FS. If so confined, it represent a substantial proportion of FS or In relation to disclosure, that are fundamental to user's understanding of the FS

### **Types of Modified opinion**

#### **Qualified Opinion**

- When having obtained SAAE, auditor concludes that MS, individually or in the aggregate, are material, but not pervasive, to the FS
- Unable to obtain SAAE on which to base the opinion, but auditor concludes that the possible effects of undetected MS, if any, on FS could be material but not pervasive.

#### **Adverse Opinion**

- When having obtained SAAE, auditor concludes that MS, individually or in the aggregate, are both material and pervasive to the FS

#### **Disclaimer of opinion**

- When the auditor is unable to obtain SAAE on which to base the opinion, and concludes that the possible effects on the FS of undetected MS, if any, could be both material and pervasive

**Basis for Opinion** - If auditor issues a modified opinion, a description of matter giving rise to such modification should be included in Basis for Opinion section. **Causes of Modification and their description in Basis for Opinion section**

#### **MMS in FS relating to specific amounts**

- Description and quantification of financial effects of MS, if practicable
- If impracticable to quantify, state this in the report

#### **MMS of FS relating to Narrative disclosures**

- Include explanation of how disclosures are misstated

#### **MMS of FS relating to non-disclosure of information required to be disclosed**

- Discuss non-disclosure with TCWG
- Describe nature of omitted information
- Include omitted disclosures, if permitted by law and regulation

**Inability to obtain SAAE** - Include the reason for such inability

### Special points in case of Disclaimer of Opinion

Auditor's Responsibility section of Audit report only following are to be included

- Statement regarding responsibility to conduct audit of FS as per SAs and issue a report
- Statement about auditor's independence and ethical responsibilities
- Statement that because of matters described in Basis for Disclaimer of Opinion, auditor unable to obtain SAAE

### Disclaimer of Opinion and KAM

Unless required by law or regulation, when the auditor disclaims an opinion on the financial statements, the auditor's report shall not include a Key Audit Matters section in accordance with SA 701

Limitation imposed by management after engagement is accepted

Auditor accepts engagement

Mgmt. Impose Limitation

Likely to result in qualification/ disclaimer

Request Mgmt. to remove limitation

Determine possibility to perform alternative APs

← Communicate with TCWG

← If management refuses

Still unable to obtain SAAE Determine possible effect on FS

Material but not pervasive -> Issue qualified opinion

Material but pervasive  
Is resignation possible → yes = Resign/Withdraw  
Is resignation possible → No = Communicate with TCWG and issue Disclaimer of opinion

## 8. AUDIT REPORT PART 2 - SA 706

### **EMPHASIS OF MATTER PARAGRAPH [EOMP]:**

Emphasis of Matter paragraph is 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 judgement, is of such importance that it is fundamental to users' understanding of the financial statements.

**OTHER MATTER PARAGRAPH [OMP]:** 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 judgement, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report

**Objective of the Auditor:** the objective of the auditor, having formed an opinion on the FS, is to draw users' attention, when in the auditor's judgment it is necessary to do so, by way of clear additional communication in the auditor's report to

- Emphasis of Matter paragraph
- Other Matter paragraph

**Usage of Emphasis of Matter Paragraph:** Emphasis of Matter paragraph is used to draw user's attention to a matter which is important for user's understanding of F/S's in view of the auditor's judgment and this shall be included in auditors report provided:

The auditor would not be required to modify the opinion in accordance with SA 705 (Revised) as a result of the matter

When SA 701 applies, the matter has not been determined to be a key audit matter to be communicated in the auditor's report

### **MANNER OF PRESENTATION OF EMPHASIS OF MATTER:**

- Include the paragraph within a separate section of the auditor's report with an appropriate heading that includes the term "Emphasis of Matter";
- Shall express the matter being emphasized (highlighted) and give the reference to such matter in the financial statements. Accordingly, this paragraph shall refer only to information presented or disclosed in the financial statements; and
- Also state that the auditor's opinion is not modified in respect of the matter emphasized.
- An Emphasis of Matter Para is not a substitute for
  - ➔ A modified Opinion in accordance with SA 705
  - ➔ Disclosures in Financial statements as per AFRFW.
  - ➔ Reporting in accordance with SA 570 when a material uncertainty exists relating to entities ability to continue as a going concern.

### **Other matter paragraphs in the auditor's report: The auditor shall include an Other Matter paragraph in the auditor's report, provided:**

- This is not prohibited by law or regulation
- When SA 701 applies, the matter has not been determined to be a key audit matter to be communicated in the auditor's report.

**Communication with TCWG:** 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 TCWG regarding this expectation and the wording of this paragraph

### 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.

## 8. AUDIT REPORT PART 2 - SA 710

### Comparative Information

Amounts and Disclosures included in the FS in respect of one or more prior periods in accordance with the applicable FRF

- Corresponding Figures
- Comparative FS

### Corresponding Figures

Amounts and disclosures for the prior period, are as an included integral part of only to be read current period F.S in relation to current figures not referred to in auditor's opinion

### Comparative FS

Amounts and disclosures for the prior period, are included for comparison with the FS of the current period Referred to in auditor's opinion, if audited

### Audit Reporting-Comparative FS:

- Audit opinion to refer to each period for which FS are presented and on which opinion is expressed.
- If opinion on prior period FS expressed in current period differs from opinion expressed in the relevant prior period, give substantive reason for difference in Other Matter Para

**Audit Reporting-Corresponding Figures** Audit opinion not to refer the corresponding Figures except in the following case:

- Auditor's report in prior period FS was modified and the subject matter is still unresolved: Modify current audit report also.
- Auditor obtains AE w.r.t. existence of MMS in prior period FS on which unmodified opinion was issued: Express qualified/ adverse opinion on current FS w.r.t. corresponding figures if misstatement has not been dealt as required by applicable FR

**Prior Period FS Audited** -When prior period FS audited by predecessor auditor

**Comparative FS** - If MMS exists in prior period FS on which unmodified opinion was issued

- Communicate to TCWG
- Request that predecessor auditor is informed

**Comparative FS & Corresponding Figures - If permitted, state in report that:**

- Prior period FS audited by predecessor auditor
- Type of opinion expressed
- Type of opinion expressed
- Date of report

**Prior Period FS Unaudited** -When prior period FS are unaudited

**Comparative FS** - Include Other Matter para:

- That comparative information is unaudited
- However, auditor not to be relieved from obtaining SAAE on opening balances

**Corresponding Figures** -Include Other Matter para:

- That corresponding figures are unaudited
- However, auditor not to be relieved from obtaining SAAE on opening balances

## 8. AUDIT REPORT PART 2 - SA 299

**MEANING:** The process of appointing two or more individuals or firms or combination of individuals and firms is known as joint audit. Joint audit basically implies pooling together the resources and expertise of more than one firm of auditors to render an expert job in a given time period which may be difficult to accomplish acting individually

### Objective

- To lay down broad principles for the joint auditors in conducting the joint audit.
- To provide a uniform approach to the process of joint audit.
- To identify the distinct areas of work & coverage thereof by each joint auditor.
- To identify individual responsibility & joint responsibility of the joint auditors in relation to audit

**Individual Responsibility for:** In respect of work divided, each joint auditor shall be responsible only for the work allocated to such joint auditor including proper execution of the audit procedure

### Communication with TCWG

When the joint auditors expect to modify the opinion or include EOM/ OM paragraph, they shall communicate with TCWG regarding the circumstances and the proposed wordings of the report

### Various advantage of joint audit:

- Sharing of expertise.
- Mutual consultation.
- Lower workload.
- Better quality of performance.
- Improved service to the client.
- A healthy competition to a better performance.

### THE GENERAL DISADVANTAGES

- The fees being shared.
- Psychological problem where firms of different standing are associated in the joint audit.
- General superiority complexes of some auditors.
- Problems of co-ordination of the work.
- Areas of work of common concern being neglected.
- Uncertainty about the liability for the work done

### Auditors Jointly & Severally Responsible for:

- Audit work not divided and carried out by all joint auditors.
- Decisions taken by all joint auditors in respect of common audit areas.
- Matters brought to the notice of joint auditors by any one of them & on which all of them agree.
- Examining compliance of FS with relevant statutes.
- Presentation & disclosure of FS as per applicable FRF.
- Ensuring compliance with relevant statute, applicable SA & other relevant pronouncements.

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

- Engagement partner & other key members from each of the joint auditors be involved in planning the audit.
- The joint auditors shall establish the overall audit strategy
- The joint auditors shall discuss & develop a joint audit plan
- ROMM is to be considered and assessed by each Joint Auditor and shall be communicated to other joint auditors and documented, whether pertaining to the overall financial statements level or to the area of allocation among the other joint auditors.
- The joint auditors shall discuss & document the NTE of audit procedures and the same shall be communicated to TCWG.
- The joint auditors shall obtain common engagement letter & common management representation letter.
- The work allocation document shall be signed by all joint auditors & communicated to TCWG.

## **Audit Conclusions and Reporting**

- Joint auditors to issue a common audit report.
- In case of disagreement, they shall express their opinion in separate audit report.
- A joint auditor is not bound by the views of the majority.
- The audit report issued by joint auditor should refer to the separate audit reports issued by other joint auditors.
- Such reference shall be made in Other Matter paragraph.
- Each joint auditor to assume that:
  - The other joint auditors carried out their work as per SA. There is no need to review the work done by other auditors.
  - Other joint auditors have informed the said joint auditor about any departure from applicable FRF.
- Before finalising their audit report, the joint auditors shall discuss & communicate with each other their respective conclusions that will form content of the audit report

# CARO 2020

## COMPANIES AUDITOR REPORT ORDER 2020

The order applies to every company including a foreign company

### Exceptions

- Banking companies
  - Insurance company
  - Small company
  - One Person Company
  - Section 8 Co.
  - Private Limited Company
- Not being a subsidiary or holding company of a public company
- Total Paid up capital and reserves & surplus shall not exceed Rs. 1 Crore
- Total Borrowings from banks and financial institutions shall not exceed Rs. 1 Crore
- Total Turnover calculated as per Schedule III shall not Exceed Rs. 10 crore

21. Qualifications or Adverse Remark in CARO Report of Group Companies - Whether there is adverse remark on CARO report of Group Companies in consolidated financial statements

## MATTERS TO BE INCLUDED IN CARO

1. Fixed Assets - Maintaining Proper Records, Physically Verified, any material discrepancies if noticed, Title deeds of FA are in name of company
2. Inventory - Physical Verification, Material discrepancies & how they are dealt in books of accounts
3. Loans Company has granted any loans to parties covered in register maintained u/s 189, if so, it shall not be compromising to company's interest
4. Loans, Investments, Guarantees & Security - Provisions of Section 1& 186 have been complied & details there of
5. Public Deposits - Company has accepted deposits whether directive issued by RBI have been followed
6. Cost Records - Maintenance of cost records has been specified, whether such accounts and records are made
7. Statutory Dues - Extent of undisputed dues on the last day of financial year, if o/s for a period of more than 6 months
8. Unrecorded Income - Whether any transactions not recorded in Bod of accounts is disclosed as Income
9. Repayment of Loans - If company has made any default, period & amount of default has to be reported, loans are applied for purpose for which it was raised
10. Usage of Term Loans - Money raised through IPO, FPO or any other public offer and Term loan is applied for the purpose for which those were raised
11. Fraud - Notice of Fraud - Any Fraud by or on company has been reported during the year, amount & nature has to be reported
12. Nidhi Company - Whether Nidhi Company has maintained Net Own Funds to Deposit Ratio of 1:20 to meet out liability & whether it is maintaining 10% of term deposits to meet out liability
13. Related Party Transactions - Whether all related Party Transactions are in compliance with Section 177 & 188 & disclosed as per AS
14. Internal Audit System - Whether Internal Audit System is commensurate with size & nature of Business
15. Non-Cash Transactions - If the company has entered any non-cash transactions with Directors or persons connected with him & provision of Section 192 are complied with
16. NBFC - Whether registration is done as per Act or not. Whether company has done any NBFC Activity without certificate, whether company is CIC, whether it continues to fulfil criteria
17. Cash Losses - If company has incurred cash losses in immediate financial year, then amount of such cash losses
18. Considerations of Issues Raised by Outgoing Auditor - Whether the is resignation of statutory Auditors, auditor has taken into consideration issued raised by those Auditors
19. Existence of Material uncertainty as to Company's Ability to Meet Claims - On basis of financial ratios, whether there is material uncertainty of meeting liabilities within one year of B/S Date
20. Transfer of Unspent CSR Amount - Whether company has transferred unspent amount to fund specified under schedule viii of companies a in respect of other than ongoing projects, For ongoing Projects unspent amount is transferred to special account as per Sec 135 (6) other act



# AUDIT OF DIFFERENT TYPES OF ENTITIES PART 1 Govt. Audit

## **Govt Audit Meaning:**

- The objective, systematic, professional and independent examination of financial, administrative and other operations of a public entity
- for the purpose of evaluating and verifying them,
- Presenting a report containing explanatory comments on audit findings,
- Together with conclusions and recommendations for future actions by the responsible officials and
- in the case of examination of FS, expressing the appropriate professional opinion regarding the fairness of the presentation

## **Objectives of Govt Accounting**

**Accounting for Public Funds:** It serves as a mechanism or process for public accounting of government funds.

**Appraisal of Govt. Policies:** It also provides public accounting of the operational, management, programme and policy aspects of public administration as well as accountability of the officials administering them

**Corrective Actions:** Audit observations based on factual data collection also serve to highlight the lapses of the lower hierarchy, thus helping supervisory level officers to take corrective measures.

**Administrative Accountability:** The main objective of audit is a combination of ensuring accountability of administration to legislature and functioning as an aid to administration

## **Appointment of C&AG**

The C&AG is appointed by the President of India and cannot be removed from office except for proven misbehaviour. C&AG can only be removed by a two-thirds majority of each house of Parliament. The Parliament can make laws to determine the salary and other conditions of service for the C&AG, but these cannot be changed to his disadvantage after appointment

## **Tenure and Fees**

The Comptroller & Auditor General's (Duties, Powers and Conditions of Service) Act, 1971 was enacted to support the provisions of the Constitution of India.

The act prescribes a fixed tenure for the C&AG's office.

The C&AG is to be paid a salary equivalent to that of a Supreme Court judge, which strengthens his independence

## **Duties of C&AG**

Compile and submit Accounts of Union and States General Provisions

- To audit and report on all expenditure from the Consolidated Fund of India
- To check whether the disbursed money was legally available and used appropriately for the designated service
- To ensure that the expenditure adheres to the governing authority
- To audit and report all transactions relating to Contingency Funds and Public Accounts of the Union and the States
- To audit and report all trading, manufacturing, profit and loss accounts, and subsidiary accounts in any department of the Union or a State
  - Audit of Receipts and Expenditure
  - Audit of Grants or Loans
  - Audit of Receipts of Union or States
  - Audit of Accounts of Stores and Inventory
  - Audit of Government Companies and Corporation

### **Powers of C&AG:**

To **inspect any accounts** office controlled by the Union or State Government

To **require accounts, books, papers, and other documents relevant to transactions** under audit to be sent to specified places.

To **ask questions and make observations to the person in charge of the office and call for necessary information** to prepare any account or report which is his duty to prepare.

The C&AG **can choose any part of the detailed audit of accounts or transactions and apply limited checks** as he sees fit during the audit process.

### **Audit of Revenue Items**

- Whether all revenues and debts owed to the Govt. are properly assessed, realized, and credited to the Govt. account
- Adequate regulations and procedures must be framed and implemented to ensure effective checks on assessment, collection, and allocation of cases.
- Adequate regulations and procedures must be framed and implemented to ensure effective checks on assessment, collection, and allocation of cases.
- The review of systems and procedures is necessary to secure correct and regular accounting of demands, collection, refunds, and due
- The audit is conducted based on a general review principle, but individual cases are also important

**Expenditure Audit:** The audit makes sure that the government only spends money that has been approved and that there are limits to how much money can be spent. This helps to ensure that government spending is done responsibly

**Audit against 'rules and orders':** The audit checks to make sure that the government is **following these laws and rules that have been created by the authorities** who are in charge of managing finances & spending the money correctly.

**Audit of sanctions:** The audit checks to make sure that the government has received permission before spending the money

**Audit against provision of funds:** The audit checks to make sure that the government is only spending money that has been authorized and allocated for that purpose.

**Propriety audit:** The audit checks to make sure that the government is spending money in a proper and ethical way. Public moneys should not be utilised for the benefit of a particular person or section of the community unless

- The amount of expenditure involved is insignificant; or
- Claim for the amount could be enforced in a Court of law; or
- The expenditure is in pursuance of a recognised policy or custom

**Performance audit:** The scope of audit has been extended to cover efficiency, economy and effectiveness audit or performance audit

- Efficiency audit examines whether schemes/projects are executed economically and yielding expected results
- Economy audit examines if government has acquired resources economically and it checks if sanctioning and spending authorities have observed economy
- Effectiveness audit appraises the performance of programs, schemes, and projects. It evaluates whether the overall targeted objectives are achieved
- Efficiency-cum-performance audit is an objective examination. The objective is to identify opportunities for greater economy and effectiveness.

The objective is to identify opportunities for greater economy and effectiveness

### **The procedure for conducting performance audit covers**

1. Identification of topic,
2. Preliminary study,
3. Planning,
4. Execution of audit, and
5. Reporting

### **Audit of Stores and Inventories**

- Check if regulations for purchasing, receiving, issuing, storing, selling, and taking inventory of stores are well-designed
- The defects in the control system, which are then brought to the attention of the government
- Ensure that purchases are sanctioned properly, made economically
- Ensure that prices paid for stores are reasonable
- Check the accuracy and correctness of accounts of receipts, issues, and inventory balances
- Check the accuracy and correctness of accounts of receipts, issues, and inventory balances
- Check whether periodic verification of inventory is conducted

### **Test Audit:**

1. The Comptroller and Auditor-General of India (C&AG) can order a test audit for companies under Section 139(5) or Section 139(7) of the Companies Act.
2. Section 19A of the Comptroller and Auditor-General's Act, 1971, applies to the report of such a test audit.
3. Professional auditors, appointed based on C&AG advice, conduct audits for government companies.
4. C&AG, under Section 143, can conduct supplementary or test audits, providing directions on book-keeping, accounts, and internal control.
5. Statutory auditors must submit their audit report to C&AG, who can comment or supplement it.

**Reporting Procedures** Article 151 of the Indian Constitution enjoins that the C&AG shall report on the accounts of the Union and of each of the States to the President or the Governor concerned and the letter shall cause the report to be laid before the legislatures

### **Audit of Commercial Account**

Public enterprises are required to maintain commercial accounts and are generally classified under three categories:

#### **Departmental Concerns**

- Audit conducted similar to government department accounting. Commercial accounts treated in the same manner.

#### **Statutory Bodies/Corporations**

- Audit approach depends on governing statute. C&AG handles financial and accounts audit. If C&AG compiles accounts, professional audit norms followed.

#### **Government Companies**

- Conducted by own auditors as per statute. C&AG performs supplementary test audit and periodic financial audit. Appraisal of performance included. Audit reports issued to government/legislatures

Power to conduct **Supplementary Audit** & comment thereupon: The Comptroller and Auditor General of India shall within 60 days from the date of receipt of the audit report have a right to:

1. Conduct a supplementary audit
2. Any comments given by the Comptroller and Auditor-General of India upon, or supplement to, the audit report shall be sent by the company to every person entitled to copies of audited financial statements

#### **Audit Report Submission:**

The appointed auditor must submit an audit report copy to the Comptroller and Auditor-General of India. The audit report includes various details, notably the directions issued by the C&AG. Audit report covers actions taken based on C&AG's directions. Impact of these actions on the company's accounts and financial statements is addressed. This process ensures proper oversight and adherence to auditing standards for Government companies

## **Qualification of Auditor**

CA or any persons holding govt diploma in co-operative accounts/in co-operation & accountancy & also person served as an auditor in co-operative department of govt

## **Restrictions on shareholding**

Where liability of member limited, no member of society other than registered society hold portion of share capital of society as would exceed a maximum of 20% of total no of shares or of the value of shareholding to 1,000/-

## **Restriction on loans**

Registered society not make loan to any person other than member. With special sanction of Registrar, registered society may make a loan to another registered society

## **Contribution for charitable purpose:**

Registered society may, with sanction of Registrar, contribute an amt not exceeding 10% of net profits remaining after compulsory transfer to reserve fund for any charitable purpose

## **Appropriation of profit**

“Prescribed % of profits transferred to Reserve Fund before distribution as dividend/bonus to members”

## **Contribution to education fund:**

Some of the state acts provide that every society shall contribute annually towards the education fund of the state federal society

## **Special feature of Co-operative audit (SAVED CO)**

- **Special report to registrar**
- **Adherence to co-operative principles**
- **Audit classification of society:** After a judgement of overall performance of the society, the auditor has to award a class to the society. The judgement is to be based on the criteria specified by the registrar. If management of the society is not satisfied about the award of the class, it can make an appeal to the registrar
- **Verification of members register and examination of their passbook**
- **Examination of overdue debts:** Overdue debts for period from 6 months to 5 years and more than 5 years to be classified & reported by an auditor.
- **Discussion of draft audit report with managing committee:** the auditor should ask the secretary of the society to convene the managing committee meeting to discuss the draft report. The audit report should never be finalised without discussion with the managing committee.
- **Certification of Bad debts:** In some state act, bad debts to be written off are certified by auditor
- **Overdue Interest:** Overdue interest amount should be excluded from interest outstanding and accrued while calculating profit

## **Special report to registrar**

“If auditor notices some irregularities in working of society, report these to the Registrar. In following cases, a special report may become necessary:

- Personal profiteering by members detrimental to interest of society.
- Detection of fraud
- Specific examples of mis-management
- In case of urban co-operative banks, disproportionate advances to vested interest groups, & deliberate negligence about recovery thereof

### ***Form of Audit report:***

Whether he obtained all necessary info & explanations which were necessary for purpose of audit.

In his opinion & to best of his info & according to explains, said accounts give all info required by Act.

PL A/c gives true & fair view of Profit & Loss made

BS gives true & fair view of state of affairs

Proper books of account as required properly maintained.

Whether BS and PL A/c in agreement with books of account”

### ***Investment of funds (Sec 32)***

“Society may invest its funds in any one or more of following:

- In Central or State Co-operative Bank
- In any of securities specified in section 20 of Indian Trusts Act, 1882
- In shares, securities, bonds or debentures of any other society with limited liability.
- In any co-operative bank, other than Central/State co-operative bank, as approved by Registrar
- In any other moneys permitted by Central or State Government

### ***Audit Questionnaires***

- “Auditor to answer 2 sets of questionnaires called as audit memos: -
- First set of general nature & applicable to all types of societies.
- Second set is specific for particular type Generally audit report as per convention divided into two parts styled as part I & part-II
- Part I throws light on comparative financial position, capital structure, solvency position & profitability. Contain comments on working of society & suggestions for future improvements.
- Part II points out observations of routine nature, which are finished products of routine vouch & post audit such as missing vouchers, loan bonds, inadequacies of documents etc.”

# MULTI CO – OPERATIVE SOCIETIES AUDIT

## Qualification of auditor (Sec 72)

“Chartered accounted to be appointed as auditor.

Persons not eligible for appointment as auditors:

- A body corporate
- An officer/employee of the society
- A person member/who is in employment, of an officer or employee of society
- A person indebted to the society or has given any guarantee or provided any security of any third person to the society for an amount exceeding 1,000”

## Appointment of Auditor (Sec 70)

- First auditor: by BOD within 1 month of date of registration & hold office until conclusion of First AGM
- If BOD fails, society in GM may appoint first auditor
- Subsequent auditor appointed by society, at each AGM. Hold office from conclusion of that meeting until conclusion of next AGM”

## Appointment of Auditor (Sec 70)

- First auditor: by BOD within 1 month of date of registration & hold office until conclusion of First AGM
- If BOD fails, society in GM may appoint first auditor
- Subsequent auditor appointed by society, at each AGM. Hold office from conclusion of that meeting until conclusion of next AGM”

## Books of accounts: It includes

- All sum of money received & expended
- The assets & liabilities
- All sale & purchase of goods
- Cost Records of MSCS engaged in production, processing & manufacturing

## Content of Auditor’s report

“In his opinion & to best of his info & according to explanation given, said account give info required & give a true & fair view:

- In case of BS, of state of society’s affairs as at end of its FY; &
- In case of PL, of PL for its FY. The report shall also state:
  - He obtained all info & explanation necessary for audit
  - Proper books of account kept by the society so far as appears from examination of books & proper returns received from branches or offices not visited by him.
- Report on accounts of any branch audited by person other than him forwarded to him & how he dealt with same
- Society’s BS & PL A/c in agreement with BOA
- Where any matters answered in negative, the auditor’s report shall state reason

## Powers of CG to direct special audit

- Affairs Not Managed in Accordance With, Prudent Commercial Practices
- Financial Position its such as would endanger its Insolvency
- Managed as it would Cause Injury to Interest of Trade or Industry or Business
- CG at any time by order direct that a special audit of the society’s accounts for such period as may be specified
- CG order for special audit only if Govt hold 51% or more of paid-up share capital in such society
- Special auditor make report to CG. On receipts of report CG take such action as it considers necessary. If CG does not take any action within 4 months the society either to circulate that copy to members or to have such copy or extracts read before the society at its next GM

## **Inquiry by central registrar (section 78) or Inspection of society (Section 79)**

When On request from: federal co-operative to which society is affiliated or

- A creditor or
- Not less than 1/3 of members or
- Not less than 1/5 of total no of members

### **Opportunity of being Heard**

- Before holding such inquiry/inspection 15 days' notice must be given to the society

### **Powers given to Central Registrar**

Access to books, accounts, documents, securities, cash & other properties & summon any person in possession/responsible for custody of any such thing

Require officers to call GM by giving notice of not less than 7 days & place at headquarters to consider such matters as may be directed, and where officers refuse to call such a meeting, he has power to call it himself

Summon any person reasonably believed to have any knowledge of affairs of the society to appear before him

### **Powers given for Inspection**

- Access to all books, accounts, papers, vouchers, securities, stock & other property of society & in event of serious irregularities discovered take them into custody & have power to verify cash balance & to call a meeting where such GM is, in his opinion necessary.
- Every officer or member shall furnish such info with regard to working as the central registrar or the person making such inspection may require."

### **Follow-up:**

- With in a period of 3 months communicate report of inquiry to the society may require."

# AUDIT OF DIFFERENT TYPES OF ENTITIES PART 3 - FIRM

## Auditor of Firm - Appointment

- Auditors are usually appointed by the partners of a firm and their remuneration is fixed by the partners.
- The appointment letter should clearly state the nature and scope of the audit and any limitations.
- If there is a change of auditor, the incoming auditor should communicate with the previous auditor.
- The auditor should ensure the application of accounting standards and disclose any non-compliance in the audit report

## Advantages of Audit of FIRM (DARS)

- **Disputes:** Audited accounts prevent disputes among partners and provide a reliable means of settling accounts.
- **Dissolution:** Audited accounts help in calculating amounts due to retiring or deceased partners.
- **Admission:** Audited accounts aid in admitting new partners.
- **Reliable:** Banks and prospective buyers rely on audited accounts for evidence of a business's profitability and financial position.
- An audit is an effective **safeguard** against any undue advantage being taken by a working partner.

## Matter Prior to Audit of FIRM

When auditing a partnership firm, the auditor should review the partnership agreement for information on the following:

- Business name
- Partnership duration
- Capital contributions by partners
- Proportions for profit/loss distribution
- Accounting standards and corrections
- Borrowing capacity
- Interest rates on loans and accounts
- Salaries and withdrawals
- Partner duties and management roles
- Bank a/c operation and investment of surplus funds

## Audit of Accounts of Partnership firm

- **Letter of Appointment:** It should clearly define the scope of the audit and any limitations
- **Partnership Documents:** Review partnership documents and minute book to ensure authorization of decisions such as extraordinary expenditures, loans, and asset purchases
- **Object of Partnership:** Verify that the partnership's business is authorized under the partnership agreement or modifications agreed upon subsequently
- **Books of Accounts:** Examine the partnership's books of account to ensure they are reasonable and adequate for the nature of the business.
- **Mutual Interest:** Verify that no partner's interest has been negatively affected by unauthorized activities or violations of the partnership agreement
- **Division of Profit:** Verify that profits and losses have been divided among partners according to their agreed profit-sharing ratio.



# AUDIT OF DIFFERENT TYPES OF ENTITIES PART 3 - LLP

## Registration:

- Minimum of 2 Partners can form an LLP and at least two partners would be Designated Partners who would be required to take DPIN (Designated Partner Identification Number)
- LLPs are required to have their accounts audited in accordance with Rule 24 of the LLP Rules 2009.
- LLPs with a turnover not exceeding 40 lakh rupees or a contribution not exceeding 25 lakh rupees in any financial year are not required to get their accounts audited.

## Maintain Books of Accounts by LLP

LLP are required to maintain books of accounts which shall contain

- Particulars of all sums of money received and expended by the LLP
- A record of the assets and liabilities of the LLP
- Statements of costs of goods Purchased, WIP, FG.
- Any other particulars which the partners may decide

## Advantages / Purpose / Need of Audit:

- Detection of Errors
- Settlement of Disputes
- Reliability increased on Audited FS
- Better Compliance and Management
- Audited accounts are accepted by those concerned who have dealings with the LLP

**Appointment of Auditor:** The auditor may be appointed by the designated partners of the LLP:

- At any time for the first financial year but before the end of first financial year,
- At least thirty days prior to the end of each financial year (other than the first financial year),
- To fill the casual vacancy in the office of auditor,
- To fill the casual vacancy caused by removal of auditor

## Auditor's Duty Regarding Audit of LLP

**Engagement Letter:** The auditor must receive clear written instructions outlining the scope of work to be performed

**Minutes Book:** If the partners maintain a minute book, the auditor should refer to it for any resolutions related to the accounts

**LLP Agreement:** The auditor should review the LLP agreement and take note of specific provisions, including:

- Nature of the LLP's business.
- Capital contributions by each partner.
- Interest on additional capital contributions.
- Duration of the partnership. e. Allowable partner drawings.
- Payments such as salaries and commissions to partners.
- Borrowing powers of the LLP, any loans provided by the partners.
- Profit-sharing ratios.

**Reporting:** The auditor's report should include:

- Confirmation of the correctness and reliability of the firm's records.
- Confirmation of obtaining all necessary information and explanations.
- Mention of any restrictions imposed on the auditor during the audit process

## Returns to be maintained and filed by an LLP:

- Every LLP would be required to file annual return in Form 11 with ROC within 60 days of closer of FY.
- Every LLP is also required to submit Statement of Account and Solvency in Form 8 which shall be filed within a period of thirty days from the end of six months the FY to which the Statement of Account and Solvency relates

## Hire Purchase

- **Definition:** A hire-purchase agreement involves letting goods on hire with an option for the hirer to purchase them based on agreed terms
- **Inclusions:** The agreement covers cases where possession is delivered based on periodic payments, property transfer occurs upon the last instalment, and the hirer can terminate the agreement before property Transfer
- **Parties Involved:** The hirer is the person in possession under the hire-purchase agreement, and the owner is the one delivering possession to facilitate the purchase, including any initial payments by the hirer.

### Audit Procedures for Hire-Purchase Transaction: The auditor may examine the following:

- Hire purchase agreement is in writing and is signed by all parties.
- Hire purchase agreement specifies clearly:
  - The hire-purchase price of the goods to which the agreement relates
  - The cash price of the goods, that is to say, the price at which the goods may be purchased by the hirer for cash
  - The date on which the agreement shall be deemed to have commenced
  - The number of instalments by which the hire-purchase price is to be paid, the amount of each of those instalments, and the date, or the mode of determining the date, upon which it is payable, and the person to whom and the place where it is payable; and
  - The goods to which the agreement relates, in a manner sufficient to identify them.
- Ensure that instalment payments are being received regularly as per the agreement.

### Audit Procedures for Lease Transaction:

- **Object Clause:** Check if the leasing company's object clause allows leasing of goods, such as capital goods or consumer durables, and if it permits financing activities.
- **Credit Analysis:** Verify the existence of a procedure to assess the lessee's creditworthiness, considering factors like ability to meet commitments, credit history, and collateral.
- **Lease Agreement:** Examine the lease agreement for details like parties involved, equipment description, installation location, tenure, payment terms, return conditions, and restrictions on assignment or subletting.
- **Lease Proposal Form:** Review the lessee's lease proposal form submitted to the lessor.
- **Invoice:** Ensure safekeeping of the lease invoice due to the long-term nature of the contract.
- **Acceptance Letter:** Examine the acceptance letter from the lessee confirming the satisfactory receipt of the equipment.
- **Board Resolution:** Confirm that a board resolution authorizing a specific director to execute the lease agreement has been passed.
- **Insurance Policies:** Verify that copies of insurance policies have been obtained by the lessor for record-keeping

# AUDIT OF DIFFERENT TYPES OF ENTITIES PART 3 - LOCAL BODIES

## Municipal government in India covers five distinct types of urban local authorities

- The municipal corporations,
- The municipal councils,
- The notified area committees,
- The town area committees
- The cantonment committees.

## Objective of Audit of Municipal government

- Reporting on the fairness of the content and presentation of financial statements
- Reporting upon the strengths and weaknesses of systems of financial control
- Reporting on the adherence to legal and/or administrative requirements
- Reporting upon whether value is being fully received on money spent; and
- Detection and prevention of error, fraud and misuse of resources.

## Different types of revenue grants which local bodies may receive

- **General purpose grants:** These are primarily intended to substantially bridge the gap between the needs and resources of the local bodies.
- **Specific purpose grants:** These grants which are tied to the provision of certain services
- **Statutory and compensatory grants:** These grants, under various enactments, are given to local bodies as compensation on account of loss of any revenue on taking over a tax by state government from local government

## Aspects to be considered in Audit Programme

**Appointment:** The Local Fund Audit Wing of the State Govt. is generally in- charge of the audit of municipal accounts

**Auditor's concerns:** -The auditor while auditing the local bodies should report on the:

fairness of the contents and presentation of financial statements,

the strengths and weaknesses of system of financial control,

the adherence to legal and/or administrative requirements;

whether value is being fully received on money spent

**Rules & regulations:** The auditor should ensure that the expenditure incurred conforms to the relevant provisions of the law & financial rules and regulations framed by the competent authority

**Authorisation:** He should ensure that all types of sanctions, either special or general, authorized by the competent authority.

**Provisioning:** He should ensure that there is a provision of funds and the expenditure is incurred from the provision

**Performance:** The auditor should check that the different schemes, programmes and projects, where large financial expenditure has been incurred, are running economically and getting the expected results

**Applicability of Law :** The 3 basic legal form of Charitable Entities are Consist of Trust, Society and Section 8 company are Governed by

- Public Trust Act → States the Indian Trust Act,1882. If state act is not existed then it governed by
- The Societies Registration Act 1860
- For Sec 8 Companies – Companies Act 2013 Also, it shall be governed by The Income Tax Act 1961 & The Foreign Contribution (Regulation) Act 2010

### ***Auditor's Consideration In case of Societies***

- Auditor should Ascertain the governing legislation of the society. i.e. The Societies Registration Act 1860 or applicable state law
- Objectives need to be ascertained from it MOA / byelaws
- Ascertain whether society has obtained registration under The Foreign Contribution (Regulation) Act 2010 in case of foreign contributions received
- Ascertain whether it registered under Income tax act which it makes possible for tax exemption.
- Obtaining understanding of internal Control in respect of donations & various Expenditure
- Evaluation of appropriateness of A/c Policies with reference to donations and grants
- Some Expenses incurred by the society are reimbursed by the donors & ascertain how it recognized in the FS
- Ascertain any inquiry has been held by the Registrar Under Applicable law or financial condition and its implication on auditor's Opinion
- Ascertain the cases of Irregular exp. Or failure or Omission to recover monies or other properties belonging to the society or loss or waste of money
- Ascertain Such expenditure or waste was caused in consequence of breach of Trust or Misapplication of misconduct of Governing body

**The Management of the Charitable Trust are required to Maintain the Following Books of A/c & FS**

- Cash Book, Ledger & Journal
- Copies of Bills issued by the trust
- Original Recipes Issued (for payment Received)- Numbered Serially in machine or otherwise.
- B/S, Income and Expenditure as per the Format given in the State Laws (FS)

### ***Auditor's Consideration In case of Trusts***

- Whether A/c are maintained as per applicable act & rules
- Whether receipts & disbursement are proper and money received in form of donations is applied as per the objects of the trust
- Whether the cash balance & vouchers are in custody of managers or trustee are in agreement with A/c's.
- Whether register of movable & Immovable properties is maintained, the changes are communicated from time to time & Inaccuracies are mentioned in the previous report are rectified
- Whether the property of Funds of trust are applied for the purpose other than the object of the trust
- Amt of O/S for > 1 year & amount written off any
- Whether any money has been invested contrary to the provision of applicable act
- All cases of improper/ illegal exp or any misconduct on the part of trustee
- Whether max & min trustees are maintained
- Meetings are held regularly as provided in such Instrument
- Whether any of the trustees have any interest in investment of the trust
- Whether any of the trustees is debtor or creditor of the trust
- Whether any anonymous donations received are properly accounted for & donations in cash are not above limits of trust
- Any special Matter auditor thinks necessary to bring to notice of deputy or assistant charity commissioner

### Working Paper of Auditor of Trust is includes

- Work done by auditor
- Explanation and Information are received
- Decisions are taken
- Judicial Pronouncements
- WR/ Certificate from Mgmt.

### Why Working Paper of Auditor of Trust is required

- Serve as Evidence that audit is conducted on the basis of examination of Financial info
- Auditor = taken cognizance = info and records
- Auditor received all info and explanation required by him
- Auditor has made reasonable test to check the completeness & Accuracy

# AUDIT OF DIFFERENT TYPES OF ENTITIES PART 4

## Audit of Educational Institutions (Schools & Colleges)

- **General**
  - Review the Trust Deed or Regulations and relevant legislative Acts.
  - Examine minutes of Managing Committee meetings for resolutions affecting accounts and compliance
- **Fee from Students:**
  - Verify student fees by cross-referencing with class registers.
  - Check fees received through counterfoils, Cash Book entries, and Fee Register
  - Ensure advance fees and irrecoverable arrears are properly handled.
  - Verify admission fees and proper crediting.
  - Confirm compliance with rules for free studentships and concessions.
  - Check collection or remission of fines.
  - Ensure hostel dues are collected
- **Other Receipts/Grants & Donations**
  - Verify rental income, endowments, legacies, and investment income.
  - Inspect securities related to investments. c. Verify Government or local authority grants and reasons for any disallowed expenses.
- **Expenditure:**
  - Confirm Provident Fund investments.
  - Vouch donations and ensure their intended use.
  - Verify capital expenditure with Committee sanction.
  - Audit establishment expenses and report any excessive spending.
  - Confirm staff salary increases were sanctioned
- **Assets & Liabilities**
  - Report old arrears to the Committee.
  - Ensure student deposits are classified as liabilities and not transferred to income unless they are non-refundable.
  - Check investments for prize endowment funds and any income in excess of the prizes have been accumulated and invested along with corpus.
  - Verify inventory items against registers and previous records. e. Verify all bills are authorised before approved before payment

## Audit of Hospitals

- Vouch patient records with bills issued.
- Cross-check bills for accuracy against attendance records.
- Ensure all recoverable amounts have been billed
- Match cash collections in the Cash Book with supporting evidence, like receipts and counterfoils
- Confirm that all expected income from rent and investments has been collected
- Verify that legacies and donations are used for their intended purpose.
- Reconcile collected subscriptions and donations with the respective registers
- Ensure purchases, expenses, and capital expenditure had proper authorization.
- Verify staff appointments and increments were duly authorized
- Check for government grants and ensure proper accounting
- Compare actual expenditure and income with the budgeted amounts.
- Report significant variations to the Trustees or Managing Committee
- Review the internal control system for receipt and issuance of various items
- Confirm that depreciation has been correctly applied to all assets
- Obtain year-end inventories, physically check a sample & Compare total values with ledger balances
- Request proper representation and certification from management for various audit aspects.

## **Audit of Hotels**

- Charges for room sales are recorded in guest bills
- Auditors should ensure correct guest charges and investigate rate discrepancies
- Daily reports of occupied rooms should be cross-checked
- Management must implement controls to minimize theft
- Weak internal controls pose serious issues for auditors
- Professional valuers often assess inventories; auditors should verify their reasonableness
- Auditors may attend physical inventory counts and perform pricing tests
- Different hotels have varied accounting policies for fixed assets
- Costs of repairs and minor renovations are considered revenue expenditure
- Costs of major alterations and additions are capitalized

### **Casual Labour:**

- Casual labour is common in the hotel industry, but wage payment records are often inadequate.
- Auditors should suggest controls to prevent defalcation

### **Travel Agents & Shops:**

- Bills from travel agents should be settled according to credit terms.
- Commission payments to travel agents should be checked against agreements

## **Audit Of Cinema**

- Confirm that entrance is allowed only with printed tickets
- Ensure tickets are serially numbered
- Check that ticket numbers vary for each show and class, even if it's on the same day.
- Verify a separate series for advance booking
- Verify that a statement of tickets sold and cash collected is prepared at the end of each show.
- Confirm that records of 'free passes' are maintained and issued under proper authority
- Verify the monthly entertainment tax returns with total number of tickets issued during the month
- Confirm that depreciation on machinery and furniture is correctly charged at an appropriate rate.
- Audit expenses for advertisement, repairs, and maintenance & Ensure none of these expenses are capitalized
- Investigate the arrangement for collecting the share of restaurant income, whether it's a fixed sum or percentage
- Verify payments for film hire with distributor bills and refer to relevant agreements
- Examine unadjusted balances of advances paid to distributors for recoverability & consider making provisions for advances deemed irrecoverable

## **Audit Of Club**

- Verify entrance fee receipts by cross-referencing with member applications, counterfoils, and committee minutes
- Confirm member subscriptions by comparing receipt counterfoils with the Register of Members; reconcile total due with collections and outstanding amount
- Ensure correct treatment of arrears from the previous year, arrears for the current year, and advance payments.
- Check and cross-verify totals in the Register of Members
- Identify and inquire about overdue member dues & report any irrecoverable amounts in the audit report
- Verify charges for food, drinks, and special services provided to members and guests
- Confirm that member accounts accurately reflect amounts owed for supplies and services
- Confirm that member accounts accurately reflect amounts owed for supplies and services
- Check purchases of consumables and confirm that gross profit rates align with industry norms; physically verify year-end inventory and its valuation
- Physically check the inventory of furniture, sports equipment, and other assets against inventory registers or year-end inventories.
- Examine the financial authority of the secretary; report any instances of exceeding authorized limits to the Managing Committee for confirmation

## **Audit of Charitable Institutions**

- Study the institution's constitution.
- Verify legal compliance in its management.
- Examine the internal control system, especially for collection
- Check changes in membership subscription amounts
- Legacies: Verify legacy amounts through correspondence and available information
- Verify grant amounts through relevant correspondence, receipts, and minute books & Obtain a certificate from a responsible official
- Vouching the amounts received with the dividend and interest counterfoils
- Checking the calculations of interest received on securities bearing fixed rates of interest.
- Examining the rent roll and inspecting tenancy agreements & Vouching the rent on to the rent roll from the counterfoils of receipt books and checking the totals of the cash book.
- Vouching payment of grants, also verifying that the grants have been paid only for a charitable purpose
- Ascertaining that any funds contributed for a special purpose have been utilised for the purpose.
- Ascertaining that any funds contributed for a special purpose have been utilised for the purpose.



## Audit of NGO

- Auditors of an NGO are appointed by the Management of the Society or Trust or the members of the company, depending on the type of registration
- Certain statutes require the accounts of NGOs to be audited and submitted to the prescribed authorities, and failure to do so may result in forfeiture of exemptions and benefits
- Verify contributions/grants for the corpus fund with reference to donor letters.
- Check transfers from projects/programs with donor letters and board resolutions of the NGO
- Check ear-marked funds for requirements of donor institutions, board resolutions of the NGO, and rules and regulations of the schemes.
- Vouch for disbursements and expenditures as per agreements with donors for project/ agency balances.
- Vouch for acquisitions, sales, or disposal of assets including depreciation and authorizations for the same. & Check the title of immovable property.
- Verify investments through the investment register and physically ensure that investments are in the name of the NGO
- Verify investments through the investment register and physically ensure that investments are in the name of the NGO
- Verify inventory in hand and obtain a certificate from the management for the quantities and valuation of the same
- Verify that provident fund, life insurance premium, employees state insurance, and their administrative charges are deducted, contributed, and deposited within the prescribed time

## Verification of Income/Receipts

- **Contributions and Grants:** Verify agreements, ensure proper accounting, and deposit foreign contributions as per the law.
- **Receipts from Fundraising Programs:** Verify internal controls and ensure daily counting and depositing of collections.
- **Membership Fees:** Check fees with the Membership Register, classify types of fees, and reconcile received fees with expected fees.
- **Subscriptions:** Check with subscription register and receipts, reconcile received subscriptions with printed and dispatched materials, and verify receipts with the subscription rate schedule.
- **Interest and Dividends:** Verify received and receivable interest and dividends

# AUDIT OF BANKS

## Major Functions of Bank

- Accepting Deposits
- Giving Advances

RBI - Regulating Body of Indian financial System

## Important Functions of RBI:

- Development and supervision of Indian Financial system
- Monetary policy formulation
- Issuance of currency
- Regulation of currency issue
- Acting as banker's bank
- Regulating activities of commercial banks

## Regulatory Framework - principal enactments governing Bank audit

- RBI Act, 1934
- Regional Rural Bank Act, 1976
- Banking Regulation Act, 1949
- Information Technology Act, 2000
- Companies Act, 2013
- Prevention of Money Laundering Act, 2002
- SBI Act, 1955
- Payment and settlement systems Act, 2007

## Peculiarities involved in functioning of Bank

- Huge volumes and complexity of transactions
- Wide geographical spread of bank's network
- Large range of products and services offered
- Extensive use of technology
- Strict vigilance by the banking regulator etc.

## Appointment of auditors

- Banking Company - By shareholders at AGM (RBI Approval required)
- Nationalised Banks - By Board of Directors (RBI Approval required)
- State Bank of India (SBI)- By Comptroller and Auditor General of India in consultation with Central Government (CG)
- Subsidiaries of SBI - By SBI
- Regional Rural banks - By Board of Directors after approval of CG

## Bank Audit Plan

### Audit plan to be drawn on basis of

- Nature and thrust of operations
- Nature of adverse features
- Audit risk based on lack or inadequacy of IC
- Level of compliance of previous report

## Controls to manage risks

- Effective segregation of duties
- Accurate measurement and reporting of positions
- Verification and approval of transactions
- Reconciliation of positions and results
- Setting of limits
- Reporting and approval of exceptions
- Physical security
- Contingency planning

**Engagement Team Discussions** *Engagement team discussions are generally done at the planning stage of an audit*

- To gain better understanding and its IC
- To assess of the bank potential MMS which Provides
  - Opportunity for experienced members to share insights
  - Opportunity for team members to share experience
  - Understanding effect of RAP on NET of FAP

## Common Steps & Questions while undertaking/performing control activities

Who ?

- Who performs control?
- Does he have requisite knowledge?

What?

- What evidence is generated that control is performed?

When?

- Frequency: Is it enough to prevent, detect & correct ROMM?

Where?

- Where is the evidence?
- Is the evidence accessible

Why?

- Why is the control performed

How?

- How is control performed
- Can control activities be by-passed, if yes can it be detected

### Engagement team discussion includes:

- Errors that may be more likely to occur
- Errors which have been identified in prior years
- Possible fraud perpetration method by bank personnel
- Audit responses to Engagement Risk, Pervasive Risks, and Specific Risks
- Need to maintain professional skepticism throughout the audit engagement
- Need to alert for information or other conditions that indicates that a material misstatement may have occurred

## Conducting an Audit

*Initial Consideration by the statutory auditor*

- Declaration of Indebtedness
- Internal Assignments in Banks by Statutory Auditors
- Planning
- Communication with Previous Auditor
- Terms of Audit Engagements
- Initial Engagements
- Assessment of Engagement Risk
- Establish the Engagement Team
- Understanding the Bank and its Environment
- *Identifying and Assessing the Risks of Material Managements*
- *Understanding the Bank and Its Environment including Internal Control*
- *Understand the Bank's Accounting Process*
- *Understanding the Risk Management Process*
  - Oversight and involvement in the control process by TCWG
  - Identification, measurement and monitoring of risks
  - Control activities
  - Monitoring activities
  - Reliable information systems
- *Engagement Team Discussion*
- *Establish the Overall Audit Strategy*
- *Develop the Audit Plan*
- *Audit Planning Memorandum*
- *Determine Audit Materiality*
- *Consider Going Concern*
- *Assess the Risk of Fraud including Money Laundering*
- *Assess Specific Risks*
- *Risk Associated with Outsourcing of Activities*
- *Response to the Assessed Risks*
- *Stress Testing*
- *BASEL III framework*
- *Reliance on/ review of other reports*

**Advances** -It is the amount given by the bank to borrower, it includes

- Term loan, CC, OD, Demand Loan
- Bills discounted & purchased
- Adverse balances in deposit accounts
- Interest bearing Staff Loan

#### Classification of Advances

- **Sector Wise**
  - Priority
  - Non-Priority
- **Security Wise**
  - Secured
  - Unsecured
- **Prudential Norm**
  - Standard
  - Standard Regular
  - SMA – Special Mention Accounts
    - SMA 0 (Accounts showing stress signals)
    - SMA 1 (Overdue between 31 to 60 days)
    - SMA 2 (Overdue between 61 to 90 days)
  - NPA - An asset becomes NPA when it ceases to generate income for the Bank
    1. Loan or Advance becomes NPA if interest/ instalment of principal is Overdue for > 90 days
    2. Bills remains Overdue for > 90 days
    3. The account remains out of order in respect of an OD/ CC account
    4. **Out of Order** : if amount is over drawn and remains outstanding for > 90 days & There is no credit

**Audit of Advances** - Auditor should obtain SAAE regarding

- Amounts are outstanding as on B/S date
- Amounts represent due to bank
- Amounts are supported by loan documents & other documents
- No unrecorded advances
- Advances are properly disclosed, classified & described in accordance with AFRF
- Appropriate provisions are made as per RBI norms

**Audit of Advances** - SAAE are obtained by:

- Examining the validity of the recorded amounts
- Examining loan documentation
- Reviewing the operation of the accounts
- Examining the existence, enforceability and valuation of the security
- Checking compliance with RBI norms including appropriate classification and provisioning
- Carrying out appropriate analytical procedures

**Audit of Advances** - Evaluation of IC over advances:

- Bank makes advances only after checking creditworthiness
- Advances are sanctioned on the basis of appropriate documents & only after ensuring end use
- Sufficient margins are kept
- No advances are provided against own shares
- Securities are registered
- Good in possession as security are checked from time to time.
- Drawing power register is updated every month
- Operation of each advance a/c should be viewed at least once in a year

#### NPA's Provisioning Requirements

- **Sub-Standard:** An asset which has been classified as NPA for a period  $\leq$  18 months = 10%
- **Doubtful** A term loan or Lease asset or hire purchase asset or any other asset which remains sub-standard asset for a period 'exceeding 18 months'
  - Secured Portion Up to 1 year 20% , 1 to 3 years 30% , More than 3 years 50%
  - Unsecured Portion Advances without collateral 100%
- **Loss:** An asset which is adversely affected by potential threat of non-recoverability due to erosion in value of security - 100%

**Income on NPA are recorded on Cash basis** - However in following cases they are considered as NPA on the basis of respected condition

**Advances guaranteed by CG** - Will be regarded as NPA on repudiation of such guarantee

**Advance under Consortium** - Advance will be treated as NPA on the basis of recovery by individual members

**Advance against Term deposit/ KVP/ NSC** -It shall not be treated as NPA provided Adequate Margin is available in the amount

**Advance to Staff** - Treated as NPA only when there is a default in principal or payment of interest respective due dates

**Agriculture Advance** - Long Crop - Regarded as NPA if it is outstanding for > 1 season. Short Crop - Regarded as NPA if it is outstanding for > 2 seasons. However, if non-payment is due to natural calamity then it should be re-scheduled

### **Accounts where there is Erosion/Reduction in value of security/ frauds committed by borrowers**

- *Value of security eroded & is < 50% of value assessed by the bank or accepted by RBI at the time of last inspection*
  - Such NPA's may be straight away classified as doubtful & provisioning should be made accordingly
- *Realizable Value of securities is < 10% of outstanding in the borrow a/c - Existence of security should be ignored*
  - Such asset should be classified as Loss asset & should be fully written off or fully provided by bank

### **Audit Objective of Revenue Items - To obtain reasonable assurance that**

- Recorded income arose from transactions during the relevant period
- Recorded income pertain to the bank
- No unrecorded income
- Income is recorded in proper amount and in proper period Auditor should obtain SAAE that the income recognition principles have been adhered to. Auditor should test check items of incomes

**Drawing Power** -Limit up to which a borrower can withdraw from the working capital limit sanctioned

Generally calculated based on value of realisable current assets secured less a specified margin set by the bank.

### **Point's auditor must bear in mind**

- All accounts should be kept within both the drawing power and the sanctioned limit at all times.
- Irregular accounts - brought to management's notice
- Drawings in the working capital account are covered by the adequacy of the current assets.
- Stock statements should not be older than 3 months
- Stock statements and audited annual reports should be submitted regularly by borrower to the bank and scrutinised in detail by the bank
- Banks must carry stock audit of accounts where funded exposure >5 crores.
- Stock auditor's report shall be reviewed by the bank auditor
- In case of consortium, lead bank calculates and allocates drawing power to member banks

### **Audit of Revenue Items**

#### *Interest Income*

- Interest/ Discount on Advances/ Bills
- Interest on Investment
- Interest on CRR
- Interest on Inter Bank Loan

#### *Other Income*

- Commission, Brokerage
- Rent on Lockers
- Dividend
- Profit on Sale of Investment
- Profit on Revolution
- Referral Income etc.

## Income Recognition

- Any income which exceeds 1% of the total income of the bank (if income on gross basis) or 1% of the net profit before taxes (if income net of costs) - Recognition on accrual basis as per AS-9
- If item does not fall under above - Cash basis
- Income on NPAs - Recorded on realisation as per RBI guidelines
- Interest on advances against TDs, IVPs, KVPs, life policies - Recorded on due date provided adequate margin available
- Discount on bills purchased at close of the year - Income to be apportioned properly (unexpired discount - Other liabilities)
- Commission on bills for collection – When Bill is Collected
- Interest / Dividend Income on Investments - Accrual basis
- Profit/Loss on Sale of Investments - Taken to profit and loss account
- Profit/Loss on Revaluation of Investments As per RBI guidelines.

## Reversal of Income from NPAs

Advances (including government guaranteed advances), bills purchased and discounted, becomes NPA as at the close of any year

### Interest accrued and credited in the past periods but unrealised

- reversed (if recorded in current period) or
- create provision (if recorded in prior periods)

### Fees, commission and similar income that have accrued should

- cease to accrue in the current period and
- should be reversed or provided for with respect to past periods, if uncollected

**Leased Assets** -Accrued, credited but unrealised Finance charge income from leases assets, before asset became NPA - reverse or create provision

**Take out Finance** - Should not recognize income unless realised from the borrower/taking-over institution

## Expenses

### Interest Expended - Interest On

- Deposits
- RBI Borrowing
- Inter Bank Borrowing
- Other

### Operating Expenses – Payment Towards

- Salaries, remuneration
- Rent, Rates, Taxes
- Printing Stationary
- Office Admin
- Advertisement
- Audit Fees
- Depreciation

### Provision and Contingencies

- NPA
- Taxation
- Contingencies
- Diminution in value of investment

## Audit of Expenses : Interest Expended

- Verify calculation sheet on test basis
- Verify whether there is any excess or short credit of material amount
- Interest rates in accordance with RBI directives, bank's regulations, fixed deposit receipt,
- Ascertain whether there are any changes in interest rate
- Examine the completeness - interest on all liabilities recorded
- Re-compute interest on sample basis

## Operating Expenses

- Study and evaluate the system of internal control - authorisation procedures
- Trend analysis - whether there is any divergent trend in any expense
- Month to month analytical review
- Verify expenditures with documentary evidences
- Check calculation and reasonableness of expenses
- Ratio analysis - comparing expenditure ratios with previous year ratios

## **Auditor's Report**

### ***Nationalised Bank***

- Reporting to CG on 5 points; whether -
  - Balance Sheet exhibit a true and fair view and all information and explanation found satisfactory
  - Transactions within powers of bank
  - Returns received from branches are adequate
  - Profit or Loss account shows true state of profit or loss during the period
  - Any other matter deemed necessary to be reported to CG
- Report of SBI in similar manner

### **Statutory and Central Branch Auditors**

- In accordance with SA 700, SA 701, SA 705, SA 706, SA 710 and SA 720
- Disclose information in relation to unaudited branches-
  - Number of such branches
  - quantification of advances
  - deposits
  - interest income and interest expense
- Compliance with Section 143 of Companies Act,2013
- CARO, 2020 is not applicable to a Banking Company
- Long Form Audit Report (LFAR)
- Reporting on matters specified by RBI
- To be submitted before 30th June every year
- Executive summary may be included to highlight key observations

# 11. Ethics and Terms of Audit Engagement (SQC 1 Not covered)

## Meaning of Independence

Independence implies that the judgement of a person is not subordinate to the wishes or direction of another person who might have engaged him.

- Independence of mind
- Independence in appearance

**Independence of mind:** The state of mind that permits the expression of conclusion/opinion without being affected by influences that compromise professional judgement.

### Independence in appearance:

- **The avoidance of facts** and circumstance that are so significant that a reasonable
- **Informed 3<sup>rd</sup> party would be likely to conclude** that a firm's or an audit or assurance team member's integrity, **objectivity and professional skepticism has been compromised.**

## Threats to Independence

**Self Interest Threats:** It is Occurs when an auditing Firm, Its partners or associate could benefits from a financial Interest in an Auditing Client

**Self-Review Threats:** When an auditor having recently been a director or Senior officer of a company or when auditor perform services that are themselves subject matter of audit

**Advocacy Threats:** When the auditor promotes a client opinion to a point where people may believe that objectivity getting compromised

**Familiarity Threats:** It occurs when auditor forms relationship with the client where they end up being too sympathetic to the client interests.

**Intimidation Threats:** It occurs when auditors are deterred (prevent) from acting objectively with an adequate degree of professional scepticism. Basically these could happen because of threat of replacement or reduce audit fee etc.

## Safeguarding Independence

- It is essential that auditor should always be and appears to be independent of the entities that they are auditing
- Before taking on any work, the auditor Consider whether it involves threats to his independence
- When such threat is exist, the auditor should either relive from the task or eliminate the threat or at least put in place safeguards which reduce the threats to an acceptable low level
- If the auditor is unable to fully implement credible and adequate safeguards , then he must not accept the work

## Professional Skepticism

Professional skepticism is an attitude includes a questioning mind, being alert to condition which indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence obtained

It reduce the Risk of

- Overlook Unusual Circumstances
- Over generalizing when drawing conclusions from audit observations
- Using inappropriate assumptions in determining NTE of audit procedures

## Objective of SA 210

The objective of the auditor is to accept or continue an audit engagement only when the basis upon which it is to be performed has been agreed, through:

- Establishing whether **the preconditions** for an audit are present
- Confirming that there is a **common understanding between the auditor and management** and, where appropriate, TCWG of the terms of the engagement



### ***Matters to be Included under terms of audit Engagement***

- Objective and Scope of audit of FS
- Responsibilities of Auditor
- Responsibilities of Management
- Identification of Applicable Financial Reporting Framework
- Expected form and Content of the report

### **Pre-Conditions for an Audit**

*Determine whether the financial reporting framework is acceptable*

*Obtain an Agreement of Management that it acknowledges and understand its Responsibilities*

- For the preparation of FS as per AFRFW
- Internal controls are placed to enable the preparation of FS free from MMs due to fraud or error

*To provide the auditor*

- Access to all Information which is relevant to preparation of FS
- Additional Information requested by auditor
- Unrestricted access to persons within the Entity

### ***Limitation on Scope Prior to Engagement (SA210)***

- If the auditor believes the limitation will result in the auditor disclaiming an opinion on the financial statements, the auditor shall not accept such a limited engagement as an audit engagement, unless required by law or regulation to do so

### ***Request from entity to change the terms of audit engagement***

Entity may request Auditor to change terms

- A change in Circumstances
- A misunderstanding the nature of an audit
- A restriction on the scope of engagement imposed by the mgmt.

### **Pre-Conditions of an audit are not present**

- If pre Conditions for an audit is not present the auditor shall discuss the matter with Management
- Unless it is required by law or Regulation, The auditor shall not accept the proposed audit Engagement
  - If the auditor has determined that AFRFW is unacceptable in the preparation of FS
  - If agreement of Management is not obtained on the matters relating to
    - For the preparation of FS as per AFRFW
    - Internal controls are placed to enable the preparation of FS free from MMs due to fraud or error
    - To provide the auditor
      - Access to all Information which is relevant to preparation of FS
      - Additional Information requested by auditor
      - Unrestricted access to persons within the Entity

### **Acceptance of change in terms of Engagement**

- Auditor before Completion of the audit engagement is requested to change the engagement.
- If Auditor concludes that there is reasonable Justification to change management, He shall prepare new engagement letter & Issue report under revised terms and to avoid confusion would not reference to original engagement or work performed under original engagement
- If No reasonable Justification, Auditor should not agree & should tell management to continue the Assignment
- If Not permitted by Mgmt. to continue he shall withdraw from the Audit engagement where possible under Law or Regulation & Report to Parties such as owner, regulator or TCWG

### **Recurring Audit**

The auditor may decide not to send a new audit engagement letter or other written agreement each period. However, the following factors may make it appropriate to revise the terms of the audit engagement or to remind the entity of existing terms

- Entity misunderstood the objective and scope
- Revised / special Terms
- Change in Senior Mgmt.
- Significant change in ownership
- Change in legal framework
- Change in FRF
- Change in reporting requirements
- Change in nature and size of the entity

### **Audit Quality**

- SQC 1 and SA 220 both deal with quality control.
- SQC 1 deals with all engagements including audits, reviews and other assurance and related service engagements, SA 220 applies to audit engagements only.
- SQC 1 applies to entire firm. However, SA 220 applies to a particular audit engagement

### **Objective of SQC 1**

- The objective of the firm is to establish and maintain a system of quality control to provide it with reasonable assurance that
- The firm and its personnel comply with professional standards and
- Reports issued by the firm or engagement partners are appropriate in the circumstances.

### **Objective of SA 220**

The objective of the auditor is to implement quality control procedures at the Engagement level that provides the auditor with reasonable assurance that:

- The audit complies with professional standards and applicable legal and regulatory requirements &
- The auditor's report issued is appropriate in the circumstances

**SQC 1** - 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
- Acceptance and continuance of client relationships and specific engagements
- Human resources
- Engagement performance
- Monitoring

### **SA 220 Is Modelled On Lines Of SQC 1.**

It describes responsibilities of engagement partner in relation to following matters: -

- Leadership responsibilities for quality on audits
- Relevant ethical requirements
- Acceptance and continuance of client relationships and audit engagements
- Assignment of engagement teams
- Engagement performance
- Monitoring

### **SA 220 - Leadership responsibilities for quality on audits**

- Performing work that complies with professional standards and regulatory and legal requirements
- Complying with the firm's quality control policies and procedures as applicable
- Issuing Appropriate Audit Report
- The engagement team's ability to raise concerns without fear.

### **SA 220 – Relevant Ethical Requirement – Responsibilities of Engagement partner**

- Identifying a threat to independence of audit engagement that safeguards may not be able to eliminate or reduce to an acceptable level
- Reporting by engagement partner to the relevant persons within the firm to determine appropriate action, which may include eliminating the activity or interest that creates the threat

## ***SA 220 - Acceptance and Continuance of Client Relationships and Audit Engagements***

The firm should obtain 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.

- Information like integrity of principal owners,
- Competence of engagement team and consideration of necessary capabilities including time and resources,
- Compliance with relevant ethical requirements and
- Significant matters arisen during current or previous audit engagement

### ***Assignment of engagement teams: SA 220***

It should be ensured by engagement partner that the engagement team and any auditor's experts who are not part of the engagement team, collectively have the appropriate competence and capabilities to perform the engagement in accordance with professional standards and regulatory and legal requirements

### ***Engagement performance – SA 220***

Engagement partner has the responsibility for direction, supervision and performance of audit engagement in accordance with professional standard. For audits of FS of listed entities, and those other audit engagements, if any, for which the firm has determined that an engagement quality control review is required, the engagement partner shall

- Determine that an engagement quality control reviewer has been appointed.
- Discuss significant matters arising during the audit engagement, including those identified during the engagement quality control review, with the engagement quality control reviewer.
- Not date the auditor's report until the completion of the engagement quality control review.
- The engagement team shall follow the firm's policies and procedures for dealing with and resolving differences of opinion

### ***Monitoring SA 220***

- An effective system of quality control includes a monitoring process designed to provide the firm with reasonable assurance that its policies and procedures relating to the system of quality control are relevant, adequate, and operating effectively.
- The engagement partner shall consider the results of the firm's monitoring process as evidenced in the latest information circulated by the firm

### ***Documentation***

- Issues identified with respect to compliance with relevant ethical requirements
- Conclusions reached regarding the acceptance and continuance of client relationships and audit engagements
- The nature and scope of, and conclusions resulting from, consultations undertaken during the course of the audit engagement.

### **Ethics**

- The term “Ethics” means moral principles which govern a person’s behaviour or his conducting of an activity.
- It is a state of mind to act and perform in accordance with moral principles.
- Ethics is the science of morals in human conduct.
- Such moral principles and rules of conduct impose obligations upon individual

### **Confidentiality**

Confidentiality serves the public interest because it facilitates the free flow of information from the professional accountant’s client or employing organization to the accountant with the understanding that the information will not be disclosed to a third party.

However, such confidential information may be disclosed, for example, when it is required by law.

### **Integrity:**

A professional accountant shall comply with the principle of integrity, which requires an accountant to be straightforward and honest in all professional and business relationships. Integrity implies fair dealing and truthfulness

### **PROFESSIONAL BEHAVIOUR:**

It requires an accountant to comply with relevant laws and regulations and avoid any conduct that the accountant knows or should know might discredit the profession. A professional accountant shall not knowingly engage in any employment, occupation or activity that impairs or might impair the integrity, objectivity or good reputation of the profession, and as a result would be incompatible with the fundamental principles

### **Objectivity:**

The principle of objectivity requires an auditor not to compromise professional judgment because of bias, conflict of interest or undue influence of others.

It requires that a professional accountant shall not undertake a professional activity if a circumstance or relationship unduly influences the accountant’s professional judgment regarding that activity.

### **Professional Competence and Due Care:**

A professional accountant shall comply with the principle of professional competence and due care, which requires an accountant to attain and maintain professional knowledge and skill at the level required to ensure that a client or employing organization receives competent professional service, based on current technical and professional standards and relevant legislation