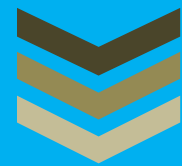


# Referencer for Quick Revision



## Intermediate Course Paper-6: Auditing and Assurance

A compendium of subject-wise capsules published in the  
monthly journal "The Chartered Accountant Student"



**Board of Studies  
(Academic)  
ICAI**

# INDEX

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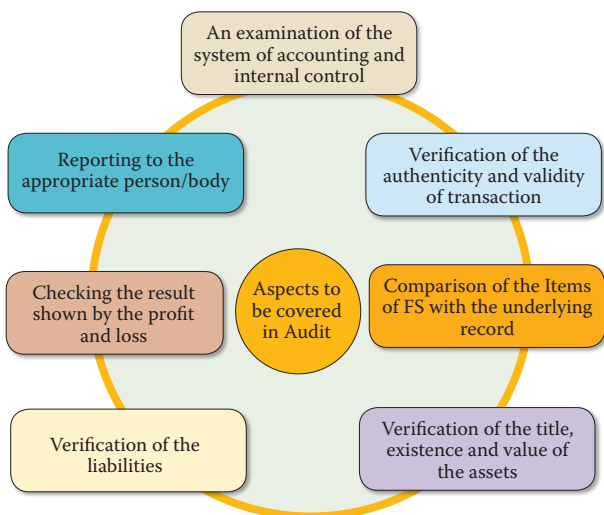
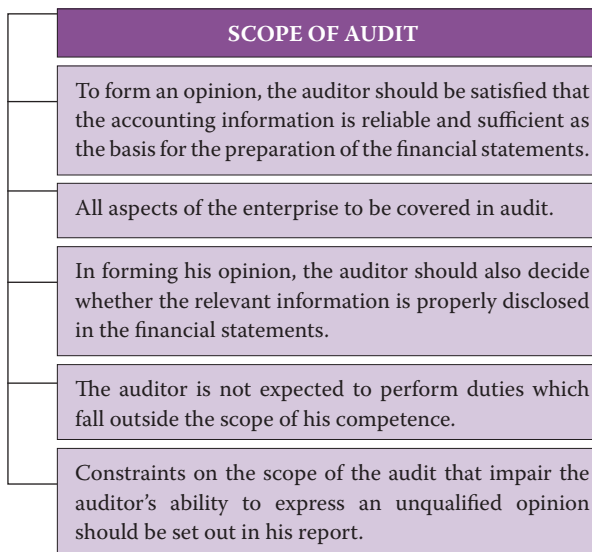
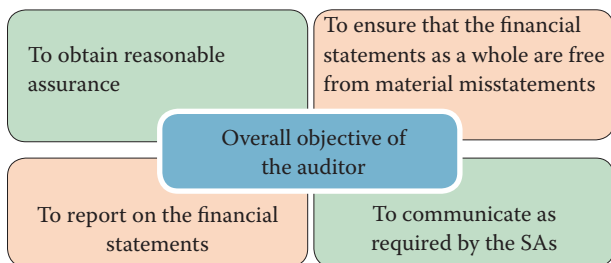
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# AUDITING & ASSURANCE ||

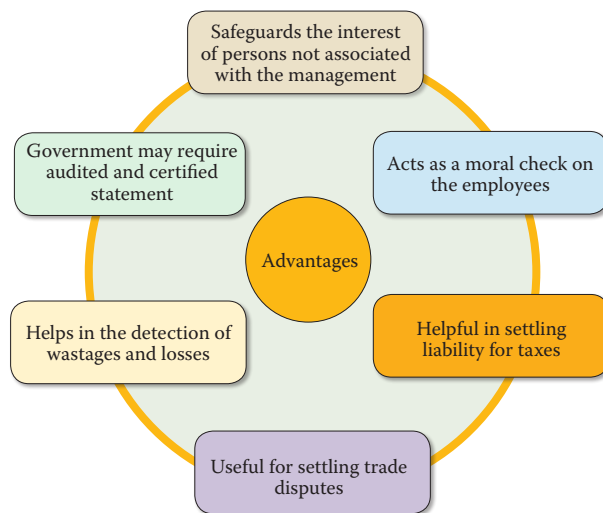
## NATURE, OBJECTIVE AND SCOPE OF AUDIT

It has always been the endeavour of Board of Studies to provide quality academic inputs to the students of Chartered Accountancy Course. Keeping in mind this objective, BoS has decided to come out with a Crisp & Concise Capsule on Paper 6: Auditing & Assurance of Intermediate Course to facilitate students for quick revision before examination. It may be mentioned that this capsule is a tool for quick revision of some significant areas of Auditing & Assurance & this should not be taken as a substitute for the detailed study of the subject. Students are advised to refer to the relevant Study Material, Practice Manual and RTP for comprehensive study & revision.

“An audit is an independent examination of financial information of any entity, whether profit oriented or not, and irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion thereon.”



### Advantages of audit of financial statements



### Inherent limitations of audit

**Inherent Limitations of Audit** (SA 200 “Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing”): The auditor is not expected to, and cannot, reduce audit risk to zero because there are inherent limitations of an audit. The inherent limitations of an audit arise from:

**The Nature of Financial Reporting:** The preparation of financial statements involves judgment by management.

**The Nature of Audit Procedures:** There are practical and legal limitations on the auditor's ability to obtain audit evidence such as:

Possibility that management or others may not provide, intentionally or unintentionally, the complete information relevant for preparation and presentation of FS.	Fraud may involve sophisticated and carefully organised schemes.	An audit is not an official investigation into alleged wrongdoing.
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**Timeliness of Financial Reporting and the Balance between Benefit and Cost:** Relevance of information, and thereby its value, tends to diminish over time, and there is a balance to be struck between the reliability of information and its cost.

**Other Matters that Affect the Limitations of an Audit:** Certain assertions or subject matters are particularly significant, such as fraud or subject matters include:

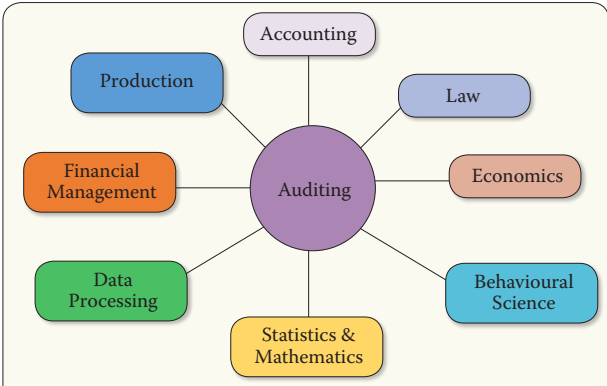
- ◆ Fraud, particularly involving senior management or collusion.
- ◆ The existence and completeness of related party relationships and transactions.
- ◆ The occurrence of non-compliance with laws and regulations.
- ◆ Future events or conditions that may cause an entity to cease to continue as a going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

**International Auditing and Assurance Standards Board (IAASB):**

**Auditing and Assurance Standards Board:**

The IFAC Board has established the IAASB to develop and issue, in the public interest and under its own authority, high quality auditing standards for use around the world. The IAASB functions as an independent standard-setting body under the auspices of IFAC. In India, ICAI constituted the AASB for the same purpose.

**Relationship of auditing with other disciplines**



**Auditing and Accounting:** Auditing reviews the financial statements which are nothing but a result of the overall accounting process.

**Auditing and Law:** An auditor should have a good knowledge of business laws affecting the entity.

**Auditing and Economics:** Auditor is expected to be familiar with the overall economic environment of the client.

**Auditing and Behavioural Science:** knowledge of human behaviour is essential for an auditor to effectively discharge his duties

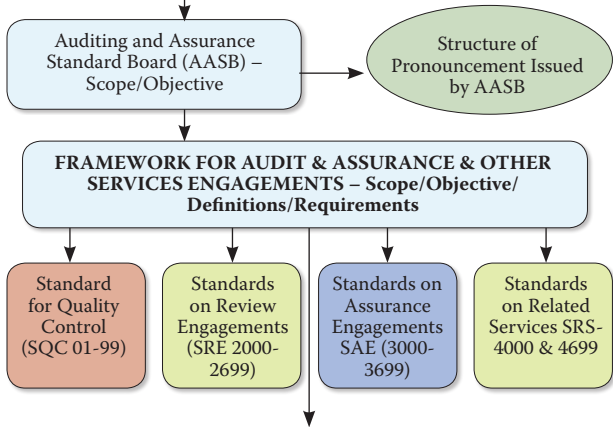
**Auditing and Statistics & Mathematics:** auditor is also expected to have the knowledge of statistical sampling for meaningful conclusions and mathematics for verification of inventories.

**Auditing and Data Processing:** EDP auditing in itself is developing as a discipline in itself.

**Auditing and Financial Management :** the auditor is expected to have knowledge about various financial techniques such as working capital management, funds flow, ratio analysis, capital budgeting etc.

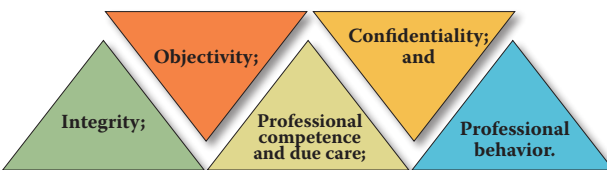
**Auditing and Production:** good auditor is one who understands the client and his business functions such as production, cost system, marketing etc.

**AUDITING STANDARDS – AN OVERVIEW**



**Standards on Auditing (SA 100-999) aspects covered in series:**  
 Introductory Matters SA 100-199  
 General Principles and Responsibilities SA 200-299  
 Risk Assessment and Response to Assessed Risk SA 300-499  
 Audit Evidence SA 500-599  
 Using Work of Others SA 600-699  
 Audit Conclusions and Reporting SA 700-799  
 Specialised Areas SA 800-899

**Ethical Requirements Relating to Audit of Financial Statements**

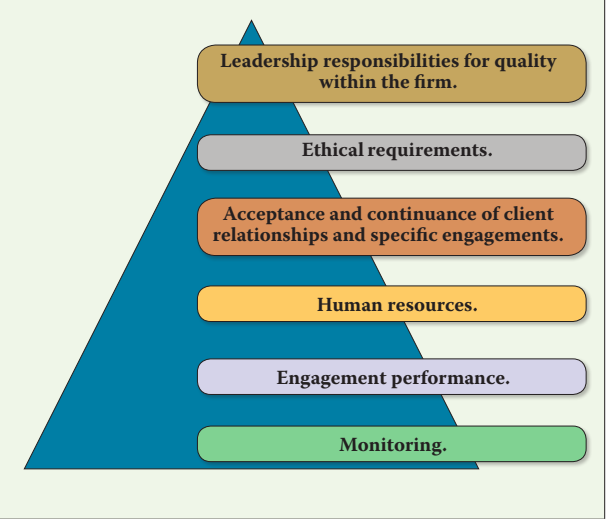


The auditor should be independent of the entity subject to the audit. The Code describes independence as comprising both Independence of Mind + Independence in Appearance.

**Human Resources :** The firm should establish policies and procedures designed to address the following personnel issues:



**Elements of a System of Quality Control :**The firm’s system of quality control should include policies and procedures addressing each of the following elements:



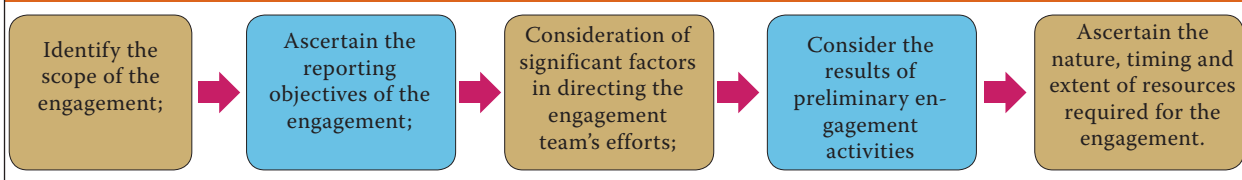
**Monitoring:** The purpose of monitoring compliance with quality control policies and procedures is to provide an evaluation of:

Adherence to professional standards and regulatory and legal requirements;	Whether the quality control system has been appropriately designed and effectively implemented; and	Whether the firm's quality control policies and procedures have been appropriately applied, so that reports that are issued by the firm or engagement partners are appropriate in the circumstances.	Follow-up by appropriate firm personnel so that necessary modifications are promptly made to the quality control policies and procedures.
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## AUDIT STRATEGY, PLANNING AND PROGRAMME

After establishment of the overall audit strategy, 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.

**In establishing the overall audit strategy, the auditor shall:**



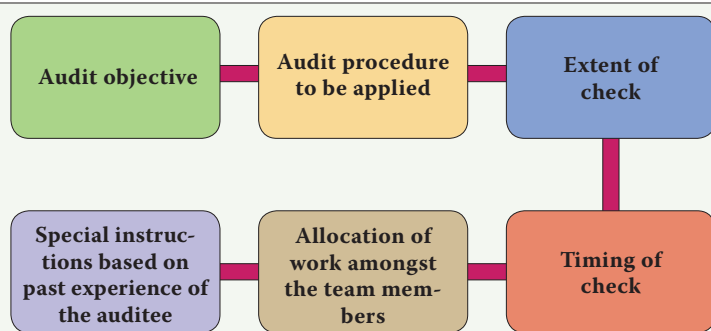
Planning is not a discrete phase of an audit, but rather a continual and iterative process that often begins shortly after (or in connection with) the completion of the previous audit and continues until the completion of the current audit engagement.

### Development of an Overall Plan:

- |   |  |
|---|--|
| <ul style="list-style-type: none"> <li><input type="checkbox"/> The terms of his engagement and statutory responsibilities.</li> <li><input type="checkbox"/> Nature and timing of reports</li> <li><input type="checkbox"/> Applicable legal or statutory requirements.</li> <li><input type="checkbox"/> Accounting policies adopted by the client</li> <li><input type="checkbox"/> Effect of new accounting or auditing pronouncements on the audit.</li> <li><input type="checkbox"/> Identification of significant audit areas.</li> <li><input type="checkbox"/> Setting of materiality levels for audit purposes.</li> <li><input type="checkbox"/> The degree of reliance on accounting system and internal control</li> </ul> | <ul style="list-style-type: none"> <li><input type="checkbox"/> Possible rotation of emphasis on specific audit areas.</li> <li><input type="checkbox"/> The nature and extent of audit evidence to be obtained.</li> <li><input type="checkbox"/> The work of internal auditors and the extent of their involvement</li> <li><input type="checkbox"/> The involvement of other auditors</li> <li><input type="checkbox"/> The involvement of experts.</li> <li><input type="checkbox"/> The allocation of work between joint auditors</li> <li><input type="checkbox"/> Establishing and coordinating staffing requirements.</li> </ul> |
|---|--|

The auditor shall document (a) the overall audit strategy;(b) the audit plan; and (c) any significant changes made during the audit engagement to the overall audit strategy or the audit plan, and the reasons for such changes.

**AN AUDIT PROGRAMME** is a detailed plan and consists of a series of verification procedures to be applied to the financial statements and accounts of a given company for the purpose of obtaining sufficient evidence to enable the auditor to express an informed opinion on such statements. For framing an audit programme the following points should be kept in view:



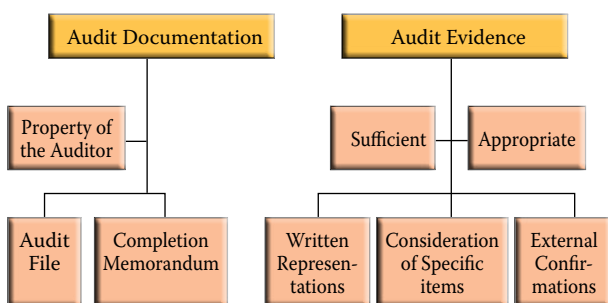
# AUDITING AND ASSURANCE ||

## CA INTERMEDIATE (NEW) - PAPER 6 - AUDITING AND ASSURANCE

It has always been the endeavour of Board of Studies to provide quality academic inputs to the students of Chartered Accountancy Course. Keeping in mind this objective, BoS has decided to come out with a Crisp & Concise Capsule of each subject to facilitate students for quick revision before examination. This Capsule is on Paper 6: Auditing & Assurance of Intermediate Course. It may be mentioned that this capsule is a tool for quick revision of some significant Topics of Auditing and Assurance, and this should not be taken as a substitute for the detailed study of the subject. Students are advised to refer to the relevant Study Material and RTP for comprehensive study & revision.

### CHAPTER 3: AUDIT DOCUMENTATION AND AUDIT EVIDENCE

#### Overview



#### SA 230- "AUDIT DOCUMENTATION"

SA 230 on "Audit Documentation", deals with the auditor's responsibility to prepare audit documentation for an audit of financial statements. It is to be adapted as necessary in the circumstances when applied to audits of other historical financial information. Laws or regulations may establish additional documentation requirements.

#### Definition: Audit Documentation refers to

- record of audit procedures performed
- relevant audit evidence obtained
- conclusions the auditor reached

#### OBJECTIVE OF THE AUDITOR

To prepare **documentation that provides-**

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

#### NATURE OF AUDIT DOCUMENTATION

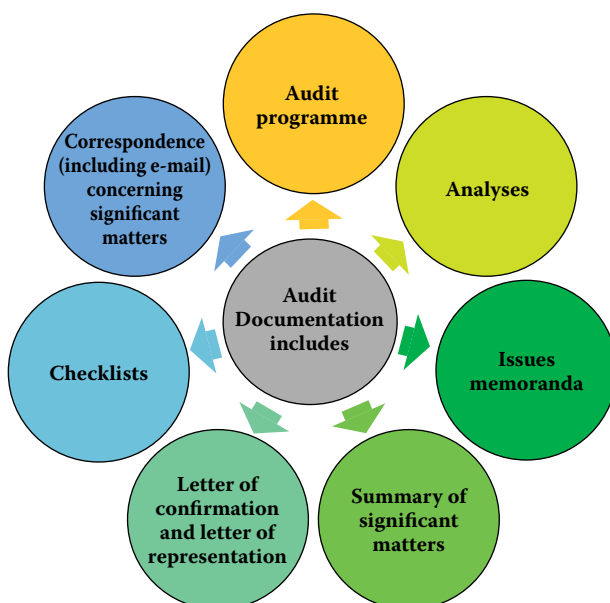
**Audit documentation provides:**

- ◆ evidence of the auditor's basis for a conclusion about the achievement of the overall objectives of the auditor; and
- ◆ evidence that the audit was planned and performed in accordance with SAs.

#### PURPOSE OF AUDIT DOCUMENTATION

1. Assisting the engagement team to plan and perform the audit.
2. Assisting engagement team to direct and supervise the audit work.
3. Enabling the engagement team to be accountable for its work.
4. Retaining a record of matters of continuing significance to future audits.
5. Enabling the conduct of quality control reviews and inspections.
6. Enabling the conduct of external inspections.

#### EXAMPLES OF AUDIT DOCUMENTATION



## AUDIT FILE- DEFINITION

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.**

## IMPORTANT ASPECTS REGARDING AUDIT FILE

An appropriate time limit within which to complete the assembly of the final audit file is ordinarily not more than 60 days after the date of the auditor's report.

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

The retention period for audit engagements ordinarily is no shorter than seven years from the date of the auditor's report, or, if later, the date of the group auditor's report.

## COMPLETION MEMORANDUM (Audit Documentation Summary)

The auditor may consider it helpful to prepare and retain as part of the audit documentation a summary that describes-

- the significant matters identified during the audit and
- how they were addressed.

Such a summary may facilitate effective and efficient review and inspection of the audit documentation.

Further, the preparation of such a summary may assist auditor's consideration of the significant matters.

It may also help the auditor to consider whether there is any individual relevant SA objective that the auditor cannot achieve that would prevent the auditor from achieving the overall objectives of the auditor.

## OWNERSHIP OF AUDIT DOCUMENTATION

Standard on Quality Control (SQC) 1 provides that audit documentation is the **property of the auditor.**

He may at his discretion, make portions of, or **extracts from, audit documentation** available to clients.

## SA 500- "AUDIT EVIDENCE"

SA 500 – "Audit Evidence", explains what constitutes audit evidence in an audit of financial statements, and deals with the auditor's responsibility to design and perform audit procedures to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion.

## Definition

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

It includes **both information contained in the accounting records underlying the financial statements and other information**

## OBJECTIVE OF THE AUDITOR

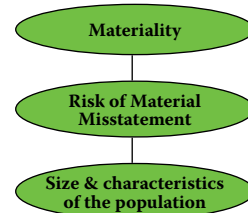
To design and perform audit procedures in such a way as to enable the auditor to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion.

## SUFFICIENT AND APPROPRIATE AUDIT EVIDENCE

**Sufficiency** → measure of **quantity** of audit evidence

**Appropriateness** → measure of **quality** of audit evidence

## FACTORS AFFECTING AUDITOR'S JUDGEMENT AS TO SUFFICIENCY OF AUDIT EVIDENCE



## AUDIT PROCEDURES TO OBTAIN AUDIT EVIDENCE

Inspection

Observation

External Confirmation

Recalculation

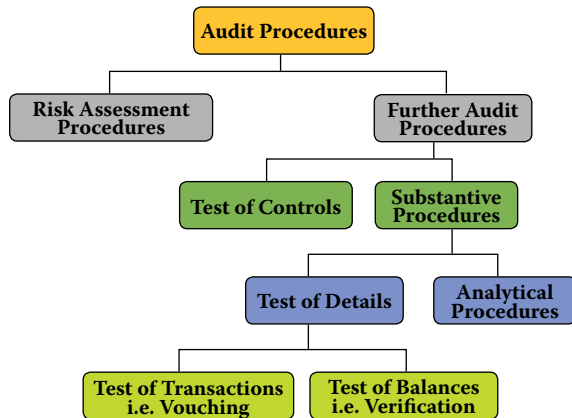
Reperformance

Analytical Procedures

Inquiry

# AUDITING AND ASSURANCE

The following chart illustrates different audit procedures:



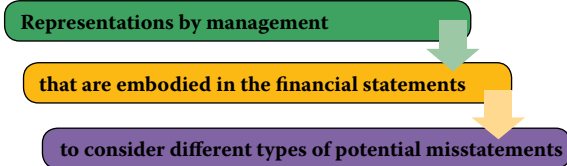
**Risk Assessment Procedures** refer to the audit procedures performed to obtain an understanding of the entity and its environment, including the entity's internal control, to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels.

**Further Audit Procedures** comprise of:  
 (i) Tests of controls, when required by the SAs or when the auditor has chosen to do so; and  
 (ii) Substantive procedures, including tests of details and substantive analytical procedures.

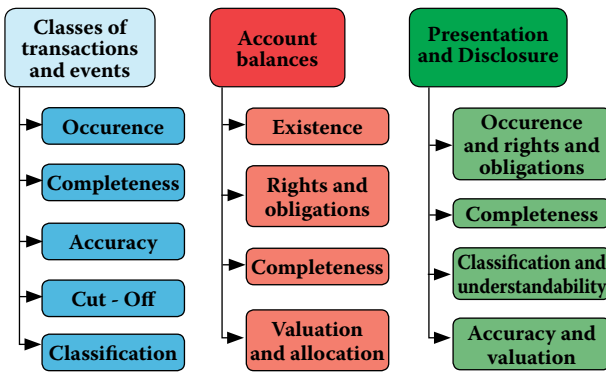
**Test of Controls** may be defined as an audit procedure designed to evaluate the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements at the assertion level.

**Substantive Procedure** may be defined as an audit procedure designed to detect material misstatements at the assertion level.

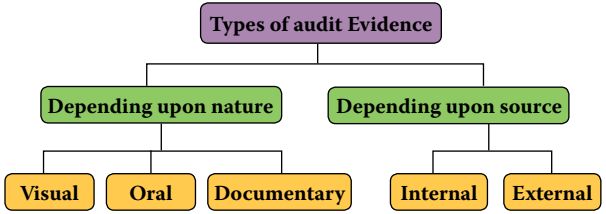
## ASSERTION- DEFINITION



Assertions used by the auditor to consider the different types of potential misstatements:

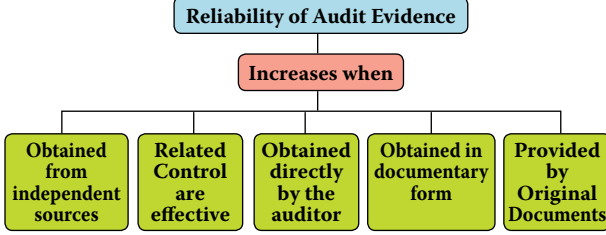


## TYPES OF AUDIT EVIDENCE

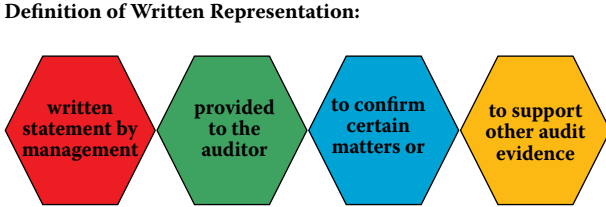


## RELEVANCE AND RELIABILITY OF AUDIT EVIDENCE

**Relevance** deals with the logical connection with the purpose of the audit procedure and the assertion under consideration.  
 The **reliability of information** to be used as audit evidence is influenced by its source and its nature, and the circumstances under which it is obtained.

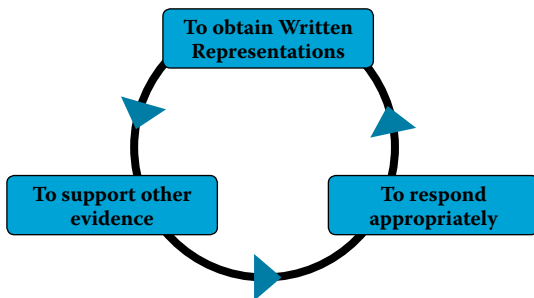


## SA 580- "WRITTEN REPRESENTATIONS"





## OBJECTIVES OF THE AUDITOR REGARDING WRITTEN REPRESENTATION



Some IMPORTANT POINTS with respect to Written Representations:
Written representations do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal.
The auditor shall request written representations from management.
The auditor shall request management to provide a written representation that it has fulfilled its responsibility for the preparation of the financial statements.
Audit evidence obtained during the audit that management has fulfilled its responsibilities is not sufficient. Auditor has to obtain confirmation from management about the same..
The auditor shall request management to provide a written representation that: <ul style="list-style-type: none"> <li>(a) It has provided the auditor with all relevant information and access as agreed in the terms of the audit engagement, and</li> <li>(b) All transactions have been recorded and are reflected in the financial statements.</li> </ul>
The date of the written representations should not be after the date of the auditor's report on the financial statements.
The written representations shall be in the form of a representation letter addressed to the auditor.
If the auditor has concerns about the competence, integrity, ethical values or diligence of management, the auditor shall determine the effect of such concerns on the audit evidence.
If management does not provide one or more of the requested written representations, the auditor shall: <ul style="list-style-type: none"> <li>(a) Discuss the matter with management;</li> <li>(b) 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; and</li> <li>(c) Take appropriate actions, including determining the possible effect on the opinion in the auditor's report in accordance with SA 705.</li> </ul>

## SA 501- "AUDIT EVIDENCE- SPECIFIC CONSIDERATIONS FOR SELECTED ITEMS"

SA 501 deals with specific considerations by the auditor in obtaining sufficient appropriate audit evidence with respect to certain aspects of inventory, litigation and claims involving the entity, and segment information in an audit of financial statements.

### OBJECTIVE OF THE AUDITOR

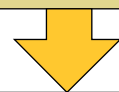
To obtain sufficient appropriate audit evidence regarding the:

- (a) Existence and condition of inventory;
- (b) Completeness of litigation and claims involving the entity; and
- (c) Presentation and disclosure of segment information in accordance with the applicable financial reporting framework.

### Inventory:

**When inventory is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by:**

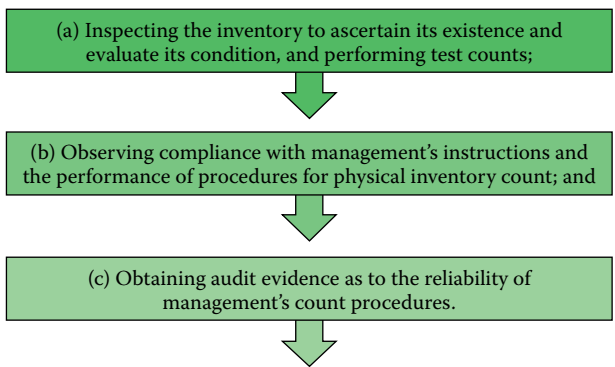
(a) Attendance at physical inventory counting, unless impracticable, to:			
(i) Evaluate management's instructions and procedures for recording and controlling the results of the entity's physical inventory counting;	(ii) Observe the performance of management's count procedures;	(iii) Inspect the inventory; and	(iv) Perform test counts.



(b) Performing audit procedures over the entity's final inventory records to determine whether they accurately reflect actual inventory count results.

### Attendance at Physical Inventory Counting

**It Involves:**

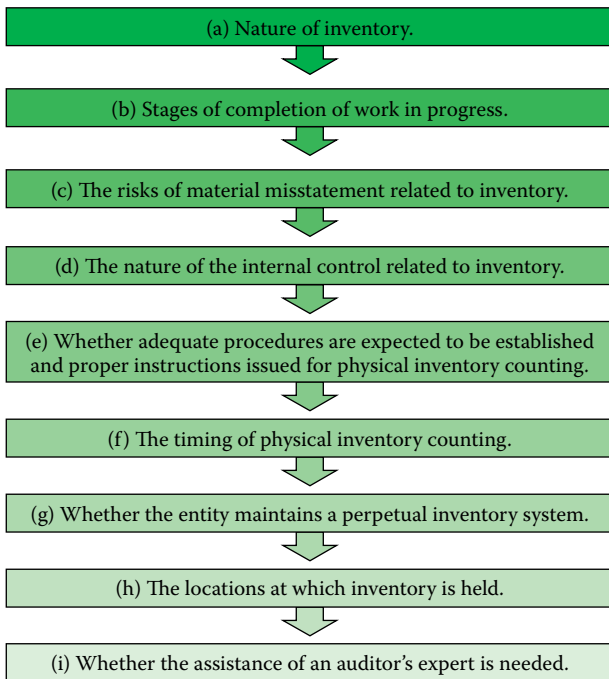


These procedures may serve as test of controls or substantive procedures depending on the auditor's risk assessment, planned approach and the specific procedures carried out.

# AUDITING AND ASSURANCE ||

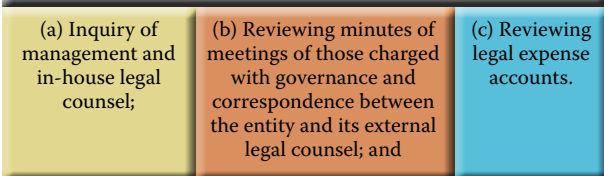
## Matters Relevant in Planning Attendance at Physical Inventory Counting:

It include, for example:



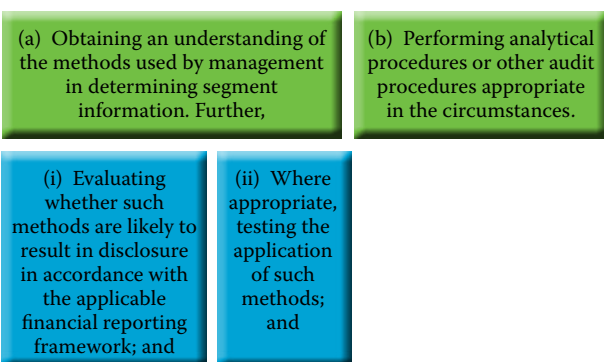
## Litigation and Claims:

The auditor shall design and perform audit procedures in order to identify litigation and claims involving the entity which may give rise to a risk of material misstatement, including:



## Segment Information:

The auditor shall obtain sufficient appropriate audit evidence regarding the presentation and disclosure of segment information in accordance with the applicable financial reporting framework by:



## SA 505- "EXTERNAL CONFIRMATIONS"

SA 505- "External Confirmations", deals with the auditor's use of external confirmation procedures to obtain audit evidence. SA 500 indicates that the reliability of audit evidence is influenced by its source and by its nature, and is dependent on the individual circumstances under which it is obtained.

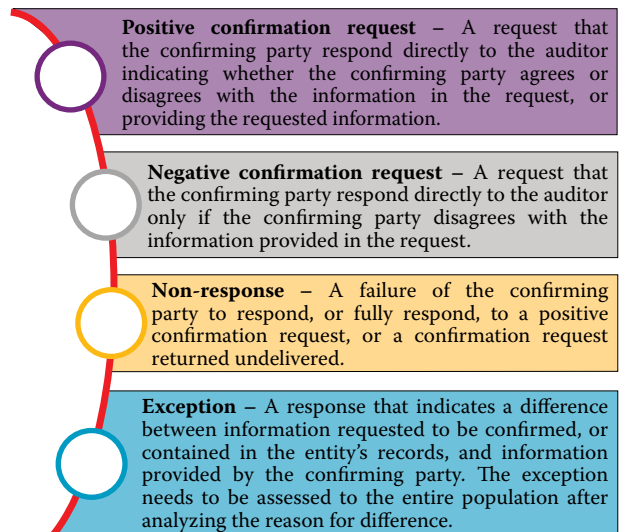
## OBJECTIVE OF THE AUDITOR

The objective of the auditor, when using external confirmation procedures, is to design and perform such procedures to obtain relevant and reliable audit evidence.

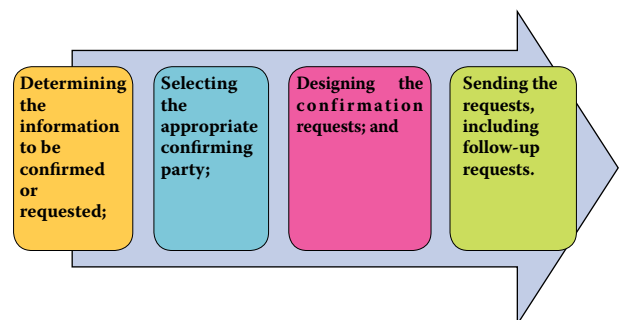
## DEFINITION OF EXTERNAL CONFIRMATION



## Other Important Terms-



## EXTERNAL CONFIRMATION PROCEDURES



## MANAGEMENT'S REFUSAL TO ALLOW THE AUDITOR TO SEND A CONFIRMATION REQUEST

THE AUDITOR SHALL:

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 risks of material misstatement; and

Perform alternative audit procedures designed to obtain relevant and reliable audit evidence.

If the auditor concludes that management's refusal to allow the auditor to send a confirmation request is unreasonable, or the auditor is unable to obtain relevant and reliable audit evidence from alternative audit procedures

The auditor shall communicate with those charged with governance in accordance with SA 260.

The auditor shall also determine the implications for the audit and the auditor's opinion in accordance with SA 705.

## RESULTS OF THE EXTERNAL CONFIRMATION PROCEDURES

Reliability of Responses to Confirmation Requests

If the auditor identifies factors that give rise to doubts about the reliability of the response to a confirmation request,

the auditor shall obtain further audit evidence to resolve those doubts.

If the auditor determines that a response to a confirmation request is not reliable,

the auditor shall evaluate the implications on the assessment of the relevant risks of material misstatement.

## NEGATIVE CONFIRMATIONS

Negative confirmations provide less persuasive audit evidence than positive confirmations.

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

(a) The auditor has assessed the risk of material misstatement as low and has obtained sufficient appropriate audit evidence regarding the operating effectiveness of controls relevant to the assertion;

(b) The population of items subject to negative confirmation procedures comprises a large number of small, homogeneous, account balances, transactions or conditions;

(c) A very low exception rate is expected; and

(d) The auditor is not aware of circumstances or conditions that would cause recipients of negative confirmation requests to disregard such requests.

## EVALUATING THE EVIDENCE OBTAINED

SA 510- "Initial Audit Engagements - Opening Balances", deals with the auditor's responsibilities relating to opening balances when conducting an initial audit engagement. In addition to financial statement amounts, opening balances include matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments.

## DEFINITION OF INITIAL AUDIT ENGAGEMENT

An engagement in which either:

- (i) The financial statements for the prior period were not audited; or
- (ii) The financial statements for the prior period were audited by a predecessor auditor.

## OBJECTIVE OF AUDITOR WITH RESPECT TO OPENING BALANCES – IN CONDUCTING AN INITIAL AUDIT ENGAGEMENT

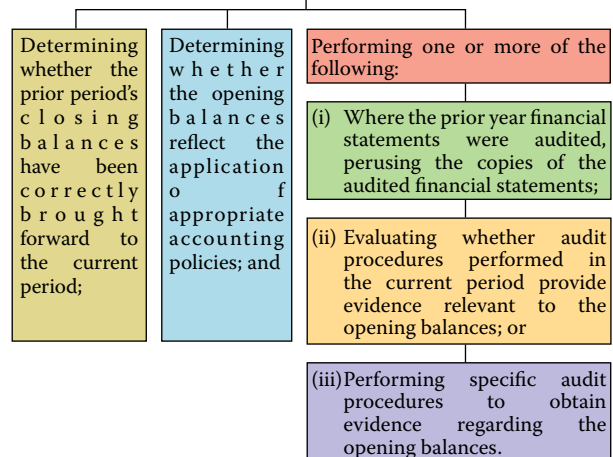
In conducting an initial audit engagement, the objective of the auditor with respect to opening balances is to obtain sufficient appropriate audit evidence about whether:

- (a) Opening balances contain misstatements that materially affect the current period's financial statements; and
- (b) Appropriate accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, or changes thereto are properly accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.

## AUDIT PROCEDURES REGARDING OPENING BALANCES

The auditor shall read the most recent financial statements, if any, and the predecessor auditor's report thereon, if any, for information relevant to opening balances, including disclosures.

The auditor shall obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements by:



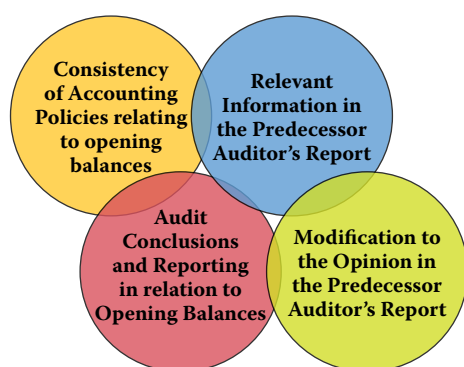
# AUDITING AND ASSURANCE

If the auditor obtains audit evidence that the opening balances contain misstatements that could materially affect the current period's financial statements

the auditor shall perform such additional audit procedures as are appropriate in the circumstances to determine the effect on the current period's financial statements.

If the auditor concludes that such misstatements exist in the current period's financial statements, the auditor shall communicate the misstatements with the appropriate level of management and those charged with governance in accordance with SA 450.

## SOME OTHER IMPORTANT POINTS



## SA 550- "RELATED PARTIES"

SA 550- "Related Parties", deals with the auditor's responsibilities regarding related party relationships and transactions when performing an audit of financial statements.

## DEFINITION OF RELATED PARTY

**A party that is either:**

- (i) A related party as defined in the applicable financial reporting framework; or
- (ii) Where the applicable financial reporting framework establishes minimal or no related party requirements:
  - (a) A person or other entity that has control or significant influence, directly or indirectly through one or more intermediaries, over the reporting entity;
  - (b) Another entity over which the reporting entity has control or significant influence, directly or indirectly through one or more intermediaries; or
  - (c) Another entity that is under common control with the reporting entity through having:
    - Common controlling ownership;
    - Owners who are close family members; or
    - Common key management.

However, entities that are under common control by a state (i.e., a national, regional or local government) are not considered related unless they engage in significant transactions or share resources to a significant extent with one another.

## RESPONSIBILITIES OF THE AUDITOR

There are specific accounting and disclosure requirements for related party relationships, transactions and balances to enable users of the financial statements to understand their nature and effects on the financial statements.

The auditor has a responsibility to perform audit procedures to identify, assess and respond to the risks of material misstatement arising from the entity's failure to appropriately account for related party relationships, transactions or balances.

The auditor needs to obtain an understanding of the entity's related party relationships and transactions sufficient to be able to conclude whether the financial statements, insofar as they are affected by those relationships and transactions:

- (a) Achieve a true and fair presentation; or
- (b) Are not misleading (for compliance frameworks).

In addition, an understanding of the entity's related party relationships and transactions is relevant to the auditor's evaluation of whether fraud risk factors are present as required by SA 240. This is because fraud may be more easily committed through related parties.

Owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with the SAs.

In the context of related parties, the potential effects of inherent limitations on the auditor's ability to detect material misstatements are greater for such reasons as the following:

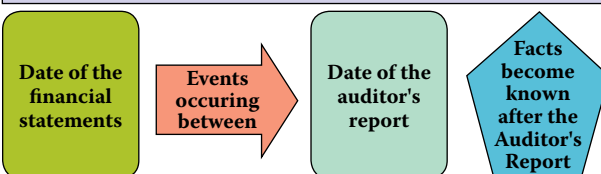
- Management may be unaware of the existence of all related party relationships.
- Related party relationships may present a greater opportunity for collusion, concealment or manipulation by management.

Planning and performing the audit with professional skepticism as required by SA 200 is therefore particularly important in this context, given the potential for undisclosed related party relationships and transactions.

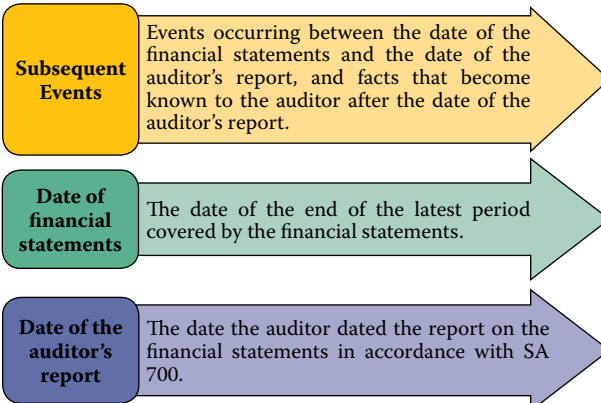
The requirements in this SA are designed to assist the auditor in identifying and assessing the risks of material misstatement associated with related party relationships and transactions, and in designing audit procedures to respond to the assessed risks.

## SA 560, "SUBSEQUENT EVENTS"

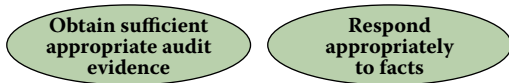
SA 560, "Subsequent Events" deals with the auditor's responsibilities relating to subsequent events in an audit of financial statements.



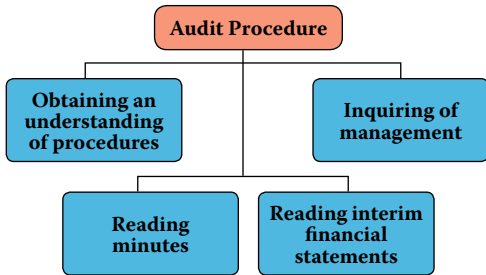
**Some definitions:**



## OBJECTIVES OF THE AUDITOR



## AUDIT PROCEDURE REGARDING EVENTS OCCURRING BETWEEN THE DATE OF THE FINANCIAL STATEMENTS AND THE DATE OF THE AUDITOR'S REPORT



## WRITTEN REPRESENTATIONS WITH RESPECT TO SUBSEQUENT EVENTS

The auditor shall request management and, where appropriate, those charged with governance, to provide a written representation in accordance with SA 580, "Written Representations" that all events occurring subsequent to the date of the financial statements and for which the applicable financial reporting framework requires adjustment or disclosure have been adjusted or disclosed.

## AUDITOR'S OBLIGATIONS REGARDING SUBSEQUENT EVENTS



## SA 570- "GOING CONCERN"

SA 570 on "Going concern" deals with:

- (I) The auditor's responsibilities in the audit of financial statements relating to going concern and
- (II) The implications for the auditor's report.

## OBJECTIVES OF THE AUDITOR REGARDING GOING CONCERN

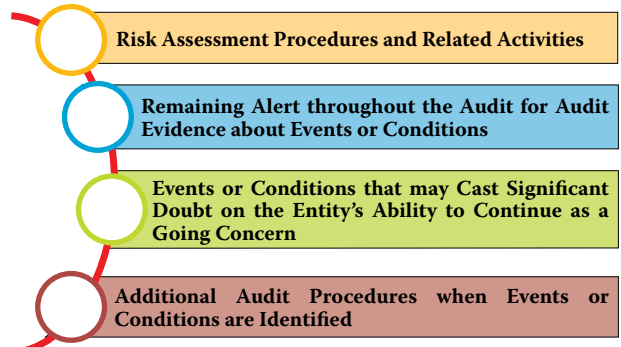
### Objectives

To obtain sufficient appropriate audit evidence regarding, and conclude on, the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements;

To conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern; and

To report in accordance with this SA.

## SOME OTHER IMPORTANT POINTS:



## Implications for the Auditor's Report

### (A) Use of Going Concern Basis of Accounting is Inappropriate

If the financial statements have been prepared using the going concern basis of accounting but, in the auditor's judgment, management's use of the going concern basis of accounting in the preparation of the financial statements is inappropriate, the auditor shall express an adverse opinion.

### (B) Use of the Going Concern Basis of Accounting is Appropriate but a Material Uncertainty Exists

The identification of a material uncertainty is a matter that is important to users' understanding of the financial statements. The use of a separate section with a heading that includes reference to the fact that a material uncertainty related to going concern exists alerts users to this circumstance.

### (1) Adequate Disclosure of a Material Uncertainty is Made in the Financial Statements

If adequate disclosure about the material uncertainty is made in the financial statements:

The auditor shall express an unmodified opinion and the auditor's report shall include a separate section under the heading "Material Uncertainty Related to Going Concern."

### (2) Adequate Disclosure of a Material Uncertainty is Not Made in the Financial Statements

If adequate disclosure about the material uncertainty is not made in the financial statements, the auditor shall:

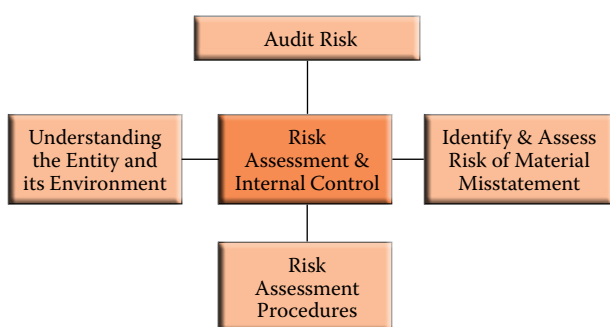
(a) Express a **qualified opinion** or adverse opinion, as appropriate, in accordance with SA 705 (Revised); and

(b) In the Basis for Qualified (Adverse) Opinion section of the auditor's report, state that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the financial statements do not adequately disclose this matter.

It has always been the endeavour of Board of Studies to provide quality academic inputs to the students of Chartered Accountancy Course. Keeping in mind this objective, BoS has decided to come out with a Crisp & Concise Capsule of each subject to facilitate students for quick revision before examination. This Capsule is on Paper 6: Auditing & Assurance of Intermediate Course. It may be mentioned that this capsule is a tool for quick revision of some significant Topics of Auditing and Assurance and this should not be taken as a substitute for the detailed study of the subject. Students are advised to refer to the relevant Study Material, Practice Manual and RTP for comprehensive study & revision.

### CHAPTER 4: RISK ASSESSMENT AND INTERNAL CONTROL

#### Overview:



#### Audit Risk:

Audit risk means the risk that the auditor gives an inappropriate audit opinion when the financial statement are materially misstated

$$\text{Audit Risk} = \text{Risk of Material Misstatement} \times \text{Detection Risk}$$

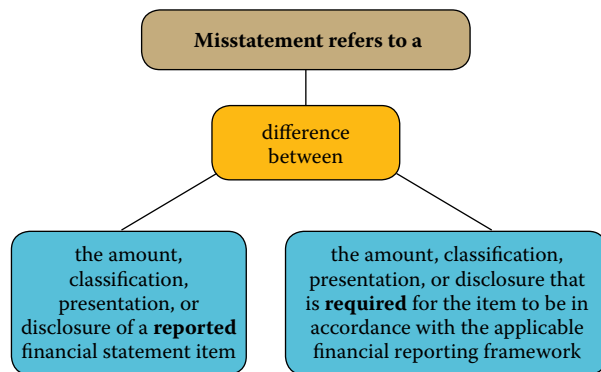
**Risk of material misstatement may be defined as** the risk that the financial statements are materially misstated prior to audit.

Inherent risk

Control risk

The susceptibility of an assertion to a misstatement that could be material **before consideration of any related controls.**

The risk that a misstatement that could occur in an assertion and that could be material, will not be prevented, or detected and corrected, on a timely basis by the entity's internal control.



#### Risks of Material Misstatement at Two levels:

(i) **The overall financial statement level-** Risks of material misstatement at the overall financial statement level refer to risks of material misstatement that relate pervasively to the financial statements as a whole and potentially affect many assertions.

(ii) **The assertion level for classes of transactions, account balances, and disclosures-** Risks of material misstatement at the assertion level are assessed in order to determine the nature, timing, and extent of further audit procedures necessary to obtain sufficient appropriate audit evidence.

#### Components of Risk of Material Misstatement:

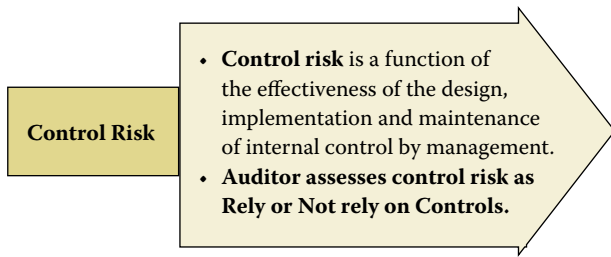
The risks of material misstatement at the assertion level consist of two components:

- (i) Inherent risk and
- (ii) Control risk.

$$\text{Risk of Material Misstatement} = \text{Inherent Risk} \times \text{Control Risk}$$

#### Inherent Risk

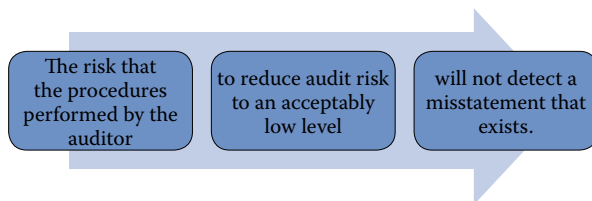
- Inherent risk is higher for some assertions and related classes of transactions, account balances, and disclosures than for others. For example, it may be higher for complex calculations.
- Inherent risk factors are considered while designing tests of controls and substantive procedures.



## Combined Assessment of the Risk of Material Misstatement:

$$\text{Audit Risk} = \text{Inherent Risk} \times \text{Control Risk} \times \text{Detection Risk}$$

### Detection Risk

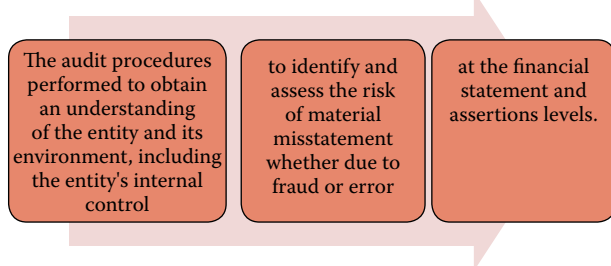


As per SA 315- "Identifying and Assessing the Risks of Material Misstatement through understanding the entity and its environment"

### Objective of the auditor

To identify and assess the risks of material misstatements, 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	thereby providing a basis for designing and implementing responses to the assessed risks of material misstatement
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### Risk Assessment Procedures



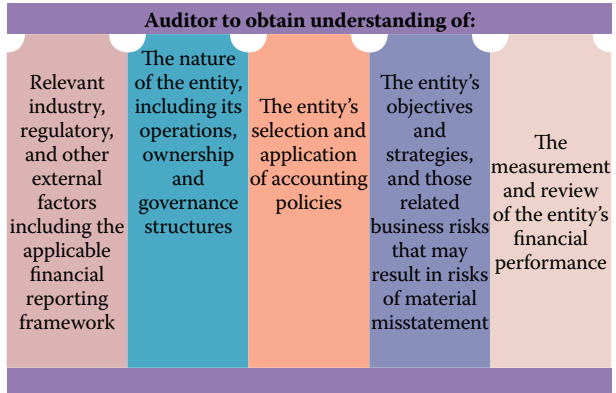
- ❖ Risk assessment procedure provides a basis for the identification and assessment of risks of material misstatement at the financial statement and assertion levels.
- ❖ Information obtained by performing risk assessment procedures may be used as audit evidence.
- ❖ The risks to be assessed include both those due to error and those due to fraud.

### What is included in Risk Assessment Procedures?

The risk assessment procedures shall include the following:

- Inquiries of management and of others within the entity.
- Analytical procedures.
- Observation and inspection.

## The Required Understanding of the Entity and Its Environment, Including the Entity's Internal Control:



## Internal Control:

- As per SA-315, the internal control may be defined as
- the process 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 regard to reliability of financial reporting, effectiveness and efficiency of operations, safeguarding of assets, and compliance with applicable laws and regulations.
- The term "controls" refers to any aspects of one or more of the components of internal control.

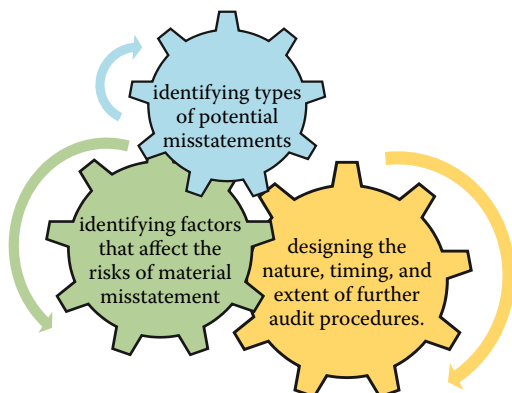
### Objectives of Internal Control:

- Transactions are executed in accordance with managements general or specific authorization
- All transactions are promptly recorded in the correct amount in the appropriate accounts and in the accounting period in which executed
- Assets are safeguarded from unauthorised access, use or disposition
- The recorded assets are compared with the existing assets at reasonable intervals.

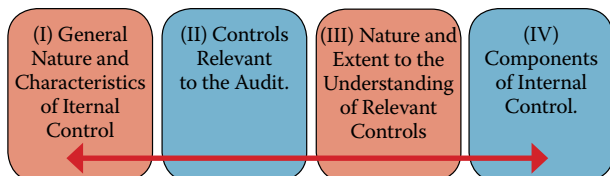
# AUDITING AND ASSURANCE

**The Entity's Internal Control:** The auditor shall obtain an understanding of internal control relevant to the audit. Although most controls relevant to the audit are likely to relate to financial reporting, not all controls that relate to financial reporting are relevant to the audit. It is a matter of the auditor's professional judgment whether a control is relevant to the audit.

**Benefits of Understanding of Internal Control:** An understanding of internal control assists the auditor in -

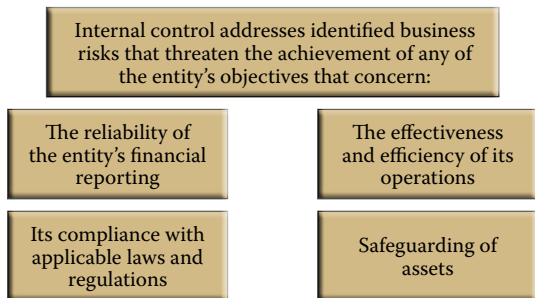


**Study of various aspects of Internal Control:**



## (I) General Nature and Characteristics of Internal Control

**Purpose of Internal Control:**



## Limitations of Internal Control

- Internal control can provide only reasonable assurance
- Human judgement in decision-making
- Lack of understanding the purpose
- Collusion among People
- Judgements by Management
- Limitations in case of Small Entities

## (II) Controls Relevant to the Audit

There is a direct relationship between an entity's objectives and the controls it implements to provide reasonable assurance about their achievement.

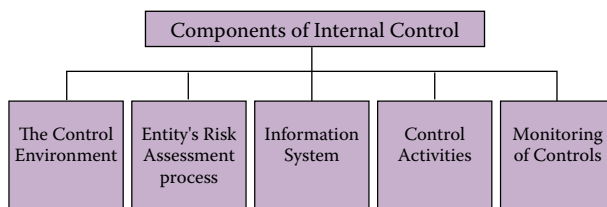
**Factors relevant to the auditor's judgment about whether a control, individually or in combination with others, is relevant to the audit may include such matters as the following:**

- Materiality.
- The significance of the related risk.
- The size of the entity.
- The nature of the entity's business.
- 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.
- Whether, and how, a specific control, individually or in combination with others, prevents, or detects and corrects, material misstatement.

## (III) Nature and Extent of the Understanding of Relevant Controls

- (i) Evaluating the design of a control involves considering whether the control is capable of effectively preventing, or detecting and correcting, material misstatements. 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.
- (ii) 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.
- (iii) Obtaining an understanding of an entity's controls is not sufficient to test their operating effectiveness.

## (IV) Components of Internal Control



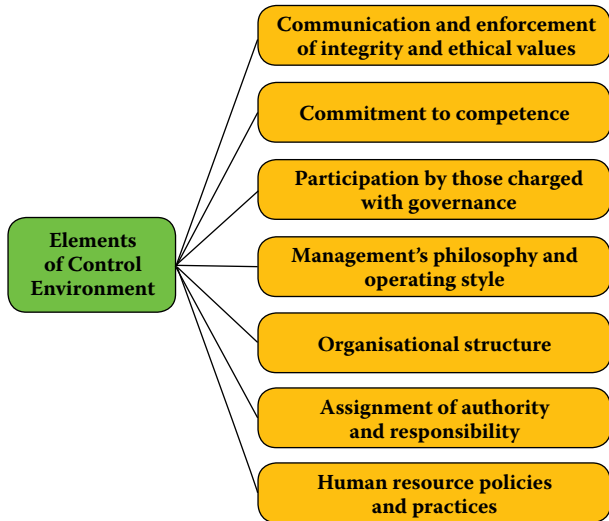
### A. Control Environment- Component of Internal Control

The auditor shall obtain an understanding of the control environment. As part of obtaining this understanding, the auditor shall evaluate whether:

- (i) Management has created and maintained a culture of honesty and ethical behavior; and
- (ii) The strengths in the control environment elements collectively provide an appropriate foundation for the other components of internal control.



## Elements of the Control Environment



## B. The Entity's Risk Assessment Process– Component of Control Environment

The auditor shall obtain an understanding of whether the entity has a process for:

- (a) Identifying business risks relevant to financial reporting objectives;
- (b) Estimating the significance of the risks;
- (c) Assessing the likelihood of their occurrence; and
- (d) Deciding about actions to address those risks.

## C. The information system, including the related business processes, relevant to financial reporting and communication–Component of Control Environment

The auditor shall obtain an understanding of the information system, including the related business processes, relevant to financial reporting, including the following areas:

(a) The classes of transactions in the entity's operations that are significant to the financial statements;

(b) The procedures by which those transactions are initiated, recorded, processed, corrected as necessary, transferred to the general ledger and reported in the financial statements;

(c) Backup records

(d) How the information system captures events and conditions that are significant to the financial statements;

(e) The financial reporting process used to prepare the entity's financial statements;

(f) Controls surrounding journal entries

**Communicating Financial Roles and Responsibilities– Obtaining an Understanding by the Auditor:** The auditor shall obtain an understanding of how the entity communicates financial reporting roles and responsibilities including:

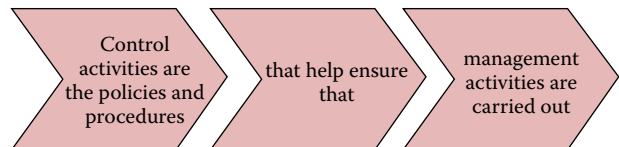
- |  |   |
|--|---|
| (a) Communications between management and those charged with governance; and | (b) External communications, such as those with regulatory authorities. |
|--|---|

The following points need consideration in this regard:

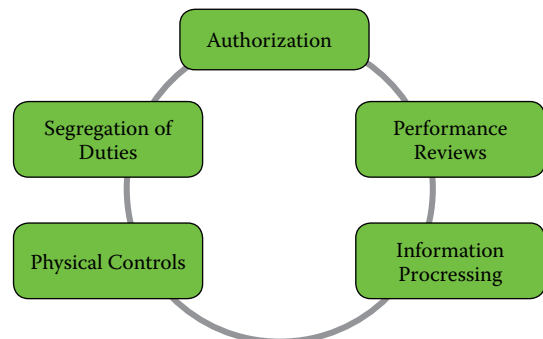
- (i) Understanding of Roles and Responsibilities
- (ii) Understanding regarding Relation of Activities
- (iii) Policy Manuals and Financial Reporting Manuals
- (iv) Open Communication Channels
- (v) Less structured and easier for Small Entities

## D. Control Activities– Component of Internal Control

The auditor shall obtain an understanding of control activities relevant to the audit, which the auditor considers necessary to assess the risks of material misstatement. An audit requires an understanding of **only those control activities** related to **significant class of transactions, account balance, and disclosure** in the financial statements and the assertions which the auditor finds relevant in his risk assessment process.



Examples of specific control activities include those relating to the following -



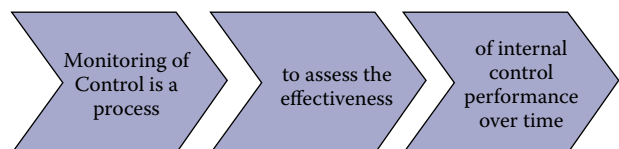
**Control activities that are relevant to the audit are:**

- Control activities that relate to significant risks and those that relate to risks for which substantive procedures alone do not provide sufficient appropriate audit evidence; or
- Those that are considered to be relevant in the judgment of the auditor;
- As part of the risk assessment, the auditor shall determine whether any of the risks identified are, in the auditor's judgment, a significant risk.

## E. Monitoring of Controls – Component of Internal Control

The auditor shall obtain an understanding of the major activities that the entity uses to monitor internal control over financial reporting.

1. Monitoring of Controls defined:



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2. Helps in assessing the effectiveness of controls on a timely basis
3. Management accomplishes monitoring of controls through ongoing activities, separate evaluations, or a combination of the two.
4. Management's monitoring activities may include using information from communications from external parties such as customer complaints and regulator comments that may indicate problems or highlight areas in need of improvement.
5. **In case of Small Entities:** Management's monitoring of control is often accomplished by management's or the owner-manager's close involvement in operations.

## Monitoring of Controls– If the entity has an internal audit function

If the entity has an internal audit function, the auditor shall obtain an understanding of the following :

- (a) The internal audit function's responsibilities and how the internal audit function fits in the entity's organisational structure; and
- (b) The activities performed, or to be performed, by the internal audit function.

## Evaluation of Internal Control by the Auditor:

The auditor should gain an understanding of the accounting system and related internal controls and should study and evaluate the operations of these internal controls upon which he wishes to rely in determining the nature, timing and extent of other audit procedures.

The review of internal controls will enable the auditor to know:

- (i) whether errors and frauds are likely to be located in the ordinary course of operations of the business;
- (ii) whether an adequate internal control system is in use and operating as planned by the management;
- (iii) whether an effective internal auditing department is operating;
- (iv) whether any administrative control has a bearing on his work;
- (v) whether the controls adequately safeguard the assets;

(vi) how far and how adequately the management is discharging its function in so far as correct recording of transactions is concerned;

(vii) how reliable the reports, records and the certificates to the management can be;

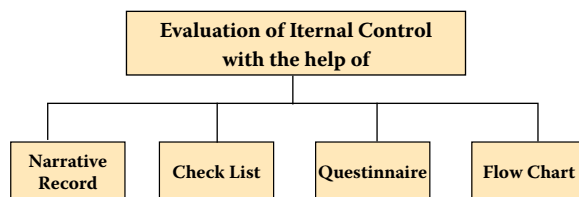
(viii) the extent and the depth of the examination that he needs to carry out in the different areas of accounting;

(ix) what would be appropriate audit technique and the audit procedure in the given circumstances;

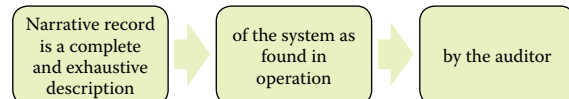
(x) what are the areas where control is weak and where it is excessive; and

(xi) whether some worthwhile suggestions can be given to improve the control system.

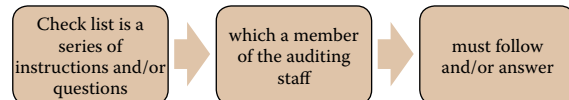
## Evaluation of Internal Control– Methods



### Narrative Record



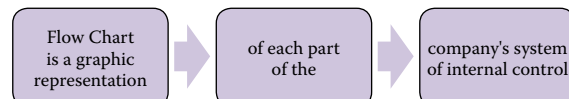
### Check List



### Internal Control Questionnaire

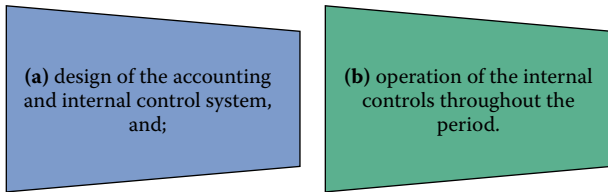
This is a comprehensive series of questions concerning internal control. This is the most widely used form for collecting information about the existence, operation and efficiency of internal control in an organisation.

### Flow Chart



## Testing of Internal Control:

Test of controls are performed to obtain audit evidence about the effectiveness of the:



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 or over the overall information technology function.

For example, the procedure for sales requires the following:

1. Before acceptance of any order the position of inventory of the relevant article should be known to ascertain whether the order can be executed in time.

2. An advice under the authorisation of the sales manager should be sent to the party placing the order, internal reference number, and the acceptance of the order. This advice should be prepared on a standardised form and copy thereof should be forwarded to inventory section to enable it to prepare for the execution of the order in time.

3. The credit period allowed to the party should be the normal credit period. For any special credit period a special authorisation of the sales manager would be necessary.

4. The rate at which the order has been accepted and other terms about transport, insurance, etc., should be clearly specified.

5. Before deciding upon the credit period, a reference should be made to the credit section to know the creditworthiness of the party and particularly whether the party has honoured its commitments in the past.

## Internal Control and IT Environment:

An entity's system of internal control contains manual elements and often contains automated elements. The characteristics of manual or automated elements relevant to the auditor's risk assessment and further audit procedures are explained hereunder-

(i) **Controls in Manual and IT System:** The use of manual or automated elements in internal control affects the manner in which transactions are initiated, recorded, processed, and reported:

- (1) Controls in a manual system may include such procedures as approvals and reviews of transactions, and reconciliations and follow-up of reconciling items. Alternatively, an entity may use automated procedures to initiate, record, process, and report transactions, in which case records in electronic format replace paper documents.
- (2) Controls in IT systems consist of a combination of automated controls (for example, controls embedded in computer programs and manual controls.)

(ii) **Use of IT:** An entity's mix of manual and automated elements in internal control varies with the nature and complexity of the entity's use of IT.

(iii) **Generally, IT benefits an entity's internal control by enabling an entity to:**

Processing of large volumes of transactions or data becomes simple:

Enhance the timeliness, availability, and accuracy of information;

Facilitate the additional analysis of information;

Enhance the ability to monitor the performance of the entity's activities and its policies and procedures;

Reduce the risk that controls will be circumvented; and

Effective segregation of duties through security controls.

(iv) **IT also poses specific risks to an entity's internal control, including, for example:**

- Reliance on systems or programs that are inaccurately processing data, processing inaccurate data, or both.
- Unauthorised access to data that may result in destruction of data or improper changes to data.
- The possibility of IT personnel gaining access privileges beyond those necessary to perform their assigned duties thereby breaking down segregation of duties.
- Unauthorised changes to data in master files.
- Unauthorised changes to systems or programs.
- Failure to make necessary changes to systems or programs.
- Inappropriate manual intervention.
- Potential loss of data or inability to access data as required.

(v) **Suitability:** Manual elements in internal control may be more suitable where judgment and discretion are required.

# AUDITING AND ASSURANCE ||

**(vi) Reliability:** Manual elements in internal control may be less reliable than automated elements because they can be more easily bypassed, ignored, or overridden.

**(vii) Nature of Entity's Information System:** The extent and nature of the risks to internal control vary depending on the nature and characteristics of the entity's information system. The entity responds to the risks arising from the use of IT or from use of manual elements in internal control by establishing effective controls in light of the characteristics of the entity's information system.

## Materiality and Audit Risk:

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

❖ Audit risk is a function of the risks of material misstatement and detection risk.

Materiality and audit risk are considered throughout the audit, in particular, when:

<b>(a)</b> Identifying and assessing the risks of material misstatement;	<b>(b)</b> Determining the nature, timing and extent of further audit procedures; and	<b>(c)</b> Evaluating the effect of uncorrected misstatements, if any, on the financial statements and in forming the opinion in the auditor's report.
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## Documenting the Risk:

### The auditor shall document:

<b>(a)</b> The discussion among the engagement team and the significant decisions reached;	<b>(b)</b> Key elements of the understanding obtained regarding each of the aspects of the entity and its environment and of each of the internal control components;	<b>(c)</b> The identified and assessed risks of material misstatement at the financial statement level and at the assertion level; and	<b>(d)</b> The risks identified, and related controls about which the auditor has obtained an understanding.
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## Internal Audit:

An independent management function

which involves a continuous and critical appraisal

of the functioning of an entity with a view to suggest improvements thereto

and add value to and strengthen the overall governance mechanism of the entity

including the entity's strategic risk management and internal control system

## Applicability of Provisions of Internal Audit

As per section 138 of the Companies Act, 2013 the following class of companies (prescribed in rule 13 of Companies (Accounts) Rules, 2014) shall be required to appoint an internal auditor or a firm of internal auditors, namely-

**(a)** every listed company;

**(b)** every unlisted public company having-

<b>(i)</b> paid up share capital of fifty crore rupees or more during the preceding financial year; or	<b>(ii)</b> turnover of two hundred crore rupees or more during the preceding financial year; or	<b>(iii)</b> outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year; or	<b>(iv)</b> outstanding deposits of twenty five crore rupees or more at any point of time during the preceding financial year; and
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**(c)** every private company having-

<b>(i)</b> turnover of two hundred crore rupees or more during the preceding financial year; or	<b>(ii)</b> outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year.
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It is provided that an existing company covered under any of the above criteria shall comply with the requirements within six months of commencement of such section.

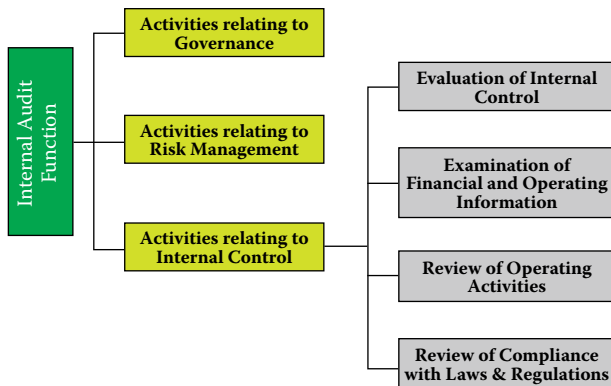
## Who can be appointed as Internal Auditor?

As per section 138, the internal auditor shall either be a chartered accountant or a cost accountant (whether engaged in practice or not), or such other professional as may be decided by the Board to conduct internal audit of the functions and activities of the companies. The internal auditor may or may not be an employee of the company.

## The objectives and scope of internal audit function

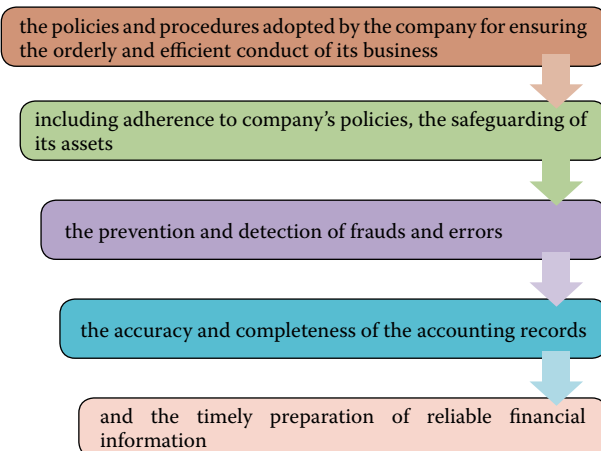
As per SA-610, "Using the Work of an Internal Auditor", the objectives of internal audit functions vary widely and depend on the size and structure of the entity and the requirements of management and, where applicable, those charged with governance.

The objectives and scope of internal audit functions typically include assurance and consulting activities designed to evaluate and improve the effectiveness of the entity's governance processes, risk management and internal control such as the following:



## Basics of Internal Financial Control and Reporting Requirements:

Clause (e) of Sub-section 5 of Section 134 explains the meaning of internal financial controls as,



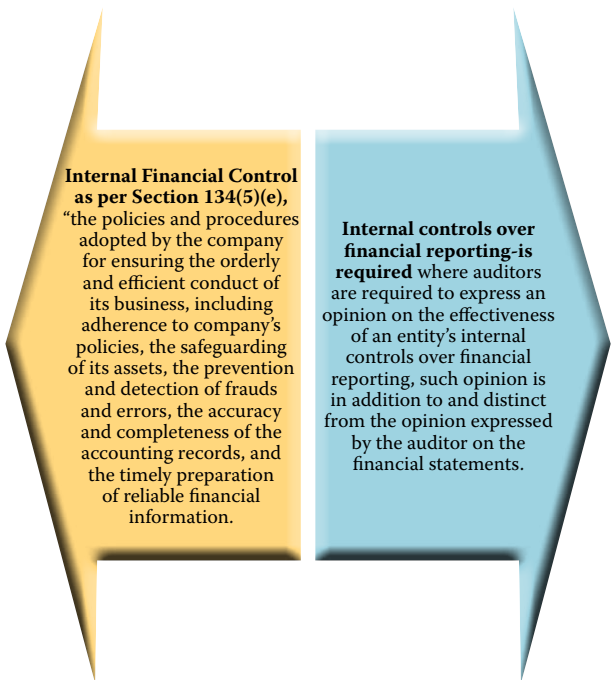
## Auditors' Responsibility for Reporting on Internal Financial Controls over Financial Reporting in India

Clause (i) of Sub-section 3 of Section 143 of the Act requires the auditors' report to state whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls.

**Objective of an auditor in an audit of internal financial controls over financial reporting is to express an opinion on the effectiveness of the company's internal financial controls over financial reporting. It is carried out along with an audit of the financial statements.**

**Rule 8(5)(viii) of the Companies (Accounts) Rules, 2014** requires the board report of all companies to state the details in respect of adequacy of internal financial controls with reference to the financial statements.

## Difference between Internal Financial Control and Internal Control over Financial Reporting:



*The best executive is one who has sense enough to pick good people to do what he wants done, and self-restraint enough to keep from meddling with them while they do it*

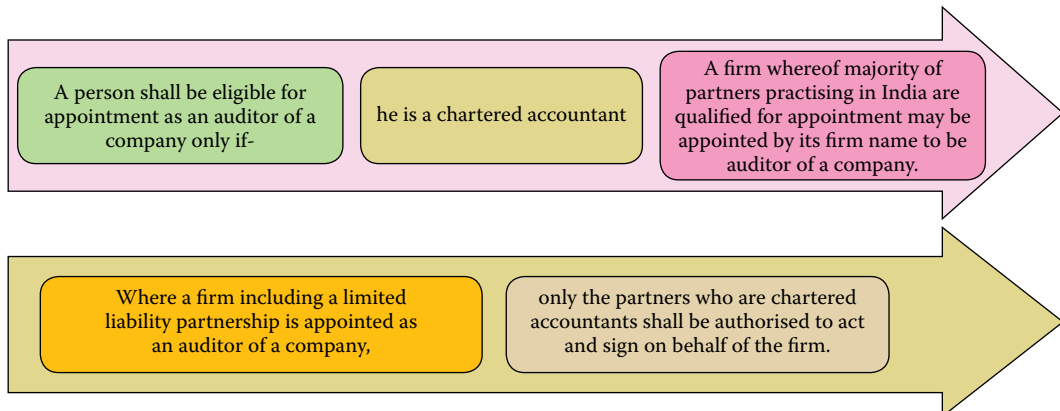
— Theodore Roosevelt

This Capsule on Paper 6: Auditing & Assurance at Intermediate Level covers selected Topics of Chapter 10-Company Audit and this should not be taken as a substitute for the detailed study of the Chapter. Students are advised to refer to the relevant Study Material, MCQs & Case Scenarios Booklet and RTP for comprehensive study & revision.

### CHAPTER 10 - COMPANY AUDIT

#### Eligibility, Qualifications and Disqualifications of an Auditor: Section 141 of the Companies Act, 2013

##### Eligibility and Qualifications of an Auditor



##### DISQUALIFICATIONS OF AN AUDITOR:

Under sub-section (3) of section 141 along with Rule 10 of the Companies (Audit and Auditors) Rules, 2014 (CAAR), **the following persons shall not be eligible for appointment as an auditor of a company, namely-**

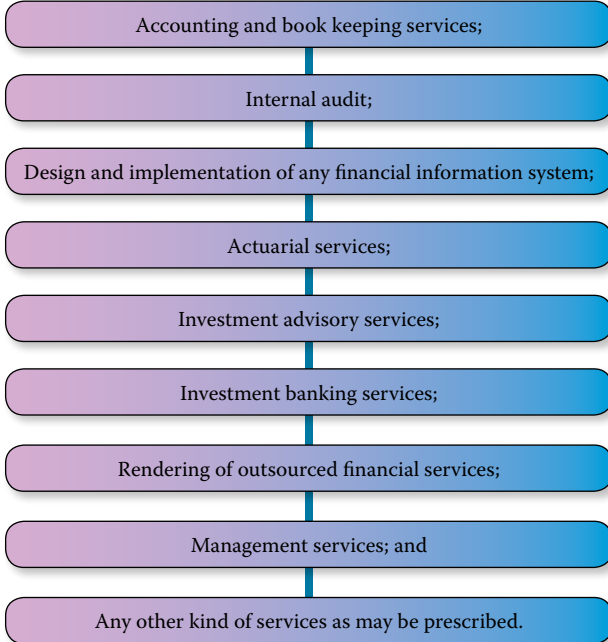
- (a) a body corporate other than a limited liability partnership registered under the Limited Liability Partnership Act, 2008;
- (b) an officer or employee of the company;
- (c) a person who is a partner, or who is in the employment, of an officer or employee of the company;
- (d)
  - a person who, or his relative or partner -
    - (i) is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company; \*
    - (ii) is indebted to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of ₹5,00,000; or
    - (iii) has given a guarantee or provided any security in connection with the indebtedness of any third person to the company or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of ₹1,00,000.

\*The relative may hold security or interest in the company of face value not exceeding ₹1,00,000.  
In the event of acquiring any security or interest by a relative, above the threshold prescribed, the corrective action to maintain the limits as specified shall be taken by the auditor within 60 days of such acquisition or interest.

- (e)
  - a person or a firm who, whether directly or indirectly
    - has business relationship with
      - the company, or its subsidiary, or its holding or associate company or subsidiary of such holding company or associate company, of such nature as may be prescribed.
- (f)
  - a person
    - whose relative
      - is a Director or is in the employment of the company as a director or key Managerial Personnel.
- (g) a person who is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such person or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies other than one person companies, dormant companies, small companies and private companies having paid-up share capital less than ₹100 crore.

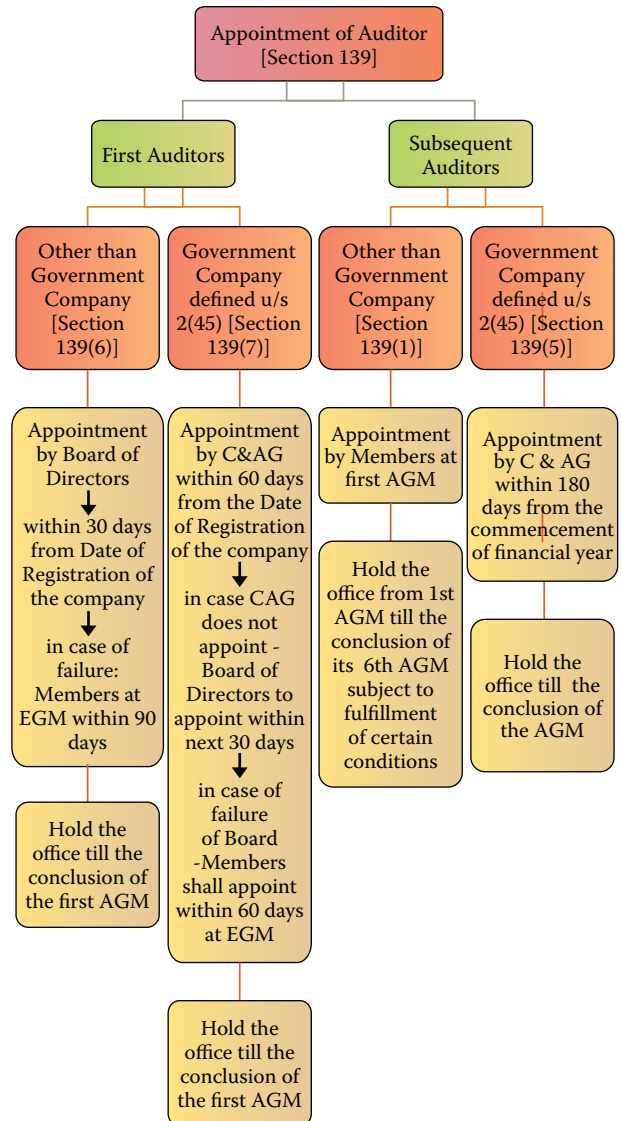
- (h) a person who has been convicted by a Court of an offence involving fraud and a period of ten years has not elapsed from the date of such conviction.
- (i) a person who, directly or indirectly, renders any service referred to in section 144 to the company or its holding company or its subsidiary company.

## CERTAIN SERVICES NOT TO BE RENDERED BY THE AUDITOR AS PER SECTION 144 OF THE COMPANIES ACT, 2013

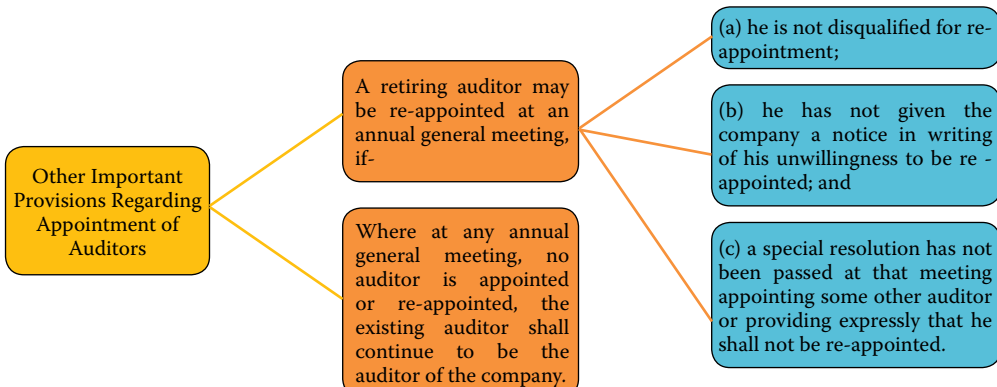


Where a person appointed as an auditor of a company incurs any of the disqualifications mentioned in **sub-section (3) of Section 141** after his appointment, he shall vacate his office as such auditor and such vacation shall be deemed to be a casual vacancy in the office of the auditor.

## SECTION 139: APPOINTMENT OF AUDITORS



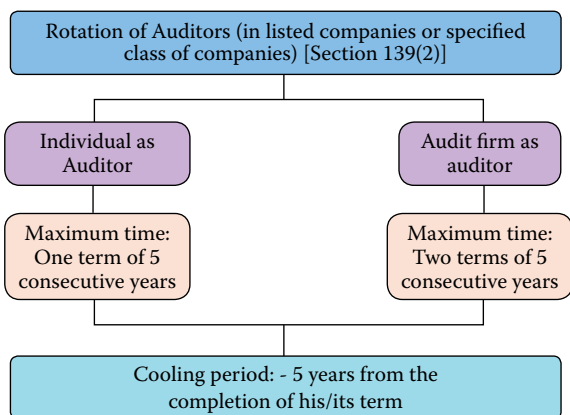
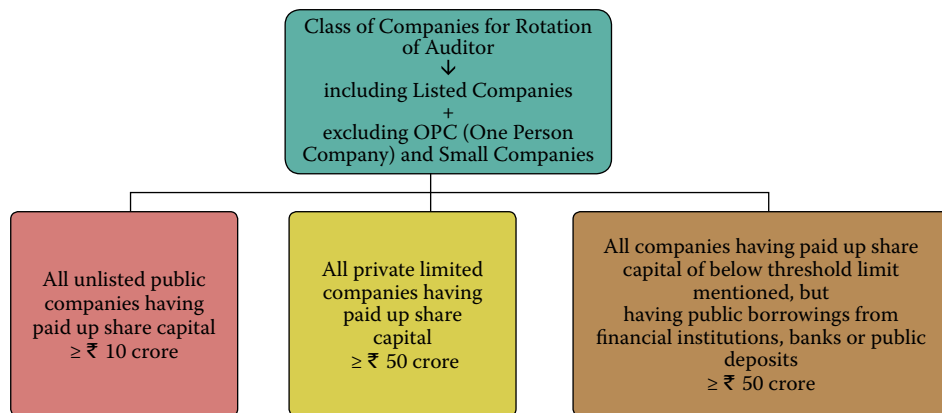
## OTHER IMPORTANT PROVISIONS REGARDING APPOINTMENT OF AUDITORS



# AUDITING AND ASSURANCE

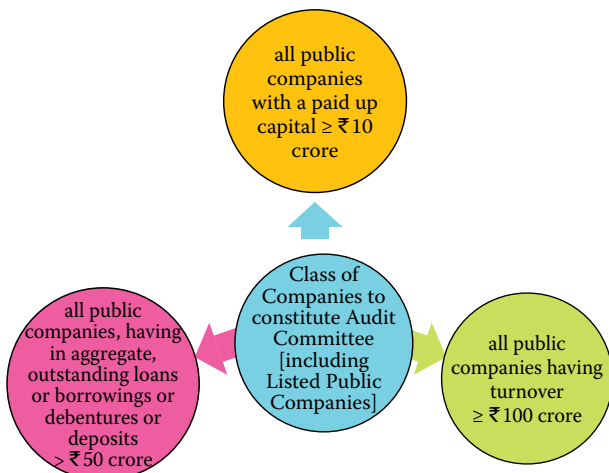
## ROTATION OF AUDITOR

**Applicability of Section 139(2)-Rotation of Auditor:**

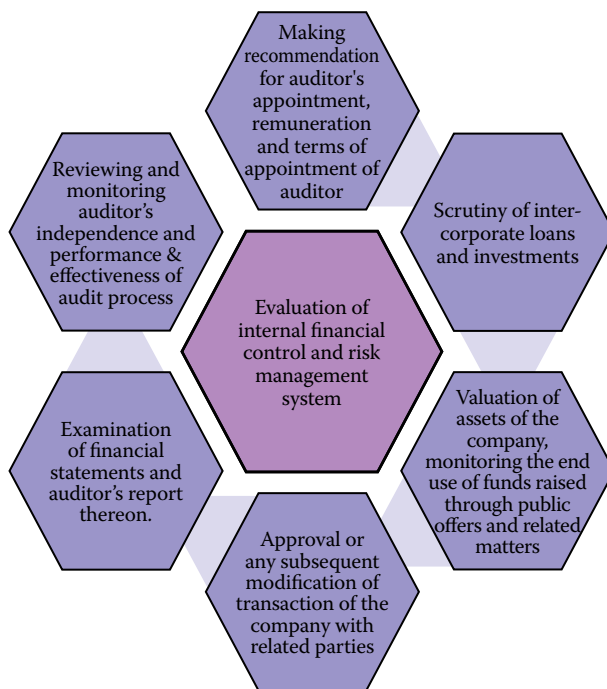


Further, as on the date of appointment, no audit firm which has common partner/s to the other audit firms whose tenure has expired in a company immediately preceding the Financial Year, shall be appointed as auditor of the same Company for a period of 5 years.

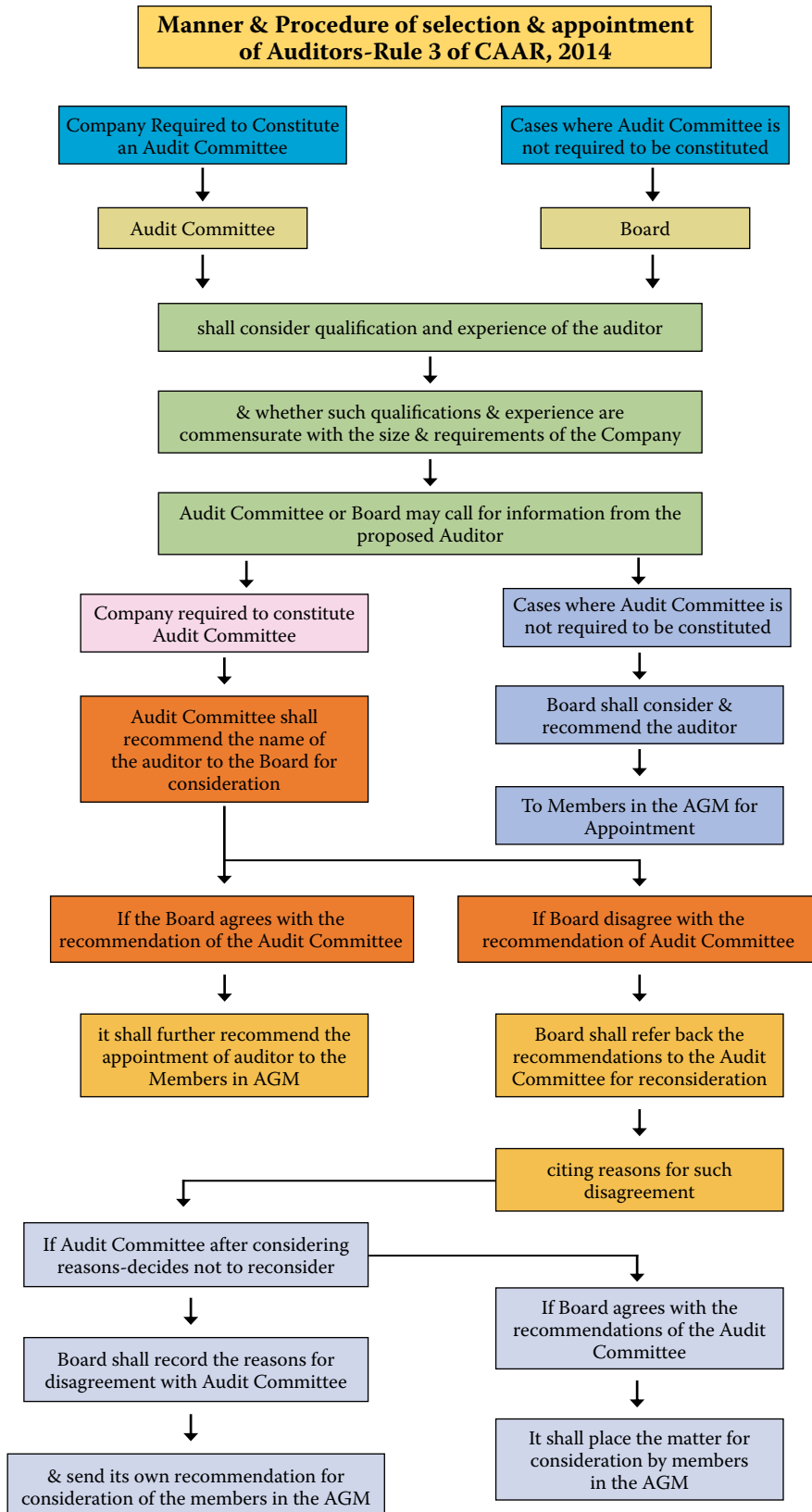
## APPLICABILITY OF SECTION 177 CONSTITUTION OF AUDIT COMMITTEE



## FUNCTIONS OF AUDIT COMMITTEE

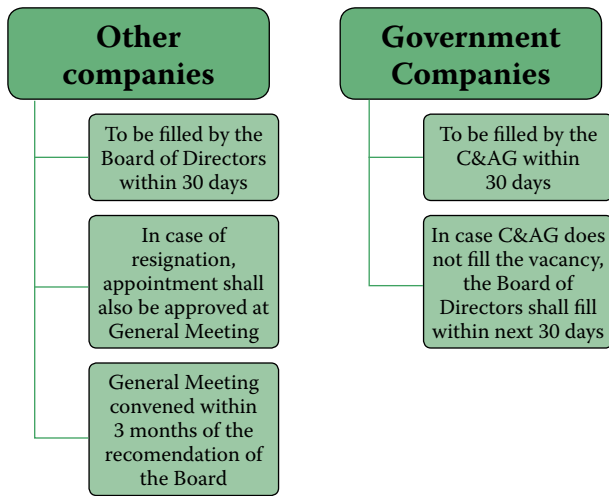




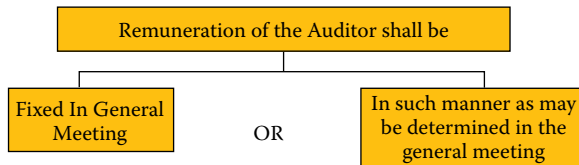


# AUDITING AND ASSURANCE

## FILLING OF CASUAL VACANCY {SECTION 139(8)}



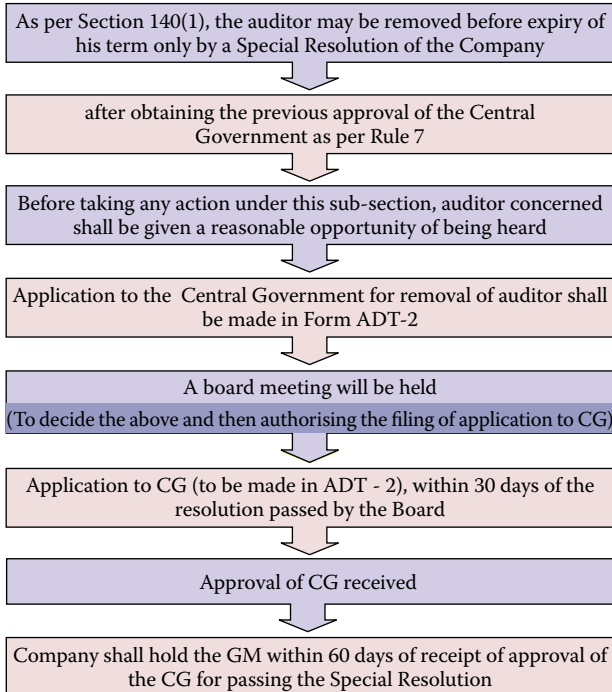
### Auditor's Remuneration Section 142



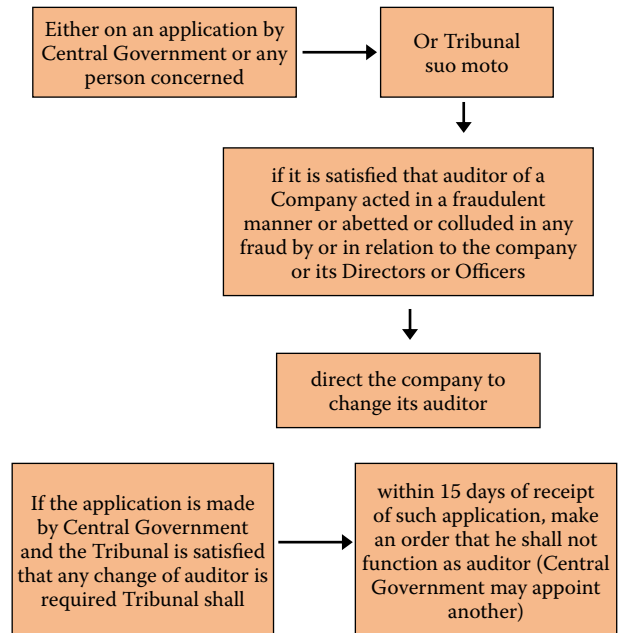
Note: Board may fix remuneration of the First Auditor appointed by it.

## Section 140: Removal, Resignation of auditor and giving of special notice

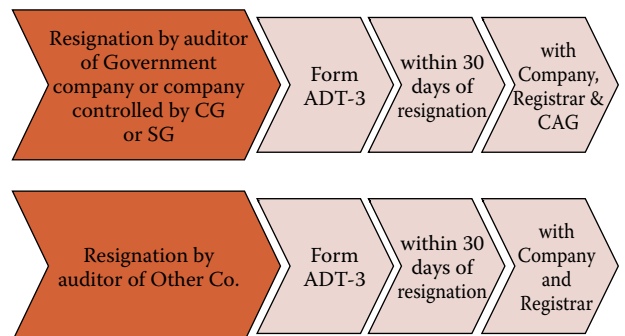
### Removal of Auditor before expiry of term: Section 140(1)



### Direction by Tribunal in case Auditor acted in a Fraudulent Manner under section 140(5)

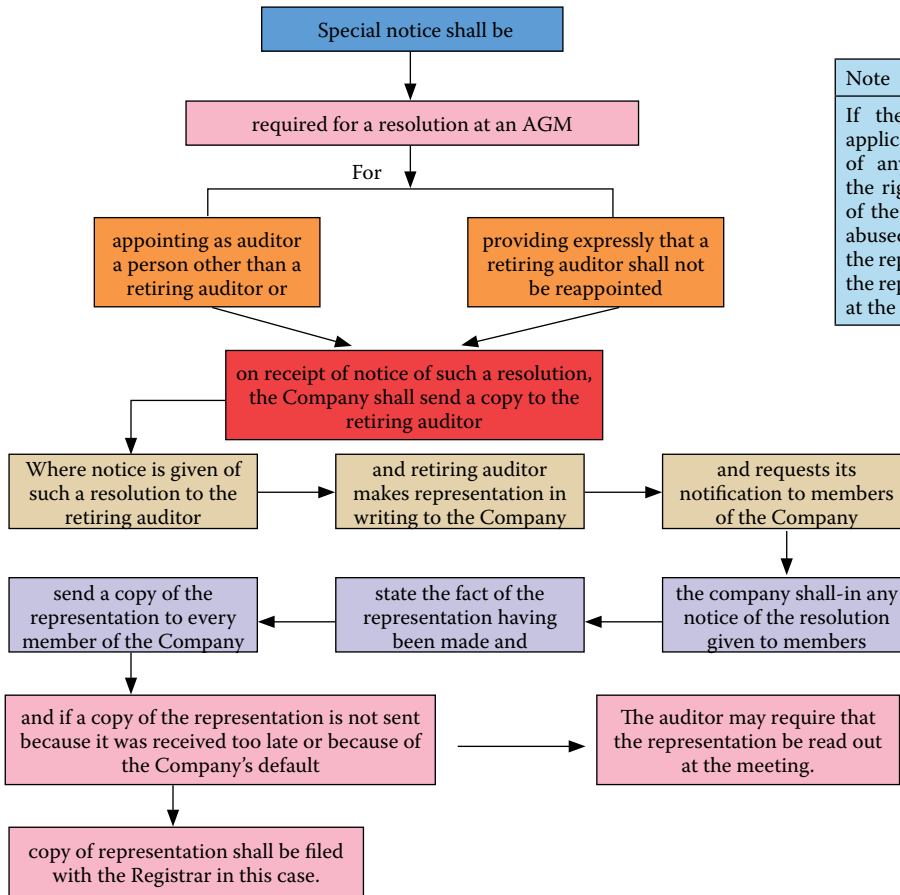


## RESPONSIBILITY OF AUDITOR TO COMMUNICATE IN CASE OF CASUAL VACANCY BY RESIGNATION OF AUDITOR {SECTION 140 (2)}



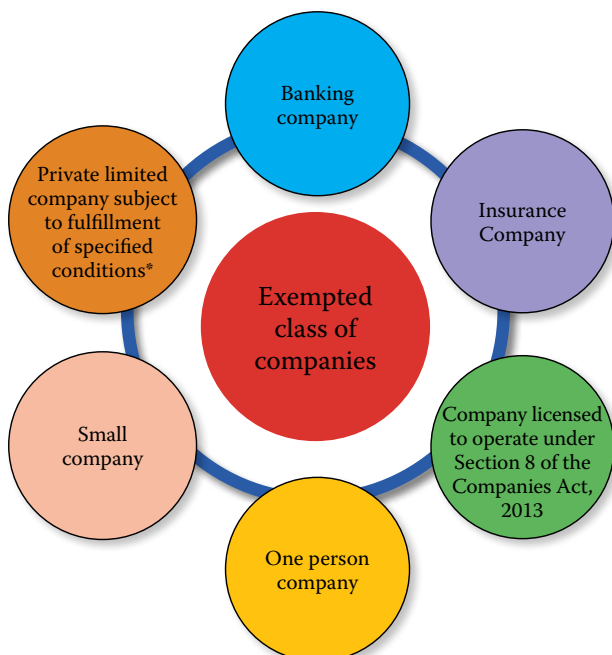
• In case of failure, the auditor shall be liable to a penalty of fifty thousand rupees or the remuneration of the auditor, whichever is less, and in case of continuing failure, with further penalty of five hundred rupees for each day after the first during which such failure continues, subject to a maximum of Two lakh rupees as per section 140(3).

## Appointment of Auditor other than Retiring Auditor Section 140(4)



**Note**  
If the Tribunal is satisfied on an application either of the company or of any other aggrieved person that the rights conferred by section 140(4) of the Companies Act, 2013 are being abused by the auditor, then, the copy of the representation may not be sent, and the representation need not be read out at the meeting.

## Reporting under Companies (Auditor's Report) Order, 2020



\*a private limited company, not being a subsidiary or holding company of a public company, having a paid up capital and reserves and surplus not more than one crore rupees as on the balance sheet date and which does not have total borrowings exceeding one crore rupees from any bank or financial institution at any point of time during the financial year and which does not have a total revenue as disclosed in Scheduled III to the Companies Act (including revenue from discontinuing operations) exceeding ten crore rupees during the financial year as per the financial statements.

### Paragraph 3: Matters to be included in auditor's report under CARO 2020:

Auditor's Report (under CARO 2020) shall include a statement on the following matters:

(i)(a)



(A) whether the company is maintaining proper records showing full particulars, including quantitative details and situation of Property, Plant and Equipment;



(B) whether the company is maintaining proper records showing full particulars of intangible assets

# AUDITING AND ASSURANCE

(b) whether these Property, Plant and Equipment have been-

physically verified by the management at reasonable intervals.

whether any material discrepancies were noticed on such verification and if so,

whether the same have been properly dealt with in the books of account.

(c) whether the title deeds of all the immovable properties disclosed in the financial statements are held in the name of the company. If not, provide the details thereof in the format below:-

Description of property	Gross carrying value	Held in name of	Whether promoter, director or their relative or employee	Period held – indicate range, where appropriate	Reason for not being held in name of company*
-	-	-	-	-	*also indicate if in dispute

(d) whether the company has revalued its Property, Plant and Equipment (including Right of Use assets) or intangible assets or both during the year and, if so,

whether the revaluation is based on the valuation by a Registered Valuer;

specify the amount of change, if change is 10% or more in the aggregate of the net carrying value of each class of Property, Plant and Equipment or intangible assets.

(e) whether any proceedings have been initiated or are pending against the company for holding any benami property.

if so, whether the company has appropriately disclosed the details in its financial statements.

(ii)

(a) whether physical verification of inventory has been conducted at reasonable intervals by the management and whether, in the opinion of the auditor, the coverage and procedure of such verification by the management is appropriate; whether any discrepancies of 10% or more in the aggregate for each class of inventory were noticed and if so, whether they have been properly dealt with in the books of account;

(b) whether during any point of time of the year, the company has been sanctioned working capital limits in excess of five crore rupees, in aggregate, from banks or financial institutions on the basis of security of current assets; whether the quarterly returns or statements filed by the company with such banks or financial institutions are in agreement with the books of account of the Company, if not, give details.

(iii) whether during the year the company has made investments in, provided any guarantee or security or granted any loans or advances in the nature of loans, secured or unsecured, to companies, firms, Limited Liability Partnerships or any other parties, if so,-

(a) whether during the year the company has provided loans or provided advances in the nature of loans, or stood guarantee, or provided security to any other entity [not applicable to companies whose principal business is to give loans], if so, indicate-

(A) the aggregate amount during the year, and balance outstanding at the balance sheet date with respect to such loans or advances and guarantees or security to subsidiaries, joint ventures and associates;

(B) the aggregate amount during the year, and balance outstanding at the balance sheet date with respect to such loans or advances and guarantees or security to parties other than subsidiaries, joint ventures and associates;

(b)

whether the investments made, guarantees provided, security given and

the terms and conditions of the grant of all loans and advances in the nature of loans and guarantees provided

are not prejudicial to the company's interest;

(c)

in respect of loans and advances in the nature of loans,

whether the schedule of repayment of principal and payment of interest

has been stipulated and whether the repayments or receipts are regular;

(d)

if the amount is overdue,

state the total amount overdue for more than ninety days,

and whether reasonable steps have been taken by the company for recovery of the principal and interest;

(e)

whether any loan or advance in the nature of loan granted which has fallen due during the year,

has been renewed or extended or fresh loans granted to settle the overdues of existing loans given to the same parties, if so,

specify the aggregate amount of such dues renewed or extended or settled by fresh loans and

the percentage of the aggregate to the total loans or advances in the nature of loans granted during the year [not applicable to companies whose principal business is to give loans];

(f)

whether the company has granted any loans or advances in the nature of loans

either repayable on demand or without specifying any terms or period of repayment, if so,

specify the aggregate amount, percentage thereof to the total loans granted, aggregate amount of loans granted to promoters, related parties as defined in clause (76) of section 2 of the Companies Act, 2013.

(iv) in respect of loans, investments, guarantees, and security, whether provisions of sections 185 and 186 of the Companies Act have been complied with, if not, provide the details thereof.

(v) in respect of deposits accepted by the company or amounts which are deemed to be deposits, whether the directives issued by the Reserve Bank of India and the provisions of sections 73 to 76 or any other relevant provisions of the Companies Act and the rules made thereunder, where applicable, have been complied with, if not, the nature of such contraventions be stated; if an order has been passed by Company Law Board or National Company Law Tribunal or Reserve Bank of India or any court or any other tribunal, whether the same has been complied with or not.

(vi) whether maintenance of cost records has been specified by the Central Government under sub-section (1) of section 148 of the Companies Act and whether such accounts and records have been so made and maintained.

(vii)

(a) whether the company is regular in depositing undisputed statutory dues including Goods and Services Tax, provident fund, employees' state insurance, income tax, sales-tax, service tax, duty of customs, duty of excise, value added tax, cess and any other statutory dues to the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as on the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated;

(b) where statutory dues referred to in sub-clause (a) have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned (a mere representation to the concerned Department shall not be treated as a dispute).

(viii) whether any transactions not recorded in the books of account have been surrendered or disclosed as income during the year in the tax assessments under the Income Tax Act, 1961 if so, whether the previously unrecorded income has been properly recorded in the books of account during the year.

(ix) (a) Whether the company has defaulted in repayment of loans or other borrowings or in the payment of interest thereon to any lender, if yes, the period and the amount of default to be reported as per the format below:-

Nature of borrowing, including debt securities	Name of lender	Amount not paid on due date	Whether principal or interest	No. of days delay or unpaid	Remarks, if any
	lender wise details to be provided in case of defaults to banks, financial institutions and Government.				

(b) whether the company is a declared wilful defaulter by any bank or financial institution or other lender;

(c) whether term loans were applied for the purpose for which the loans were obtained; **if not, the amount of loan so diverted and the purpose for which it is used may be reported;**

(d) whether funds raised on short term basis have been utilised for long term purposes, **if yes, the nature and amount to be indicated;**

(e) whether the company has taken any funds from any entity or person on account of or to meet the obligations of its subsidiaries, associates or joint ventures, **if so, details thereof with nature of such transactions and the amount in each case;**

(f) whether the company has raised loans during the year on the pledge of securities held in its subsidiaries, joint ventures or associate companies, **if so, give details thereof and also report if the company has defaulted in repayment of such loans raised.**

(x)

(a) whether money raised by way of initial public offer or further public offer (including debt instruments) during the year were applied for the purposes for which those are raised, if not, the details together with delays or default and subsequent rectification, if any, as may be applicable, be reported;

(b) whether the company has made any preferential allotment or private placement of shares or convertible debentures (fully, partially or optionally convertible) during the year and **if so, whether the requirements of section 42 and section 62 of the Companies Act, 2013 have been complied with and the funds raised have been used for the purposes for which the funds were raised, if not, provide details in respect of amount involved and nature of non-compliance.**

(xi)

(a) whether any fraud by the company or any fraud on the company has been noticed or reported during the year, if yes, the nature and the amount involved is to be indicated;

(b) whether any report under sub-section (12) of section 143 of the Companies Act has been filed by the auditors in Form ADT-4 as prescribed under rule 13 of Companies (Audit and Auditors) Rules, 2014 with the Central Government;

(c) whether the auditor has considered whistleblower complaints, if any, received during the year by the company.

(xii) (a) whether the Nidhi Company has complied with the Net Owned Funds to Deposits in the ratio of 1:20 to meet out the liability;

(b) whether the Nidhi Company is maintaining ten percent unencumbered term deposits as specified in the Nidhi Rules, 2014 to meet out the liability;

(c) whether there has been any default in payment of interest on deposits or repayment thereof for any period and if so, the details thereof.

(xiii) whether all transactions with the related parties are in compliance with sections 177 and 188 of Companies Act, where applicable and the details have been disclosed in the financial statements, etc., as required by the applicable accounting standards.

(xiv)

(a) whether the company has an internal audit system commensurate with the size and nature of its business;

(b) whether the reports of the Internal Auditors for the period under audit were considered by the statutory auditor.

## AUDITING AND ASSURANCE ||

(xv) whether the company has entered into any non-cash transactions with directors or persons connected with him and if so, whether the provisions of section 192 of Companies Act have been complied with.

(xvi)

(a) whether the company is required to be registered under section 45-1A of the Reserve Bank of India Act, 1934 and if so, whether the registration has been obtained;

(b) whether the company has conducted any Non-Banking Financial or Housing Finance activities without a valid Certificate of Registration (CoR) from the Reserve Bank of India as per the Reserve Bank of India Act, 1934;

(c) whether the company is a Core Investment Company (CIC) as defined in the regulations made by the Reserve Bank of India, if so, whether it continues to fulfil the criteria of a CIC, and in case the company is an exempted or unregistered CIC, whether it continues to fulfil such criteria;

(d) whether the Group has more than one CIC as part of the Group, if yes, indicate the number of CICs which are part of the Group.

(xvii) whether the company has incurred cash losses in the financial year and in the immediately preceding financial year, if so, state the amount of cash losses.

(xviii) whether there has been any resignation of the statutory auditors during the year, if so, whether the auditor has taken into consideration the issues, objections or concerns raised by the outgoing auditors.

(xix) on the basis of the financial ratios, ageing and expected dates of realisation of financial assets and payment of financial liabilities, other information accompanying the financial statements, the auditor's knowledge of the Board of Directors and management plans, whether the auditor is of the opinion that no material uncertainty exists as on the date of the audit report that company is capable of meeting its liabilities existing at the date of balance sheet as and when they fall due within a period of one year from the balance sheet date.

(xx)

(a) whether, in respect of other than ongoing projects, the company has transferred unspent amount to a Fund specified in Schedule VII to the Companies Act within a period of six months of the expiry of the financial year in compliance with second proviso to sub-section (5) of section 135 of the said Act;

(b) whether any amount remaining unspent under subsection (5) of section 135 of the Companies Act, pursuant to any ongoing project, has been transferred to special account in compliance with the provision of subsection (6) of section 135 of the said Act.

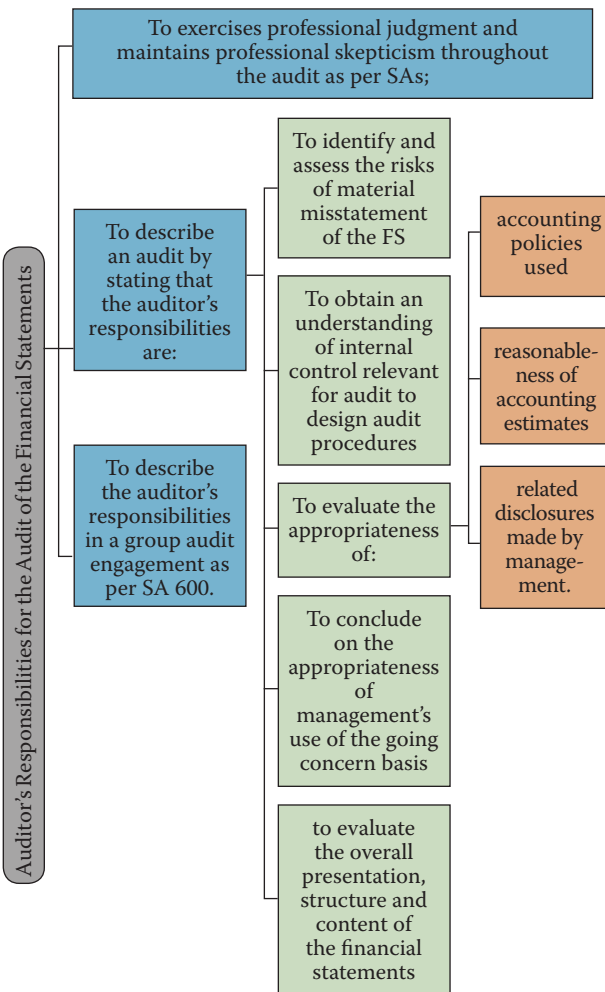
(xxi) whether there have been any qualifications or adverse remarks by the respective auditors in the Companies (Auditor's Report) Order (CARO) reports of the companies included in the consolidated financial statements, if yes, indicate the details of the companies and the paragraph numbers of the CARO report containing the qualifications or adverse remarks.

## AUDIT REPORT

<p><b>The Auditor's Report on Financial Statements</b></p> <p>The SA 700 series is purely dedicated to the auditor report to be issued by the auditor. Here, we are discussing SA 700, SA 701, SA 705 and SA 706</p>		<p>The diagram shows a green arrow pointing from a box labeled 'Results' to a box labeled 'Audit Report'. There are two black circles with green plus signs on either side of the 'Results' box.</p>
<b>SA-700</b>	<b>Forming an Opinion and Reporting on Financial Statements</b>	
<b>Objective</b>	<ul style="list-style-type: none"> <li>Forming opinion on the financial statements.</li> <li>Form and content of the audit report.</li> </ul>	
<p><b>Basic Elements of the Auditor's Report:</b> The auditor's report includes the following basic elements, which ordinarily includes in case of Auditors' Report for Audits Conducted in Accordance with Standards on Auditing:</p>		
<b>1. Title</b>		
<b>2. Addressee</b>	shall be addressed as required by the circumstances of the engagement	
<b>3. Auditor's Opinion:</b>	<p>The first section of the auditor's report shall include the auditor's opinion, and shall have the heading "Opinion."</p> <p><b>The Opinion section of the auditor's report shall also:</b></p> <ul style="list-style-type: none"> <li>(a) Identify the entity whose financial statements have been audited;</li> <li>(b) State that the financial statements have been audited;</li> <li>(c) Identify the title of each statement comprising the financial statements;</li> <li>(d) Refer to the notes, including the summary of significant accounting policies; and</li> <li>(e) Specify the date of, or period covered by, each financial statement comprising the financial statements.</li> </ul> <p>If the reference to the applicable financial reporting framework in the auditor's opinion is not to Accounting Standards, the auditor's opinion shall identify the origin of such other framework.</p>	
<b>4. Basis for Opinion:</b>	<p>The auditor's report shall include a section, directly following the Opinion section, with the heading "Basis for Opinion", that:</p> <ul style="list-style-type: none"> <li>(a) States that the audit was conducted in accordance with Standards on Auditing;</li> <li>(b) Refers to the section of the auditor's report that describes the auditor's responsibilities under the SAs;</li> <li>(c) Includes a statement that the auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit, and has fulfilled the auditor's other ethical responsibilities in accordance with these requirements. The statement shall refer to the Code of Ethics issued by ICAI</li> </ul>	

	(d) States whether the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's opinion. ;
<b>5. Going Concern:</b>	Where applicable, the auditor shall report in accordance with SA 570.
<b>6. Key Audit Matters</b>	For audits of complete sets of general purpose financial statements of listed entities, the auditor shall communicate key audit matters in the auditor's report in accordance with SA 701.
<b>7. Responsibilities for the Financial Statements:</b>	
<p><b>This section of the auditor's report shall describe management's responsibility for:</b></p>	
(a) Preparing the financial statements in accordance with the applicable financial reporting framework, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and	(b) Assessing the entity's ability to continue as a going concern and whether the use of the going concern basis of accounting is appropriate as well as disclosing, if applicable, matters relating to going concern. The explanation of management's responsibility for this assessment shall include a description of when the use of the going concern basis of accounting is appropriate.
<b>8. Auditor's Responsibilities for the Audit of the Financial Statements:</b> The auditors report shall include a section with the heading "Auditor's Responsibilities for the Audit of the Financial Statements."	
<b>(I) This section of the auditor's report shall:</b>	
<b>(a) State that the objectives of the auditor are to:</b>	
<ul style="list-style-type: none"> <li>(i) Obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error; and</li> <li>(ii) Issue an auditor's report that includes the auditor's opinion.</li> </ul>	
<b>(b) State that reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with SAs will always detect a material misstatement when it exists; and</b>	
<b>(c) State that misstatements can arise from fraud or error, and either:</b>	
<ul style="list-style-type: none"> <li>(i) Describe that they are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements; or</li> <li>(ii) Provide a definition or description of materiality in accordance with the applicable financial reporting framework.</li> </ul>	

(II) The Auditor's Responsibilities for the Audit of the Financial Statements section of the auditor's report shall further:

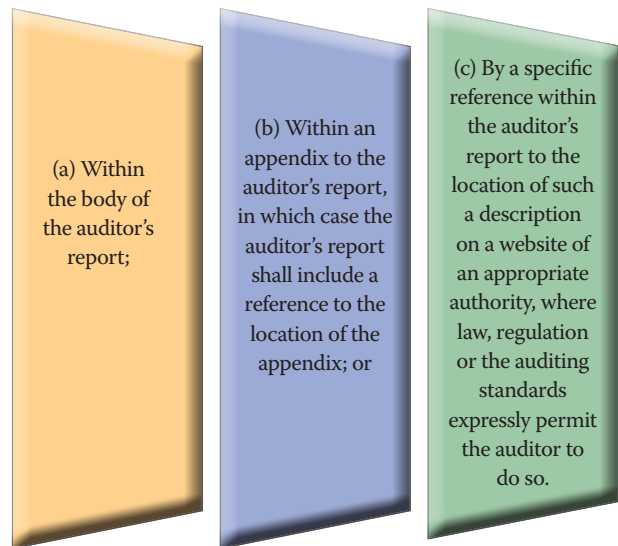


(III) The Auditor's Responsibilities for the Audit of the Financial Statements section of the auditor's report also shall:

- (a) **State that the auditor communicates with those charged with governance regarding, among other matters:**
  - ◆ the planned scope and timing of the audit and
  - ◆ significant audit findings,
  - ◆ including any significant deficiencies in internal control that the auditor identifies during the audit;
- (b) **State that the auditor provides those charged with governance with a statement that the auditor has:**
  - ◆ complied with relevant ethical requirements regarding independence and
  - ◆ communicate with them all relationships and
  - ◆ other matters that may reasonably be thought to bear on the auditor's independence, and where applicable, related safeguards; and
- (c) For audits of financial statements of all such entities for which key audit matters are communicated in accordance with SA 701, state that, from the matters communicated with those charged with governance, the auditor determines those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters.

In accordance with the requirements of SA 701, the auditor describes these matters in the auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, the auditor determines that a matter should not be communicated in the auditor's report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

**9. Location of the description of the auditor's responsibilities for the audit of the financial statements:** The description of the auditor's responsibilities for the audit of the financial statements required by this SA shall be included:



When the auditor refers to a description of the auditor's responsibilities on a website of an appropriate authority, the auditor shall determine that such description addresses, and is not inconsistent with, the requirements of this SA.

**10. Other Reporting Responsibilities:**

- 11. Signature of the Auditor:** The auditor's report shall be signed.
  - ◆ The report is signed by the auditor (i.e. the engagement partner) in his personal name.
  - ◆ Where the firm is appointed as the auditor, the report is signed in the personal name of the auditor and in the name of the audit firm.
  - ◆ The partner/proprietor signing the audit report also needs to mention the membership number assigned by the Institute of Chartered Accountants of India. They also include the registration number of the firm, wherever applicable, as allotted by ICAI, in the audit reports signed by them.
- 12. Place of Signature:** The auditor's report shall name specific location where the audit report is signed.
- 13. Date of the Auditor's Report:** The auditor's report shall be dated no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor's opinion on the financial statements, including evidence that:



# AUDITING & ASSURANCE ||

(a) All the statements that comprise the financial statements, including the related notes, have been prepared; and

(a) Those with the recognized authority have asserted that they have taken responsibility for those financial statements.

**Auditor's Report Prescribed by Law or Regulation:** If the auditor is required by law or regulation applicable to the entity to use a specific layout, or wording of the auditor's report, the auditor's report shall refer to Standards on Auditing only if the auditor's report includes, at a minimum, each of the following elements

- (1) A title.
- (2) An addressee, as required by the circumstances of the engagement.
- (3) An Opinion section containing an expression of opinion on the financial statements and a reference to the applicable financial reporting framework used to prepare the financial statements.
- (4) An identification of the entity's financial statements that have been audited.
- (5) A statement that the auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit, and has fulfilled the auditor's other ethical responsibilities in accordance with these requirements. The statement shall refer to the Code of Ethics issued by ICAI.
- (6) Where applicable, a section that addresses, and is not inconsistent with, the reporting requirements of SA 570.
- (7) Where applicable, a Basis for Qualified (or Adverse) Opinion section that addresses, and is not inconsistent with, the reporting requirements of SA 570 (Revised).
- (8) Where applicable, a section that includes the information required by SA 701, or additional information about the audit that is prescribed by law or regulation and that addresses, and is not inconsistent with, the reporting requirements in that SA 701.
- (9) A description of management's responsibilities for the preparation of the financial statements and an identification of those responsible for the oversight of the financial reporting process that addresses, and is not inconsistent with, the requirements.
- (10) A reference to Standards on Auditing and the law or regulation, and a description of the auditor's responsibilities for an audit of the financial statements that addresses, and is not inconsistent with, the requirements.
- (11) The auditor's signature.
- (12) The Place of signature
- (13) The date of the auditor's report.

**Auditor's Report for Audits Conducted in Accordance with Both Standards on Auditing Issued by ICAI and International Standards on Auditing or Auditing Standards of Any Other Jurisdiction.** In this case, the auditor's report

may refer to Standards on Auditing in addition to the International Standards on Auditing or auditing standards of such other jurisdiction, but the auditor shall do so only if:

- (a) There is no conflict between the requirements in the ISAs or such auditing standards of other jurisdiction and those in SAs that would lead the auditor:
  - (i) to form a different opinion, or
  - (ii) not to include an Emphasis of Matter paragraph or Other Matter paragraph that, in the particular circumstances, is required by SAs; **and**
- (b) The auditor's report includes, at a minimum, each of the elements set out in Auditor's Report Prescribed by Law or Regulation discussed above when the auditor uses the layout or wording specified by the Standards on Auditing. However, reference to "law or regulation" in above paragraph shall be read as reference to the Standards on Auditing. The auditor's report shall thereby identify such Standards on Auditing.

When the auditor's report refers to both the ISAs or the auditing standards of a specific jurisdiction and the Standards on Auditing issued by ICAI, the auditor's report shall clearly identify the same including the jurisdiction of origin of the other auditing standards.

### Supplementary Information Presented with the Financial Statements:

**If supplementary information that is not required by the applicable financial reporting framework is presented with the audited financial statements, the auditor shall evaluate:**

- |   |   |
|---|---|
| <ul style="list-style-type: none"> <li>◆ whether, in the auditor's professional judgment, supplementary information is nevertheless an integral part of the financial statements due to its nature or how it is presented. When it is an integral part of the financial statements, the supplementary information shall be covered by the auditor's opinion.</li> </ul> | <ul style="list-style-type: none"> <li>◆ whether such supplementary information is presented in a way that sufficiently and clearly differentiates it from the audited financial statements. If this is not the case, then the auditor shall ask management to change how the unaudited supplementary information is presented. If management refuses to do so, the auditor shall identify the unaudited supplementary information and explain in the auditor's report that such supplementary information has not been audited.</li> </ul> |
|---|---|

SA-701	Communicating Key Audit Matters in the Independent Auditor's Report
<b>Objective</b>	<ul style="list-style-type: none"> <li>• To enhance the communicative value of the auditor's report by providing greater transparency about the audit that was performed.</li> <li>• To assist the user in understanding those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period.</li> </ul>

<b>Definition of Key Audit Matters</b>	Key Audit matter are those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance.		
<b>Scope:</b> Communicating key audit matters in the auditor's report is not:	a substitute for disclosures in the financial statements;	a substitute for the auditor expressing a modified opinion when required by the circumstances of a specific audit engagement in accordance with SA 705;	
	a substitute for reporting in accordance with SA 570 or	a separate opinion on individual matters.	
<b>Applicability of SA 701</b>	<ul style="list-style-type: none"> <li>◆ It is intended to address both the auditor's judgment as to what to communicate in the auditor's report and the form and content of such communication</li> <li>◆ This SA applies to audits of complete sets of general purpose financial statements of:                             <ul style="list-style-type: none"> <li><input type="checkbox"/> listed entities and</li> <li><input type="checkbox"/> circumstances when the auditor otherwise decides to communicate key audit matters in the auditor's report and</li> <li><input type="checkbox"/> required by law or regulation to communicate key audit matters in the auditor's report</li> </ul> </li> </ul> <p>However, SA 705 (Revised) prohibits the auditor from communicating key audit matters when the auditor disclaims an opinion on the financial statements, unless such reporting is required by law or regulation</p>		
<b>Determining Key Audit Matters:</b>	The auditor shall determine, from the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit. In making this determination, the auditor shall take into account the following:		
(a) Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with SA 315	(b) Significant auditor judgments relating to areas in the financial statements that involved significant management judgment, including accounting estimates that have been identified as having high estimation uncertainty.	(c) The effect on the audit of significant events or transactions that occurred during the period.	

<b>Communicating Key Audit Matters:</b>	<p>The introductory language in this section of the auditor's report shall state that:</p> <div style="border: 1px solid black; background-color: #00a0e3; color: white; padding: 5px; margin: 5px 0;"> <p>(a) Key audit matters are those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements [of the current period]; and.</p> </div> <div style="border: 1px solid black; background-color: #c08040; color: white; padding: 5px; margin: 5px 0;"> <p>(b) These matters were addressed in the context of the audit of the financial statements as a whole, and in forming the auditor's opinion thereon, and the auditor does not provide a separate opinion on these matters.</p> </div>
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<b>SA-705</b>	<b>Modifications to the Opinion in the Independent Auditor's Report</b>						
<b>Scope:</b>	<ul style="list-style-type: none"> <li>◆ This SA deals with the auditor's responsibility to issue an appropriate report in circumstances when, in forming an opinion in accordance with SA 700 (Revised), the auditor concludes that a modification to the auditor's opinion on the financial statements is necessary.</li> <li>◆ This SA also deals with how the form and content of the auditor's report is affected when the auditor expresses a modified opinion.</li> </ul>						
<b>Objective</b>	<p>The objective of the auditor is to <b>express</b> clearly an appropriately <b>modified opinion</b> on the financial statement that is necessary when:</p> <p>(a) The auditor <b>concludes</b>, based on the <b>audit evidence obtained</b>, that the financial statements as a whole are not free from material misstatement; or</p> <p>(b) The auditor <b>is unable to obtain sufficient appropriate</b> audit evidence to conclude that the financial statements as a whole are free from material misstatement.</p>						
<b>Types of Modified Opinion</b>	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="background-color: #00a0e3; color: white; text-align: center;">Types of Modified Opinions as per SA 705:</td> <td style="background-color: #ff8c00; color: white; text-align: center;">(i) Qualified Opinion</td> </tr> <tr> <td></td> <td style="background-color: #ffcc00; color: white; text-align: center;">(ii) Adverse Opinion</td> </tr> <tr> <td></td> <td style="background-color: #90d090; color: white; text-align: center;">(iii) Disclaimer of Opinion</td> </tr> </table> <p>The decision regarding which type of modified opinion is appropriate depends upon:</p> <p>(a) The <b>nature of the matter</b> giving rise to the modification, that is, whether the financial statements are materially misstated or, in the case of an inability to obtain sufficient appropriate audit evidence, may be materially misstated; and</p> <p>(b) The <b>auditor's judgment about the pervasiveness</b> of the effects or possible effects of the matter on the financial statements.</p>	Types of Modified Opinions as per SA 705:	(i) Qualified Opinion		(ii) Adverse Opinion		(iii) Disclaimer of Opinion
Types of Modified Opinions as per SA 705:	(i) Qualified Opinion						
	(ii) Adverse Opinion						
	(iii) Disclaimer of Opinion						

## Requirements

### Circumstances When a Modification to the Auditor's Opinion is Required:

The auditor shall modify the opinion in the auditor's report when:

The auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement; or

The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.

### Determining the Type of Modification to the Auditor's Opinion:

**Qualified Opinion:** The auditor shall express a qualified opinion when:

- The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or
- The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.

**Adverse Opinion:** The auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.

**Disclaimer of Opinion:** The auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive

### Consequence of an Inability to Obtain Sufficient Appropriate Audit Evidence Due to a Management-Imposed Limitation after the Auditor Has Accepted the Engagement

The auditor need to express a qualified opinion or to disclaim an opinion on the financial statements and auditor shall request that management remove the limitation.

If management refuses to remove the limitation, the auditor shall communicate the matter to those charged with governance, unless all of those charged with governance are involved in managing the entity, and determine whether it is possible to perform alternative procedures to obtain sufficient appropriate audit evidence.

If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor shall determine the implications as follows:

- If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive, the auditor shall qualify the opinion;
- or

(b) If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive so that a qualification of the opinion would be inadequate to communicate the gravity of the situation, the auditor shall:

- Withdraw from the audit, where practicable and possible under applicable law or regulation; or
- If withdrawal from the audit before issuing the auditor's report is not practicable or possible, disclaim an opinion on the financial statements.

**If the auditor decides to withdraw:** When the auditor decides to withdraw before withdrawing, the auditor shall communicate to those charged with governance any matters regarding misstatements identified during the audit that would have given rise to a modification of the opinion.

### Other Considerations Relating to an Adverse Opinion or Disclaimer of Opinion:

When the auditor considers it necessary to express an adverse opinion or disclaim an opinion on the financial statements as a whole, the auditor's report shall not also include an unmodified opinion with respect to the same financial reporting framework on a single financial statement or one or more specific elements, accounts or items of a financial statement. To include such an unmodified opinion in the same report in these circumstances would contradict the auditor's adverse opinion or disclaimer of opinion on the financial statements as a whole.

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.

### Communication with Those Charged with Governance:

When the auditor expects to modify the opinion in the auditor's report, the auditor shall communicate with those charged with governance the circumstances that led to the expected modification and the wording of the modification.

Nature of Matter Giving Rise to the Modification:	Auditor's judgment about the Pervasiveness of the Effects or Possible Effects on the Financial Statements	
	Material but not pervasive	Material and pervasive
Financial Statements are materially misstated	Qualified Opinion	Adverse Opinion
Inability to obtain Sufficient appropriate audit evidence	Qualified Opinion	Disclaimer of Opinion

SA-706

**Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report**

**Scope**

- ◆ This SA deals with additional communication in the auditor's report when the auditor considers it necessary to draw users' attention to a matter or matters
- ◆ (a) presented or disclosed in the financial statements that are of such importance that they are fundamental to users' understanding of the financial statements; or
- ◆ (b) other than those presented or disclosed in the financial statements that are relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.

**Objectives**

- ◆ The objective of the auditor, having formed an opinion on the financial statements, 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:
  - (a) A matter, although appropriately presented or disclosed in the financial statements, that is of such importance that it is fundamental to users' understanding of the financial statements; or
  - (b) As appropriate, any other matter that is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.

**Definitions**

- ◆ **Emphasis of Matter paragraph** : A paragraph included in the auditor's report that refers to *a matter appropriately presented or disclosed* in the financial statements that, in the *auditor's judgment*, is of such importance that it is *fundamental to users* understanding of the financial statements.
- ◆ **Other Matter paragraph**: A paragraph included in the auditor's report that refers to a matter *other than those presented or disclosed* in the financial statements that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.

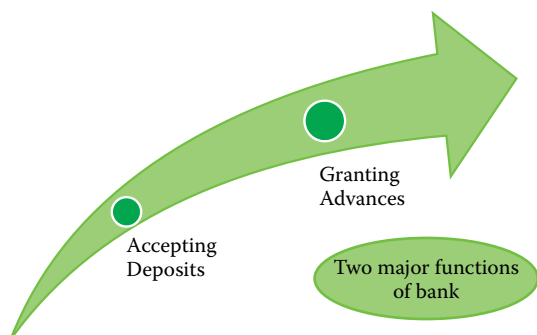
**Requirements**

- ◆ **Emphasis of Matter Paragraphs in the Auditor's Report**  
When the auditor includes an Emphasis of Matter paragraph in the auditor's report, the auditor shall:
  - (a) Include the paragraph within a separate section of the auditor's report with an appropriate heading that includes the term "Emphasis of Matter";
  - (b) Include in the paragraph a clear reference to the matter being emphasized and to where relevant disclosures that fully describe the matter can be found in the financial statements. The paragraph shall refer only to information presented or disclosed in the financial statements; and
  - (c) Indicate that the auditor's opinion is not modified in respect of the matter emphasized.
- ◆ **Other Matter Paragraphs in the Auditor's Report**  
If the auditor considers it necessary to communicate a matter other than those that are presented or disclosed in the financial statements that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report, the auditor shall include an Other Matter paragraph in the auditor's report, provided:
  - (a) This is not prohibited by law or regulation; and
  - (b) When SA 701 applies, the matter has not been determined to be a key audit matter to be communicated in the auditor's report.  
The auditor shall include the paragraph within a separate section with the heading "Other Matter," or other appropriate heading.
- ◆ **Communication with Those Charged with Governance**  
If the auditor expects to include an *Emphasis of Matter or an Other Matter paragraph* in the auditor's report, the auditor shall communicate with those charged with governance regarding this expectation and the wording of this paragraph.

### Types of banks in India:

Commercial Banks.	Regional Rural Banks.
Co-operative Banks.	Payment Banks.
Development Banks (more commonly known as 'Term-Lending Institutions').	Small Finance Banks.

### Major Functions of Bank:



### Regulatory Framework:

Banking Regulation Act, 1949.	State Bank of India Act, 1955.
Companies Act, 2013.	
Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970.	
Regional Rural Banks Act, 1976.	
Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980.	
Information Technology Act, 2000.	Prevention of Money Laundering Act, 2002.
Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.	
Credit Information Companies Regulation Act, 2005.	
Payment and Settlement Systems Act, 2007.	

### Types of Audit Reports to be issued (generally):

Presently, the Statutory Central Auditors (SCAs) have to furnish the following reports in addition to their main audit report:

a	◆ Report on adequacy and operating effectiveness of Internal Controls over Financial Reporting in case of banks which are registered as companies under the Companies Act in terms of Section 143(3)(i) of the Companies Act, 2013.
b	◆ Long Form Audit Report

c	◆ Report on compliance with SLR requirements
d	◆ Report on whether the treasury operations of the bank have been conducted in accordance with the instructions issued by the RBI from time to time.
e	◆ Report on whether the income recognition, asset classification and provisioning have been made as per the guidelines issued by the RBI from time to time.
f	◆ Report on whether any serious irregularity was noticed in the working of the bank which requires immediate attention.
g	◆ Report on status of the compliance by the bank with regard to the implementation of recommendations of the Ghosh Committee relating to frauds and malpractices and of the recommendations of Jilani Committee on internal control and inspection/ credit system.
h	◆ Report on instances of adverse credit-deposit ratio in the rural areas.

### Performing Control Activities:

Nature of Questions	Questions to be considered / answered
Who	<ul style="list-style-type: none"> <li>Who performs the control?</li> <li>Does the above person have requisite knowledge and authority to perform the control?</li> </ul>
What	<ul style="list-style-type: none"> <li>What evidence is available to demonstrate / prove that the control is performed?</li> </ul>
When	<ul style="list-style-type: none"> <li>When and with what frequency is the control performed?</li> <li>Is the frequency enough to prevent, detect and correct risk of material misstatements?</li> </ul>
Where	<ul style="list-style-type: none"> <li>Where is the evidence of performance of the control retained?</li> <li>For how long is the evidence retained?</li> <li>Is the evidence accessible/ available for audit?</li> </ul>
Why	<ul style="list-style-type: none"> <li>Why is the control being performed?</li> <li>What type of errors are prevented or detected through the performance of the control?</li> </ul>
How	<ul style="list-style-type: none"> <li>How is the control performed?</li> <li>What are the control activities?</li> <li>Can these activities be bypassed?</li> <li>Can the bypass, if any, be detected?</li> <li>How are exceptions/deviations resolved on identification?</li> <li>What is the time frame for resolving the exceptions?</li> </ul>

## The Bank Auditor:

- 1. ELIGIBILITY, QUALIFICATIONS AND DISQUALIFICATIONS OF AUDITOR**  
 • Section 141 of the Companies Act, 2013
- 2. APPOINTMENT OF AUDITOR**  
 • The auditor of a banking company is to be appointed at the **Annual General Meeting** of the shareholders, whereas the auditor of a nationalised bank is to be appointed by the bank concerned acting through its Board of Directors.
- 3. REMUNERATION OF AUDITOR**  
 • The remuneration of auditor of a banking company is to be fixed in accordance with the provisions of Section 142 of the Companies Act, 2013
- 4. POWERS OF AUDITOR**  
 • The auditor of a banking company, nationalised bank, State Bank of India, subsidiary of State Bank of India or regional rural bank has the same powers as those of a company's auditor in the matter of access to the books, accounts, documents and vouchers
- 5. CONDUCTING A BANK AUDIT**

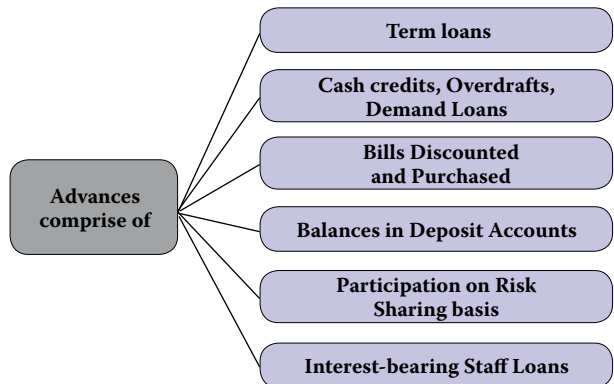
## Conducting an Audit:

- 1. Initial consideration by the statutory auditor:**

Declaration of Indebtness	Internal Assignments in Banks by Statutory Auditors	Planning
Communication with Previous Auditor	Terms of Audit Engagement	Initial Engagements
Assessment of Engagement Risk	Establishment of Engagement Team	Understanding the Bank & Its Environment
2. Identifying and Assessing the Risks of Material Misstatements
3. Understanding the Bank and its Environment including Internal Control
4. Understanding the Bank's Accounting Process
5. Understanding the Risk Management Process
  - (a) Oversight and involvement in the control process by those charged with governance
  - (b) Identification, measurement and monitoring of risks
  - (c) Control activities
  - (d) Monitoring activities
  - (e) Reliable information systems
6. Engagement Team Discussions
7. Establish the Overall Audit Strategy - SA 300 "Planning an Audit of financial Statements"

8. Develop the Audit Plan
9. Audit Planning Memorandum
10. Determine Audit Materiality
11. Consider Going Concern
12. Assess the Risk of Fraud including Money Laundering
13. Assess Specific Risks
14. Risk Associated with Outsourcing of Activities
15. Response to the Assessed Risks
16. Stress Testing
17. BASEL III Framework
18. Reliance on / review of other reports

## Advances:

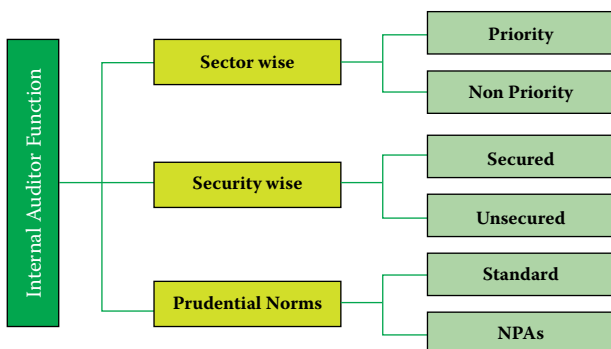


### Legal requirements of Disclosure in the Balance Sheet:

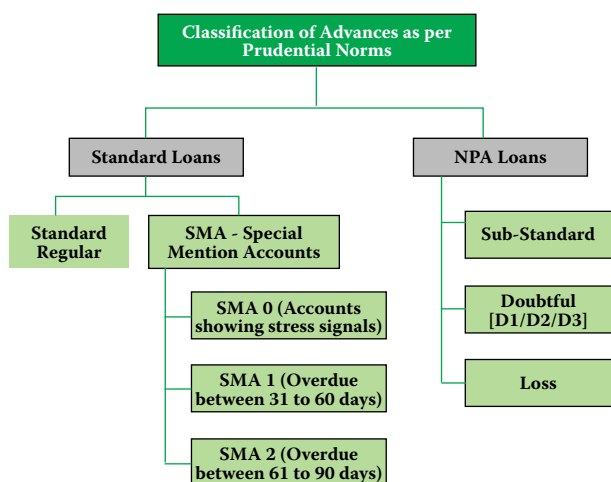
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| <b>A.</b><br>(i) Bills purchased and discounted<br>(ii) Cash credits, Overdrafts and loans repayable on demand<br>(iii) Term Loans | <b>B.</b><br>(i) Secured by tangible assets<br>(ii) Covered by Bank/ Government guarantees<br>(iii) Unsecured  |
| <b>C.I. Advances in India:</b><br>(i) Priority sectors<br>(ii) Public sector<br>(iii) Banks<br>(iv) Others                         | <b>C.II. Advances outside India</b><br>(i) Due from Banks<br>(ii) Due from Others:<br>(a) Bills Purchased and discounted<br>(b) Syndicated loans<br>(c) Others |

# AUDITING AND ASSURANCE

## Classification of Advances:



## Classification of Advances as per RBI Prudential Norms



## Non-Performing Asset (NPA):

A non-performing asset (NPA) is a loan or an advance where :-

- interest and / or installment of principal remain overdue for a period of more than 90 days in respect of a term loan;
- the account remains 'out of order' in respect of an Overdraft / Cash Credit (OD / CC);
- the bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted.



**Income Recognition** :- Income from non-performing assets (NPA) is not recognized on accrual basis but is booked as income only when it is actually received.



**Borrower Wise** :- Asset classification would be borrower-wise and not facility-wise. All facilities including investments in securities would be termed as NPA.



**Record of Recovery** :- Classification as NPA should be based on the record of recovery. Availability of security or net worth of borrower/guarantor is not to be taken into account for purpose of treating an advance as NPA or otherwise.

## Provisioning of NPA

Categories of Non-Performing Assets:	Provision required
<ul style="list-style-type: none"> <li><b>Standard Assets:</b> Would be one, which has remained NPA for a period less than or equal to 12 months.</li> <li><b>Doubtful Assets:</b> Would be one, which has remained in the substandard category for a period of 12 months. <b>Sub-categories:</b> Doubtful up to 1 Year (D1) Doubtful 1 to 3 Years (D2) Doubtful more than 3 Years (D3)</li> <li><b>Loss Assets:</b> Would be one, where loss has been identified by the bank or internal or external auditors or the RBI inspection but the amount has not been written off wholly.</li> </ul>	<p>15%</p> <p>(Secured + Unsecured) 25% + 100% 40% + 100% 100% + 100%</p> <p>100%</p>

## Drawing Power:

**Meaning :-** Drawing Power generally addressed as "DP" is an important concept for **Cash Credit (CC)** facility availed from banks and financial institutions. **Drawing power** is the limit up to which a firm or company can withdraw from the working capital limit sanctioned.

**Different from Sanction Limit:-** The **Sanctioned limit** is the total exposure that a bank can take on a particular client for facilities like cash credit, overdraft, export packing credit, non-funded exposures etc. On the other hand, **Drawing Power** refers to the amount calculated based on primary security less margin as on a particular date.

**Considerations:-** All accounts should be kept within both the drawing power and the sanctioned limit at all times. The accounts which exceed the sanctioned limit or drawing power or are against unapproved securities or are otherwise irregular should be brought to the notice of the Management/Head Office regularly.

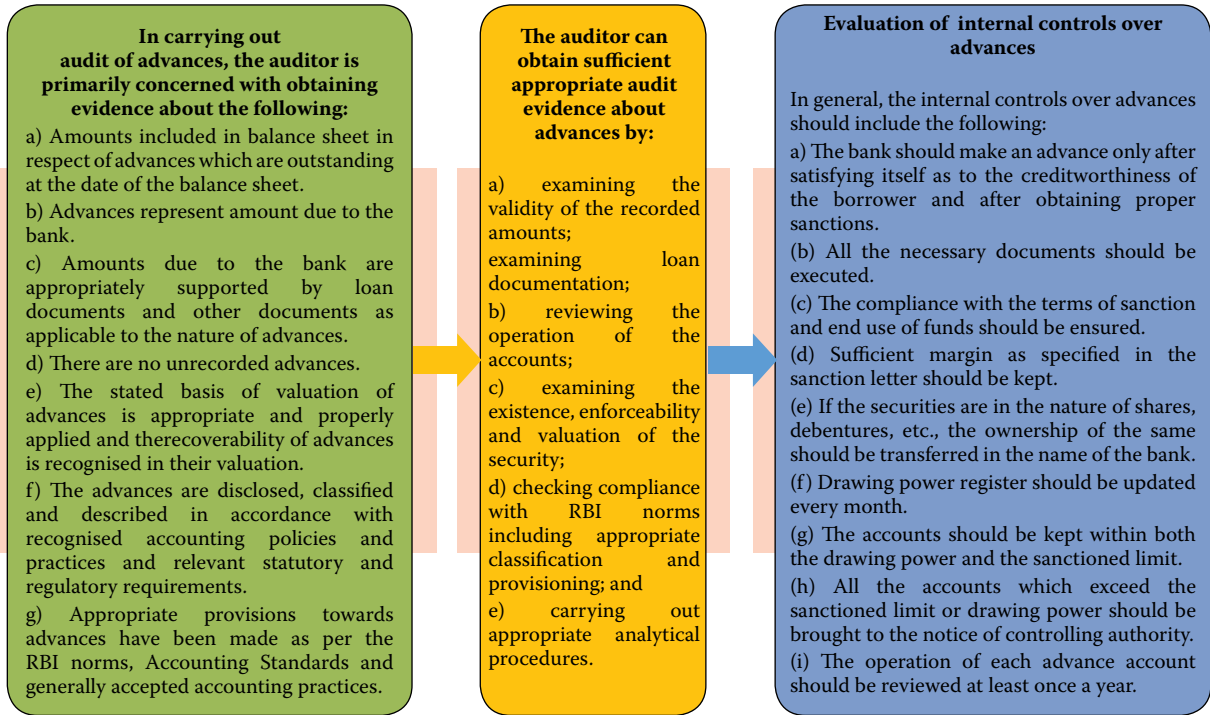
**Bank's Duties:-** Banks should ensure that drawings in the working capital account are covered by the adequacy of the current assets. Drawing power is required to be arrived at based on current stock statement which should not be older than **three months** otherwise it is deemed as irregular.

**Auditor's Concern:-** The stock statements, quarterly returns and other statements submitted by the borrower to the bank should be scrutinized in detail. The audited Annual Report submitted by the borrower should be scrutinized properly. The monthly stock statement of the month for which the audited accounts are prepared and submitted should be compared and the reasons for **deviations**, if any, should be ascertained.

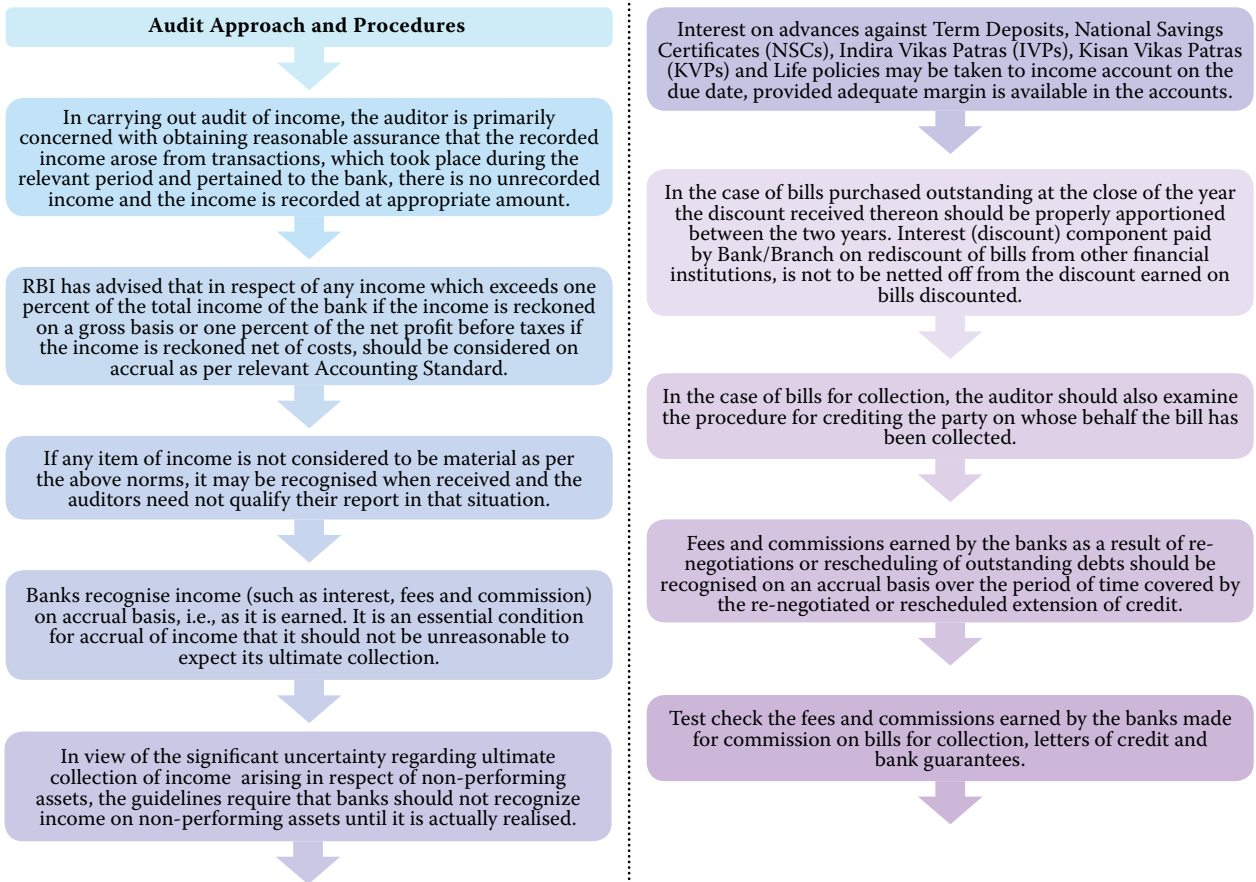
**Stock Audit:-** The stock audit should be carried out by the bank for all accounts having funded exposure of more than **₹5 crores**. Auditors can also advise for stock audit in other cases if the situation warrants the same.

**Computation of DP:-** DP needs to be calculated as per the extant guidelines formulated by the Board of Directors of the respective bank and agreed upon by the concerned Statutory auditors. Special consideration should be given to proper reporting of sundry creditors for the purposes of calculating drawing power.

**Audit of Advances:**

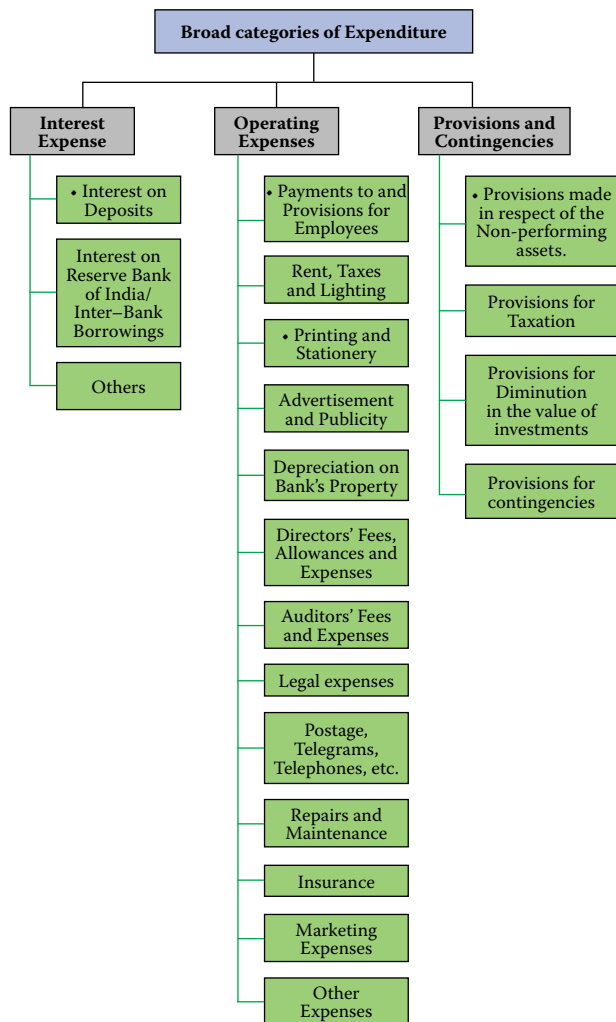


**Audit of Revenue Items:**





## Audit of Expenses:



### Audit Approach and Procedures for Interest Expenses

In carrying out an audit of interest expense, the auditor is primarily concerned with assessing the overall reasonableness of the amount on interest expenses by analysing ratios of interest paid on different types of deposits and borrowings to average quantum of the respective liabilities during the year.

The auditor should obtain from the bank an analysis of various types of deposits outstanding at the end of each quarter.

The auditor should also compare the average rate of interest paid on the relevant deposits with the corresponding figures for the previous years and analyse any material differences.

The auditor should obtain general ledger break-up for the interest expense incurred on deposits and borrowings each month/ quarter.

### Audit Approach and Procedures for Operating Expenses

For audit of operating expenses, the auditor should study and evaluate the system of internal control relating to expenses, including authorization procedures in order to determine the nature, timing and extent of his other audit procedures.

The auditor should examine whether there are any divergent trends in respect of major items of expenses.

The auditor should perform substantive analytical procedures in respect of these expenses. eg. assess the reasonableness of expenses by working out their ratio to total operating expenses and comparing it with the corresponding figures for previous years.

The auditor should also verify expenses with reference to supporting documents and check the calculations wherever required.

### Audit Approach and Procedures for Provisions and contingencies

For audit of Provisions and contingencies, the auditor should ensure that the compliances for various regulatory requirements for provisioning as contained in the various circulars have been fulfilled.

The auditor should obtain an understanding as to how the bank computes provision on standard assets and non-performing assets.

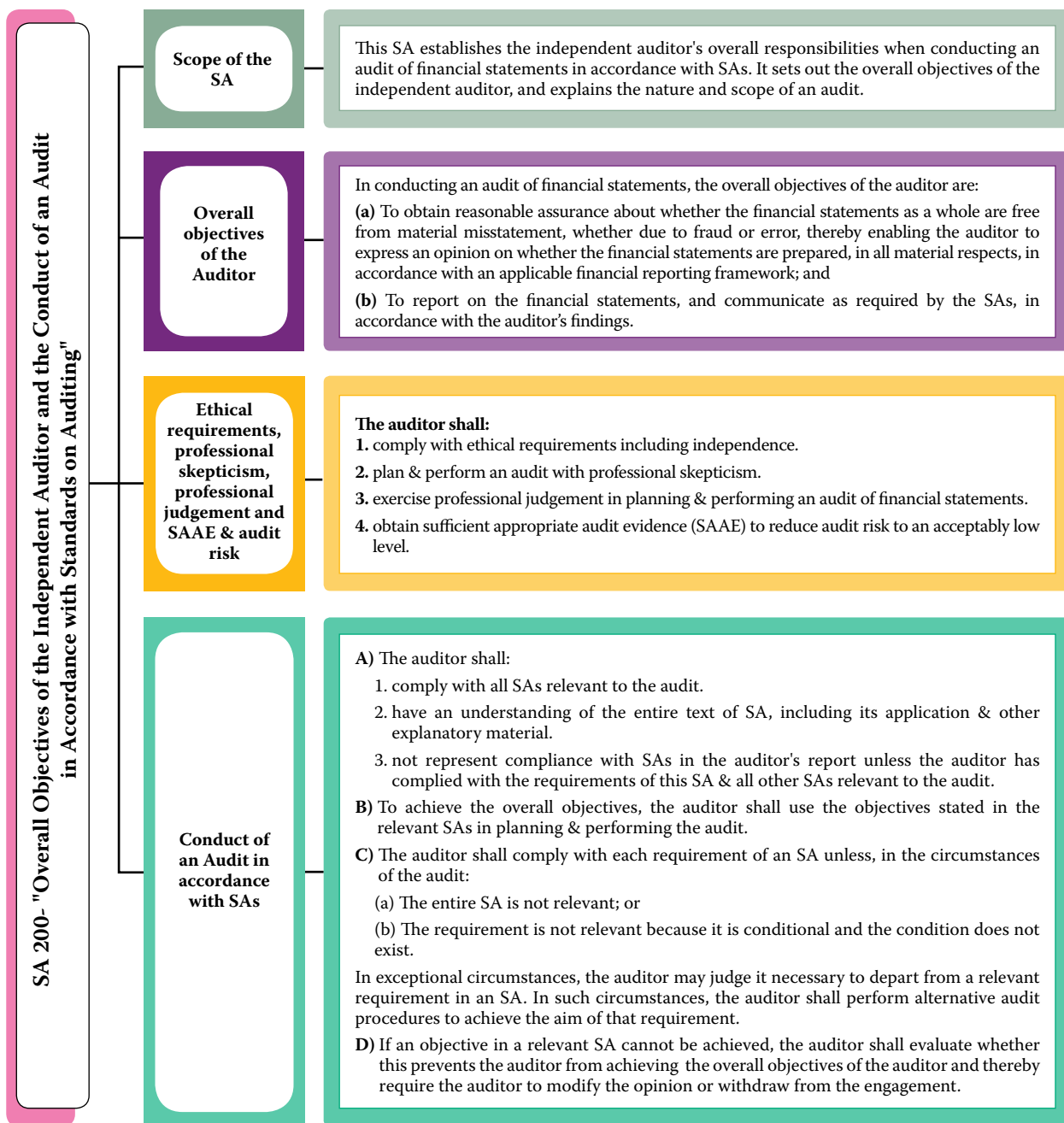
The auditor may verify the loan classification on a sample basis.

The auditor should obtain the detailed break up of standard loans, non-performing loans and agree the outstanding balances with the general ledger.

The auditor should obtain the tax provision computation from the bank's management and verify the nature of items debited and credited to profit and loss account to ascertain that the same are appropriately considered in the tax provision computation.

## CA INTERMEDIATE - PAPER 6 - AUDITING AND ASSURANCE

It has always been the endeavour of Board of Studies to provide quality academic inputs to the students of Chartered Accountancy Course. Keeping in mind this objective, BoS has decided to come out with a Crisp & Concise Capsule of each subject to facilitate students in quick revision before examination. This series of capsules is on Paper 6: Auditing and Assurance of Intermediate Course. In this capsule we are covering Engagement and Quality Control Standards i.e. SA 200, SA 210, SA 220, SA 230 and SA 240. It may be mentioned that this capsule is a tool for quick revision of some significant areas of Auditing subject. This should not be taken as a substitute for the detailed study of the subject. Students are advised to refer to the relevant Study Material, Auditing Pronouncements and RTP for comprehensive study and revision.



Definitions

<b>Applicable financial reporting framework</b>	The financial reporting framework (FRF) adopted by management and, where appropriate, those charged with governance in the preparation and presentation of the financial statements that is acceptable in view of the nature of the entity and the objective of the financial statements, or that is required by law or regulation.
<b>Audit evidence</b>	Information used by the auditor in arriving at the conclusions on which the auditor's opinion is based. Audit evidence includes both information contained in the accounting records underlying the financial statements and other information.
<b>Audit risk</b>	The risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated. Audit risk is a function of the risks of material misstatement and detection risk.
<b>Auditor</b>	"Auditor" is used to refer to the person or persons conducting the audit, usually the engagement partner or other members of the engagement team, or, as applicable, the firm.
<b>Detection risk</b>	The risk that the procedures performed by the auditor to reduce audit risk to an acceptably low level will not detect a misstatement that exists and that could be material, either individually or when aggregated with other misstatements.
<b>Misstatement</b>	A difference between the amount, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework. Misstatements can arise from error or fraud.
<b>Professional judgement</b>	The application of relevant training, knowledge and experience, within the context provided by auditing, accounting and ethical standards, in making informed decisions about the courses of action that are appropriate in the circumstances of the audit engagement.
<b>Professional skepticism</b>	An attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence.
<b>Reasonable assurance</b>	In the context of an audit of financial statements, a high, but not absolute, level of assurance.
<b>Risk of material misstatement</b>	The risk that the financial statements are materially misstated prior to audit.
<b>Those charged with governance</b>	The person(s) or organisation(s) (e.g., a corporate trustee) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process.

## SA 210- "Agreeing the Terms of Audit Engagements"

### Scope of the SA & objective of the auditor

#### Scope

This SA deals with the auditor's responsibilities in agreeing the terms of the audit engagement with management/ TCWG.

#### Objective

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

- a) Establishing whether the preconditions for an audit are present.
- b) Confirming that there is a common understanding between the auditor & management/ TCWG of the terms of the audit engagement.

### Preconditions for an audit

#### In order to establish whether the preconditions for an audit are present, the auditor shall:

1. Determine whether the FRF to be applied in the preparation of the financial statements is acceptable and
2. Obtain the agreement of management that it acknowledges and understands its responsibility:
  - i) For the preparation of financial statement as per FRE.
  - ii) For such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and
  - iii) To provide the auditor with access to all the information, additional information, & unrestricted access to persons within the entity.

### Limitations on scope prior to audit engagement acceptance

If management or those charged with governance impose a limitation on the scope of the auditor's work in the terms of a proposed audit engagement, such that 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.

### Other factors affecting audit engagement acceptance

If the preconditions of audit are not present, the auditor shall discuss the matter with management. The auditor shall not accept the proposed engagement if FRF is not acceptable or if engagement agreement has not been obtained.

### Agreement on audit engagement terms

#### Audit engagement terms shall include:

- i) Objective & scope of audit
- ii) Responsibilities of the auditor
- iii) Responsibilities of management
- iv) Identification of applicable FRF
- v) Reference to expected content & form of report.

If law/ regulation prescribes the terms of audit engagement, then the auditor need not record them in a written agreement, except for the fact that such law/ regulation applies & the management acknowledges the same.

### Recurring audits

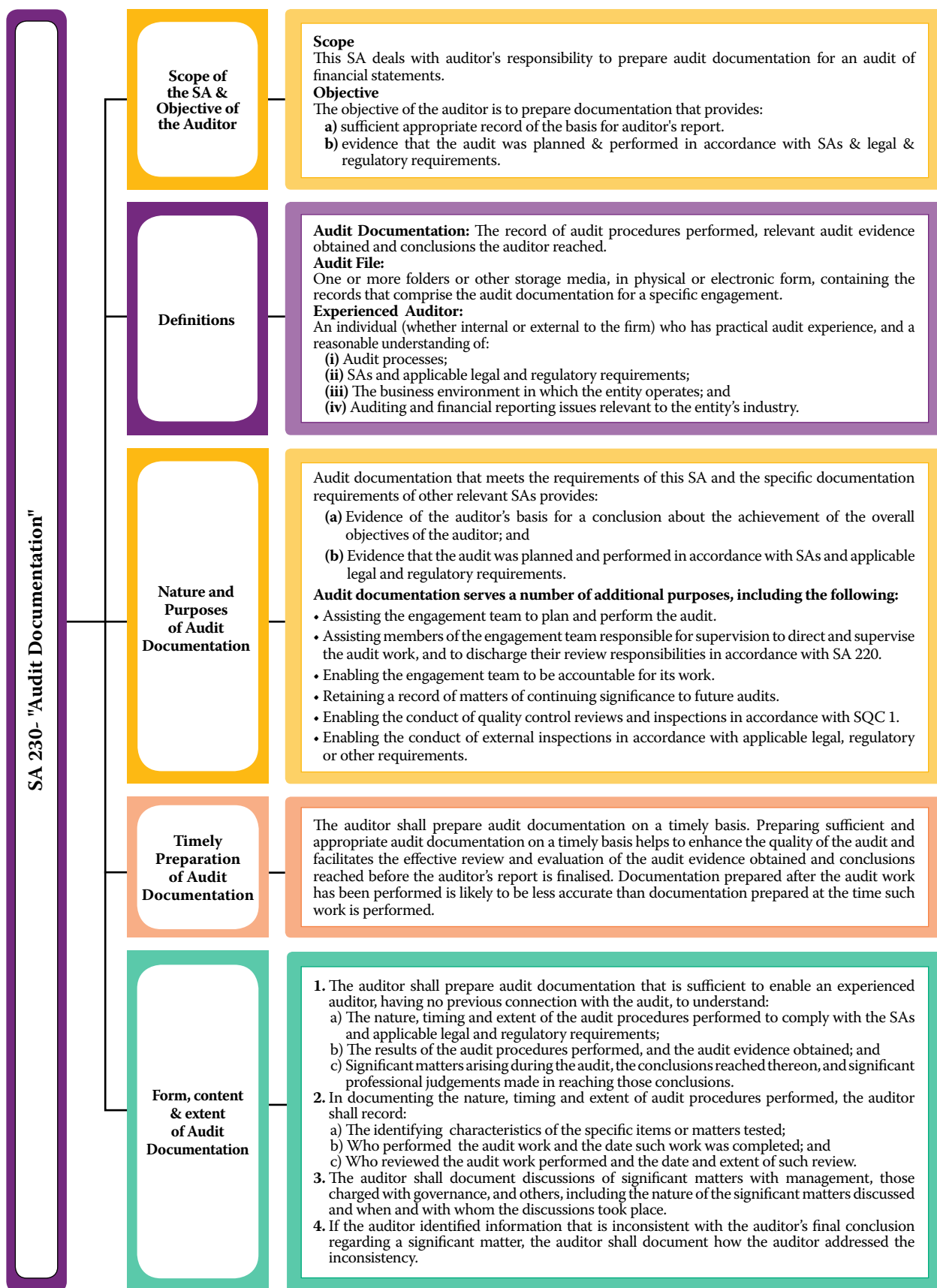
On recurring audits, the auditor shall assess whether circumstances require the terms of the audit engagement to be revised and whether there is a need to remind the entity of the existing terms of the audit engagement.

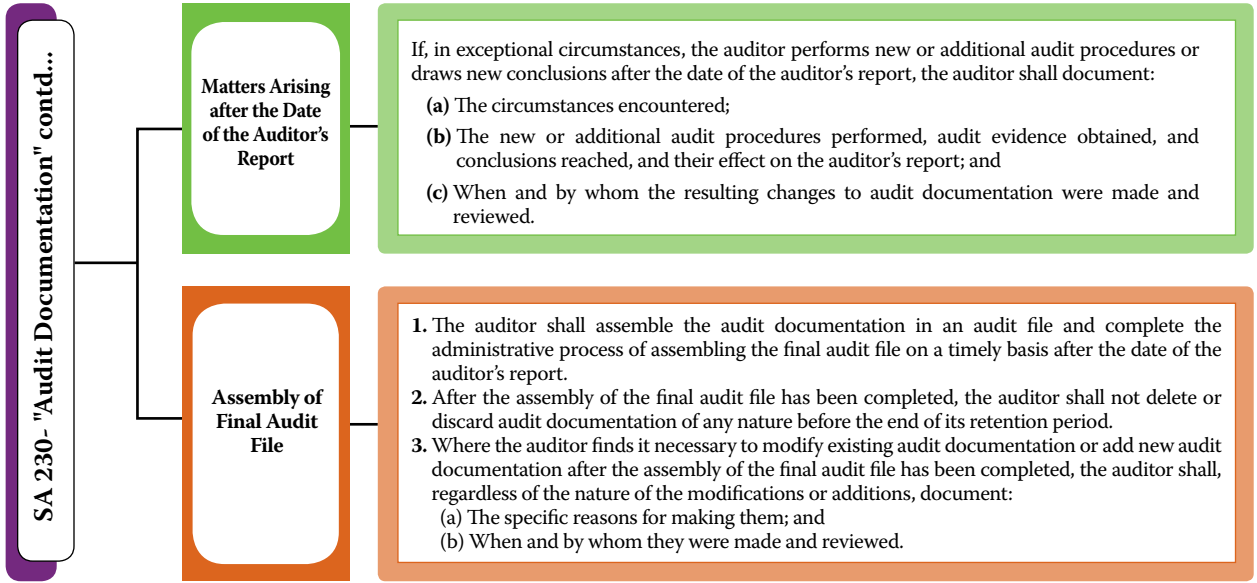
### Acceptance of a change in the terms of the audit engagement

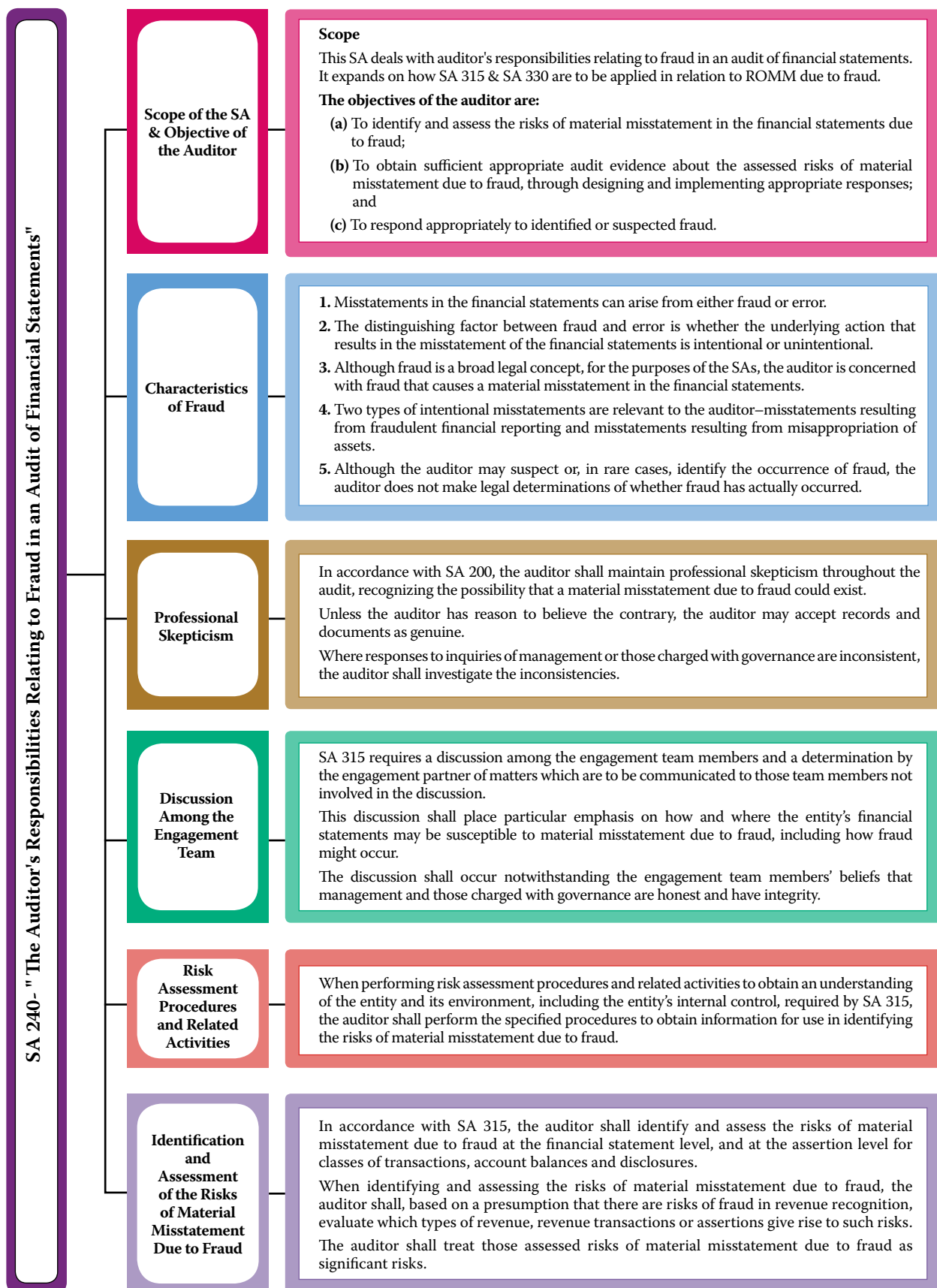
1. If, prior to completing the audit engagement, the auditor is requested to change the audit engagement that conveys a lower level of assurance, the auditor shall determine whether there is reasonable justification for doing so.
2. If terms of audit engagement are changed, the auditor & management shall agree on the new terms of engagement.
3. If the auditor is unable to agree to a change of the terms of the audit engagement and is not permitted by management to continue the original audit engagement, the auditor shall:
  - (a) Withdraw from the audit engagement where possible under applicable law or regulation; and
  - (b) Determine whether there is any obligation, either contractual or otherwise, to report the circumstances to other parties, such as those charged with governance, owners or regulators.

SA 220- "Quality Control for an Audit of Financial Statements"











SA 240- "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements" contd...

**Responses to the Assessed Risks of Material Misstatement Due to Fraud- Overall Responses**

In accordance with SA 330, the auditor shall determine overall responses to address the assessed risks of material misstatement due to fraud at the financial statement level.

In determining overall responses to address the assessed risks of material misstatement due to fraud at the financial statement level, the auditor shall:

- (a) Assign and supervise personnel taking account of the knowledge, skill and ability of the individuals to be given significant engagement responsibilities and the auditor's assessment of the risks of material misstatement due to fraud for the engagement;
- (b) Evaluate whether the selection and application of accounting policies by the entity, particularly those related to subjective measurements and complex transactions, may be indicative of fraudulent financial reporting resulting from management's effort to manage earnings; and
- (c) Incorporate an element of unpredictability in the selection of the nature, timing and extent of audit procedures.

**Audit Procedures Responsive to Assessed Risks of Material Misstatement Due to Fraud at the Assertion Level**

In accordance with SA 330, the auditor shall design and perform further audit procedures whose nature, timing and extent are responsive to the assessed risks of material misstatement due to fraud at the assertion level.

**Evaluation of Audit Evidence**

The auditor shall evaluate whether analytical procedures that are performed when forming an overall conclusion as to whether the financial statements as a whole are consistent with the auditor's understanding of the entity and its environment indicate a previously unrecognized risk of material misstatement due to fraud.

When the auditor identifies a misstatement, the auditor shall evaluate whether such a misstatement is indicative of fraud.

If there is such an indication, the auditor shall evaluate the implications of the misstatement in relation to other aspects of the audit.

If the auditor identifies a misstatement and the auditor has reason to believe that it is or may be the result of fraud and that management (in particular, senior management) is involved, the auditor shall re-evaluate the assessment of the risks of material misstatement due to fraud.

The auditor shall also consider whether circumstances or conditions indicate possible collusion involving employees, management or third parties when reconsidering the reliability of evidence previously obtained.

When the auditor confirms that, or is unable to conclude whether, the financial statements are materially misstated as a result of fraud, the auditor shall evaluate the implications for the audit.

**Auditor Unable to Continue the Engagement**

If, as a result of a misstatement resulting from fraud or suspected fraud, the auditor encounters exceptional circumstances that bring into question the auditor's ability to continue performing the audit, the auditor shall:

- (a) Determine the professional and legal responsibilities applicable in the circumstances.
- (b) Consider whether it is appropriate to withdraw from the engagement, where withdrawal from the engagement is legally permitted; and
- (c) If the auditor withdraws:
  - (i) Discuss with the appropriate level of management and those charged with governance, the auditor's withdrawal from the engagement and the reasons for the withdrawal; and
  - (ii) Determine whether there is a professional or legal requirement to report to the person or persons who made the audit appointment.