

SQC 1 – QC for firms that performs audits and review of historical financial info, and other assurance and related service engagements

SQC 1 requires that firm should **establish a system of QC** designed to provide it with **reasonable assurance** that firm and its personnel.

- o **comply** with professional standards and regulatory and legal requirements (PLR) and
- o that **reports issued** by firm or engagement partners **are appropriate**.

This QC std. applies to all firms irrespective of their constitution.

Elements of System of Quality Control

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

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

Leadership Responsibilities for Quality within Firm

SQC 1 requires firms to **establish policies & procedures** designed to **promote an internal culture**.

Firm's CEO or managing partners to assume ultimate responsibility for firm's system of QC.

Audit quality is paramount in all engagements. It is **non-negotiable**.

In this regard, it should be ensured that: - (**Q- Considerations one should exercise to uphold Firm?**)

1. **Firm assigns its management responsibilities** so that **commercial considerations don't override quality of work performed**.
2. **Firm's policies and procedures** with regard to its personnel **are designed to demonstrate firm's overriding commitment to quality &**
3. Firm devotes **sufficient resources** for development, documentation and support of its QC policies and procedures.
4. A firm **before accepting** an engagement should **acquire vital info.** about client. Such an info. help firm to decide about **integrity** of **Client, promoters and KMP, competence to perform engagement** and compliance with ethical requirements.

Ethical Requirements

Firm should establish policies & procedures designed to provide it with reasonable assurance that firm and its personnel **comply with relevant ethical requirements**.

Fundamental principles include integrity, objectivity, professional competence & due care, confidentiality & professional behaviour.

Observance of "Independence" in all engagements is the founding requirement.

Firm should **establish policies and procedures** designed to **provide it with reasonable assurance** that firm, its personnel and (including experts) **maintain independence** where required by the Code.

Such policies and procedures should enable the firm to: -

- (a) **Communicate** its independence requirements to its personnel.
- (b) **Identify and evaluate circumstances and relationships that create threats to independence**, and to **take appropriate action** to eliminate those threats.

At least **annually**, firm should **obtain written confirmation of compliance** with its policies and procedures on **independence** from **all firm personnel** required to be independent.

SQC 1 lays special emphasis on familiarity threat. Using the **same senior personnel** on assurance engagements **over a prolonged period** may impair the quality of performance of the engagement.

Therefore, firm should **establish criteria for determining the need for safeguards** to address this threat.

In determining appropriate criteria, **firm considers such matters as-**

- a) **nature** of engagement, including **extent to which it involves a matter of public interest** and
- b) **length** of service of senior personnel on engagement

Ex of safeguards include **rotating the senior personnel or requiring an engagement quality control review**

Note: For **Listed entities audits**, **engagement partner should be rotated after a pre- defined period, normally not more than 7 years** (except in cases where audit of listed entities is conducted by a sole practitioner). (Rotation once in 7 years)

There is a process for **mandatory peer review** of such firms.

Q 14

Acceptance and Continuance of Client Relationships and Specific Engagements

A firm **before accepting engagement** should **acquire vital info about the client**. Such info should help firm to **decide about:** -

- **Integrity** of Client, promoters and key managerial personnel.
- **Competence** (including capabilities, time and resources) to perform engagement.
- **Compliance** with ethical requirements.

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

1. **Nature of client's operations**, including its business practices.
2. **Identity & business reputation** of client's principal owners, key Mgt., related parties and TCWG.
3. **Reasons for proposed appointment** of firm and **non-reappointment** of previous firm.
4. **Info concerning attitude** of client's principal owners, key mgt. and TCWG **towards such matters as aggressive interpretation of AS and IC environment**.
5. Whether client is **aggressively concerned** with maintaining the **firm's fees as low as possible**.
6. Indications of an **inappropriate limitation** in scope of work.
7. Indications that client might be **involved in money laundering or other criminal activities**.

In considering whether the **firm has the capabilities, competence, time and resource to undertake an engagement**, following matters **have to be taken into consideration:** -

- o Firm personnel have **knowledge** of relevant industries or subject matters;
- o Firm personnel have **experience** with relevant regulatory or reporting requirements,
- o Firm has **sufficient personnel** with the necessary capabilities and competence;
- o **Experts** are available, if needed;
- o Firm would be able to **complete** the engagement within the **reporting deadline**.
- o **Individuals meeting the criteria and eligibility requirements to perform engagement quality control review** are available, where applicable.

Q. Considerations of reviewers - SQC 1

Q 5

- 1) Work has been performed as per professional standards and regulatory and legal requirements;
- 2) Significant matters have been raised for further consideration;
- 3) Appropriate consultations have taken place and resulting conclusions have been documented and implemented;
- 4) There is a need to revise the NTE of work performed;
- 5) Work performed supports conclusions reached & is appropriately documented;
- 6) Evidence obtained is sufficient and appropriate; and
- 7) Objectives of engagement procedures have been achieved.

Where the firm obtains info. that would have caused it to decline an engagement if that info. had been obtainable earlier, policies and procedures on continuance of engagement and client relationship should include **consideration** of:

- (a) **Professional & legal responsibilities** that apply, including whether there is a requirement for firm to report to persons who made appointment or, to regulatory authorities; and
- (b) **Possibility of withdrawing** from engagement or from both engagement and client relationship.

Q 8

Policies & procedures on withdrawal from an engagement or from both engagement and client relationship address issues that include:

- o **Discussing** with client's mgt. and TCWG **regarding appropriate action** that the firm might take.
- o If firm determines that **it's appropriate to withdraw**, discussing with client's mgt. & TCWG withdrawal from engagement and reasons for withdrawal.
- o **Considering** whether there is a **professional, regulatory or legal requirement** for firm to report withdrawal + reasons for withdrawal, to regulatory authorities.
- o **Documenting** significant issues, consultations, conclusions and basis for conclusions.

Human Resources

Firm should establish policies and procedures designed to provide it with **reasonable assurance** that it has **sufficient personnel** to perform its engagements as per PLR and to enable firm or engagement partners to **issue reports** that are appropriate.

Firm should establish policies and procedures requiring that:

- (a) **Identity and role** of engagement partner are **communicated** to key members of client's mgt. & TCWG;
- (b) Engagement partner has **appropriate capabilities, competence, authority and time** to perform role; and
- (c) **Responsibilities** of engagement partner are **clearly defined** communicated to that partner.

Engagement Performance

Consultation in difficult or contentious matters:

- o Consultation should take place in **difficult or contentious matters** pertaining to an engagement.
- o It includes **discussion**, with individuals within or outside firm who have **specialized expertise**, to **resolve difficult or contentious matter**
- o **Consultation procedures** require consultation with those having appropriate knowledge, seniority and experience within firm (or outside the firm) on significant technical, ethical and other matters.
- o A firm needing to **consult externally**, for example, a firm without appropriate internal resources, may take advantage of advisory services provided by other firms.

Engagement quality control review (EQCR):

Significant judgments made in an engagement should be **reviewed by an EQC reviewer** for taking an objective view before the report is issued.

Review **doesn't reduce responsibilities** of the engagement partner.

EQCR is **mandatory** for all audits of FS of **listed entities.**

Q 7

An EQCR for audits of FS of listed entities includes considering following:-

1. Engagement team's evaluation of the firm's **independence** in relation to specific engagement.
2. **Significant risks identified** during engagement and **responses** to those risks.
3. **Judgments** made particularly w.r.t. materiality & significant risks
4. Whether **appropriate consultation** has taken place on matters involving differences of opinion or other difficult or contentious matters, and conclusions arising from those consultations.
5. **Matters to be communicated** to mgt. & TCWG and other parties such as regulatory bodies.
6. **Appropriateness of report** to be issued.
7. Whether **working papers selected** for review reflect work performed in relation to significant judgments and support conclusions reached.

EQC reviewer - is a partner, other person in the firm (who should be member of ICAI), suitably qualified external person (partner or experienced employee from another firm) or a team made up of such individuals.

Objectivity Maintenance:

- Maintain objectivity of EQC reviewer.
- Participation in engagement or decision for team should be avoided

Replacement Protocols:

- Firm policies should outline procedures for replacing EQC reviewer if objectivity is compromised.
- Another individual within firm or a suitably qualified external person may be appointed in such cases.

Differences of Opinion:

There might be difference of opinion within engagement team, with those consulted and between engagement partner and EQC reviewer.

Report should only be issued **after resolution** of such differences.

In case, **recommendations** of EQC reviewer **are not accepted** by engagement partner and **matter is not resolved**, matter should be resolved by following established procedures of firm like by consulting with another practitioner or firm, or a professional or regulatory body.

Engagement documentation:

Firm should establish policies & procedures to complete **assembly of final engagement files** on timely basis after report has been finalized. Engagement files should be completed **in not more than 60 days after date of auditor's report** in case of **audit engagements** and in **other cases** within the limits appropriate to engagements.

Where **2 or more different reports** are issued in respect of the same subject matter information of an entity, time limits for the assembly of final engagement files should be **considered for each report as if it were for a separate engagement**.

Care should be taken that policies and procedures on documentation of EQCR should require documentation that: -

- Procedures required by the firm's policies on EQCR have been performed.
- EQCR has been completed before the report is issued and
- Reviewer is not aware of any unresolved matters that would cause the reviewer to believe that significant judgments the engagement team made and the conclusions they reached were not appropriate.

Ownership: Engagement documentation is the **property of the firm**. Firm can, at its discretion, share portions or extracts with clients.

Retention Period: For **audit engagements**, the retention period is typically **not less than 7 years** from the auditor's report date or, if later, the group auditor's report date.

Monitoring

QC of engagements has to be monitored taking into account **following factors:**

- Deciding whether **QC system of firm** has been appropriately **designed and effectively implemented**.
- Examining whether **new developments** in PLR have been reflected in the quality control policies.
- Conducting monitoring** by entrusting responsibility of monitoring process to a partner or other persons with sufficient and appropriate experience and authority.
- Dealing with **complaints and allegations** against firm or any employees of it of non-compliance with PLR.
- Taking action when **deficiencies** in the design or operation of the firm's QC policies and procedures, or non-compliance with firm's system of QC are identified.
- Taking appropriate **remedial actions** against the personnel who did not conform to QC policies.

Policies required for dealing with such complaints and allegations

- Firm should **establish policies and procedures** designed to provide it with reasonable assurance that it deals appropriately with:
 - Complaints & allegations** that the work performed by **firm fails to comply** with PLR; and
 - Allegations of non-compliance** with the firm's system of QC.
- Complaints and allegations may **originate from within or outside the firm**.
- Firm establishes clearly defined channels for firm personnel to raise any concerns enabling them to come forward **without fear of reprisals**.
- Firm **investigates** such complaints and allegations **as per established policies and procedures**. Investigation is **supervised by a partner** with sufficient and appropriate experience and authority within the firm but who is **not otherwise involved in engagement**, and includes involving legal counsel as necessary.
- Where the **results of investigations indicate deficiencies** in design or operation of firm's QC policies and procedures, or **non-compliance** with firm's system of quality control - **takes appropriate action**.

SA-220 – Quality control for an audit of FS

Engagement partner of a team is responsible for quality control procedures of a particular audit engagement as per SA-220.

Hence, SA 220 is premised on the basis that firm is subject to SQC 1

As per SA-220, objective of auditor is to implement quality control procedure the engagement level that provides the auditor with reasonable assurance that:

- Audit **complies** with professional standards and regulatory and legal requirements and;
- Auditor's report issued is **appropriate** in the circumstances.

SA 220 is modelled on lines of SQC 1. It describes the responsibilities of engagement partner in relation to following matters:

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

Leadership Responsibilities for Quality on Audits

Leadership responsibility of an engagement partner is to take responsibility for overall quality on each audit engagement.

In taking responsibility for the overall quality on each audit engagement, emphasis:

- Importance to audit quality of: -
 - Performing work that **complies** with professional standards and regulatory and legal requirements;
 - Complying** with firm's quality control policies & procedures as applicable.
 - Engagement team's **ability to raise concerns** without fear of reprisals.
 - Issuing auditor's reports** that are appropriate.
- Fact that quality is essential in performing audit engagements.

Relevant Ethical Requirements

Responsibilities of an engagement partner in relation to ethical requirements are -

- o **Identifying a threat to independence.**
- o **Reporting** by engagement partner to the relevant persons to **determine appropriate action.**

Acceptance and Continuance of Client Relationships and Audit Engagements

SAME AS SQC 1

Assignment of Engagement Teams

Have **appropriate competence and capabilities** to perform the engagement in accordance with PLR.

Engagement Performance

Engagement partner has the **responsibility for direction, supervision & performance of audit engagement** in accordance with PLR.

He is responsible for **review of audit documentation before issue of audit report** is his responsibility.

It has to be ensured that **SAAE** has been obtained to support the conclusions reached and for issuance of auditor's report.

He is also responsible for **ensuring undertaking appropriate consultation** on difficult or contentious matters by engagement team.

Engagement Quality Control Review

Q 17

For audits of financial statements of listed entities, and those other audit engagements, if any, for which the firm has **determined that an EQCR is required**, the engagement partner shall:

- (a) Determine that an **EQC reviewer has been appointed**
- (b) Discuss **significant matters arising** during the audit engagement, including those identified during the EQCR, with the EQC reviewer
- (c) **Not date the auditor's report until the completion of EQCR.**

EQCR shall perform an **objective evaluation of significant judgments** made by the engagement team, and the conclusions reached in formulating the auditor's report. This evaluation shall involve:

- (a) Discussion of **significant matters** with the engagement partner
- (b) **Review** of the **FS** and the **proposed auditor's report.**
- (c) **Review of selected audit documentation** relating to the significant judgments the engagement team made and the conclusions it reached and
- (d) **Evaluation of the conclusions reached** in formulating the auditor's report and consideration of whether the proposed auditor's report is appropriate

For audits of FS of listed entities, **EQC reviewer, on performing an EQCR**, shall also consider the following:

SAME AS SQC 1

Differences of Opinion - follow the firm's policies and procedures for dealing with and resolving differences of opinion.

Monitoring**Documentation**

Engagement partner should document -

- a) **Issues identified** w.r.t compliance with relevant ethical requirements and how they were resolved.
- b) **Conclusions** on compliance with independence requirements.
- c) **Conclusions** reached regarding the acceptance and continuance of client relationships and audit engagements.
- d) Nature & scope of, and conclusions resulting from, **consultations undertaken.**

Besides, **EQC reviewer shall document**, for the audit engagement reviewed, that:

- a) **Procedures** required by the firm's policies on EQCR have been **performed.**
- b) EQCR has been **completed on or before the date of auditor's report.**
- c) Reviewer is not aware of any **unresolved matters** that would cause reviewer to believe that significant judgments the engagement team made and the conclusions they reached were **not appropriate.**

SQC 1 vs. SA 220- Key Differences

S.N	SQC 1	SA 220
1	It applies to entire firm and fixes the responsibility of firm to be assumed by CEO or managing partners	It applies to a particular audit engagement and engagement partner takes responsibility of the same.
2	It is applicable to audits, reviews of historical financial information and other assurance and related services engagements.	It is applicable to audit engagements only.
3	It relates to setting up of a QC system consisting of policies and procedures for firm as a whole.	It deals with <u>responsibilities of engagement teams to implement QC procedures</u> that are applicable to audit engagements
4	It pertains to establishing a system of quality control designed to provide firm with a reasonable assurance that a firm and its personnel comply with PLR so that reports issued by firm or engagement partners are appropriate.	It is premised on the basis that firm is subject to SQC 1. Therefore, SQC 1 is a sine qua non for applicability of SA 220. It is within overall context of a firm's system of quality control, engagement teams implement quality control procedures applicable to audit engagements.

Mechanism for Review of QC

Peer Review Board

Peer review Board is constituted by Council of ICAI.

Main objective of Peer review Board is to ensure that, in carrying out assurance assignments:

- o Technical, professional and ethical standards including regulatory requirements are complied with by members of ICAI
- o Proper systems are in place including documentation which demonstrate quality of assurance services provided by members

Peer review means an examination and review of the systems and procedures to determine whether the same have been put in place by the Practice Unit for ensuring the quality of assurance services as envisaged by the technical, professional and ethical Standards or any other regulatory requirements.

Once a Practice Unit is subjected to Peer review, its assurance engagement records pertaining to the Peer review period are subject to examination and review by the Peer Reviewer.

On completion of this exercise, a "peer review certificate" is issued in case of **unqualified report** issued by Peer Reviewer.

In case of a **qualified report**, it is **informed to the Practice Unit that same cannot be issued along with the reasons** therefor as well as inform about the due date for conducting a follow-on review as may be decided by the Board.

Quality Review Board

Quality review Board has been set up by CG. It consists of members nominated by CG and Council of ICAI.

Functions of QRB are:-

- (a) To make recommendations to the Council regarding quality of services provided by the members of Institute;
- (b) To review quality of services provided by members of Institute including audit services and
- (c) To guide members of Institute to improve quality of services and adherence to the various statutory and other regulatory requirements;

Statutory auditors in respect of the companies are identified for their audit quality review based upon risk-based approach. The review is carried out by technical reviewers who are empanelled by QRB on engagement basis from across the country.

National Financial Reporting Authority (NFRA)

NFRA has been constituted in terms of **Sec 132(1) of Co. Act, 2013**

Duties -

- o Monitor and enforce compliance with AS and SA.
- o Oversee the quality of service of the professions associated with ensuring compliance with such standards and suggest measures for improvement in quality of service

Power to -

- o Monitor & Enforce compliance with AS and SA and oversee quality of service under **section 132(2)** or
- o Undertake investigation under section 132(4) of auditors of certain class of companies

Such companies include listed companies, insurance companies, banking companies and other companies as provided for in **rule 3 of NFRA Rules, 2018**

QRB VS NFRA -

- o **Overseeing quality of audit services of listed companies falls under the purview of NFRA**
- o **QRB can review quality of audit services** provided by the members of Institute only in respect of entities other than those specified under Rule 3 of NFRA Rules, 2018 and those referred to QRB by NFRA under relevant rules.

Q.15 During the audit of FMP Ltd, a listed company, Engagement Partner (EP) completed his reviews and also ensured compliance with independence requirements that apply to the audit engagement. The engagement files were also reviewed by the (EQCR) Engagement Quality Control Reviewer **except the independence assessment documentation**. Engagement Partner was of the view that matters related to independence assessment are the responsibility of the Engagement Partner and not Engagement Quality Control Reviewer. Engagement Quality Control Reviewer objected to this and refused to sign off the documentation. Please advise as per SA 220. (SM)

Answer

As per SA 220, **Engagement Partner shall form a conclusion on compliance with independence requirements that apply to the audit engagement**. In doing so, Engagement Partner shall:

Obtain relevant info. from firm and network firms, to identify and evaluate circumstances and relationships that create threats to independence;

Evaluate info. on identified breaches, of firm's independence policies and procedures to determine whether they create a threat to independence for audit engagement; and

Take appropriate action to eliminate such threats or reduce them to an acceptable level by **applying safeguards**, or, if considered appropriate, to withdraw from the audit engagement, where withdrawal is permitted by L/R. Engagement partner shall promptly report to firm any inability to resolve matter for appropriate action. Engagement Partner shall take responsibility for reviews being performed in accordance with firm's review policies and procedures.

As per SA 220, "Quality Control for Audit of Financial Statements", for audits of financial statements of listed entities, Engagement Quality Control Reviewer (EQCR), on performing an engagement quality control review, **shall also consider engagement team's evaluation of firm's independence in relation to audit engagement**.

In the given case, Engagement Partner is **not right**. The independence assessment documentation should also be given to Engagement Quality Control Reviewer for his review.

SA 200 Overall Objectives of The Independent Auditor & Conduct Of Audit In Accordance With SA's

Overall Objectives of the Auditor

Obtain **reasonable assurance** about whether the F.S. as a whole are free from MM, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the F.S. are prepared, in all material respects, in accordance with an applicable FRF.

Professional skepticism

- 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.

Professional skepticism includes being alert to, for ex-

- AE that contradicts other AE obtained.
- Info. that brings into question reliability of documents & responses.
- Conditions that may indicate possible fraud.

Maintaining professional skepticism reduce risks of:

- Overlooking unusual circumstances.
- Over generalising when drawing conclusions from audit observations.
- Using inappropriate assumptions

Professional Judgment

Application of **relevant training, knowledge and experience**, within the context provided by auditing, accounting and ethical standards, in making informed decisions.

Sufficient Appropriate Audit Evidence

To obtain reasonable assurance, auditor shall obtain SAAE to reduce audit risk to an acceptably low level.

Reasonable assurance - In the context of an audit of FS a high, but **not absolute, level of assurance**.

Audit evidence.

- Sufficiency- is **measure of quantity** of audit evidence.
- Appropriateness - **measure of quality** of audit evidence.

Audit risk

Risk that auditor **expresses an inappropriate audit opinion** when FS are materially misstated.

Audit Risk = Risk of Material Misstatement X Detection Risk

Risk of MM = Inherent risk X Control risk

Inherent Limitations for an audit

Q 36

Nature of financial reporting:

Preparation of F.S. **involves judgment by Mgt.** in applying the requirements of the applicable FRF to the facts and circumstances of entity. For ex- **Accounting estimates**.

Nature of audit procedures:

1. Mgt. & others **don't provide complete info.** intentionally/ unintentionally.
2. **Audit procedures** used to gather audit evidence may be **ineffective against fraud detection**.
3. Audit is **not an official investigation** into alleged wrongdoings.

Timeliness of Financial Reporting and the Balance between Benefit and Cost

User expectation that auditor will form an opinion on the F.S. within a reasonable period of time and at a **reasonable cost**.

Other Matters that Affect the Limitations of an Audit:

Q 35

In case of certain assertions or subject matters, potential effects of limitations on auditor's ability to detect MMs are particularly significant.

Such assertions or subject matters include:

- 1) **Fraud**, particularly fraud involving senior Mgt. or collusion.
- 2) **Existence and completeness of related party relationships and transactions**.
- 3) **Occurrence of (NOCLAR)** non-compliance with laws and regulations.
- 4) **Future events or conditions** that may cause an entity to **cease to continue as a going concern**.

Complying with relevant Requirements

- Auditor shall comply **with each requirement** of an SA **Unless**:
 - **Entire SA is not relevant**.
 - **Requirement is not relevant** because it is conditional & condition **does not exist**.
- In exceptional circumstances, auditor may judge it **necessary to depart** from a relevant requirement in an SA. In such case he shall **perform alternative audit procedures** to achieve the aim of that requirement

SA 210 Agreeing the Terms of Audit Engagements

Objective of Auditor

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

- a) Establishing whether **pre-conditions** for audit are present; and
- b) Confirming that there is a **common understanding** b/w auditor and Mgt. & TCWG.

Preconditions for an Audit

Q 37

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

- a) Determine whether **FRF** to be applied in the preparation of FS is **acceptable**; and
- b) Obtain the **agreement of Mgt.** that it acknowledges and understands its responsibility:
 - For **preparation of FS** in accordance with the applicable FRF, including where relevant their fair presentation;
 - For **such IC** as Mgt. determines is necessary to enable the preparation of FS that are free from MM, whether due to fraud or error; and
 - To **provide auditor with:**

Access to all info. that is relevant to the preparation of the FS such as records, documentation & other matters;	Additional info. that the auditor may request from Mgt. and	Unrestricted access to persons within the entity from whom auditor determines it necessary to obtain audit evidence.
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Agreement on Audit Engagement Terms

Q 38

- Auditor shall agree terms of audit engagement with Mgt. or TCWG, as appropriate.
- Agreed terms of audit engagement shall be recorded in an audit engagement letter or other suitable form of written agreement and shall include: (**Content of EL**)
 - a) **Objective and scope** of audit of F.S.;
 - b) **Responsibilities of auditor**;
 - c) **Responsibilities of Mgt.**;
 - d) **Identification of applicable FRF** for preparation of F.S.; and
 - e) **Reference to expected form & content** of any reports to be issued by auditor.

If L/R prescribes in sufficient detail terms of audit engagement referred above, auditor **need not record** them in a written agreement.

Other Factors Affecting Audit Engagement Acceptance

If preconditions for an audit **are not present**, auditor shall **discuss matter with Mgt.** Unless required by L/R to do so, auditor **shall not accept** proposed audit engagement:

- a) If auditor has determined that **FRF** to be applied is **unacceptable**; or
- b) If **agreement of Mgt.'s responsibility** has **not been obtained**

Recurring Audits

Q 39

1. In recurring audits- assess whether **circumstances require revision** in terms & whether there is **need to remind entity** of existing terms.
 2. May decide not to send a new audit EL or other written agreement each period.
- However, following factors may make it **appropriate to revise terms** of the audit engagement or to **remind** the entity of existing terms:
- a) Any **indication** that **entity misunderstands objective & scope** of audit.
 - b) Any **revised or special terms** of audit engagement.
 - c) A **recent change of senior Mgt.**
 - d) A **significant change in ownership.**
 - e) A **significant change in nature or size of entity's business.**
 - f) A **change in legal or regulatory requirements.**
 - g) A **change** in the **FRF** adopted in the preparation of F.S.
 - h) A **change in other reporting requirements.**

Acceptance of Change in Terms of Audit Engagement

- a) Auditor shall **not agree** to a change in the terms **where there is no reasonable justification for doing so.**
- b) If, **prior to completing** audit engagement, auditor is **requested to change** audit engagement to an engagement that **conveys a lower level of assurance**, he shall **determine whether there is reasonable justification for doing so.**
- c) If **terms of audit engagement are changed, auditor and Mgt. shall agree** on and **record new terms** of engagement in an EL or other suitable form of written agreement.
- d) If auditor is **unable to agree to a change** terms & is **not permitted** by Mgt. to **continue the original audit engagement**, he shall:
 - (i) **Withdraw** from audit engagement **where possible under applicable L/R**; and
 - (ii) **Determine** whether there is **any obligation to report circumstances** to other parties, such as TCWG, owners or regulators.

FRF Prescribed by Law or Regulation—Other Matters Affecting Acceptance

If auditor has determined that **FRF prescribed** by L/R would be **unacceptable** but for fact that it is prescribed by L/R, he shall accept the audit engagement only if following conditions are present:

- a) **Mgt. agrees to provide additional disclosures** in FS required to **avoid the FS being misleading**; and
- b) It is **recognised in the terms** of audit engagement that:
 - (i) Auditor's report on FS will incorporate an **Emphasis of Matter paragraph**, drawing users attention to the additional disclosures, in accordance with SA 706; and
 - (ii) **Unless auditor is required by L/R** to express auditor's opinion on the FS by using the phrases "present fairly, in all material respects", or "give a true and fair view" in accordance with the applicable FRF, **auditor's opinion on the FS will not include such phrases.**

If above conditions are not present and auditor is required by L/R to undertake the audit engagement, he shall:

- a) **Evaluate effect of the misleading nature** of FS on the auditor's report; and
- b) **Include appropriate reference** to this matter in the terms of the audit engagement.

Determining the Acceptability of the FRF

Factors that are relevant to the auditor's determination of the acceptability of the FRF to be applied in the preparation of the FS include:

- Nature of the entity
- Purpose of the FS
- Nature of the FS and
- Whether law or regulation prescribes the applicable FRF

Audits of Components

When auditor of a parent entity is also the auditor of a component, factors that may influence decision whether to **send a separate audit engagement letter** to the component include the following:

- **Who appoints** component auditor;
- Whether a **separate auditor's report is to be issued** on component;
- **Legal requirements** in relation to audit appointments;
- **Degree of ownership by parent**; and
- **Degree of independence** of **component Mgt.** from the parent entity.

SA 230 Audit Documentation

Record of audit procedures performed + relevant **AE obtained** + **conclusions reached**

Purposes/Importance of Audit Documentation

- 1) Assisting engagement team to **plan & perform audit**.
- 2) Enabling engagement team to be **accountable** for its work.
- 3) Enabling conduct of **quality control reviews & inspections** as per SQC 1.
- 4) Enabling conduct of **external inspections** as per applicable legal, regulatory or other requirements.
- 5) Retaining a record of matters of continuing significance to future audits.

Form, Content and Extent of Audit Documentation

Auditor shall prepare AD that is sufficient to enable an auditor, having no previous connection with the audit, **to understand**:

- a) **NTE** of audit procedures performed
- b) **Results** of the audit procedures performed, and **AE obtained**; and
- c) **Significant matters** arising during audit, **conclusions** reached, and significant professional **judgments** made in reaching those conclusions.

In documenting NTE of audit procedures performed, shall record:

- a) Identifying characteristics of **specific items or matters tested**;
- b) **Who performed** audit work and **date** such work was completed; and
- c) **Who reviewed** audit work performed and **date** and **extent** of such review.

Factors effecting form, content & extent of audit documentation

Q 40

- 1) **Size & complexity** of entity.
- 2) **Nature of audit procedures** to be performed.
- 3) Identified risks of MM.
- 4) **Significance** of AE obtained.
- 5) **Nature and extent of exceptions identified**.
- 6) **Audit methodology** and **tools** used.
- 7) Timely **preparation of AD**.

Documentation of Departure from Relevant Requirement

If, in exceptional circumstances, auditor judges it necessary to depart from a relevant requirement in a SA, he shall **document**

- a) how **alternative audit procedures performed**, and
- b) **reasons for departure**.

Matters Arising after the Date of the Auditor's Report

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

- a) **Circumstances encountered**;
- b) **New or additional audit procedures performed**, AE obtained, and conclusions reached, and their effect on auditor's report; and
- c) **When and by whom** resulting changes to audit documentation **were made & reviewed**.

Assembly of the Final Audit File

SQC 1 requires firms to establish policies and procedures for the timely completion of the assembly of audit files i.e. **not more than 60 days after the date of auditor's report**.

After assembly of final audit file, its **retention period** i.e. **no shorter than 7 years** from the date of the auditor's report.

If auditor finds it **necessary to modify AD** or **add new AD** after assembly of the final audit file has been completed, he shall document:

- a) **Specific reasons for making them**; and
- b) **When and by whom** they were **made and reviewed**.

Q. You are team leader of 10 members for audit of Multinational Co. All team members are concerned about audit documentation in order to provide evidence that audit complies with SAs. Hence, **team members wish to document every matter concerned**. In your opinion it is **neither necessary nor practicable for auditor to document every matter** considered or professional judgement made in audit. Further you feel that it is unnecessary for auditor to document separately compliance with matters for which compliance is demonstrated by documents included within audit file. Illustrate by giving examples with reference to relevant SA.

Q 41

Answer:

SA 230, "Audit Documentation", provides **evidence that audit complies with SAs**. However, it is **neither necessary nor practicable** for auditor to **document every matter** considered, or professional judgement made, in audit. For example,

- 1) **Existence of adequately documented audit plan** demonstrates that auditor has planned audit.
- 2) **Existence of signed engagement letter** in audit file demonstrates that auditor has agreed terms of audit engagement with Mgt. or TCWG.
- 3) **Auditor's report containing qualified opinion** demonstrates that auditor has complied with requirement to express qualified opinion.
- 4) In relation to **requirements that apply generally throughout audit**, there may be a **number of ways** in which compliance with them may be demonstrated within audit file:
 - For ex: there may be **no single way** in which auditor's **professional skepticism** is documented. But **audit documentation may nevertheless provide evidence of auditor's exercise of professional skepticism** in accordance with SAs. Such evidence may include specific procedures performed to corroborate Mgt.'s responses to auditor's inquiries.
 - Similarly, that **engagement partner has taken responsibility for direction, supervision & performance of audit** in compliance with SAs may be evidenced in a no. of ways within audit documentation. This may **include documentation of engagement partner's timely involvement** in aspects of audit, such as participation in team discussion required by SA 315.

SA 240 "The Auditor's Responsibilities Relating To Fraud In An Audit Of FS"

Objectives

- To identify and assess the ROMM in FS due to fraud;
- To obtain SAAE about the assessed ROMM to fraud
- To respond appropriately to identified or suspected fraud

Two types of intentional misstatements: -

- Misstatements resulting from **fraudulent financial reporting**
- Misstatements resulting from **misappropriation of assets**

Q 4

How Fraudulent Financial Reporting may be caused by identities?

- Fraudulent financial reporting involves **intentional misstatements including omissions of ams or disclosures** in FS to deceive FS users.
- It can be caused by the efforts of Mgt. to **manage earnings in order to deceive FS users.**

Fraudulent financial reporting may be accomplished by the following:

- Manipulation, falsification, or alteration of accounting records or supporting documentation from which the FS are prepared.
- Misrepresentation in or intentional omission from, the FS of events, transactions or other significant info.
- Intentional misapplication of accounting principles.

Fraud can be committed by Mgt. overriding controls using such techniques as: -

- Altering records and terms related to significant and unusual transactions.
- Engaging in complex transactions that are structured to misrepresent financial position.
- Concealing, or not disclosing, facts that could affect the amounts recorded in FS.
- Recording fictitious journal entries, to manipulate operating results or achieve other objectives.
- Inappropriately adjusting assumptions and changing judgments used to estimate account balances.
- Omitting, advancing or delaying recognition in the FS of events and transactions.

How misappropriation of assets may be accomplished by entities?

Misappropriation of assets involves **theft of an entity's assets.** Misappropriation of assets can be accomplished in a variety of ways including:



Embezzling receipts.



Stealing physical assets or intellectual property.



Causing an entity to pay for goods and services not received.



Using an entity's assets for personal use.

Responsibilities of the Auditor

Q 3

- Auditor is responsible for **obtaining reasonable assurance** that FS taken as whole are free from MM, whether caused by fraud/error.
- Owing to **inherent limitations of an audit**, there is an **unavoidable risk** that **some MM of the FS may not be detected**, even though the audit is properly planned & performed in accordance with SAs.
- Risk of **not detecting a MM resulting from fraud is higher** than the risk of **not detecting one resulting from error.**
- This is because fraud may involve sophisticated and carefully organized schemes designed to conceal it, such as forgery, or intentional misrepresentations being made to the auditor.
- Such attempts at concealment may be even more difficult to detect when accompanied by **collusion.**
- Furthermore, risk of auditor not detecting a MM **resulting from Mgt. fraud is greater than for employee fraud**, because Mgt. is frequently in a position to directly or indirectly manipulate accounting records, present fraudulent financial information or override control procedures.
- When **obtaining reasonable assurance**, auditor is **responsible for maintaining professional skepticism** throughout the audit.

Primary responsibility of Mgt./TCWG

Primary responsibility for the prevention & detection of fraud rests with both TCWG and Mgt.

Responses to the assessed ROMM due to fraud at FS level

In determining overall responses to address assessed ROMM due to fraud at FS level, auditor shall: -

- Assign and supervise personnel and auditor's assessment of the **ROMM due to fraud for the engagement;**
- Evaluate whether 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** and
- Incorporate an element of unpredictability in the selection of the NTE of audit procedures.

Audit procedures responsive to assessed ROMM due to fraud at the assertion level

- Auditor shall **design and perform further audit procedures whose NTE are responsive to assessed ROMM** due to fraud at assertion level.
- In doing so, he may **change NTE of audit procedures** to obtain AE that is more reliable and relevant or to obtain additional corroborative info.
- For Ex: if he identifies that Mgt. is under pressure to meet earnings expectations, there may be a related risk that Mgt. is **inflating sales** by entering into sales agreements that include terms that preclude revenue recognition or by invoicing sales before delivery. Here, he may **design EC** not only to confirm outstanding amounts, but also to **confirm the details of the sales agreements**, including date, any rights of return and delivery terms. Also, **supplement** such EC with **inquiries** of non-financial personnel in entity regarding any changes in sales agreements and delivery terms.

Audit procedures responsive to risks related to Mgt. override of controls

- Auditor shall design & perform audit procedures to:
- Test **appropriateness of journal entries** recorded in the general ledger and other adjustments made.
 - Review **accounting estimates for biases** and evaluate whether the circumstances producing the bias, if any, represent a ROMM due to fraud.
 - For significant transactions that are **outside the normal course of business** for the entity or appear to be **unusual**, he shall evaluate whether the **business rationale of transactions suggests** that they may have been **entered into to engage in fraudulent financial reporting or to conceal MOA.**

What are fraud risk factors?

[A] Risk factors relating to misstatements arising from fraudulent financial reporting

Incentives/Pressures

Financial stability or profitability is threatened by economic, industry, or entity operating conditions, such as (or as indicated by):

- High degree of competition
- Rapid changes such as changes in technology.
- Significant declines in customer demand.
- Recurring negative cash flows from operations

Excessive pressure exists for mgt. to meet the requirements or expectations of third parties due to the following:

- 1) Profitability or trend level expectations of institutional investors, significant creditors, or other external parties.
- 2) Need to obtain additional debt or equity financing to stay competitive.
- 3) Marginal ability to meet exchange listing requirements or debt repayment or other debt covenant requirements.
- 4) Perceived or real adverse effects of reporting poor financial results on significant pending transactions, such as business combinations or contract awards.

Information available indicates that the personal financial situation of Mgt. or TCWG is threatened by entity's financial performance arising from following: -

- Significant financial interests in the entity.
- Significant portions of their compensation (ex- bonuses) being contingent upon achieving aggressive targets for operating results, financial position, or cash flow.
- Personal guarantees of debts of the entity.
- Excessive pressure on Mgt. or operating personnel to meet financial targets.

Opportunities:

The nature of the industry or the entity's operations provides opportunities to engage in fraudulent financial reporting that can arise from the following: -

- 1) Significant related-party transactions not in the ordinary course of business.
- 2) A strong financial presence or ability to dominate a certain industry sector that allows the entity to dictate terms or conditions to suppliers or customers that may result in inappropriate or non-arm's-length transactions.
- 3) Assets, liabilities, revenues, or expenses based on significant estimates that involve subjective judgments or uncertainties.

- 4) Significant operations located or conducted across international borders in jurisdictions where differing business environments and cultures exist.
- 5) Use of business intermediaries for which there appears to be no clear business justification.
- 6) Significant bank accounts /subsidiary / branch operations in tax-haven jurisdictions for which there appears to be no clear business justification.

Attitudes/Rationalizations

- Known history of violations of securities laws or other laws and regulations, or claims against the entity, its senior Mgt., or TCWG.
- Excessive interest by Mgt. in maintaining or increasing the entity's stock price or earnings trend.
- Mgt. failing to remedy known significant deficiencies in internal control on a timely basis.
- An interest by Mgt. in employing inappropriate means to minimize reported earnings for tax-motivated reasons.
- Low morale among senior Mgt.
- Dispute between shareholders in a closely held entity.
- Relationship between Mgt. and the current or predecessor auditor is strained, as exhibited by the following: -

Frequent disputes with the current or predecessor auditor on accounting, auditing, or reporting matters.

Unreasonable demands on the auditor, such as unrealistic time constraints regarding the completion of the audit or the issuance of the auditor's report.

Restrictions on the auditor that inappropriately limit access to people or information.

Domineering Mgt. behaviour in dealing with the auditor.

[B] Risk factors relating to misstatements arising from misappropriation of assets

Incentives/Pressures

- Personal financial obligations may create pressure on Mgt. or employees with access to cash or other assets susceptible to theft to misappropriate those assets.
- Adverse relationships between the entity and employees with access to cash or other as susceptible to theft may motivate those employees to misappropriate those assets.
- For ex, adverse relationships may be created by the following: -
 - Known or anticipated future employee layoffs
 - Recent or anticipated changes to employee compensation
 - Promotions, compensation, or other rewards inconsistent with expectations

Opportunities

For Ex: opportunities to misappropriate assets increase when there are the following: -

- 1) Large amounts of cash on hand
- 2) Inventory items that are small in size/of high value/ high demand.
- 3) Easily convertible assets, such as bearer bonds, diamonds, or computer chips.
- 4) Fixed assets which are small in size, marketable, or lacking observable identification of ownership.

Inadequate internal control over assets may increase the susceptibility of misappropriation of those assets.

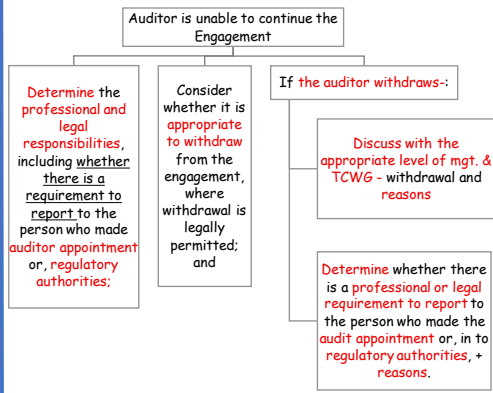
For Ex: misappropriation of assets may occur because of following:

- 1) Inadequate segregation of duties or independent checks.
- 2) Inadequate oversight of senior Mgt. expenditures, such as travel & other reimbursements.
- 3) Inadequate Mgt. oversight of employees responsible for assets.
- 4) Inadequate record keeping with respect to assets.
- 5) Lack of complete and timely reconciliations of assets.
- 6) Lack of mandatory vacations for employees performing key control functions.

Attitudes/Rationalizations

1. Disregard for the need for monitoring or reducing risks related to misappropriations of assets.
2. Disregard for internal control over misappropriation of assets.
3. Behaviour indicating displeasure or dissatisfaction with the entity.
4. Changes in behaviour or lifestyle that may indicate assets have been misappropriated.
5. Tolerance of petty theft.

Circumstances in which auditor is unable to continue the engagement



Evaluation of Audit Evidence

- Auditor shall evaluate whether **analytical procedures that are performed** as to whether the **FS** as a whole are **consistent** with **auditor's understanding** of entity.
- When he **identifies a misstatement**, he shall **evaluate** whether such a misstatement **is indicative of fraud**.
- **If there is such an indication**, he shall **evaluate** the **implications of the misstatement** in relation to **other aspects of the audit**, particularly the **reliability of Mgt. representations**.
- If auditor **identifies a misstatement**, and **has reason to believe that it is or may be the result of fraud** and that **Mgt. (in particular, senior Mgt.) is involved**: **re-evaluate assessment of ROMM** due to fraud and **its resulting impact on NTE** of audit procedures to respond to the assessed risks.
- Consider whether circumstances or conditions **indicate possible collusion** involving employees, Mgt. or 3rd parties.

Mgt. Representations

- 1) They **acknowledge** their responsibility for **design, implementation and maintenance of internal control**;
- 2) They have **disclosed** to the auditor the **results of Mgt.'s assessment of the risk**;
- 3) They have **disclosed** to the auditor their **knowledge of fraud or suspected fraud affecting the entity**; and
- 4) They have **disclosed** to auditor **their knowledge of fraud, or suspected fraud, affecting the entity's FS**.

Note: Auditor shall report fraud as per section 143(12) of companies act ,2013 and clause (xi) of para 3 of CARO 2020.

SA 250 "Consideration of laws and regulations in audit of FS"

Not applicable: To other assurance engagements in which auditor is specifically engaged to test and report separately on compliance with specific L/R.

Responsibility of Mgt. for Compliance with L&R

Q 12

To ensure that entity's operations are conducted in accordance with the provisions of L&R.

Examples of the types of policies and procedures an entity may implement to assist in prevention and detection of NOCLAR :-

- 1) **Monitoring** legal requirements and **ensuring that** operating procedures are designed to meet these requirements.
- 2) **Instituting & operating** appropriate systems of **IC**.
- 3) Developing, publicising and following a **code of conduct**.
- 4) **Ensuring employees** are properly trained and understand the **COC**.
- 5) **Engaging legal advisors** to assist in monitoring legal requirements.
- 6) **Maintaining a register** of significant laws and regulations.

Audit Procedures when Non-Compliance is Identified or Suspected

Q 11

He shall obtain:

- a) An **understanding** of the nature of the act and circumstances in which it has occurred &
- b) **Further info.** to evaluate **possible effect** on the FS.
 - If auditor **suspects** there may be non-compliance, he shall **discuss** the matter with Mgt. and TCWG.
 - If Mgt. or TCWG **don't provide sufficient information** that supports that the entity is in compliance with laws and regulations and, in his judgment, effect of the suspected non-compliance may be material to FS, consider the need to **obtain legal advice**.
 - If **sufficient information** about suspected non-compliance **can't be obtained**, he shall **evaluate the effect** of the lack of SAAE on auditor's opinion.
 - Also, evaluate the **implications of non-compliance** in relation to other aspects of the audit.

Responsibility of Auditor

- Auditor is **not responsible** for preventing NOCLAR and **can't be expected to detect** NOCLAR.
- Responsible for **obtaining reasonable assurance** that FS, taken as a whole, are free from MM, whether caused by fraud or error.
- Owing to **inherent limitations of an audit**, there is an **unavoidable risk** that some MM in the FS may not be detected.

Potential effects of inherent limitations on auditor's ability to detect MM are greater for such reasons as the following: -

Q 18

- 1) There are many laws and regulations, relating to **operating aspects** that **don't affect the FS** and are **not captured by entity's IS**.
- 2) Non-compliance may involve **conduct designed to conceal** it, such as **collusion, forgery, intentional misrepresentations** being made to auditor.
- 3) Whether an **act constitutes non-compliance** is ultimately a **matter** for legal determination by a **court** of law.

SA 250 distinguishes auditor's responsibilities in relation to compliance with 2 different categories of laws and regulations as follows: -

Q 19

Provisions of those L&R recognised to have a direct effect on the determination of material amounts and disclosures in FS such as tax and labour laws and	Other L&R that don't have a direct effect on the determination of the amounts and disclosures in the FS, but <ul style="list-style-type: none"> • compliance with which may be fundamental to the operating aspects of the business, • to an entity's ability to continue its business, or • to avoid material penalties. (ex, compliance with regulatory solvency requirements, or compliance with environmental regulations). Non-compliance with such L&R may, have a material effect on FS.
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Responsibilities

Auditor's responsibility is to obtain SAAE about compliance with the provisions of those L&R.	Auditor's responsibility is limited to undertaking specified audit procedures to help identify non-compliance with those L&R that may have a material effect on the FS.
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Auditor's consideration of compliance with laws and regulations

Q 16

As part of obtaining an understanding of entity and its environment, he shall obtain a **general understanding** of: -

- a) **Legal and regulatory framework** applicable to the entity & industry or sector in which the entity operates; and
- b) **How the entity is complying** with that framework.

Auditor shall perform the following audit procedures to help identify instances of NOCLAR that may have a material effect on the FS:

- a) **Inquiring** of Mgt. and TCWG, **whether** entity is in compliance with such L&R; and
- b) **Inspecting correspondence** with the relevant licensing or regulatory authorities

Indications of NOCLAR:

Q 13

- 1) **Investigations** by regulatory Organisations & govt. departments or payment of fines or penalties.
- 2) **Payments** for **unspecified services** or loans to consultants, related parties, employees or government employees.
- 3) **Sales commissions** or **agent's fees** that appear **excessive** in relation to those ordinarily paid.
- 4) Purchasing at **prices significantly above or below** market price.
- 5) Unusual payments towards **legal and retainership fees**.
- 6) Unusual transactions with **companies registered in tax havens**.
- 7) Payments for goods/services made **other than to the country** from which the goods or services originated.
- 8) **Adverse media comment**.

Q 15

Reporting of Identified or Suspected Non-Compliance

(A) Reporting Non-Compliance to TCWG

- Auditor shall **communicate with TCWG** involving matter about **NOCLAR** that come to his attention during the course of the audit, other than when the matters are clearly inconsequential.
- Non-compliance is **believed to be intentional and material** -he shall **communicate the matter to TCWG** as soon as practicable.
- If the auditor suspects that **Mgt. or TCWG are involved** in non-compliance - communicate the matter to the **next higher level of authority** at the entity such as an audit committee or supervisory board.

Where no higher authority exists, - he shall consider the need to **obtain legal advice**.

(B) Reporting non-compliance in the auditor's report on the FS

- If auditor concludes that **non-compliance has a material effect on FS**, and **has not been adequately reflected in FS**, he shall **express a qualified or adverse opinion**. (SA 705)
- If auditor is **precluded by Mgt. or TCWG** from obtaining SAAE to evaluate whether non-compliance that may be material to the FS has, or is likely to have, occurred, he shall **express a qualified opinion or disclaim an opinion** on FS on the **basis of a limitation on the scope**. (SA 705)
- If auditor is **unable to determine whether non-compliance has occurred** because of limitations imposed by the circumstances rather than by Mgt. or TCWG, he shall evaluate the **effect on the auditor's opinion** (SA 705).

(C) Reporting non-compliance to regulatory and enforcement authorities

Determine whether auditor has a responsibility to report the identified or suspected non-compliance to parties outside the entity.

SA 260 "Communication with TCWG"

Matters to be Communicated by the Auditor

Q 20

A] Auditor's responsibilities in relation to the FS audit

- Responsible for forming and expressing an opinion on FS and
- Audit of FS doesn't relieve Mgt. or TCWG of their responsibilities.

B] Planned scope and timing of the audit

Communication regarding the planned scope and timing of the audit may:

- Assist TCWG to understand better the consequences of the auditor's work, to discuss issues of risk and the concept of materiality with the auditor, and to identify any areas in which they may request the auditor to undertake additional procedures and
- Assist the auditor to understand better the entity and its environment.

[c] Significant findings from the audit

- Auditor's views about significant qualitative aspects of entity's accounting practices, including accounting policies, accounting estimates and FS disclosures.

- Significant difficulties encountered during the audit;

Q 21

Significant difficulties encountered during the audit may include such matters as: - (Q)

Significant delays by Mgt., unavailability of entity personnel, or an unwillingness by Mgt. to provide info. necessary for the auditor.

An unreasonably brief time within which to complete the audit.

Extensive unexpected effort required to obtain SAAE.

Unavailability of expected info.

Restrictions imposed on the auditor by Mgt..

Mgt.'s unwillingness to make or extend its assessment of the entity's ability to continue as a going concern when requested.

- Unless all of TCWG are involved in managing the entity: -

- Significant matters arising during the audit that were discussed, or subject to correspondence, with Mgt.;
- WR auditor is requesting

- Circumstances that affect the form and content of auditor's report, if any and

- Any other significant matters arising during the audit that are relevant to the oversight of the financial reporting process.

Significant matters that were discussed, or subject to correspondence with Mgt. may include such matters as: -

- Significant events or transactions that occurred during the year.
- Business conditions affecting entity, and business plans and strategies that may affect the ROMM.
- Concerns about Mgt.'s consultations with other accountants on accounting or auditing matters.
- Discussions or correspondence in connection with initial or recurring appointment of auditor regarding accounting practices, application of SA or fees.
- Significant matters on which there was disagreement with Mgt.

Circumstances in which auditor is required or consider it necessary to include additional info. in auditor's report in as per SAs, and for which communication with TCWG is required, include when: -

- Auditor expects to modify the opinion in the report (As per SA 705)
- A material uncertainty related to going concern is reported in accordance with SA 570.
- Key audit matters are communicated in accordance with SA 701.
- Auditor considers it necessary to include an Emphasis of Matter paragraph or Other Matter paragraph in accordance with SA 706 or is required to do so by other SAs.
- There is an uncorrected MM of other information in accordance with SA 720.

Q 23

Communication of Auditor's Independence in Case of Listed Entities

- A statement that engagement team and others in the firm, network firms have complied with relevant ethical requirements regarding independence; and

-

All relationships & other matters between firm, network firms, and entity that may reasonably be thought to bear on independence.

This shall include total fees charged during the period covered by FS for audit and non-audit services.

Related safeguards that have been applied to eliminate identified threats to independence or reduce them to an acceptable level.

Factors affecting mode of communication

- Whether matter has been satisfactorily resolved
- Whether mgt. has previously communicated
- Whether discussion of matter will be included in auditors report (Eg- KAM)
- Legal requirements
- In case of an audit of special purpose FS, whether auditor also audit entity's general purpose FS.

Q 22

Q. Why it is important to communicate key audit matters to TCWG

SA 260 requires auditor to communicate with TCWG on a timely basis.

Appropriate timing for communications about KAM will vary with the circumstances of the engagement.

However, he may communicate preliminary views about key audit matters when discussing planned scope and timing of the audit.

Doing so may help to alleviate the practical challenges of attempting to have a robust two-way dialogue about key audit matters at the time FS are being finalized for issuance.

Communication with TCWG enables them to be made aware of key audit matters that auditor intends to communicate in report, and provides them with an opportunity to obtain further clarification where necessary.

He may consider it useful to provide TCWG with a draft of the auditor's report to facilitate this discussion.

Communication with TCWG recognizes their important role in overseeing the financial reporting process, and provides the opportunity for TCWG to understand the basis for auditor's decisions.

Enables TCWG to consider whether new or enhanced disclosures may be useful in light of the fact that these matters will be communicated in the auditor's report.

SA 299 "Joint Audit of FS"

What is joint audit of FS?

A joint audit is an audit of FS of an entity by 2 or more auditors.

Such auditors, known as joint auditors, conduct the audit jointly and report on the FS entity.

However, it **doesn't deal with the relationship** between a principal auditor who is appointed to report on FS of an entity and another auditor who is appointed to report on FS of one or more component (divisions, branches, subsidiary, joint venture, associates, other entity) included in FS of entity.

Audit planning, Risk Assessment and Allocation of Work

Prior to the commencement of the audit, joint auditors shall discuss and develop a **joint audit plan**. In developing the joint audit plan, joint auditors shall: -

- Identify **division of audit areas** and **common audit areas** that define the scope of the work of each joint auditor.
By mutual discussion, **divide** the audit work among themselves. Division of work would usually be in terms of audit of identifiable units or specified areas.
In some cases, due to the nature of the business such a **division of work may not be possible**. Then, **division of work may be with reference to items of assets or liabilities or income or expenditure**. Certain areas of work, owing to their **importance** or owing to the **nature** of the work involved, would **not be divided** and would be covered by **all** the joint auditors.
- Ascertain **reporting objectives** of the engagement to plan timing of the audit and nature of the communications required.
- Consider and communicate** among all joint auditors **factors** that are **significant** in directing the engagement team's efforts
- Consider the **results of preliminary engagement activities** and, whether **knowledge gained** on other or similar engagements performed earlier is relevant.
- Ascertain **NTE of resources** necessary to perform the engagement.

Responsibility and Co-ordination among Joint Auditors

Q 26/27/29

In respect of audit work divided among the joint auditors-

- Each joint auditor shall be **responsible** only for work allocated to such joint auditor.
- In cases where **specific divisions, zones or units** are allocated to different joint auditors, it is the **separate and specific responsibility** of each joint auditor to **obtain information and explanations** from the Mgt. and to evaluate them.
- Joint auditors shall have **proper coordination and rationality** wherever required.

Where, **course of the audit**, a joint auditor comes across matters which are relevant to the areas of responsibility of other joint auditors and which deserve their attention joint auditor shall communicate the same to all the other joint auditors.

It shall be the responsibility of each joint auditor to determine **NTE of audit procedures** to be applied in relation to the areas of work allocated to said joint auditor. It is the **individual responsibility** of each joint auditor to **study and evaluate the prevailing system of internal control and assessment of risk** relating to the areas of work allocated to said joint auditor.

As regards **decisions** taken by **all the joint auditors under audit planning in respect of common audit areas** concerning NTE of audit procedures to be performed by each of the joint auditors, **all the joint auditors are responsible only in respect of the appropriateness of the decisions**, proper execution of these audit procedures is the individual responsibility of the joint auditor concerned.

All joint auditors shall be jointly and severally responsible for: -

- audit work which is **not divided** among the joint auditors and is carried out by all joint auditors
- decisions taken by all the joint auditors** under audit planning in respect of **common audit areas** concerning NTE of audit procedures to be performed by each of them.
- matters** which are **brought to the notice** of the joint auditors by any one of them and on which there is an **agreement** among the joint auditors
- examining that **FS comply with requirements of the relevant statutes**
- ensuring that **audit report complies** with the requirements of the relevant statutes, applicable **SA** and other relevant **pronouncements** issued by ICAI.
- presentation and disclosure** of FS as required by the applicable FRF.

Audit Conclusion and Reporting

Q 27/28

- Joint auditors are required to **issue common audit report**.
- In case of **disagreement** with regard to the opinion or any matters to be covered by the audit report, they shall **express their opinion in a separate audit report**.
- A joint auditor is **not bound by the views of the majority** of the joint auditors and shall express opinion formed by the said joint auditor in **separate audit report in case of disagreement**.
- In such case, **audit report(s)** issued by the joint auditor(s) shall **make a reference to the separate audit report(s)** issued by the other joint auditor(s).
- Further, **separate audit report shall also make reference** to the audit report issued by other joint auditors. Such reference shall be made under the heading **"Other Matter Paragraph" as per SA 706**.

Each Joint Auditor is entitled to assume that: -

Other joint auditors **have carried out their part of the audit work** and the work has actually been performed in accordance with SA. It is **not necessary** for a joint auditor to **review the work performed by other joint auditors** or **perform any tests** in order to ascertain whether the work has actually been performed. Other joint auditors **have brought to said joint auditor's notice any departure from applicable FRF or significant observations** that are relevant to their responsibilities noticed in the course of the audit.

Where FS of a division/branch are audited by one of the joint auditors,

other joint auditors are entitled to proceed on the basis that such FS comply with

- all the legal and regulatory requirements and
- present a **true and fair view** of the state of affairs and of the results of operations of division/branch concerned.

SA 402 "Audit considerations relating to an entity using service organisation"

SA 402 deals with **user auditor's responsibility** to obtain SAAE when a user entity uses services of one or more service organisations.

Service organisation: Third-party organisation that provides services to user entities.

User entity is an entity that uses a SO and whose FS are being audited.

Service auditor is an auditor who, at request of SO, provides an assurance report on controls of a SO.

User auditor is an auditor who audits & reports on FS of a user entity.

Q – Factors related to be considered by Auditor related to financial reporting of SO

Q 33

When services provided by a SO are relevant to audit of a user entity's FS?

SO's services are part of a user entity's information system, including related business processes, relevant to financial reporting if **these services affect any of the following:** -

Classes of transactions in user entity's operations that are significant to the user entity's FS.

Procedures, within both information technology (IT) and manual systems, by which **user entity's transactions** are initiated, recorded, processed, transferred to the general ledger and reported in the FS.

Related accounting records, either in electronic or manual form, supporting info. and specific accounts in user entity's FS that are used to initiate, record, process and report the transactions.

How user entity's information system captures events and conditions, other than transactions, that are significant to FS.

Financial reporting process used to **prepare the user entity's FS**, including significant accounting estimates and disclosures and

Controls surrounding journal entries, including non-standard journal entries.

Types of reports

Q 34

Type 1 report	Type 2 report
1) A description , of SO system, control objectives and related controls and	1) A description , of SO system, control objectives & related controls
2) A report by the service auditor conveying reasonable assurance that includes: (a) service auditor's opinion on description of SO system, control objectives and related controls and suitability of design of controls .	2) A report by service auditor conveying reasonable assurance that includes: (a) Service auditor's opinion on the description of SO system, control objectives and related controls, suitability of design of controls , and (b) A description of service auditor's tests of controls and results thereof.

Obtaining an Understanding of the Services provided by SO

Q 30

- (a) **Nature of services** provided by SO and significance of those services to user entity, including the effect thereof on user entity's IC.
- (b) **Nature and materiality** of **transactions processed** or accounts or financial reporting processes affected by SO.
- (c) **Degree of interaction** between activities of SO and those of user entity.
- (d) **Nature of relationship** between user entity and SO, including relevant contractual terms for activities undertaken by SO.

Unable to obtain a sufficient understanding

If user auditor is **unable to obtain a sufficient understanding** from user entity, user auditor shall obtain understanding from following procedures:

- a) Obtaining a **Type 1 or Type 2 report**, if available
- b) **Contacting SO**, through the user entity, to obtain specific info.
- c) **Visiting SO** and **performing procedures that will provide the necessary info. about relevant controls** at SO or
- d) Using **another auditor** to **perform procedures** that will provide the necessary info. about relevant controls at SO.

Using Type 1 or Type 2 Report

In determining SAAE provided by a Type 1 or Type 2 report, user auditor shall be satisfied as to: -

- (a) Service auditor's **professional competence** (except where service auditor is a member of ICAI) and independence from SO; and
- (b) **Adequacy of the standards** under which Type 1 or Type 2 report was issued.

If **user auditor plans to use a Type 1 or Type 2 report as audit evidence** to support user auditor's understanding about design and implementation of controls at SO, **user auditor shall:**

- (a) **Evaluate** whether **description and design of controls at SO** is at a date or for a period that is **appropriate** for user auditor's purposes;
- (b) **Evaluate sufficiency and appropriateness** of evidence provided by report for **understanding of user entity's IC** relevant to audit; and
- (c) **Determine** whether **complementary user** entity controls identified by SO are relevant to user entity and, if so, obtain an understanding of whether user entity has designed and implemented such controls.

Complementary user entity controls refer to controls that SO **assumes**, in the design of its service, **will be implemented by user entities**, and which, if necessary to achieve control objectives.

Reporting by user auditor

Q 31

User auditor shall **modify opinion** in accordance with SA 705 if user auditor is **unable to obtain SAAE** regarding the services provided by SO.

User auditor shall **not refer** to work of a service auditor in user auditor's report containing an **unmodified opinion** unless required by L/R to do so.

If **such reference is required by L/R**, user auditor's report shall **indicate** that reference **does not diminish user auditor's responsibility for audit opinion**.

If **reference to work of a service auditor is relevant to an understanding of a modification** to user auditor's opinion, **user auditor's report shall indicate** that such reference **doesn't diminish** user auditor's responsibility for that opinion.

Tests of Controls

When user auditor's risk assessment includes an expectation that controls at SO are operating effectively, user auditor shall obtain audit evidence about the operating effectiveness of those controls from following procedures: -

- (a) Obtaining a **Type 2 report**, if available;
- (b) **Performing appropriate tests** of controls at SO; or
- (c) Using **another auditor** to perform tests of controls at the service organisation on behalf of the user auditor.

Using a Type 2 report as audit evidence that controls at SO are operating effectively

User auditor shall determine whether service auditor's report provides SAAE about effectiveness of the controls by:

- (a) Evaluating whether **description, design and operating effectiveness** of controls at SO is at a date or for a period that is appropriate for the user auditor's purposes ;
- (b) Determining whether **complementary user entity controls** identified by SO are relevant to the user entity and, if so, obtaining an understanding of whether user entity has **designed and implemented** such controls and, if so, **testing** their operating effectiveness;
- (c) Evaluating **adequacy of time period covered by the tests of controls**; and
- (d) Evaluating whether **tests of controls performed** by service auditor and results thereof, are relevant to the assertions in the user entity's FS and provide SAAE to support the user auditor's risk assessment.

Controls at a Sub Service Organisation

Q 32

- User entity may use a SO that in turn uses a SSO to provide some of the services provided to a user entity that are part of the user entity's IS relevant to financial reporting.
- SSO may be a separate entity from SO or may be related to SO.
- A user auditor may need to **consider controls at the SSO**.
- In situations where **one or more SSO are used, interaction** between the activities of user entity and those of SO is expanded to include the interaction between the user entity, the SO and the SSOs.
- **Degree of this interaction**, as well as **nature and materiality** of the transactions processed by SO and SSOs are the most important factors for user auditor to consider in determining the significance of SO and SSO's controls to the user entity's controls.
- Further, user auditor shall determine whether a **sufficient understanding of the nature and significance** of the services provided by SO and their effect on user entity's IC relevant to the audit has been obtained to provide a basis for the identification and assessment of ROMM.
- If user auditor is **unable to obtain a sufficient** understanding from the user entity, user auditor shall obtain that understanding by application of following **two methods of presenting description of IC** i.e. (i) Type 1 report; or (ii) Type 2 report.
- If a SO uses SSO, service auditor's report may either include or exclude the SSO relevant control objectives and related controls in SO description of its system and in the scope of the service auditor's engagement.
- 2 methods of reporting are known as **inclusive method** and **carve-out method**.
- In either method, SO includes in its description of controls a description of the functions and nature of the processing performed by the SSO.
- If the Type 1 or Type 2 report excludes the control at a SSO and services provided by SSO are relevant to the audit of the user entity's FS, user auditor is required to apply the requirements of the SA 402 in respect of SSO.
- Nature and extent of work to be performed by user auditor regarding the services provided by a SSO depend on the nature and significance of those services to the user entity and relevance of those services to the audit.

SA 300 Planning an Audit of FS

Benefits/Advantages of Planning in an Audit of FS

Q 11

- 1) **Attention to Important areas**
- 2) **Timely resolution** of Potential Problems
- 3) **Proper Org. & Mgt. of Audit Engagement.**
- 4) **Proper Selection of Engagement Team**
- 5) **Direction and Supervision** of Engagement Team
- 6) **Easy Coordination** in work done by auditors of components & experts

Nature and Extent of Planning

Q 12

So far as the nature of planning is concerned, it would vary according to-

1. **Size & Complexity of Auditee** - If size & complexity of org. of which audit is to be conducted is large, then much **more planning activities** would be required.
2. **Past Experience & Expertise** - key engagement team **members' previous experience & expertise** also contributes towards variation in planning activities.
3. **Change in Circumstances** - **Another factor contributing towards variation in planning activities** is change in circumstances.

Documenting Audit Plan

Q 13

The auditor shall document-

1. **Overall audit strategy;**
 2. **Audit plan;** and
 3. Any **significant changes made** during the audit engagement to the overall audit strategy or audit plan, and reasons for such changes
- Documentation of these matters assists auditor as under: -
- ↳ Record of Key Decisions
 - ↳ Record of NTE of RAP
 - ↳ Record of reasons for change in audit strategy and plan

Relationship b/w Overall Audit Strategy & Audit Plan

Q 10

- **Audit strategy** is prepared **before** audit plan.
- **Audit plan** is **more detailed** than the overall audit strategy.
- Audit strategy and audit plan **are inter-related** because change in one would result into change in the other.
- **Audit strategy** provides **guidelines** for developing audit plan. It establishes **scope and conduct of audit procedures** and thereby, works as basis for developing a detailed audit plan.
- **Detailed audit plan** would include the NTE of audit procedures to obtain SAAE.

Factors while establishing Overall Audit Strategy

Q 7

- 1) **Determination of Characteristics of Audit:** Identify characteristics of the engagement that **defines its scope.**
- 2) **Reporting Objectives:** Ascertain reporting objectives of engagement to plan timing of audit and nature of the **communications required.**
- 3) **Team's Efforts:** Consider factors that are significant in **directing the engagement team's efforts.**
- 4) **Considering result of preliminary engagement activities:** Consider the results of preliminary engagement activities and, where applicable, whether knowledge gained on other engagements performed by the engagement partner **for the entity is relevant.**
- 5) **NTE of Resources:** Ascertain NTE of resources **necessary to perform the engagement.**

Benefits of Overall Audit Strategy

Q 7

- 1) **Employment of Qualitative Resources:** Resources to deploy for **specific audit areas**, such as - use of **experienced team members for high risk areas** or involvement of **experts** on complex matters.
- 2) **Allocation of Quantity of Resources:** allocation to **specific audit areas**, such as - **no. of team members assigned** to observe inventory count at material locations
- 3) **Timing of Deployment of Resources:** such as **whether at an interim audit stage** or at or close to **key cut-off dates.**
- 4) **Management of Resources:** How such **resources shall be managed, directed and supervised,** such as when team briefing and debriefing meetings are expected to be held.

Contents of an Audit Plan (SA 300)

Q 9

Auditor should develop an audit plan that shall include description of -

1. NTE of planned RAP, as determined under **SA 315**
2. NTE of planned further audit procedures at the assertion level, as determined under **SA 330**
3. **Other planned audit procedures** that are required to be carried out so that engagement complies with SAs.

Changes to Planning Decisions

Auditor may need to modify the overall audit strategy and audit plan due to below mentioned factors-

- | | |
|-----------------------------------------------------|-----------------------------|
| ○ result of unexpected events, | ○ changes in conditions, or |
| ○ AE obtained from the results of audit procedures. | |

Further, auditor would also have to **modify** the NTE of further audit procedures, based on the revised consideration of assessed risks.

Considerations in Establishing Overall Audit Strategy

Some of factors that auditor may consider:

(A) Characteristics of Engagement

- FRF.
- Industry-specific reporting requirements such as reports mandated by industry regulators.
- Expected audit coverage, including no & locations of components to be included.
- Extent to which components are audited by other auditors.
- Expected use of audit evidence obtained in previous audits.
- Effect of information technology on audit procedures.

(B) Reporting Objectives, Timing of Audit, & Nature of Communications

- Entity's timetable for reporting.
- Discussion with Mgt. regarding type & timing of reports to be issued.
- Discussion with mgt. regarding communications on status of audit work.
- Communication with auditors of components regarding types & timing of reports to be issued.
- Nature & timing of communications among engagement team members.

(C) Significant Factors, Preliminary Engagement Activities, and Knowledge Gained on Other Engagements

- Determination of materiality (SA 320).
- Preliminary identification of areas where there may be a higher ROMM.
- Results of previous audits including identified deficiencies and action taken to address them.
- Significant business developments affecting entity.
- Significant changes in FRF, such as changes in accounting standards.

(D) NTE of Resources

- Election of engagement team and assignment of audit work to team members.
- Engagement budgeting.

Audit Programme

Prepared to allocate work to team members which may include the list of audit procedures & instructions to be followed.

Formulating an Audit Programme

Important matters which need to be considered in this regard are -

- Nature of business in which the organisation is engaged:** considering technical, financial and accounting set-up of e co.
- Overall plan:** If in drawing audit programme, any divergence from the overall plan becomes necessary, first overall plan should be modified after due consideration and thereafter, only that specific matter may be taken in the audit programme.
- System of IC and accounting procedures:** study and evaluation of IC helps auditor to establish reliance he can place on the ICs in determining the NTE of his SP.
- Size of org. and structure of its Mgt.:** An increase in the size of the org. enhances complexity of examination of its accounting records.
- Info. as regards org. of business:** obtain info - client's history, business, purpose and nature of engagement.
- Accounting and management policies:** Accounting and mgt. policies followed in past and whether these have been employed consistently.

Few circumstances where in the audit program would have to be suitably altered

Q 15

- If the audit procedures were designed for a certain volume of turnover and subsequently the volume have substantially increased. Also, significant changes in accounting organisation, procedures and personnel subsequent to the audit procedures.
- IC procedures were not as effective as assumed** at the time the audit programme was framed.
- Extraordinary increase** in amount of book debts or that in the value of stocks as compared to that in PY.
- Suspicion** has aroused during the course of audit or information has been received that assets have been misappropriated.

Audit Execution

Q 14

Key phases in the audit execution stage are

- Execution Planning
- Risk and Control Evaluation
- Testing
- Reporting

SA 450 Evaluation of Misstatement Identified During Audit

Misstatement

Difference between	
Amounts, Classification, Presentation, or Disclosure of a reported financial statement item and	Amount, Classification, Presentation, or Disclosure that is required for the item to be in accordance with applicable FRF

Sources of Misstatement

Q 17

- An **inaccuracy** in gathering or processing data from which FS are prepared;
- An **omission** of an amount or disclosure;
- An **incorrect accounting estimate** arising from overlooking, or clear misinterpretation of, facts; and
- Judgments of management** concerning accounting estimate that auditor considers **unreasonable** or **selection and application of accounting policies** that the auditor **considers inappropriate**.

Communication and Correction of Misstatements

- **Communicate on a timely basis** all misstatements to appropriate level of management, unless prohibited by L/R.
- Auditor shall request management to **correct** those misstatements.
- If management refuses to correct some or all of the misstatements, obtain an understanding of **management's reasons for not making the corrections**.
 - If management corrects:** perform additional to determine whether misstatements remain.
 - If management refuses :**
 - ✓ Reason for refusal
 - ✓ Reassess materiality
 - ✓ **If material** - communicate to TCWG including effect of misstatement & request for correction
 - ✓ **If not corrected:** Obtain WR from Mgt./TCWG w.r.t their believing that effect of uncorrected misstatements is immaterial.

Impact of Uncorrected Misstatements identified during audit & Auditor's responses to them

Q 18

[Evaluating effect of Uncorrected Misstatements]

- Auditor shall determine whether uncorrected misstatements are **material** (individually or aggregate)
- Auditor shall consider -
 - **Size & Nature of misstatement** for class of transaction, account balance and disclosures & FS
 - **Effect of uncorrected misstatement** related to prior periods on class of transaction, account balance and disclosures & FS.
- Auditor shall communicate with TCWG Uncorrected misstatement & their effect. (refer communication)
- Reassess materiality determined in SA 320
- As per Mgt., if effects of uncorrected misstatements are immaterial, auditor shall request WR from Mgt. & TCWG.
- If Mgt. refuses to adjust financial information & auditor **not able to conclude whether aggregate of uncorrected misstatement is not material**, **express qualified or adverse opinion**

SA 520 "Analytical Procedures"

Analytical Procedures" means

- **evaluation of financial information**
- through **analysis of relationships** among both financial & non-financial data

Substantive Analytical Procedures (SAP)

Q 19

Q. Consideration kept while performing SAP

When designing & performing SAP, either alone or in combination with tests of details, as substantive procedures as per SA 330, auditor shall:

- Determine **suitability** of particular SAP for given assertions, taking account of assessed ROMM & tests of details;
- Evaluate **reliability** of data from which auditor's expectation of recorded amounts or ratios is developed, taking account of source, comparability, & nature & relevance of info. available, & controls over preparation;
- Develop **expectation** of recorded amounts or ratios & evaluate whether expectation is sufficiently precise to identify misstatement.
- Determine **amount of any difference of recorded amt.** from expected values that is acceptable without further investigation.

Suitability of Particular AP for Given Assertions

- SAP are **more applicable to large volumes of transactions** that tend to be predictable over time.
- In some cases, **unsophisticated predictive model** may be effective as AP.
- Different types of analytical procedures** provide different levels of assurance.
- Determination of **suitability of SAP is influenced by** -
 - ✦ nature of assertion &
 - ✦ auditor's assessment of ROMM
- Particular SAP may be considered suitable** when tests of details are performed on same assertion.

Following factors affects the Reliability of Data

Q 20

- ❑ Source of info. available
- ❑ Comparability of info. available
- ❑ Nature & relevance of info. available
- ❑ Controls over preparation of info

Investigating Results of AP

Q 21

If auditor identifies **fluctuations or relationships that are inconsistent** with other relevant information or that **differ from expected values by significant amt.**, he shall investigate such differences by:

- Inquiring of Mgt. & obtaining appropriate AE relevant to Mgt. responses.
- Performing other AP as necessary: Need to perform other AP may arise when,
 - Mgt. is unable to provide explanation, or
 - explanation, together with AE obtained w.r.t Mgt. response, is not considered adequate.

Techniques for AP

- Trends
- Ratios
- Reasonableness of amounts
- Structural modelling - to predict current a/c balances

SA 540-Auditing accounting estimates, including accounting estimates, including fair value accounting estimates and related disclosures

Auditor's responsibilities regarding accounting estimates, including fair value accounting estimates + related disclosures in an audit of FS.

Examples of situations where **Accounting Estimates**, other than fair value a/c estimates, may be required include:

- 1) Allowance for doubtful accounts.
- 2) Inventory obsolescence.
- 3) Warranty obligations.
- 4) Depreciation method or asset useful life.
- 5) Outcome of long term contracts.
- 6) Financial Obligations / Costs arising from litigation settlements & judgments.

Examples of situations where **Fair Value A/c Estimates** may be required include:

- 1) Complex financial inst. which are not traded in active and open market
- 2) Share-based payments.
- 3) Property or equipment held for disposal.
- 4) Certain assets or liabilities acquired in a business combination, including goodwill & intangible assets.
- 5) Transactions involving exchange of assets or liabilities b/w independent parties without monetary consideration.

Nature Of Accounting Estimates

Q 26

Accounting estimates involve relatively **low estimation uncertainty** & may give rise to lower ROMM

- 1) A/E arising in entities that engage in business activities that are not complex.
- 2) A/E that are **frequently made & updated** because they relate to routine transactions
- 3) A/E derived from **data that is readily available**, such as published interest rate data.
- 4) Fair value A/E estimates where **method of measurement prescribed by applicable FRF is simple & applied easily** to asset or liability.
- 5) Fair value A/E estimates where **model used** to measure A/E estimate is well-known or generally accepted.

Q 27

Accounting estimates with relatively **high estimation uncertainty**, particularly where they are based on significant assumptions, For Ex:

- 1) Fair value A/E for **derivative financial instruments**, not publicly traded.
- 2) Fair value A/E for which a highly **specialised entity-developed model** is used.

- 3) A/E that are **highly dependent upon judgment**, for example, judgments about the outcome of pending litigation
- 4) A/E that are **not calculated using recognised measurement techniques**.
- 5) A/E where auditor's review of similar accounting estimates made in the **prior period FS indicate substantial difference between the original AE and the actual outcome**.

Risk assessment procedures & related activities for A/E

Q- how do you minimize the risk of material misstatements

Q 23

Identification & assessment of ROMM (SA 315) for A/E

- a) **Requirements of applicable FRF relevant to A/E**, including related disclosures.
- b) **How Mgt. identifies** those transactions, events & conditions that **may give rise to need for A/E** to be recognised or disclosed in F.S. In obtaining understanding, **make inquiries of Mgt. about changes in circumstances** that may give rise to new, or need to revise existing, A/E.
- c) **How Mgt. makes A/E**, & **understanding of data on which they are based** including:
 - **Method used** in making A/E;
 - **Relevant controls**;
 - **Whether Mgt. has used an expert**;
 - **Assumptions** underlying A/E;
 - **Whether there has been a change from prior period in methods for making A/E**, and if so, why; and
 - **Whether and, if so, how Mgt. has assessed effect of estimation uncertainty**.

Obtaining an Understanding of How Mgt. Identifies Need for Accounting Estimates:

Q 29

Inquiries of Mgt. about changes in circumstances may include, For Ex: Inquiries about whether:

- 1) Entity has engaged in **new types of transactions** that may give rise to a/c estimates.
- 2) **Terms of transactions** that gave rise to A/E that have changed.
- 3) **A/c policies relating to A/E have changed**, as a result of changes to requirements of FRF.
- 4) **Regulatory or other changes outside control of Mgt.** have occurred.
- 5) **New conditions or events have occurred**.

Estimation Uncertainty: A/c estimates that give rise to significant risks

Q 28

Auditor shall evaluate following:

- (a) **How Mgt. has considered alternative assumptions or outcomes & why it has rejected them**.
- (b) Whether **significant assumptions** used by Mgt. are **reasonable**.
- (c) Where relevant to reasonableness of assumptions used, or appropriate application of FRF, **Mgt.'s intent to carry out specific courses of action** & its ability to do so.
- (d) If Mgt. has **not adequately addressed effects of estimation uncertainty** on A/E that give rise to significant risks, he shall **develop a range** to evaluate the reasonableness of A/E.

Review of outcome of accounting estimates of prior period F.S.

Q 24

- Auditor shall **review outcome of A/c estimates** included in prior period F.S., or their subsequent re-estimation for purpose of current period.
- **Outcome of A/E will often differ** from A/E recognised in prior period F.S.
- **By performing RAP to identify & understand reasons for such differences**, obtain:
 - 1) **Info. regarding effectiveness of Mgt.'s prior period estimation process**.
 - 2) **Audit evidence that is pertinent to re-estimation, in current period of prior period A/E**.
 - 3) **Audit evidence of matters, such as estimation uncertainty, that may be required to be disclosed in F.S.**
- It may **assist auditor in current period in identifying conditions that increases susceptibility of A/E to possible Mgt. bias**.
- Auditor's **professional skepticism** assists in identifying such conditions and in determining NTE of FAP.
- However, **Review is not intended to call into question judgments made in prior periods** that were based on info. available at that time.

Matters that the auditor may consider in obtaining an understanding of the assumptions underlying the accounting estimates include, for example:

- 1) **Nature of assumptions**.
- 2) **How Mgt. assesses whether assumptions are relevant and complete**.
- 3) **How Mgt. determines that assumptions used are internally consistent**.
- 4) **Whether assumptions relate to matters within control of Mgt.**

Audit Reporting & Disclosure:**Disclosures Related to Accounting Estimates**

Auditor shall obtain **SAAE** about whether disclosures in F.S. related to A/E are as per requirements of applicable FRF.

For A/E that give rise to significant risks, he shall also **evaluate adequacy of disclosure of their estimation uncertainty** in F.S. in context of applicable FRF.

- a) **Presentation of F.S.** as per applicable FRF includes adequate disclosure of material matters. These disclosures include,
- **Assumptions** used.
 - **Method of estimation** used.
 - **Basis for selection of the estimation.**
 - **Any changes in method** of estimation from prior period & its subsequent effect.
 - **Sources & implication** of estimation uncertainty.
- b) In relation to A/E **having significant risk**, even where disclosures are as per applicable FRF, he may conclude that disclosure of is inadequate in light of circumstances & facts involved.

Written Representations:

Q 25

- 1) **About appropriateness of measurement processes**, including related assumptions & models used by Mgt. in determining A/E.
- 2) That **assumptions appropriately reflect** Mgt.'s intent & ability to carry out specific courses of action on behalf of entity.
- 3) That **disclosure related to A/E** are complete & appropriate.
- 4) That **no subsequent event requires adjustment to A/E & disclosures.**

For those A/E not recognised or disclosed in FS, W/R include representations about:

- Appropriateness of the basis used by Mgt. for determining that the **recognition or disclosure criteria of applicable FRF have not been met.**
- Appropriateness of the basis used by Mgt. to overcome the presumption relating to the use of fair value. for those A/E not measured or disclosed at fair value.

SA 600 - Using Work of another Auditor

Principal Auditor

Auditor with responsibility for reporting on financial information (i.e. F.S) of entity when that financial information includes financial information of one or more components audited by another auditor.

Not Reduce Responsibility

- When auditor **delegates work to assistants** or **uses work** performed by other auditors & experts, he will **continue to be responsible** for **forming & expressing his opinion**.
- However, he will be **entitled to rely on work performed by others**, provided he **exercises adequate skill & care** and is not aware of any reason to believe that he should not have so relied.

Not applicable

SA 600 does not deal with

- joint auditors nor
- Predecessor auditor.

Q 33

Factors before accepting his work as Principal auditor

Auditor would consider following factors before accepting his work as Principal auditor:

- Materiality** of portion of the financial information which PA audits
- PA's degree of **knowledge** regarding business of components
- ROMM** in financial information of components audited by other auditor(s); and
- Performance of **additional procedures** as set out in this SA regarding components audited by other auditor(s).

Division of responsibility

- PA would **not be responsible** in respect of work carried out by OA, **except** in circumstances which should have aroused his suspicion about **reliability of work** performed by other auditors.
- When **PA has to base his opinion on financial information** of entity as a whole **relying upon statements & reports of OA**, his report should **state clearly** **division of responsibility for financial information of entity** by **indicating extent** to which financial information of components audited by OA have been included in FI of entity.
- If **PA notices any material discrepancies**, same has to be **brought to knowledge of OA & should be incorporated in Audit Report**.

Principal auditor's procedure

- Right of PA to visit component & examine books of accounts of component.
- PA to consider **professional competence** of other auditor.
- Procedures** to be performed by PA when **using work of other auditor**. Q 31
 - advise other auditor** regarding use of his **(other auditor) work & report** and make **sufficient arrangements for co-ordination at planning stage** of audit.

PA would inform other auditor of matters such as:

 - areas** requiring **special** consideration,
 - procedures for **identification of inter-component transactions** and
 - time-table** for completion of audit
 - advise other auditor of significant accounting, auditing & reporting requirements** and obtain **representation as to compliance** with them.
 - PA might **discuss** with other auditor **audit procedures applied or review a written summary** of the other auditor's **procedures & findings**.
 - PA should **consider** the **significant findings** of the other auditor.
 - PA to **document** in his **working papers** - Components whose financial information audited by other auditors. Also document procedures performed & conclusions reached.

Reporting consideration

- PA to express a **qualified opinion or disclaimer of opinion** in case of a **limitation on scope of audit**. When PA concludes that
 - work of OA can't be used &**
 - PA has **not been able to perform sufficient additional procedures** regarding financial information of component audited by OA.
- If other auditor **issues a Modified Report**.

PA should consider **whether subject of modification** is of such **nature & significance, that it requires a modification of PA's report**.

Coordination between auditors

Sufficient liaison between PA & OA.	OA should co-ordinate with PA	PA should advise OA of any matters having an important bearing on OA's work	PA may require OA to answer a detailed questionnaire	OA should respond to such questionnaire on a timely basis.
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Role of Principal Auditor:

Q 32

- To **issue written communication(s)** as PA to OA.
- Advise** OA of any **matters that come to his attention** that may have important bearing on OA's work.
- PA may **require OA to answer a detailed questionnaire** regarding matters on which PA requires info. for discharging his duties.

Role of Other Auditor (OA):

- Co-ordinate** with PA.
- Ensure compliance** with relevant statutory requirements.
- Respond** to questionnaire sent by PA on a timely basis.

SA 610- Using the work of Internal Auditors

Scope

- using work of internal audit function (IAF) and
- using internal auditors to provide direct assistance under the direction, supervision and review of the external auditor.

This SA doesn't apply if the entity doesn't have IAF.

Auditor responsibility will not reduce. Remain sole responsible for expressing opinion.

Internal Audit Function: A function of an entity designed to evaluate and improve the effectiveness of the entity's governance, risk mgt. and internal control processes.

Direct Assistance: Use of IA to perform audit procedures under the direction, supervision and review of the external auditor.

Objectives & scope of internal audit functions:

Activities Relating to Governance

- Ethics and values, performance management and accountability,
- Communicating risk and control info.

Activities Relating to Risk Management

- Identifying and evaluating significant risk.
- Detection of fraud.

Activities Relating to Internal Control

- Evaluation of internal control
- Examination of financial and operating information
- Review of operating activities.
- Review of compliance with laws and regulations.

Work of IAF that can be used by external auditor

- Testing of operating effectiveness of controls.
- Substantive procedures involving limited judgment.
- Observations of inventory counts.
- Tracing transactions through the information system relevant to financial reporting.
- Testing of compliance with regulatory requirements.

Evaluating whether work of IAF can be Used For the purposes of audit

Q 34

- External auditor shall determine whether work of IAF can be used for purposes of the audit by evaluating the following:
 - Extent to which internal audit function's organizational status & relevant policies & procedures support the objectivity of IA;
 - level of competence of IAF; and
 - Whether IAF applies a systematic and disciplined approach, including QC.
- External auditor shall not use the work of IAF if external auditor determines that:
 - The function's organizational status and relevant policies and procedures do not adequately support the objectivity of internal auditors;
 - The function lacks sufficient competence; or
 - The function does not apply a systematic and disciplined approach, including quality control.

Determining nature & extent of work of IAF that can be used

- External auditor shall consider nature & scope of work performed by IAF.
- EA shall make all significant judgments and, to prevent undue use of the work of IAF:
 - More judgment is involved in:
 - Planning & performing relevant audit procedures; and
 - Evaluating A/E gathered;
 - Higher assessed ROMM at the assertion level;
 - Less the internal audit function's organizational status and relevant policies and procedures adequately support the objectivity of internal auditors; and
 - Lower level of competence of IAF.
- Extent of involvement of external auditor: whether using work of IAF to the extent planned would still result in external auditor being sufficiently involved in the audit.
- External auditor in communicating with TCWG shall share an overview of the planned scope and timing of the audit (SA 260), communicate how external auditor has planned to use the work of IAF.

Using the work of IAF

- Discussion regarding planned use of its work and Coordination with the Internal Audit Function
- EA shall read the reports of IAF relating to the work of the function that external auditor plans to use.
- EA perform sufficient audit procedures to determine adequacy of IAF, including evaluating whether:
 - Work of IAF had been properly planned, performed, supervised, reviewed and documented;
 - SAAE had been obtained to draw reasonable conclusions; and
 - Conclusions reached are appropriate.
- Nature and extent of the external auditor's audit procedures shall be responsive to the external auditor's evaluation of:
 - Amount of judgment involved;
 - Assessed ROMM;
 - Extent to which IAF supports the objectivity of the internal auditors; and
 - level of competence of the function.

External auditor shall not use an IA to provide direct assistance if:

- There are significant threats to the objectivity of internal auditor; or
- Internal auditor lacks sufficient competence to perform the proposed work.

Significant Judgements

Q 35

- Assessing ROMM
- Evaluating sufficiency of test performed.
- Evaluating appropriateness of Mgt. use of Going concern assumption.
- Evaluating significant accounting estimate.
- Evaluating adequacy of disclosure in FS & other matter affecting auditor's report.

Determining whether IA can be used to provide direct assistance for the purposes of audit

- a) External auditor prohibited by L/R from obtaining direct assistance from IA.
- b) Using internal auditors to provide direct assistance is not prohibited
- Evaluation of **existence & significance of threats to objectivity** and **level of competence** of internal auditors.
 - Evaluation of **existence and significance of threats shall include inquiry of internal auditors.**

Inquiry of the internal auditors regarding interests and relationships that may create a threat to their objectivity.

In evaluating the existence and significance of threats to the objectivity of an internal auditor, the following factors may be relevant:

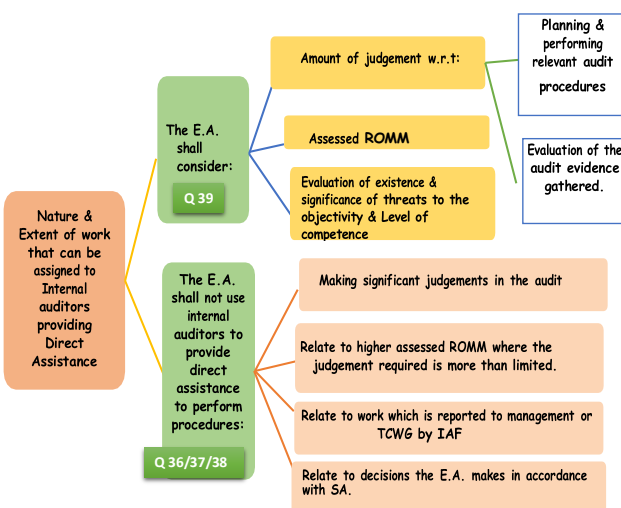
- Extent to which the internal audit function's organizational status and relevant policies and procedures **support the objectivity** of the internal auditors.
- Family and personal relationships** with an individual working in, or responsible for, to which the work relates.
- Association with the division or department** in the entity to which the work relates.
- Significant financial interests** in the entity other than remuneration.

Q 38

Q External auditor shall include in the audit documentation:

- Evaluation of **existence & significance of threats to the objectivity** of the internal auditors, and **level of competence** of the internal auditors used to provide direct assistance;
- Basis for the decision regarding the nature and extent** of the work performed by the internal auditors;
- Who reviewed** the work performed and the **date and extent** of that review;
- Written agreements** obtained from an authorized representative of the entity and the internal auditors; and
- Working papers prepared** by the internal auditors who provided direct assistance.

Determining the Nature and Extent of Work that Can Be Assigned to Internal Auditors Providing Direct Assistance:



SA 620-Using Work of an Auditor's Expert

SA 620 deals with auditor's responsibilities regarding use of work in a field of expertise other than accounting or auditing when that work is used to assist auditor in obtaining SAAE.

Auditor's Expert –

An auditor's expert may be either an **auditor's internal expert** (who is a partner or staff, including temporary staff, of the auditor's firm or a network firm), or an **auditor's external expert**.

Management's Expert – An individual/organisation possessing expertise in a field other than accounting or auditing, whose work in that field is **used by entity** to assist entity in preparing F.S.

Expertise in a field other than accounting or auditing may include expertise in relation to Auditors Expert:

Q 45

Q- Types of report/opinion Auditor can obtain from auditor's expert.

- 1) Valuation of complex financial instruments, L&B, P&M, IA etc.
- 2) Actuarial calculation of liabilities
- 3) Estimation of oil & gas reserves.
- 4) Interpretation of contracts, laws & regulations
- 5) Analysis of complex or unusual tax compliance issues.

Areas where Auditor's Expert can assist Auditor:

- 1) Obtaining an understanding of entity & its environment, including IC. (SA 315)
- 2) Identifying & assessing ROMM. (SA315)
- 3) Determining & implementing overall responses to assessed risks at F.S. level. (SA 330)
- 4) Designing & performing FAP to respond to assessed risks at assertion level, comprising TOC or substantive procedures. (SA 330)
- 5) Evaluating sufficiency & appropriateness of AE obtained in forming an opinion on F.S. (SA 500)

Evaluating Adequacy of Auditor's Expert's Work

Q 43

Auditor shall evaluate adequacy of auditor's expert's work for auditor's purposes, including:

A. Relevance & reasonableness of that expert's findings or conclusions, & their consistency with other audit evidence;

Findings & Conclusions of Auditor's Expert

Specific procedures to evaluate adequacy of auditor's expert's work for auditor's purposes may include:

- a. Inquiries of auditor's expert.
- b. Reviewing auditor's expert's working papers & reports.
- c. Corroborative procedures, such as:
 - (i) Observing auditor's expert's work;
 - (ii) Examining published data;
 - (iii) Confirming relevant matters with third parties;
 - (iv) Performing detailed analytical procedures to see whether Principles of materiality aspects considered; and
 - (v) Re-performing calculations.
- d. Discussion with another expert with relevant expertise when, for example, the findings or conclusions of auditor's expert are not consistent with other audit evidence.
- e. Discussing auditor's expert's report with management.

B. If that expert's work involves use of significant assumptions & methods, relevance & reasonableness of those assumptions & methods;

Factors relevant to auditor's evaluation of those assumptions & methods include whether they are:

- 1) Generally accepted within auditor's expert's field;
- 2) Consistent with requirements of applicable FRF;
- 3) Dependent on use of specialised models; and
- 4) Consistent with those of management, and if not, the reason, and effects of the differences.

C. If that expert's work involves use of source data that is significant to that expert's work, relevance, completeness, & accuracy of that source data.

Procedures used to test use of Source Data:

- (a) Verifying origin of data, including obtaining an understanding of, & testing IC over data.
- (b) Reviewing data for completeness & internal consistency.

Evaluating Adequacy of Auditor's Expert's Work

Q 43

If auditor determines that work of auditor's expert is **not adequate** for auditor's purposes, auditor shall:

- (a) Agree with expert on nature & extent of further work to be performed by that expert; or
- (b) Perform further audit procedures appropriate to circumstances.

If auditor concludes that work of auditor's expert is **not adequate** for auditor's purposes & auditor **can't resolve matter** through additional audit procedures, **express a modified opinion** as per SA 705 because auditor has **not obtained SAAE**.

Competence, Capabilities & Objectivity of Auditor's

Competence, capabilities & objectivity of an auditor's expert are factors that significantly affect whether work of auditor's expert will be adequate for auditor's purposes. (Q)

Competence relates to nature & level of expertise of auditor's expert.

Capability relates to ability of auditor's expert to exercise that competence

Objectivity relates to possible effects that bias, conflict of interest, or influence of others may have on professional or business judgment of auditor's expert

Sources for obtaining Info. regarding Competence, Capabilities & Objectivity of an Auditor's Expert

- Personal experience with previous work of that expert.
- Discussions with that expert.
- Discussions with other auditors or others who are familiar with that expert's work.
- Knowledge of that expert's qualifications, membership of a professional body or industry association, license to practice, or other forms of external recognition.
- Published papers or books written by that expert.
- Auditor's firm's quality control policies & procedures

Agreement With Auditor's Expert

Q 42

Auditor shall agree, in writing when appropriate, on following matters with auditor's expert:

- Nature, scope & objectives of expert's work;
- Respective roles & responsibilities;
- NTE of communication b/w auditor & that expert and
- Confidentiality requirements.

Following factors suggest need for more a detailed agreement or for Written Agreement:

- Auditor's expert will have access to sensitive or confidential entity information.
- Respective roles or responsibilities of auditor & auditor's expert are different from those normally expected.
- Multi-jurisdictional legal or regulatory requirements apply.
- Matter to which auditor's expert's work relates is highly complex.
- Auditor has not previously used work performed by that expert.
- Greater the extent of auditor's expert's work, & its significance in context of audit.

Reference to auditor's expert in auditor's report

Q 44

- Auditor shall not refer to work of auditor's expert in auditor's report containing an unmodified opinion unless required by L/R to do so. If such reference is required by L/R he shall indicate in auditor's report that reference doesn't reduce auditor's responsibility for audit opinion.
- If auditor makes reference to work of an auditor's expert in auditor's report because such reference is relevant to an understanding of a modification to auditor's opinion, auditor shall indicate in auditor's report that such reference does not reduce auditor's responsibility for that opinion.

When management has used a management's expert

When Mgt. has used a management's expert, auditor's decision on whether to use an auditor's expert may also be influenced by such factors as:

- Whether ME is employed by entity, or is a party engaged by it.
- Extent to which Mgt. can exercise control over the work of ME.
- ME competence and capabilities.
- Whether management's expert is subject to technical performance standards or other professional or industry requirements.
- Any controls over management's expert's work within entity.

Evaluation of significance of threats to objectivity & need for safeguards

Evaluating the objectivity of an auditor's external expert:

- Inquire of entity about any known interests or relationships that may affect that expert's objectivity.
- Discuss with that expert any applicable safeguards, & evaluate whether safeguards are adequate to reduce threats to an acceptable level.

Interests & relationships that may be relevant to discuss with auditor's expert include:

- Financial interests.
- Business & personal relationships.
- Provision of other services by expert

Nature, timing & extent of audit procedures

In determining NTE of those procedures, auditor shall consider:

- Nature of matter;
- ROMM in matter;
- Significance of that expert's work;
- Auditor's knowledge of & experience with previous work performed by that expert; and
- Whether that expert is subject to auditor's firm's quality control policies & procedures.

Following factors may suggest need for different or more extensive procedures than would otherwise be the case:

- Work of auditor's expert relates to a significant matter that involves subjective & complex judgments.
- Auditor has not previously used work of auditor's expert, & has no prior knowledge of that expert's competence, capabilities & objectivity.
- Auditor's expert is performing procedures that are integral to audit.
- External expert is not subject to firm's quality control policies & procedures.

Considerations when deciding whether to use an Auditors expert

- Whether Mgt. has used a Mgt.'s expert in preparing F.S.
- Nature & significance of matter.
- ROMM in the matter.
- availability of alternative sources of audit evidence.

Audit Risk Components

Audit Risk = Risk of Material Misstatement X Detection Risk

ROMM- is anticipated risk that a MM may exist in FS before start of the audit.

It has 2 components inherent risk and control risk.

ROMM = Inherent risk X Control risk

Inherent Risk:

Susceptibility of an assertion to a misstatement that could be material, individually or when aggregated with other misstatements, assuming that **there are no related controls**.

Inherent risk is addressed **at both the FS level and at the assertion level**.

Ex- Technological developments that might make a particular product obsolete.

Accounting estimates that are subject to significant measurement uncertainty;

Detection risk: Risk that a **MM remained undetected** even if all audit procedures applied.

Note- Combined level of Inherent Risk and Control Risk is inversely related with Detection Risk, and Audit Materiality is also inversely related with Audit Risk.

Control Risk:

Risk that **entity's IC system will not prevent, or detect and correct** on a timely basis, a misstatement that could be material, individually or when aggregated with other misstatements.

Types of Assertions

SA 315, categorises **types of assertions** used by auditor

Assertions about Classes of Transactions and Events

Occurrence	Transactions and events recorded have <u>occurred and pertain to entity</u> .
Completeness	All transactions that should have been recorded have been <u>recorded</u> .
Accuracy	Amt. & other data related to recorded transactions & events <u>have been recorded appropriately</u> .
Cut-off	Transactions & events have been recorded in <u>correct accounting period</u> .
Classification	Transactions & events recorded in <u>proper accounts</u> .

Assertions about Account Balances at the Period End

Existence	Assets, liabilities, and equity interests <u>exist</u> .
Rights and Obligations	Entity holds or controls <u>rights to assets</u> , and liabilities are <u>obligations</u> of entity.
Completeness	All assets, liabilities, and equity interests that should have been recorded <u>are recorded</u> .
Valuation and Allocation	Assets, liabilities, and equity interests are included in FS at appropriate amounts, and any resulting adjustments are <u>appropriately recorded</u> .

SA Assertions about Presentation and Disclosure

Occurrence/Rights and Obligations	Disclosed events, transactions, & other matters <u>have occurred and pertain to entity</u> .
Completeness	All disclosures that should have been included in the FS <u>have been included</u> .
Classification and Understandability	Financial information is <u>appropriately presented</u> and described, and disclosures are <u>clearly expressed</u> .
Accuracy and Valuation	Financial and other information are disclosed <u>fairly and at appropriate amounts</u> .

Possible potential misstatements – Indicators

Completeness	
Transactions not identified	Source documents not prepared
Rejected source documents not represented.	Source documents not captured
Existence	
Fictitious or unauthorised transactions entered on source documents	
Source documents overstated	
Transactions duplicated on source documents	
Capture of source documents duplicated.	
Invalid source documents captured on subsidiary ledgers.	
Recording	
Source documents captured inaccurately.	Processing of transactions is inaccurate.
Inaccurate adjustments made in subsidiary ledgers.	
Cut-off Procedures	
Transactions that occur in period are recorded in another period.	

Risk Based Audit Approach

Risk-based audit (RBA) is an approach to audit that analyzes audit risks, sets materiality thresholds and develops audit programmes.

Audit Risk Analysis

- Auditor should **perform an analysis of audit risks** that impact on auditee before undertaking specific audit procedures.
- Risk assessment is a **subjective process**.
- It is part of **professional judgment** of auditor.
- It is **risk that auditor may unknowingly fail to appropriately modify his opinion on FS that are materially misstated**.

General Steps in the Conduct of Risk Based Audit

RBA process is presented in 3 distinct phases:

Risk assessment.	Risk response	Reporting
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Risk Assessment

Risk assessment phase of audit involves the following steps:

- 1) Performing **client acceptance or continuance procedures**;
- 2) **Planning** the overall engagement;
- 3) **Performing RAP to understand business** and identify IR & CR.
- 4) **Assessing ROMM** in FS;
- 5) **Communicating any material weaknesses** in design and implementation of IC to Mgt. and TCWG;

Risk response

Design and perform further audit procedures that respond to assessed ROMM and will provide evidence necessary to support audit opinion.

Reporting

Issuing an audit report based on audit findings.

Steps for Risk Identification

Q 13

- 1) **Assess significance** of assessed risk, **impact** of its occurrence & also **revise materiality** accordingly for specific account balance.
- 2) Determine **likelihood** for assessed risk to occur and **its impact** on auditing procedures.
- 3) **Document assertions** that are effected.
- 4) Consider **impact of the risk** on each of assertions.
- 5) (completeness, existence, accuracy, validity, valuation and presentation) **relevant** to account balance, class of transactions, or disclosure.
- 6) **Identify degree of significant risks** that would require **separate attention and response** by auditor.

Internal Control system

Q 5

SA 315 defines system of IC as the

process designed, implemented and maintained by TCWG, Mgt. and other personnel to provide reasonable assurance about achievement of an entity's objectives with regard to

reliability of financial reporting, effectiveness & efficiency of operations, safeguarding of assets, & compliance with L&R.

Objectives of Internal Control System

Transactions are executed through general or specific Mgt. authorization.

All transactions are **promptly recorded** in an appropriate manner to permit preparation of financial information and to maintain accountability of **assets**.

Assets and records are **safeguarded** from unauthorized access, use or disposition.

Assets are **verified at reasonable intervals** and appropriate action is taken with regard to the **discrepancies**.

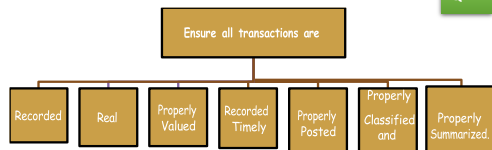
Inherent limitations of IC

Q 16

- 1) Mgt. consideration that **cost of an IC doesn't exceed expected benefits** to be derived.
- 2) **Potential for human error**, such as, due to carelessness, distraction, mistakes of judgement.
- 3) **Possibility of circumvention of IC through collusion** with employees or with parties outside entity.
- 4) **Possibility** that a person responsible for exercising an IC could **abuse** that responsibility.
- 5) **Manipulations by Mgt.** w.r.t transactions or estimates and judgements.

Basic accounting control objectives which are sought to be achieved by any accounting control system are:

Q 7

**Components of Internal Control**

Q 5

Control environment	Entity's RAP	Control activities	Information system and communication	Monitoring of Controls
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Structure of Internal Control

In order to achieve objectives of internal controls, it is necessary to **establish adequate control policies and procedures. Most of these policies and procedures cover:**

- 1) **Segregation of duties** - Following functions are segregated -
 - (a) authorization of transactions;
 - (b) execution of transactions;
 - (c) physical custody of related assets; and
 - (d) maintenance of records and documents
- 2) **Authorization of Transaction** - Delegation of authority to different levels and to particular persons are required to establish by Mgt. for controlling execution of transaction in accordance with prescribed conditions.

3) **Adequacy of Records and Documents** - Accounting controls should ensure that -

- (i) Transactions are executed in accordance with Mgt.'s general or specific authorization.
- (ii) Transactions & other events are promptly recorded at correct amounts.
- (iii) Transactions should be classified in appropriate accounts and in the appropriate period to which it relates.
- (iv) Recording of transaction should facilitate maintaining accountability for assets.

4) **Accountability and Safeguarding of Assets** - Accountability of assets commences from acquisitions of assets its use and final disposal. Safeguarding of assets requires appropriate maintenance of records, their periodic reconciliation with related assets.

5) **Independent Checks** - Independent verification of control systems, involves periodic or regular review by independent persons to ascertain whether control procedures are operating effectively or not.

Control Environment

Control environment encompasses **following elements:**

- (a) **Communication & enforcement of integrity and ethical values:** How they are communicated, and how they are reinforced in practice.
- (b) **Commitment to competence:** Competence is **knowledge and skills** necessary to accomplish tasks that define individual's job.
- (c) **Participation by TCWG**
- (d) **Mgt.'s philosophy and operating style:** Mgt.'s philosophy and operating style encompass a broad range of characteristics.
- (e) **Organisational structure:** considering **key areas of authority** and **responsibility** and **appropriate lines of reporting.**
- (f) **Assignment of authority and responsibility**
- (g) **Human resource policies and practices**

Entity's Risk Assessment Process

Q 15

Risks can arise or change due to circumstances such as the following:

- 1) **Changes in operating environment.** Changes in regulatory or operating environment can result in changes in competitive pressures and significantly different risks.
- 2) **New personnel:** New personnel may have a different focus on or understanding of IC.
- 3) **New or revamped information systems:** Significant and rapid changes in IS can change risk relating to IC.

- 4) **Rapid growth:** Significant and rapid expansion of operations can strain controls and increase the risk of a breakdown in controls.
- 5) **New technology:** Incorporating new technologies into production processes or IS may change the risk associated with IC.
- 6) **New business models, products, or activities:** Entering into business areas or transactions with which an entity has little experience may introduce new risks associated with IC.
- 7) **Corporate restructurings:** Restructurings may be accompanied by staff reductions and changes in supervision and segregation of duties that may change the risk associated with IC.
- 8) **Expanded foreign operations:**
- 9) **New accounting pronouncements**

Control Activities

Q 17

Control activities that may be relevant to an audit may be **categorised as policies and procedures** that pertain to the following:

- (a) **Performance reviews:** These control activities include
 - **reviews and analyses of actual performance vs budgets, forecasts, and prior period performance;**
 - **comparing internal data with external sources** of info. and
 - **review of functional or activity performance.**
- (b) **Information processing:**

2 broad groupings of IS control activities are:

 - **Application controls** - apply to the **processing of individual applications.**
 - **General IT-controls** - are policies & procedures that **relate to many applications & support the effective functioning of application controls.**
- (c) **Physical controls:** Controls that encompass:
 - **Physical security of assets,** including adequate safeguards
 - **Periodic counting and comparison** with amounts shown on control records
- (d) **Segregation of duties:** **Assigning different people the responsibilities** of authorising transactions, recording transactions, and maintaining custody of assets.

Information System, Including Related Business Processes, Relevant to Financial Reporting, & Communication

IS relevant to financial reporting objectives, which includes the financial reporting system, encompasses methods and records that:

Identify and **record** all valid transactions.

Describe on a timely basis the transactions in sufficient detail to **permit proper classification** of transactions for financial reporting.

Measure the **value of transactions** in a manner that permits recording their proper monetary value in the FS.

Determine **time period** in which transactions occurred to permit recording of transactions in proper accounting period.

Present properly **transactions** and related **disclosures** in the FS.

Monitoring of Controls

1. **Internal audit**
2. **Internal Check System** - organization of overall system of book-keeping and arrangement of staff duties in such a way that **no one person can carry** through transaction & record every aspect thereof.

Objectives of internal check system:

- 1) To **detect error and frauds** with ease.
- 2) To **avoid and minimize possibility of commission of errors and fraud** by any staff.
- 3) To **increase the efficiency of the staff**.
- 4) To **prevent and avoid misappropriation of cash and falsification of accounts**.

Effectiveness of an efficient system of IC depends on following considerations-

- 1) **Clarity of Responsibility**
- 2) **Division of Work**
- 3) **Standardization** - by creating suitable policies.
- 4) **Appraisal** - Periodic review

General condition pertaining to the internal check system

- 1) **No single person** should have **complete control** over any important aspect of the business operation. Every employee's action should come under the review of another person.
- 2) **Staff duties should be rotated** from time to time so that members do not perform the same function for a considerable length of time.
- 3) Every member of staff should be encouraged to **go on leave at least once a year**.

- 4) Persons having **physical custody** of assets must **not** be permitted to have access to books of accounts.
- 5) **Mechanical devices** should be used, where ever practicable to prevent loss or misappropriation of cash.
- 6) **Budgetary control** should be exercised and wide deviations observed should be reconciled.

Internal Control Assessment and Evaluation

Q 18

Following are some of the key components to assess & evaluate the controls environment:

Standard Operating Procedures (SOPs): A well defined set of SOPs helps define role, responsibilities, process & controls.

- 1) **Enterprise Risk Mgt:** Org. which has **robust process to identify & mitigate risks** across enterprise & its **periodical review** will assist in early identification of gaps & taking effective control measures.
- 2) **Segregation of Job Responsibilities:** **No 2 commercial activities** should be conducted by **same person**.
- 3) **Job Rotation in Sensitive Areas:** lead to **possible misuse in sensitive areas**.
- 4) **Delegation of Financial Powers Document:** A **clearly defined document on delegation of powers** allows controls to be **clearly operated without being dependent** on individuals.
- 5) **Information Technology based Controls:** **Embed controls** through system instead of being human dependent.

Techniques of evaluation of Internal control

Questionnaire

- **Set of questions framed** in an organised manner, about **each functional area**, which has as purpose the evaluation of effectiveness of control and detection of its weakness if any.
- Intended to be **filled by co. executives** who are in charge of the various areas.
- For this purpose, often **one general question** is broken down into a **no. of questions and sub-questions** to enable executive to provide a just 'Yes', 'No' or 'Not applicable' form of reply.
- If the answer to this is 'Yes', it fits with the plan of good IC. But if it is 'No' it **indicates weakness** in the system.
- For the **1st year** of engagements, **issue of questionnaire is necessary**.
- For **subsequent years**, **instead of issuing a questionnaire again**, may request client to confirm whether any change in nature and scope of business has taken place.
- However, it would be a good practice in the case of continuing engagements to issue a questionnaire irrespective of any change, say, **every 3rd year**.

In the use of standardized IC questionnaire, certain basic assumptions about elements of good control are taken into account. These are -

Q 19

- 1) Org.'s are such that permit an **extensive division of duties and responsibilities**.
- 2) Employees concerned with **accounting function are not assigned any custodial function**.
- 3) **No single person** is thrust with responsibility of completing a transaction all by himself.
- 4) There should always be **evidence to identify person who has done work**.
- 5) Work performed by each one is expected to **come under review of another** in the usual course of routine.
- 6) There is **proper documentation and recording of transactions**.

Check List

- **Series of instructions or questions on IC** which the **auditor must follow or answer**.
- If it is in the form of a question, the answer generally 'Yes', 'No' or 'Not Applicable' is entered opposite the question.
- A check list is more in the nature of a reminder to auditor about matters to be checked for testing the IC system.

Flow chart

Q 6

- Flow charting technique can also be resorted to for **evaluation of IC system**.
- It is a **graphic presentation of IC** in the org. and is normally drawn up to show the controls in each section or sub-section.
- It gives a **bird's eye view of the system** and is drawn up as a result of the auditor's review thereof.

A properly drawn up flow chart can provide a neat visual picture of the whole activities of the section or department involving flow of documents and activities.

More specifically, it can show-

- (i) **at what point a document is raised** internally or received from external sources;
- (ii) **no. of copies** in which a document is raised or received;
- (iii) **intermediate stages set sequentially** through which the document and the activity pass;
- (iv) **distribution of the documents** to various sections, department or operations;
- (v) **checking authorisation and matching**;
- (vi) **filing of documents**; and
- (vii) **final disposal**.

International Internal Control Frameworks

Q 20

Internal Control - Integrated Framework issued by Committee of the Sponsoring Organisations of the Treadway Commission (COSO Framework)

Framework includes **more than 17 basic principles** representing the fundamental concepts **associated with its 5 components**:

Control environment, risk assessment, control activities, information and communication, and monitoring.

Framework lists 3 categories of objectives as below:

- **Operations Objectives** - related to **effectiveness and efficiency** of entity's operations.
- **Reporting Objectives** - related to **internal and external financial and non-financial reporting to stakeholders** or other terms as established by regulators, standard setters, or entity's policies.
- **Compliance objectives** -"relating to entity's compliance with applicable laws and regulations."

Guidance on Assessing Control published by Canadian Institute of Chartered Accountants (CoCo)

CoCo was introduced with **objective of improving organizational performance and decision-making** with better controls, risk Mgt. and corporate governance.

Framework includes **20 criteria** for effective control in **4 areas** of an organization.

Purpose	Commitment	Capability	Monitoring and Learning
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Framework emphasizes that control **involves the entire organization** but **begins on an individual level**, with the employee.

Control Objectives for Information and Related Technology (COBIT)

- Created by **ISACA** (Information Systems Audit and Control Association) for **IT governance and Mgt.**
- COBIT has **34 high-level processes that cover 210 control objectives** categorized in 4 domains: planning and organization, acquisition and implementation, delivery and support, and monitoring and evaluation.
- **Supportive tool** for managers and allows **bridging crucial gap between technical issues, business risks and control requirements.**
- **Ensures quality, control and reliability of IS** in org., which is also most imp. aspect of every modern business.
- **Guides an org. on how to use IT resources** to manage IT domains, processes, and activities.

Internal Control: Guidance for Directors on Combined Code, published by the Institute of Chartered Accountants in England & Wales (known as the Turnbull Report)

Provide guidance to assist listed companies to implement requirements in Code relating to IC.

Key principles of the Code are :

- Board should **maintain a sound system of IC** to safeguard shareholders' investment and company's assets.
- Directors should, **at least annually**, conduct a **review of effectiveness of the group's system of IC** and should report to shareholders. Review should cover all controls, including financial, operational and compliance controls and risk Mgt.
- Companies which **don't have an internal audit function** should from time to time review the need for one.

Section 404 of Sarbanes-Oxley Act

(Sarbanes-Oxley Act Section 404) of United States of America **mandates that all publicly-traded companies must establish IC and procedures for financial reporting and must document, test and maintain those controls and procedures to ensure their effectiveness.**

Purpose of SOX is to **reduce the possibilities of corporate fraud.**

The SEC rules and PCAOB standard require that:

- Mgt. perform a **formal assessment** of its controls over financial reporting including tests that confirm the design and operating effectiveness of controls.
- Mgt. include in its **annual report an assessment of ICFR.**
- External auditors provide **2 opinions** as part of a single integrated audit of company:
 - **An independent opinion on effectiveness of system of ICFR.**
 - **Traditional opinion on the FS.**

Control System over Selling and Collection of Tickets (Q)

Q 11

Refer QB

SA 265 – Communicating deficiencies in IC to TCWG & Mgt.

Requirements

- If auditor has identified one or more deficiencies in IC, he shall determine, whether, individually or in combination, they constitute significant deficiencies.
- Communicate in writing significant deficiencies in IC identified during audit to TCWG on a timely basis.

Also communicate to Mgt. at an appropriate level of responsibility on a timely basis

- In writing, significant deficiencies in IC that auditor has communicated or intends to communicate to TCWG, unless it would be inappropriate to communicate directly to Mgt.; and
- Other deficiencies in IC identified during audit that have not been communicated to Mgt. by other parties and that, in auditor's professional judgment, are of sufficient importance to merit Mgt.'s attention.

Auditor shall include in the written communication of significant deficiencies in IC:

- A description of deficiencies and an explanation of their potential effects; and
- Sufficient information to enable TCWG and Mgt. to understand context of communication. In particular, auditor shall explain that:
 - Purpose of audit was for the auditor to express an opinion on FS;
 - Audit included consideration of IC relevant to preparation of FS in order to design audit procedures; and
 - Matters being reported are limited to those deficiencies that auditor has identified during audit and that auditor has concluded are of sufficient importance to merit being reported to TCWG.

When to communicate

Listed Entities	Before date of FS
Other Entities	Before assembly of audit file (60 days from date from the date of audit report)

Significant Deficiencies in IC

Q 23

Examples of matters that auditor may consider in determining whether a deficiency or combination of deficiencies in IC constitutes a significant deficiency include:

- likelihood of deficiencies leading to MM in FS in future.
- Susceptibility to loss or fraud of the related asset or liability.
- Subjectivity and complexity of determining estimated amounts, such as fair value accounting estimates.
- FS amounts exposed to the deficiencies.
- Volume of activity that has occurred or could occur in A/c balance or class of transactions exposed to deficiency or deficiencies
- Importance of controls to financial reporting process; for ex:
 - General monitoring controls (such as oversight of Mgt.).
 - Controls over the prevention and detection of fraud.
 - Controls over selection & application of significant accounting policies.
 - Controls over significant transactions with related parties.
 - Controls over significant transactions outside the entity's normal course of business.
 - Controls over the period-end financial reporting process.
- Cause and frequency of exceptions detected as a result of the deficiencies in the controls.
- Interaction of deficiency with other deficiencies in IC.

Q 25

Indicators of significant deficiencies in IC include, for Ex

- Evidence of ineffective aspects of control environment, such as:
 - Indications that significant transactions in which Mgt. is financially interested are not being appropriately scrutinised by TCWG.
 - Identification of Mgt. fraud, whether or not material, that was not prevented by entity's IC.
 - Mgt.'s failure to implement appropriate remedial action on significant deficiencies previously communicated.
- Absence of a risk assessment process within entity where such a process would ordinarily be expected to have been established.
- Evidence of an ineffective entity risk assessment process.
- Evidence of an ineffective response to identified significant risks (e.g. absence of controls over such a risk).
- Evidence of Mgt.'s inability to oversee the preparation of the FS.
- Misstatements detected were not prevented, or detected and corrected, by entity's IC.
- Disclosure of a MM due to error or fraud as prior period items in the current year's Statement of P&L.

Factors that auditor may consider in determining an appropriate level of detail for communication include, for Ex:

- Nature of entity.**
For instance, communication required for a public interest entity may be different from that for a non-public interest entity.
- Size and complexity of the entity.**
For instance, the communication required for a complex entity may be different from that for an entity operating a simple business.
- Nature of significant deficiencies** that auditor has identified.
- Entity's governance composition.**
For instance, more detail may be needed if TCWG include members who don't have significant experience in the entity's industry or in the affected areas.
- Legal or regulatory requirements** regarding communication of specific types of deficiency in IC.

Reporting to client on IC weakness

Q 11

Communicate such material weaknesses to the Mgt. or audit committee, on a timely basis preferably, in writing through a letter of weakness or Mgt. letter.

Important points with regard to such a letter are as follows:

- Letter lists down the area of weaknesses in the system and offers suggestions for improvement.
- Indicate that it discusses only weaknesses which have come to the attention of the auditor as a result of his audit and that his examination has not been designed to determine the adequacy of IC for Mgt.
- letter serves as a valuable reference document for Mgt. for the purpose of revising the system and insisting on its strict implementation.
- Serve to minimize legal liability in the event of a major defalcation or other loss resulting from a weakness in IC.

The practice of the issue of letter of weaknesses has a great merit in relieving auditor from liability in case serious frauds or losses have occurred, which probably would not have taken place had the client taken due note of the auditor's points in the letter of weakness.

SA 315 Identifying and Assessing ROMM Through Understanding the Entity and its Environment

Objective

to **identify and assess ROMM**, whether due to fraud or error, at FS and assertion levels, through **understanding** entity and its environment, including the entity's IC, thereby providing a basis for designing and implementing responses to the assessed ROMM.

Definitions

Assertions – Representations by **Mgt.**, explicit or otherwise, that are embodied in the FS, as used by auditor to consider different types of potential misstatements that may occur.

Risk Assessment Procedures and Related Activities

Auditor shall perform RAP to provide a **basis for the identification and assessment of ROMM at FS and assertion levels.**

RAP shall include:

- Inquiries** of Mgt., of appropriate individuals and of others within entity who may have info. that is likely to assist in identifying ROMM.
- Analytical procedures.**
- Observation & inspection.**

Understanding of the Entity and its Environment, Including the Entity's IC (Knowledge of business)

Auditor shall obtain an understanding:

- Relevant industry, regulatory, and other external factors** including applicable FRF.
- Nature of entity**, including:
 - its operations;
 - its ownership and governance structures;
 - the types of investments that entity is making and plans to make, including investments in special-purpose entities; and
 - the way that entity is structured and how it is financed;
- Entity's selection and application of accounting policies**, including reasons for changes thereto.
- Entity's objectives and strategies**, and those **related business risks** that may result in ROMM.
- Measurement and review** of entity's financial performance.

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

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

IS, including the related business processes

Auditor shall obtain an understanding of info. system, including related business processes, relevant to financial reporting, including following areas:

- Classes of transactions** in entity's operations that are significant to the FS;
- Procedures**, within both information technology (IT) and manual systems, by which those transactions are initiated, recorded, processed, corrected as necessary, transferred to general ledger and reported in FS;
- Related accounting records**, supporting info. and specific accounts in FS that are used to initiate, record, process and report transactions; this includes the correction of incorrect info. and how info. is trfd to the general ledger.
- How information system captures events and conditions**, other than transactions, that are significant to the FS;
- Financial reporting process** used to prepare the entity's FS, including significant accounting estimates and disclosures;
- Controls surrounding journal entries**, including non-standard journal entries used to record non-recurring, unusual transactions or adjustments.

Significant Risks

Q 27

In exercising judgment as to which risks are significant risks, auditor shall consider at least following:

- Whether **risk is a risk of fraud**;
- Whether **risk is related to recent significant economic, accounting, or other developments** like changes in regulatory environment, etc., and, therefore, requires specific attention;
- Complexity of transactions**;
- Whether risk involves **significant transactions with related parties**;
- Degree of subjectivity** in measurement of financial information related to the risk, especially those measurements involving a wide range of measurement uncertainty; and
- Whether risk involves **significant transactions** that are **outside normal course of business**, or that otherwise appear to be unusual.

Process of Assessing Risk of MM

Q 26

Q- Consideration of auditor assessing ROMM

- Identify risks** throughout process of obtaining an understanding of entity and its environment, including relevant controls that relate to risks.;
- Assess identified risks**, and evaluate whether they relate more pervasively to FS as a whole and potentially affect many assertions;
- Relate identified risks to what can go wrong** at **assertion level**, taking account of relevant controls that auditor intends to test; and
- Consider likelihood of misstatement**, including the possibility of multiple misstatements, and whether **potential misstatement is of a magnitude that could result in a MM.**

IT benefits an IC by enabling an entity to:

- Enhance timeliness, availability, and accuracy of info.**
- Enhance ability to monitor the performance of the entity's activities** and its policies and procedures;
- Facilitate additional analysis of info.**
- Reduce risk that controls will be circumvented**

IT specific risks to an entity's IC, including, for ex-

- Possibility of **IT personnel gaining access privileges beyond** those necessary to perform their assigned duties thereby breaking down SOD.
- 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.

Sources of obtaining client info:

- Client's **annual report** to shareholders;
- Minutes** of shareholders/board of directors;
- Internal financial Mgt. reports** of current & previous year;
- Previous year **audit working papers**;
- Discussion with client;

SA 330 The Auditor's Responses to Assessed Risks

SA 330 deals with auditor's responsibility to **design and implement responses** to the ROMM identified and assessed by the auditor in accordance with SA 315.

Audit Procedures Responsive to the Assessed ROMM at the Assertion Level

Q 26

Auditor shall design and perform further audit procedures whose NTE are based on and are responsive to assessed ROMM at assertion level.

In designing the further audit procedures to be performed, auditor shall:

- a) Consider **reasons for the assessment** given to the ROMM at the assertion level for each class of transactions, account balance, and disclosure, including:
 - (i) **likelihood of MM** due to the particular characteristics of the relevant class of transactions, account balance, or disclosure (i.e., the inherent risk); and
 - (ii) Whether the **risk assessment takes into account the relevant controls** (i.e., the control risk), thereby requiring the auditor to **obtain audit evidence** to determine **whether the controls are operating effectively** (i.e., the auditor intends to rely on the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures); and
- b) Obtain **more persuasive audit evidence** the higher the auditor's assessment of risk.

Test of controls

Auditor shall design and perform tests of controls to obtain SAAE as to operating effectiveness of relevant controls when:

- a) Auditor's assessment of risks of MM at the assertion level **includes an expectation that the controls are operating effectively**. (i.e., auditor intends to rely on the operating effectiveness of controls in determining NTE of SP); or
- b) **SP alone cannot provide SAAE** at assertion level.

Using audit evidence obtained during an interim period

When auditor obtains audit evidence about operating effectiveness of controls during an interim period, auditor shall:

- a) **Obtain audit evidence about significant changes to those controls** subsequent to the interim period; and
- b) Determine **additional audit evidence** to be obtained for the remaining period.

Definitions

Substantive procedure - An audit procedure **designed to detect MMs** at the assertion level.

- a) **Substantive procedures** comprise:
 - (i) **Tests of details** (of classes of transactions, account balances, and disclosures), and
 - (ii) **Substantive analytical procedures**.
- b) **Test of controls** - An audit procedure designed to **evaluate the operating effectiveness** of controls in preventing, or detecting and correcting, MM at assertion level.

Relevant factors in determining what additional audit evidence to obtain about controls that were operating during the period remaining after an interim period, include:

- 1) **Significance of assessed risks of MM** at the assertion level.
- 2) **Specific controls** that were tested during the interim period, and **significant changes** to them since they were tested, including changes in the information system, processes, and personnel.
- 3) **Degree** to which audit evidence about operating effectiveness of those controls was obtained.
- 4) **length of remaining period**.
- 5) **Extent to which the auditor intends to reduce** further SP based on the reliance of controls.
- 6) **Control environment**.

Extent of tests of controls

When more persuasive audit evidence is needed regarding effectiveness of a control, it may be appropriate to increase the extent of testing of the control.

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

- 1) **Frequency of performance of control** by entity during the period.
- 2) **length of time** during audit period that auditor is relying on operating effectiveness of control.
- 3) **Expected rate of deviation** from a control.
- 4) **Relevance and reliability of audit evidence** to be obtained regarding operating effectiveness of control at assertion level.
- 5) **Extent to which audit evidence is obtained** from tests of other controls related to the assertion.

Using audit evidence obtained in previous audits

In determining whether it is appropriate to use audit evidence about the operating effectiveness of controls obtained in previous audits **auditor shall consider:**

- (a) **Effectiveness of other elements of IC**, including **control environment, entity's monitoring of controls, and entity's RAP**;
- (b) **Risks arising from the characteristics of control**, including **whether it is manual or automated**;
- (c) **Effectiveness of general IT-controls**;
- (d) **Effectiveness of the control and its application by the entity**, including **nature and extent of deviations** in the application of the control noted in **previous audits**;
- (e) Whether **lack of a change in a particular control** **poses a risk** due to changing circumstances; and
- (f) **ROMM and extent of reliance on the control**.

If auditor plans to use audit evidence from a previous audit about the operating effectiveness of specific controls, auditor shall establish the **continuing relevance** of that evidence by **obtaining audit evidence about whether significant changes in those controls have occurred** subsequent to the previous audit.

Obtain this evidence by performing **inquiry** combined with **observation or inspection, to confirm** the understanding of those specific controls, and:

- (a) If **there have been changes** that affect the continuing relevance of audit evidence from previous audit, auditor shall **test controls in current audit**.
- (b) If **there have not been such changes**, he shall **test the controls at least once in every third audit**, and shall test **some controls each audit** to avoid possibility of testing all controls on which auditor intends to rely in a single audit period with no testing of controls in subsequent two audit periods.

Factors that warrant retesting of a control

Q 30

- 1) A **deficient control environment**.
- 2) **Deficient monitoring of controls**.
- 3) **Personnel changes** that significantly affect the application of the control.
- 4) **Changing circumstances** that indicate the need for changes in the control.
- 5) **Deficient general IT-controls**.
- 6) A **significant manual element** to the relevant controls.

SA 320 Materiality in Planning and Performing an Audit

Performance Materiality

- Amount or amounts set by auditor at **less than materiality for FS as a whole** to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for FS as a whole.
- If applicable, performance materiality also refers to amount or amounts set by auditor at less than materiality level or levels for **particular classes of transactions, account balances or disclosures.**

Determining Materiality & Performance Materiality when Planning the Audit

- When establishing overall audit strategy, auditor shall **determine materiality for FS as a whole.** If, **there is one or more particular classes of transactions, account balances or disclosures** for which **misstatements of lesser amounts than materiality for the FS as a whole** could reasonably be expected to **influence economic decisions** of users taken on basis of FS, auditor shall also **determine materiality level or levels** to be applied to those particular classes of transactions, account balances or disclosures.
- **Determine performance materiality** for purposes of assessing ROMM and determining NTE of further audit procedures.

Revision of Materiality

Q 29

- Auditor shall revise materiality for FS as a whole (and, if applicable, materiality level or levels for particular classes of transactions, account balances or disclosures) **in event of becoming aware of info.** during audit that would have caused auditor to have determined a different amount (or amounts) initially.
- If auditor **concludes that a lower materiality** for the FS as a whole (and, if applicable, materiality level or levels for particular classes of transactions, account balances or disclosures) than that **initially determined** is appropriate, he shall determine **whether it is necessary to revise performance materiality,** and **whether NTE of further audit procedures remain appropriate.**

Use of Benchmarks in Determining Materiality for the FS as a Whole

Determining materiality involves the exercise of professional judgment.

A percentage is often applied to a chosen benchmark as a starting point in determining materiality for the FS as a whole.

Q 28

Factors that may affect the identification of an appropriate benchmark include the following:

- 1) **Elements** of the FS (for ex, assets, liabilities, equity, revenue, expenses);
- 2) Whether there are items on which **attention of users of the particular entity's FS tends to be focused** ;
- 3) **Nature of entity, where the entity is at in its life cycle,** and industry and economic environment in which the **entity operates;**
- 4) Entity's **ownership structure** and the **way it is financed**
- 5) **Relative volatility of benchmark.**

SA 500 Audit Evidence

Audit Evidence

Info. used by auditor in arriving at conclusions on which auditor's opinion is based.

Mgt.'s expert - An individual/org. possessing expertise in a field **other than accounting or auditing**, whose work in that field is used by entity to assist entity in preparing FS.

Methods of obtaining Audit Evidence

- Observation:** - consists of **looking at a process or procedure** being performed by others,
- Inspection:** - **involves examining records or documents**, whether internal or external, in paper form, electronic form, or a **physical examination of an asset**.
- Inquiry:** - **seek info.** of knowledgeable persons within entity or outside entity.
- Recalculation:** - checking **mathematical accuracy** of documents or records.
- Reperformance:** - **auditor's independent execution of procedures or controls** that were originally performed as part of entity's IC.
- Analytical Procedures:** - consist of **evaluations of financial info.** made by a study of **plausible relationships** among both **financial and non-financial data**.
- External Confirmation:** - AE obtained by auditor as a direct written response from a 3rd party.
- Written Representation:** - **to confirm** certain matters or to **support** other evidence.

Sufficiency And Appropriateness of AE

Sufficiency	Measure of quantity
Appropriateness	Measure of Quality

- Higher the quality, the less quantity may be required.

Factors Determining Reliability of Audit Evidence

- Reliability of AE increased when obtained from **independent sources outside** entity.
- Reliability of AE generated **internally** increased **when related controls are effective**.
- AE obtained **directly** by auditor is more reliable than obtained indirectly.
- AE in **documentary form** more reliable than obtained orally.
- AE provided by **original documents** more reliable than provided by photocopies or documents filmed/digitised or transformed into electronic form.

Auditor's Consideration before Use/Reliability of Info. Produced by a Mgt.'s Expert

a) Evaluate competence, capabilities & objectivity of that expert:

Obtain info. regarding CCO of Mgt.'s expert from following sources: -

Personal experience with <u>previous work of expert.</u>	Discussions with expert.
Discussions with <u>others who are familiar with expert's work</u>	Published papers /books written by expert.
<u>Knowledge of expert's qualifications, membership of professional body/industry association, license to practice.</u>	<u>Auditor's expert, who assists him in obtaining SAAE</u>

b) Obtain understanding of work of Expert: -

- Whether expert's field has **areas of speciality** within it that are relevant to audit.
- Whether any professional or other standards, & regulatory or legal requirements **apply**.
- What **assumptions & methods** are used by Mgt. expert, & whether they are generally accepted & appropriate for financial reporting purposes.
- Nature** of internal & external data or info. Mgt. expert uses.

c) Evaluate appropriateness of expert's work as audit evidence for relevant assertion: -

Considerations when evaluating appropriateness of Mgt. expert's work:

- Relevance & reasonableness** of expert's findings or conclusions, **their consistency** with other AE, & whether they have been **appropriately reflected** in FS;
- If expert's work involves **use of significant assumptions & methods**,
- Relevance & reasonableness** of those assumptions & methods; &
- If expert's work **involves significant use** of source data, relevance, completeness, & accuracy of source data.

Matters affecting NTE of Audit Procedures while using info. produced by Mgt. Expert

- Nature & complexity** of matter to which Mgt. expert relates.
- ROMM** in the matter.
- Nature, scope & objectives** of Mgt. expert's work.
- Whether **Mgt. expert is employed by entity**, or is a party engaged by it to provide relevant services.
- Extent to which Mgt. can exercise control** or **influence over work of Mgt. expert**.
- Auditor's previous experience** of work of that expert.

Q. Importance of Inquiry as one of the methods of collecting Audit Evidence.

Inquiry: As per SA 500 Audit Evidence:

- Inquiry consists of seeking info. of knowledgeable persons, financial and non-financial, within the entity or outside the entity.** Inquiry is used throughout audit, Inquiries may range from formal written inquiries to informal oral inquiries.
- Responses to inquiries may provide auditor with info. not previously possessed or with corroborative audit evidence.** Alternatively, responses might provide info. that differs significantly from other info. that auditor has obtained, for ex, information regarding possibility of mgt. override of controls. In some cases, responses to inquiries provide a basis to modify or perform additional audit procedures.
- Although corroboration of evidence obtained through inquiry is often of particular importance, in case of inquiries about Mgt. intent, info. available to support management's intent may be limited.** In these cases, understanding management's past history of carrying out its stated Intentions, management's stated reasons for choosing a particular course of action, and management's ability to pursue a specific course of action may provide relevant info. to corroborate evidence obtained through inquiry.
- In some matters, auditor may consider it necessary to obtain WR from mgt. & TCWG to confirm responses to oral inquiries.

SA 501 Audit Evidence – Specific considerations for selected items

Objective

To obtain SAAE regarding:

Existence & condition of Inventory **Completeness of litigation & claims involving the entity**

Presentation & disclosure of segment info. in accordance with the applicable FRF

PART A: - Inventory

Existence & Condition of Inventory

Q 9/11

When inventory is material to FS, obtain SAAE regarding existence & condition of inventory by:

- 1) **Attendance** at physical inventory counting, unless impracticable
 - Evaluate Mgt. instructions & procedures for recording & controlling results of entity's physical inventory counting;
 - Observe performance of Mgt. count procedures;
 - Inspect inventory;
 - Perform test counts; &
- 2) **Performing audit procedures** over entity's final inventory records to determine whether they accurately reflect actual inventory count results.

Attendance at physical inventory counting involves:

- ⊙ Inspecting inventory to ascertain its existence & evaluate its condition & perform test counts.
- ⊙ Observing compliance with management's instructions and performance of procedures for recording & controlling results of physical inventory count; and
- ⊙ Obtaining audit evidence as to reliability of management's count procedures.

Physical Inventory Counting at a date other than date of FS

Q 12

- For **practical** reasons, may be conducted.
- This may be done **irrespective** of whether Mgt. determines inventory quantities by an annual physical inventory counting or maintains a perpetual inventory system.
- In either case, effectiveness of design, implementation & maintenance of controls over changes in inventory determines whether conduct of physical inventory counting at a date, or dates, other than date of FS is **appropriate for audit purposes**.
- Auditor shall **perform audit procedures** to obtain AE about whether changes in inventory b/w count date & date of FS are **properly recorded**.

Matters for auditor's consideration when designing audit procedures to obtain AE about **whether changes in inventory amounts between count date, or dates, & final inventory records are properly recorded** include:

- a) Whether **perpetual inventory records** are properly adjusted.
- b) **Reliability** of entity's perpetual inventory records.
- c) **Reasons for significant differences** b/w info. obtained during physical count & perpetual inventory records.

If auditor unable to Attend Physical Inventory Counting due to Unforeseen Circumstances

- He shall make or observe some physical counts on an **alternative date**.
- Perform **alternative audit procedures** to assess whether changes in inventory b/w date of physical count & period end date are correctly recorded.
- **Verify** procedure adopted, treatment given for discrepancies noticed during physical count.
- Ensure that **appropriate cut off procedures** were followed by Mgt.
- Get Mgt. **written representation** on
- **Completeness of info.** provided regarding inventory, &
- **Assurance** w.r.t adherence to laid down procedures for physical inventory count.

Attendance at Physical Inventory Counting becomes impractical

Q 9

- Due to factors such as **nature & location of inventory**, ex: location may pose threats to safety of auditor
- **As per SA 200**, matter of difficulty, time, or cost involved is **not in itself a valid basis** for auditor to **omit audit procedure** or satisfied with AE that is less than persuasive.
- He shall perform **alternative audit procedures** to obtain SAAE regarding existence & condition of inventory.
- If **not possible** to do so- **modify opinion** as per SA 705.

When inventory under the custody and control of a 3rd party is material to FS

Q 8

He shall obtain SAAE regarding existence & condition of that inventory by performing one or both of following:

- a) **Request confirmation** from the 3rd party as to the quantities & condition of inventory.
- b) Perform **inspection** or **other audit procedures** appropriate in the circumstances.

Where info. is obtained that **raises doubt about integrity and objectivity** of the 3rd party. Auditor may consider it appropriate to perform other audit procedures:

- **Attending, or arranging** for another auditor to attend, 3rd party's physical counting of inventory, if practicable.
- **Obtaining another auditor's report** on adequacy of 3rd party's IC for ensuring that inventory is properly counted & safeguarded.
- **Inspecting documentation** regarding inventory held by 3rd parties, for ex, **warehouse receipts**.
- Requesting **confirmation** from other parties when inventory has been pledged as collateral.

PART 2: - Litigations & Claims

Completeness litigation & claims

Q 13(4)

Auditor shall design & perform **audit procedures** in order to **identify litigation & claims** involving entity which may give rise to a ROMM, including:

- Inquiry of Mgt.** & others within entity, including inhouse legal counsel;
- Reviewing minutes** of meetings of TCWG & **Correspondence** b/w entity & its external legal counsel; &
- Reviewing legal expense accounts.**

Communicate with Entity's External Legal Counsel

- If auditor assesses a ROMM regarding **litigation or claims exist**, or when audit procedures performed **indicate that other material litigation or claims exist**, he shall **seek direct communication with entity's external legal counsel**.
- Same can be done by **Letter of "General Inquiry" Or "Specific Enquiry"** (Prepared by Mgt. & Sent by Auditor)
- If **Law/Legal council's professional body deny or prohibit** to communicate directly with auditor he shall **perform Alternate audit Procedure**.
- If Mgt. Or Legal Counsel **refuse to communicate** with external legal council & Auditor **not able to obtain SAAE** using Alternate Audit Procedure he shall **modify Opinion as per SA 705**.

Letter of General Enquiry:

In some cases, auditor may seek **direct communication with entity's external legal counsel** through a letter of:

- **any litigation and claims** that counsel is aware of, and
- an **assessment of outcome** of litigation and claims, and
- an **estimate** of the **financial implications**, including costs involved

Letter Of Specific Inquiry:

If it is considered **unlikely** that entity's external legal counsel will **respond appropriately** to a letter of general inquiry.

Ex-. if his professional body prohibits response to such letter & have significant Risk.

Auditor may seek direct communication through a letter of specific inquiry. For this purpose, a **letter of specific inquiry** includes:

- A **list** of litigation and claims
- Where available, **Mgt. assessment of outcome of each of identified litigation and claims** and its **estimate of financial implications**, including costs
- A **request** that entity's external legal counsel **confirm reasonableness of Mgt. assessments** and **provide auditor with further info.** if list is considered by entity's external legal counsel to **be incorrect**.
- Auditor may **seek meeting** with external legal counsel if matter is:
 - Matter is a significant risk**
 - Matter is **complex**.
 - Disagreement** between Mgt & external legal counsel.

Written Representations

Auditor shall request Mgt. & TCWG to provide WR that all litigation and claims whose effects should be considered when preparing FS have been

- **disclosed** to the auditor and
- **appropriately accounted for & disclosed** as per applicable FRF.

PART-3 Segment Info: Presentation & Disclosure

Audit Procedure:

Obtain **SAAE** w.r.t presentation & disclosure of segment info. as per FRF:

- Obtaining an **understanding of methods used** by Mgt. in determining segment info. **Further**,
 - Evaluating whether such methods are **likely to result in disclosure as per applicable FRF**
 - Testing application of such methods**.
- Performing analytical procedures or other audit procedures**.

Examples of matters that may be relevant when obtaining an **understanding of methods used by Mgt.** in determining segment info. & disclosure as per applicable FRF include:

Q 10

- Sales, transfers & charges** b/w segments, & elimination of intersegment amounts
- Allocation of **assets & costs** among segments
- Comparisons of budgets & other expected results**, for Ex: operating profits as a % of sales
- Consistency with prior periods, & adequacy of disclosures** w.r.t inconsistencies

SA 505 - External Confirmations

AE obtained as a **direct written response** to the auditor **from a 3rd party** (the confirming party), in paper form, or by electronic or other medium.

Situations where EC may be used

Debtor balances	Creditor balances
Bank loans	Bank Balance & other info. from bankers
Stock held by 3 rd parties	Property title deeds held by third parties
Investments purchased but delivery not taken	Terms of agreement/transactions with 3 rd parties

External Confirmation Procedures

- 1) **Determining info. to be confirmed or requested;**
- 2) **Selecting appropriate confirming party;**
- 3) **Designing confirmation requests**, including determining that requests are properly addressed.
- 4) **Sending requests**, including follow-up requests.

Factors to be considered by auditor when designing confirmation requests

- 1) **Assertions being addressed.**
- 2) Specific identified **ROMM**, including fraud risks.
- 3) **Layout & presentation** of confirmation request.
- 4) **Prior experience** on audit or similar engagements.
- 5) **Method of communication** (ex: in paper form/by electronic or other medium)
- 6) **Mgt. authorisation** to confirming parties to respond to auditor.
- 7) **Ability of intended confirming party** to confirm or provide requested info. (ex: individual invoice amount v/s total balance).

Types Of External Confirmation

Positive confirmation request (PCR)

Q 19

Confirming party respond directly to auditor indicating whether **confirming party agrees or disagrees with info.** in request, or providing requested info.

- PCR asks confirming party to **reply in all cases**, either by indicating agreement with given info, or providing info..
- Response to PCR is expected to provide **reliable AE**.
- **Risk** - party may **reply without verifying** that info. is correct.
- Auditor may **reduce this risk** by using PCR that **do not state amt (or other info)** on confirmation request, and ask confirming party to fill amount or furnish other info.
- Use of this type of **"blank" confirmation request may result in lower response rates** because additional effort is required by confirming parties

Negative confirmation request (NCR)

A request that the confirming party **respond directly to auditor only if confirming party disagrees** with the info. provided in request.

NCR provide less persuasive AE than PCR.

Q 18

Accordingly, auditor **shall not use NCR as sole substantive audit procedure** to address assessed ROMM at assertion level unless **all of following are present:**

- a) Auditor has **assessed ROMM as low** & has **obtained SAAE regarding operating effectiveness of controls relevant to assertion;**
- b) **Population** of items comprises a large no. of small, homogeneous, account balances, transactions or conditions;
- c) **Very low exception rate** is expected; and
- d) Auditor **is not aware of circumstances or conditions** that would cause recipients of NCR to disregard such requests.

Failure to receive response to NCR

Q 15

- Failure to receive response to NCR **does not explicitly indicate receipt by intended confirming party of confirmation request or verification of accuracy of info.** contained in request.
- Failure of confirming party to respond to NCR **provides significantly less persuasive AE** than does a response to PCR.
- Confirming parties also **may be more likely to respond indicating their disagreement** with a confirmation request **when the info.** in the request **is not in their favour, and less likely to respond otherwise.**

Non-Responses: Alternative Audit Procedures

Examples of alternative audit procedures auditor may perform:

- **For accounts receivable balances** - examining specific subsequent cash receipts, shipping documentation, & sales near period-end.
- **For accounts payable balances** - examining subsequent cash disbursements or correspondence from 3rd parties, & other records, such as goods received notes.

Mgt.'s refusal to allow auditor to send a confirmation request

Q 16

Auditor shall:

- a) **Inquire** as to Mgt.'s **reasons for the refusal**, and **seek AE as to their validity and reasonableness;**
- b) **Evaluate implications of Mgt.'s refusal** on auditor's assessment of relevant risks of MM, including risk of fraud, and on NTE of other audit procedures; and
- c) Perform **alternative audit procedures** to obtain relevant and reliable AE.

If **Mgt. refusal is unreasonable, or he is unable to obtain relevant & reliable AE** from alternative audit procedures, he shall:

- communicate with TCWG as per SA 260 &
- determine implications for audit & auditor's opinion as per SA 705

Factors assist auditor in determining whether EC procedures are to be performed as Substantive audit procedure include

Q 17

- 1) **Confirming party's knowledge of subject matter** - responses may be more reliable if provided by person at confirming party who has requisite knowledge about info. being confirmed.
- 2) **Ability or willingness of intended confirming party to respond** - for ex: confirming party:
 - a) May not accept **responsibility for responding** to confirmation request;
 - b) May consider **responding too costly or time consuming;**
 - c) May have concerns about **potential legal liability** resulting from responding;
 - d) May **account for transactions in different currencies;** or
 - e) May **operate in environment where responding** to confirmation requests is **not significant aspect of day-to-day operations.**
- 3) **Objectivity of intended confirming party** - if **confirming party is related party** of entity, responses to confirmation requests may be **less reliable.**

SA 510 Initial Audit Engagements -Opening Balances

Initial audit engagement - An engagement in which either:

FS for prior period were not audited; or	FS for prior period were audited by a predecessor auditor
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Objective Q 23

To obtain SAAE about whether:

- (i) opening balances of preceding period have been **correctly brought forward** to current period;
- (ii) opening balances **do not contain any misstatement** that materially affect the current period's FS; and
- (iii) **appropriate accounting policies reflected** in opening balances have been **consistently applied** in current period's FS, or **changes** are properly accounted for & adequately presented and disclosed.

Audit Procedures: Opening balances

Auditor shall read most recent FS & predecessor auditor's report thereon for info. relevant to opening balances, including disclosures.

Obtaining SAAE Q 22/23

Auditor shall obtain SAAE about whether opening balances contain MM affect current period's FS by:

- a) Determining whether **prior period's closing balances have been correctly b/f** to current period or, **any adjustments** have been disclosed as prior period items in current year's P&L;
- b) Determining whether opening balances **reflect application of appropriate accounting policies**; &
- c) Performing one or more of following:
 - Where **prior year FS were audited**, perusing copies of audited FS including other relevant doc's relating to prior period FS;
 - **Evaluating whether audit procedures performed in current period provide evidence** relevant to opening balances; or
 - Performing **specific audit procedures** to obtain evidence regarding opening balances.

If auditor obtains AE that opening balances contain misstatements that could materially affect current period's FS - **perform additional audit procedures** as are appropriate in circumstances to **determine effect on current period's FS**.

If auditor **concludes** that such misstatements exist in current period's FS, - communicate misstatements with appropriate level of Mgt. & TCWG as per **450**.

Performing specific audit procedures to obtain evidence regarding opening balances Q 23

For Current Assets & Liabilities Q 20	For NCA & NCL
<p>Some AE about opening balances may be obtained as part of current period's audit procedures.</p> <p>In case of inventories, audit procedures on closing inventory balance <u>provide little AE regarding inventory on hand at beginning of period</u>.</p> <p>Therefore, additional audit procedures may be necessary:</p> <ul style="list-style-type: none"> □ Observing a current physical inventory count and reconciling it to the opening inventory quantities. □ Performing audit procedures on valuation of opening inventory items. □ Performing audit procedures on gross profit and cut-off. 	<ul style="list-style-type: none"> □ such as PPE, investments & long-term debt, some AE may be obtained by examining accounting records & other info, underlying opening balances. □ In certain cases, to obtain some audit evidence regarding opening balances through confirmation with 3rd parties.

Consistency of Accounting Policies

Auditor shall obtain SAAE about

- whether **accounting policies** reflected in **opening balances consistently applied** in current period's FS, &
- whether **changes in accounting policies** have been **accounted for & adequately presented & disclosed** as per FRF.

Nature and extent of Audit Procedures

Nature & extent of audit procedures necessary to obtain SAAE w.r.t opening balances **depend on such matters as**:

- **Accounting policies** followed by entity.
- **Nature of a/c balances, classes of transactions & disclosures & ROMM** in current period's FS.
- **Significance** of opening balances relative to current period's FS.
- Whether **prior period's FS were audited** &, if so, whether predecessor auditor's opinion was modified.

If prior period's FS were audited by predecessor auditor Q 21

- Current auditor may be able to **obtain SAAE** regarding opening balances by **perusing copies of audited FS**.
- Ordinarily, **current auditor can place reliance on closing balances contained in FS for preceding period, except** when during performance of audit procedures for current period **possibility of misstatements in opening balances is indicated**.

Audit Conclusions and Reporting Q 22

Opening Balances

If auditor is **unable to obtain SAAE**, he shall express **Qualified opinion or Disclaimer of opinion**, as appropriate, as per SA 705

If auditor **concludes** that **opening balances contain MM** affects current period's FS, & effect of misstatement is not properly accounted for or not adequately presented or disclosed, auditor shall express **Qualified opinion or Adverse opinion**, as per SA 705.

Modification to the Opinion in Predecessor Auditor's Report

If predecessor auditor's opinion w.r.t prior period's FS included a modification to auditor's opinion that remains relevant & material to current period's FS, auditor **shall modify** auditor's opinion on current period's FS as per SA 705 & SA 710.

SA 530 “Audit Sampling”

Application of audit procedures to **less than 100%** of items within a population such that all sampling units have a chance of selection.

Statistical & Non-statistical sampling

Q 29

Statistical Sampling

Approach to sampling that has following characteristics:

- (i) **Random selection** of sample items; &
- (ii) Use of **probability theory** to evaluate sample results, including measurement of sampling risk.

This method is **more scientific** as it involves use of laws of probability. This method has reasonably **wide application** where population consists of large no. of similar items.

Non-Statistical Sampling

- (i) Sampling approach that **doesn't have characteristics of random selection & use of probability theory** is considered as non-statistical sampling.
- (ii) In this method, **sample size & its composition are determined on basis of personal experience & knowledge of auditor.**

Sampling Risk & Non-sampling risk

Q 26

Sampling Risk

Risk that auditor's conclusion based on sample may be **different from conclusion** if **entire population were subjected to same audit procedure.**

Sampling risk can lead to **2 types of erroneous conclusions:**

- (i) In case of TOC, that **controls are more effective than they actually are**, or
In case of a TOD, that a **MM doesn't exist** when in fact it does.
Auditor is concerned with this type of erroneous conclusion because it **affects audit effectiveness** & is more likely to lead to inappropriate audit opinion.
- (ii) In case of TOC, that **controls are less effective than they actually are**, or
In case of TOD, that **MM exists when in fact it does not.**
This type of erroneous conclusion **affects audit efficiency** as it would usually lead to additional work to establish that initial conclusions were incorrect.

Non-sampling risk

Risk that auditor reaches an **erroneous conclusion** for any reason **not related to sampling risk.**

Tolerable Misstatement

Monetary amount set by auditor is **not exceeded by actual misstatement** in population.

Tolerable Rate of deviation

Rate of deviation set by auditor is not exceeded by actual rate of deviation in population.

Sample Design, Size and Selection of Items for Testing

- (i) When **designing audit sample**, consider purpose of audit procedure & characteristics of population.
- (ii) **Determine sample size sufficient to reduce sampling risk to acceptably low level.**
- (iii) **Select items for sample in such a way that each sampling unit in population has a chance of selection.**

Performing Audit Procedures

- (i) Auditor shall **perform audit procedures on each item selected.**
- (ii) **If audit procedure is not applicable to selected item** - perform procedure on a **replacement item.**
- (iii) **If auditor is unable to apply designed audit procedures**, or suitable alternative procedures, to a selected item, he shall **treat that item as a deviation from prescribed control**, in case of TOC, or misstatement, in case of TOD.

Nature & Cause of Deviations & Misstatements

- Auditor shall **investigate nature & cause** of any deviations or misstatements & **evaluate their possible effect.**
- When auditor considers misstatement or deviation discovered in sample to be **anomaly - obtain high degree of certainty that such misstatement or deviation is not representative of population.**
- Auditor shall **obtain this degree of certainty by performing additional audit procedures** to obtain SAAE that misstatement or deviation doesn't affect remainder of population.

Evaluating Results of Audit Sampling

Q 25

Auditor shall evaluate

- a) **Results of sample &**
- b) Whether use of audit sampling provided **reasonable basis for conclusions** about population that has been tested.

If audit sampling has **not provided a reasonable basis** for conclusions about population auditor may:

- **Request Mgt. to investigate misstatements** & to make necessary adjustments; or
- **Tailor NTE of FAP to best achieve required assurance.**

Projecting Misstatements

- Auditor **project misstatements for population to obtain a broad view of scale of misstatement** but this projection may not be sufficient to determine amount to be recorded.
- When **misstatement has been established as anomaly**, it excluded when projecting misstatements to population.
- However, **effect of any such misstatement, if uncorrected**, still needs to be **considered in addition to projection of non-anomalous misstatements.**
- For TOD, **project misstatements** found in sample to population
- For TOC, **no explicit projection of deviations is necessary** since sample deviation rate is also projected deviation rate for population as a whole.

Methods of Sample Selection

Q 28

Random Selection

This method is applied through random number generators or random number tables.

2 types of Random Sampling:

a) Simple Random Sampling:

- This method ensures that all items within a population stand an **equal chance of selection** by use of random number tables or random number generators.
- Sampling units could be physical items, such as sales invoices or monetary units.
- **Considered appropriate** when population to be sampled consists of reasonably similar units & **false within reasonable range**.
- Suitable for **homogeneous population** having a similar range

b) Stratified Sampling:

- **Dividing population into sub-populations**, each of which is group of sampling units which have similar characteristics (often monetary value).
- Every **such group** so divided is called a **strata**.
- Each **stratum** is treated as if it were a separate population & proportionate items are selected from each of stratum.
- Groups into which whole population is divided is determined by auditor on **basis of his judgment**. e.g.

Entire expense vouchers divided into:	Auditor then decide to check
Vouchers above ₹ 1,00,000	100% testing
Vouchers b/w ₹ 25,000 and ₹ 1,00,000	50% testing
Vouchers below ₹ 25,000	25% testing

Reasoning behind stratified sampling is that for a **highly diversified population**, weights should be allocated to reflect these differences.

Systematic Selection/Interval sampling

- No. of sampling units in population is divided by sample size to give a **sampling interval**.
- Ex: 50, and having determined a starting point within the first 50, **50th sampling unit thereafter** is selected.
- Although **starting point** may be determined haphazardly, sample is more likely to be truly random if it is determined by use of a computerised random number generator or random number tables.

Monetary Unit Sampling

Type of **value-weighted selection** in which sample size, selection & evaluation results in a conclusion in **monetary amounts**.

Haphazard Selection

- Samples are selected **without following structured technique**.
- Although no structured technique is used, **avoid any conscious bias or predictability** & thus attempt to ensure that all items in population have a chance of selection.
- **Not appropriate when using statistical sampling**.

Block Selection

- It involves **selection of a block(s) of contiguous items** from within population.
- Block selection **can't ordinarily be used in audit sampling** because most populations are structured such that items in a sequence can be expected to have similar characteristics .

Factors affecting Sample Size

In case of tests of controls

Increase in extent to which auditor's risk assessment takes into account relevant controls	Increases
Increase in tolerable rate of deviation	Decreases
Increase in expected rate of deviation of population to be tested	Increases
Increase in auditor's desired level of assurance that tolerable rate of deviation is not exceeded by actual rate of deviation in population	Increases

In case of tests of details

Increase in auditor's assessment of ROMM	Increase
Increase in use of other substantive procedures directed at same assertion	Decrease
Increase in auditor's desired level of assurance that tolerable misstatement is not exceeded by actual misstatement in population	Increase
Increase in tolerable misstatement	Decrease
Increase in amount of misstatement auditor expects to find in population	Increase
Stratification of population when appropriate	Decrease

Uses of Stratification

Q 27

- A. **Audit efficiency may be improved** if auditor stratifies a population by dividing it into discrete sub-populations which have an identifying characteristic. **Objective** of stratification is to **reduce variability of items** within each stratum and **therefore allow sample size to be reduced without increasing sampling risk**.
- B. **When performing tests of details, population is often stratified by monetary value**. This allows **greater audit effort to be directed to larger value items**, as **these items may contain the greatest potential misstatement in terms of overstatement**. Similarly, a population may be stratified according to a particular characteristic that indicates a higher risk of misstatement, for example, when testing the allowance for doubtful accounts in valuation of accounts receivable, balances may be stratified by age.
- C. **The results of audit procedures applied to a sample of items within a stratum can only be projected to the items that make up that stratum**. To draw a conclusion on entire population, **consider ROMM in relation to whatever other strata make up entire population**.
- D. If a class of transactions or a/c balance has been divided into strata, **misstatement is projected for each stratum separately**. Projected misstatements for each stratum are then combined when considering the possible effect of misstatements on the total class of transactions or account balance.

SA 550 Related Parties

A party that is either:

- (i) RP as defined in FRF; or
- (ii) Where FRF establishes minimal or no related party requirements:
 - a) Person or other entity that has control or significant influence, over reporting entity;
 - b) Another entity over which reporting entity has control or significant influence; or
 - c) Another entity that is under common control with reporting entity through having:
 - Common controlling ownership;
 - Owners who are close family members; or
 - Common key Mgt.

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

Related Party Disclosures: As per Ind AS 24

Q 36

"Related Party Disclosures", reporting entity is exempt from disclosure in relation to RPT & o/s balances, including commitments, with:

- (i) Govt. that has control or joint control of, or significant influence over reporting entity; and
- (ii) Another entity that is RP because same govt. has control or joint control of, or significant influence over, both reporting entity & other entity.

If reporting entity applies above exemption, shall disclose following about transactions & related o/s balances referred to:

- (i) Name of government & nature of its relationship with reporting entity (i.e. control, joint control or significant influence);
- (ii) Following info. in sufficient detail to enable users to understand effect of RPT on its F.S.:
 - **Nature & amount** of each individually significant transaction; and
 - for other transactions that are collectively, but not individually, significant, a qualitative or quantitative indication of their extent.

Understanding Entity's Related Party Relationships & Transactions

Auditor shall inquire of Mgt. regarding:

- a) **Identity of entity's RP**, including changes from prior period;
- b) **Nature of relationships** between entity & these related parties; and
- c) Whether entity entered into any transactions with these RP during period and, if so, **type & purpose of transactions**.

Auditor shall inquire of Mgt. & others within entity, & perform other RAP, to obtain understanding of controls that Mgt. has established to:

- a) **Identify, account for, & disclose** RP relationships & transactions
- b) **Authorise & approve significant transactions & arrangements** with RP; and
- c) **Authorise & approve significant transactions & arrangements outside normal course of business**

Discussion among Engagement Team

Q 33

Matters addressed in discussion among engagement team include:

- 1) **Nature & extent** of entity's relationships & transactions with RP.
- 2) An **Emphasis on importance** of maintaining professional skepticism throughout audit regarding potential for MM associated with RPR & RPT.
- 3) **Circumstances or conditions** of entity that indicate existence of RPR or RPT that Mgt. has not identified or disclosed to auditor
- 4) **Records or documents** that indicate existence of RPR or RPT.
- 5) **Importance that Mgt. and TCWG attach to identification, appropriate accounting for, and disclosure** of RPR & RPT and related risk of Mgt. override of relevant controls.

Records or Documents That Auditor May Inspect

Q 34

Auditor shall inspect following for indications of **existence of RP relationships or transactions** that Mgt. has not previously identified or disclosed to auditor:

- a) **Bank, legal & 3rd party confirmations** obtained.
- b) **Minutes** of meetings of shareholders & of TCWG; and
- c) **Such other records** or documents necessary.

During audit, auditor may inspect records or documents that may provide info. about RPR & RPT, for Ex:

- Entity ITR.
- **Info. supplied** by entity to regulatory authorities.
- **Shareholder registers** to identify entity's principal shareholders.
- **Statements of conflicts of interest** from Mgt. & TCWG.
- **Records of entity's investments** & those of its pension plans.
- **Contracts & agreements** with key Mgt. or TCWG.
- **Significant contracts & agreements** not in entity's ordinary course of business.
- **Life insurance policies** acquired by entity.
- **Internal auditors' reports**.

If auditor identifies significant transactions outside entity's normal course of business when performing audit procedures, inquire Mgt. about:

- a) **Nature of these transactions**; and
- b) **Whether related parties could be involved**.

Identification of Previously Unidentified or Undisclosed RP or Significant RPT

If auditor identifies RP or significant RPT that Mgt. has not previously identified or disclosed to auditor, then he shall:

- a) **Promptly communicate** relevant info. to other members of team;

Request Mgt. to identify all transactions with newly identified RP for further evaluation; and	Inquire as to why entity's controls failed to enable identification or disclosure of RPR or RPT;
------------------------------------------------------------------------------------------------	--------------------------------------------------------------------------------------------------

- b) Where **FRF establishes RP requirements**;
- c) Perform **Substantive procedure** relating to such newly identified RP or significant RPT;
- d) **Reconsider risk** that other RP or significant RPT may exist that Mgt. has not previously identified or disclosed to auditor, & perform additional audit procedures as necessary; and
- e) If **non-disclosure** by Mgt. appears intentional, evaluate implications for audit.

Examples of arrangements that may indicate existence of RPR's or RPT that Mgt. has not previously identified or disclosed to auditor include:

- Participation in **unincorporated partnerships** with other parties.
- Agreements for **provision of services** to certain parties under T&C that are o/s entity's normal course of business.
- **Guarantees and guarantor relationships**

Disclosure under AS 18

- **Name** of transacting related party;
- A **description** of relationship between parties;
- A **description** of nature of transactions;
- **Volume of transactions**
- Any **other elements** of RPT's which is necessary for an understanding of FS;

Identified	Significant	RPT	o/s	Entity's	Normal
Course of Business					
					Q 35

Q- Transactions appears to be biased?

For identified significant RPT outside entity's normal course of business, auditor shall:

- a) **Inspect underlying contracts or agreements & evaluate whether:**
- (i) **Business rationale** of transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets;
 - (ii) **Terms of transactions** are consistent with Mgt. explanations; and
 - (iii) Transactions have been **appropriately accounted for & disclosed** as per FRF; and
- b) Obtain AE that transactions have been **appropriately authorised & approved**

Q 32

Examples of transactions o/s entity's normal course of business may include:

- ❑ **Complex equity transactions**, such as corporate restructurings or acquisitions.
- ❑ Transactions with **offshore entities** in jurisdictions with weak corporate laws.
- ❑ **Sales transactions** with unusually large discounts or returns.
- ❑ Transactions with **circular arrangements**, for ex, sales with a commitment to repurchase.
- ❑ Transactions under contracts whose terms are changed before expiry.
- ❑ **Leasing** of premises or rendering of Mgt. services by entity to

SA 560 Subsequent Events

Subsequent events - Events occurring between date of F.S. & date of auditor's report, & facts that become known to auditor after date of auditor's report.

Types Of Events

- Those that provide evidence of conditions that **existed at date of F.S (Require Adjustment)**; &
- Those that provide evidence of conditions that **arose after date of F.S (Only disclosure)**.

Events Occurring Between the Date of FS and Date of Auditor's Report

Audit procedure in case of Subsequent Events

Auditor shall perform audit procedures designed to obtain SAAE that all subsequent that require adjustment or disclosure in F.S. **have been identified**.

Auditor shall take into account auditor's risk assessment in determining nature & extent of such audit procedures, which shall include following:

- Obtaining understanding of procedures** Mgt. has established to ensure that subsequent events are identified.
- Inquiring of Mgt. & TCWG** as to whether any subsequent events have occurred.
- Reading minutes** of meetings of owners, Mgt. & TCWG, that have been held after date of F.S. & inquiring about matters discussed at any such meetings for which minutes are not yet available.
- Reading entity's **latest subsequent interim F.S.**

If auditor identifies events that require adjustment of, or disclosure in, F.S. - determine whether each such event is appropriately reflected in those FS.

Written Representations

Obtain WR, that all events occurring subsequent to date of F.S. & for which FRF requires adjustment or disclosure **have been adjusted or disclosed**.

Auditor inquire specific inquiries about the following matters:

- Whether **new commitments, borrowings or guarantees** have been entered into.
- Whether any **increases in capital or issuance of debt instruments**.
- Whether **sales/acquisitions of assets** have occurred or are planned.
- Whether any events have occurred that are relevant to **recoverability of assets**.
- Whether any **assets** have been **appropriated by govt.** or destroyed, for ex, by fire or flood.
- Whether there have been any developments regarding **contingencies**.
- Whether any **unusual accounting adjustments** have been made.

Chapter Which Become Known to Auditor After Date of Auditor's Report but Before Date F.S. are Issued

Q3

Auditor has **no obligation** to perform any audit procedures regarding F.S. after date of auditor's report.

However, **if fact becomes known to auditor that, had it been known to auditor at date of auditor's report**, may have caused auditor to **amend auditor's report**, he shall:

- Discuss** matter with Mgt. & TCWG.
- Determine **whether F.S. need amendment** and, if so,
- Inquire how Mgt. intends to address** matter in F.S.

If Mgt. amends F.S., Auditor shall:

- Carry out **audit procedures necessary** on amendment.
- Extend audit procedures** to date of new auditor's report; &
- Provide new auditor's report on amended F.S. not be dated earlier than date of approval of amended F.S.**

However, when **Mgt. doesn't amend the FS**, then:

If auditor's report has not yet been provided to entity :- Modify opinion as required by SA 705; or	- If auditor's report has already been provided to entity:- Notify Mgt. & TCWG not to issue F.S. to 3rd parties before necessary amendments have been made. - If FS are issued without amendments, - take appropriate action, to seek to prevent reliance on auditor's report.
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Facts Which Become Known to Auditor After FS have been Issued

Q5

After F.S. have been issued, he has **no obligation** to perform any audit procedures regarding such F.S.

However, when, after F.S. have been issued, fact becomes known to auditor that, had it been known to auditor at date of auditor's report, **may have caused auditor to amend auditor's report**, he shall:

- Discuss** matter with Mgt. & TCWG.
- Determine whether F.S. need amendment** & if so,
- Inquire how Mgt. intends to address** matter in F.S.

If the Mgt. amends F.S., Auditor shall:

- Carry out **audit procedures necessary**.
- Extend audit procedures to date of new auditor's report, & date new auditor's report no earlier than date of approval of amended F.S.**
- Provide new auditor's report on amended F.S.**
- Review steps taken by Mgt.** to ensure that **anyone in receipt of previously issued F.S. together with auditor's report thereon is informed of the situation.**
- When L/R or FRF doesn't prohibit, amend auditor's report, or provide new auditor's report.

Auditor shall include in new or amended auditor's report an **EOM para or OM para** referring to a note to F.S. that discusses reason for amendment of previously issued F.S. & to earlier report provided by auditor.

If **Mgt. doesn't take necessary steps** to ensure that **anyone in receipt of previously issued F.S. is informed of situation & doesn't amend F.S.** where auditor believes they need to be amended- notify Mgt. & TCWG, that auditor will seek to prevent future reliance on auditor's report.

Despite such notification, Mgt. or TCWG **do not take these necessary steps**, auditor shall take **appropriate action** (i.e. legal) to seek to **prevent reliance on auditor's report**.

SA 570 Going Concern

Scope

This SA deals with

- auditor's responsibilities in audit of FS relating to GC & implications for auditor's report.

SA 701 deals with auditor's responsibility to **communicate KAM** in auditor's report.

Q14

when SA 701 applies, matters relating to GC may be determined to be KAM, & explains that material uncertainty related to events or conditions that may cast significant doubt on entity's ability to continue as GC is, by its nature, a KAM.

GC Basis of Accounting

- Under GC basis of accounting, **FS are prepared on assumption that entity is a GC & will continue its operations for foreseeable future**.
- When use of GC basis of accounting is appropriate, **assets & liabilities are recorded on basis that entity will be able to realize its assets & discharge its liabilities** in normal course of business.

Responsibilities/Objectives of Auditor

- To **obtain SAAE** & conclude on, appropriateness of Mgt.'s use of GC basis of accounting in preparation of F.S., &
- To **conclude**, based on AE obtained, whether material uncertainty exists about entity's ability to continue as GC.
- As described in SA 200, potential effects of inherent limitations on auditor's ability to **detect MM are greater for future events or conditions** that may cause an entity to cease to continue as GC. Auditor **can't predict** such future events or conditions.
- **Absence of any reference to MU** about entity's ability to continue as GC in auditor's report **can't be viewed as guarantee** as to entity's ability to continue as GC.

Evaluating Mgt.'s Assessment

- Auditor shall evaluate **Mgt.'s assessment** of entity's ability to continue as GC.
- Auditor shall **cover same period as that used by Mgt.** to make its assessment as required by applicable FRF, or by law or regulation if it specifies a longer period.
- If Mgt.'s assessment **covers less than 12 months from date of FS** as defined in SA 560, shall request Mgt. to **extend its assessment period to at least 12 months** from that date.
- Consider whether Mgt.'s assessment **includes all relevant info.** of which auditor is aware as a result of audit.

Examples of events or conditions that may cast significant doubt on entity's ability to continue as a GC

Q17

Financial

- Net liability or net current liability position.
- Indications of withdrawal of financial support by creditors.
- Negative operating cash flows indicated by historical or prospective FS.
- Adverse key financial ratios.
- Substantial operating losses or significant deterioration in value of assets used to generate cash flows.
- Arrears or discontinuance of dividends.
- Inability to pay creditors on due dates.
- Inability to comply with the terms of loan agreements.

Operating

- Mgt. intentions to liquidate entity or to cease operations.
- Loss of key Mgt. without replacement.
- Loss of a major market, key customer(s), franchise, license, or principal supplier(s).
- Labor difficulties.
- Shortages of important supplies.
- Emergence of highly successful competitor.

Other

- Non-compliance with capital or other statutory or regulatory requirements, such as solvency or liquidity requirements.
- Pending legal or regulatory proceedings against entity that may, result in claims that entity is unlikely to be able to satisfy.
- Changes in L/R or govt. policy expected to adversely affect entity.
- Uninsured or underinsured catastrophes when they occur.

Additional Audit Procedures When Events or Conditions are Identified

Q15

- Where Mgt. has **not yet performed an assessment** of entity's ability to continue as a GC, **requesting Mgt. to make its assessment**.
 - Evaluating Mgt.'s plans**, whether outcome of these plans is likely to improve situation & whether Mgt.'s plans are feasible.
 - Where entity has prepared cash flow forecast & analysis of forecast is significant factor in evaluation of Mgt.'s plans for future actions:

Evaluating reliability of data generated to prepare forecast:	Determining whether there is <u>adequate support</u> for assumptions forecast.
---------------------------------------------------------------	--------------------------------------------------------------------------------
- Considering whether **any additional facts or info.** have become available since date on which Mgt. made its assessment.
 - Requesting **WR from Mgt. & TCWG**, regarding their plans for future actions & feasibility of these plans.

Additional Audit Procedures :

- Analyzing & discussing **cash flow, profit** & other relevant forecasts with Mgt.
- Analyzing & discussing entity's latest available **interim FS**.
- Reading **terms of debentures & loan agreements** & determining whether any have been breached.
- Reading **minutes of meetings** of shareholders, TCWG & relevant committees for reference to financing difficulties.
- Inquiring of **entity's legal counsel** regarding existence of litigation & claims and reasonableness of Mgt.'s assessments of their outcome & estimate of their financial implications.
- Evaluating entity's plans to deal with **unfilled customer orders**.
- Confirming existence, terms & adequacy of **borrowing facilities**.
- Obtaining & reviewing **reports of regulatory actions**.
- Determining adequacy of support for any **planned disposals of assets**.

Auditor Conclusions

- Auditor shall evaluate whether SAAE has been obtained & shall conclude on appropriateness of Mgt.'s use of GC basis of accounting in preparation of FS.
- **Based on AE obtained**, he shall **conclude** whether, a **MU exists** related to events or conditions that, may cast significant doubt on entity's ability to continue as a GC.
- **MU exists when magnitude of its potential impact & likelihood of occurrence** is such that appropriate disclosure of nature & implications of uncertainty is necessary for:

In case of fair presentation FRF	In case of compliance framework
Fair presentation of FS	FS not to be misleading

Adequacy of Disclosures

Q11

When Events or Conditions Have Been Identified & Material Uncertainty Exists

If auditor concludes that Mgt.'s use of GC basis of accounting is appropriate but MU exists, determine whether FS:

- a) **Adequately disclose** principal events or conditions that may cast significant doubt on entity's ability to continue as GC & **Mgt.'s plans** to deal with these events or conditions; &
- b) **Disclose clearly** that there is MU related to events or conditions that may cast significant doubt on entity's ability to continue as GC & therefore, that it may be **unable to realize** its assets & discharge its liabilities in normal course of business.

When Events or Conditions Have Been Identified but No Material Uncertainty Exists

Auditor shall evaluate whether **FS provide adequate disclosures** about these events or conditions.

Implications for Auditor's Report

Q12/13

Use of GC Basis of Accounting is Inappropriate - Auditor shall express **adverse opinion**.

Use of GC Basis of Accounting is Appropriate but MU Exists

Adequate Disclosure of Material Uncertainty is Made in F.S.

Auditor shall **express unmodified opinion** & auditor's report shall include **separate section** under heading "**Material Uncertainty Related to GC**" to:

- (a) **Draw attention to note in FS** that discloses matters; &
- (b) **State** that these events or conditions indicate that a MU exists that may cast significant doubt on entity's ability to continue as GC & that auditor's opinion is **not modified in respect of that matter**.

Adequate Disclosure of MU is Not Made in F.S.

Auditor shall:

- a) Express **qualified / adverse opinion**, as appropriate, (SA 705); &
- b) **In Basis for Qualified (Adverse) Opinion section** of auditor's report, state that MU exists that may cast significant doubt on entity's ability to continue as a GC & that **FS do not adequately disclose this matter**.

Mgt. Unwilling to Make or Extend Its Assessment - when requested to do so by auditor, he shall consider **implications for auditor's report**.

SA 580 Written Representation

- ❑ WR by Mgt. provided to auditor to confirm certain matters or to support other AE.
- ❑ WR in this context don't include FS, assertions therein, or supporting books & records.

Objectives

- a) To obtain WR from Mgt. & TCWG that they believe that they have fulfilled their responsibility for preparation of FS & for completeness of info. provided to auditor;
- b) To support other audit evidence relevant to FS or specific assertions in FS
- c) To respond appropriately to WR provided by Mgt. & TCWG, or if Mgt. or, TCWG do not provide WR requested by auditor.

Date of and Period(s) Covered by WR

Q21

Date

- ❑ Date of WR shall be as near as practicable to, but not after, date of auditor's report on F.S.
- ❑ Because WR are necessary AE, auditor's opinion cannot be expressed, & auditor's report can't be dated, before date of WR.
- ❑ In some case it may be appropriate for auditor to obtain a WR about a specific assertion in FS during course of audit. Where this is the case, it may be necessary to request updated WR

Period

- ❑ WR shall be for all F.S. & period(s) referred to in auditor's report.
- ❑ WR are for all periods referred to in auditor's report because Mgt. needs to reaffirm that WR it previously made W.r.t prior periods remain appropriate.
- ❑ Auditor & Mgt. may agree to a form of WR that updates WR relating to prior periods by addressing whether there are any changes to such WR and, if so, what they are.
- ❑ Situations may arise where current Mgt. were not present during all periods referred to in auditor's report. Such persons may assert that they are not in a position to provide some or all of WRs because they were not in place during period.
- ❑ This fact, however, doesn't diminish such persons responsibilities for FS as a whole. Accordingly, requirement for auditor to request from them WRs that cover whole of relevant period(s) still applies.

Doubt as to Reliability of WR

Q20

- ❑ If auditor has concerns about competence, integrity, ethical values or diligence of Mgt., he shall determine effect that such concerns may have on reliability of representations & audit evidence..
- ❑ If WRs are inconsistent with other AE, he shall perform audit procedures to attempt to resolve the matter.
- ❑ If matter remains unresolved, he shall reconsider assessment of competence, integrity, ethical values or diligence of Mgt., & shall determine effect that this may have on reliability of representations (oral or written) & audit evidence in general.
- ❑ If auditor concludes that WRs are not reliable, he shall take appropriate actions, including determining possible effect on opinion in auditor's report as per SA 705 i.e. disclaim an opinion.

Requested WR Not Provided

If Mgt. doesn't provide one or more of requested WRs, auditor shall:

- ❑ Discuss matter with Mgt.
- ❑ Re-evaluate integrity of Mgt. & evaluate effect that this may have on reliability of representations & AE in general; and
- ❑ Take appropriate actions, including determining possible effect on opinion in auditor's report as per SA 705 i.e. disclaim an opinion.

Q- An auditor of Sagar Ltd. was not able to get confirmation about existence and value of certain machineries.

However, Mgt. gave him a certificate to prove existence & value of machinery as appearing in books of account.

Auditor accepted same without any further procedure and signed audit report. Is he right in his approach?

Validity of Written Representation:

Physical verification of fixed assets is primary responsibility of Mgt..

Auditor, however, is required to examine verification programme adopted by Mgt.

He must satisfy himself about existence, ownership & valuation of fixed assets.

In case of Sagar Ltd., auditor has not been able to verify existence and value of some machinery despite verification procedure followed in routine audit. He accepted the certificate given to him by Mgt. without making any further enquiry. As per SA 580 "WR", when representation relate to matters which are material to financial information, then auditor should seek corroborative audit evidence from other sources inside or outside entity. He should evaluate whether such representations are reasonable & consistent with other evidences and should consider whether individuals making such representations can be expected to be well informed on the matter.

"Written Representations" cannot be a substitute for other audit evidence that auditor could reasonably expect to be available. If auditor is unable to obtain SAAE that he believes would be available regarding a matter which has or may have a material effect on financial information, this will constitute a limitation on scope of his examination even if he has obtained a representation from Mgt. on matter. Therefore, approach adopted by auditor is not right.

SA 700 Forming an opinion and reporting on FS

Objective: As per SA 700 objectives of auditor are:

- (a) To form opinion on F.S. based on evaluation of conclusions drawn from AE obtained; &
- (b) To express clearly that opinion through a written report

SA 700 applies to **audit of complete set of general-purpose FS** & is written in that context

General purpose framework	Special purpose framework
Designed to meet <u>common financial info. needs of wide range of users.</u>	Designed to <u>meet financial info. needs of specific users.</u>

Note – Above framework may be a **fair presentation framework or a compliance framework.**

Fair presentation framework

Is used to refer to a FRF that requires compliance with the requirements of the framework and:

- Acknowledges explicitly or implicitly** that, to achieve fair presentation of FS, it may be necessary for management to provide disclosures beyond those specifically required by the framework; or
- Acknowledges explicitly** that it may be necessary for **management to depart** from a requirement of the framework to achieve fair presentation of the FS.

Such departures are expected to be necessary only in extremely rare circumstances.

Compliance framework

It is used to refer to FRF that requires compliance with requirements of framework, **but does not contain the acknowledgements given in (1) or (2) above.**

Specific Evaluation by Auditor

Q4

- (a) FS **adequately disclose significant accounting policies** selected and applied;
- (b) **Accounting policies selected** and applied are **consistent with applicable FRF and are appropriate;**
- (c) **Accounting estimates** made by management are reasonable;
- (d) **Info. presented in FS** is relevant, reliable, comparable, and understandable;
- (e) **FS provide adequate disclosures** to enable intended users to understand the effect of material transactions and events on the info. conveyed in FS; and
- (f) **Terminology used in FS**, including title of each FS, is **appropriate.**

Basic Elements of Auditor's Report

As per SA 700 "Forming an opinion and reporting on FS", auditor's report shall be in writing & shall include following basic elements.

- Title:** title that clearly indicates that it is a report of an independent auditor.
- Addressee:** Addressed as required by circumstances of engagement.
Ex: - Report could be addressed to **Members of Co.** in case of **general purpose** (statutory) F.S. & to **BOD** in case of **special purpose F.S.**
- Auditor's Opinion:** **First section** of auditor's report shall include **auditor's opinion**, & shall have heading "**Opinion.**"
Opinion section of auditor's report shall also:
 - Identify entity whose F.S. have been audited;**
 - State that F.S. have been audited;**
 - Identify title of each statement** comprising F.S.;
 - Refer to notes**, including summary of significant accounting policies
 - Specify date of, or period covered by, each F.S. comprising F.S.
- Basis for Opinion:** Auditor's report shall include a section, directly following Opinion section, with heading "Basis for Opinion", that:
 - States that audit was **conducted as per SA;**
 - Refers** to section of auditor's report that **describes auditor's responsibilities** under SAs;
 - Includes a statement that auditor is independent of entity** in accordance with relevant ethical requirements.
 - Statement shall refer to Code of Ethics** issued by ICAI
 - States whether auditor believes that **AE** auditor has obtained is **sufficient & appropriate** to provide a basis for auditor's opinion.
- Going Concern:** SA 570
Note: Where use of Going Concern Basis is **appropriate** then **no special paragraph** is required in Auditors Report mentioning the fact.
- Key Audit Matters (KAM):** For audits of complete sets of **general purpose FS of listed entities**, **communicate KAM** in auditor's report as per SA 701. When an auditor is otherwise required by law or regulation or decides to communicate KAM in auditor's report, auditor shall do so as per SA 701.
- Other Information:** SA 720.
- Responsibilities for F.S:** Auditor's report shall include a section with heading "Responsibilities of Mgt. for F.S.
- Auditor's Responsibilities for Audit of F.S:**

10. Location of description of auditor's responsibilities for audit of F.S

- Within **body** of auditor's report;
- Within **appendix** to auditor's report or
- By a **specific reference** within auditor's report to location of such a description on a **website of an appropriate authority, where law, regulation or auditing standards expressly permit auditor to do so.**

11. Other Reporting Responsibilities:

- Clearly differentiate** other reporting responsibilities from reporting that is required by SAs.
- Heading "Report on Audit of F.S." > "Report on Other Legal and Regulatory Requirements"

12. Signature of the Auditor:

- Signed by **auditor (i.e. engagement partner)** in his personal name.
- Firm - **signed in personal name of auditor & in name of audit firm.**
- Membership no.**
- Registration no. of firm**

Under Section 145 read with Section 141(2) of the Companies Act, 2013, **only person appointed as auditor of co.** or, where a firm is so appointed, **only partner in firm** who is a CA, may sign auditor's report or sign or authenticate any other document of Co. required by law to be signed or authenticated by auditor.

Clause (12) of Part I of the First Schedule to CA Act, 1949

13. Place of Signature: specific location, ordinarily city where audit report is signed.

14. Date of Auditor's Report: dated no earlier than date on which auditor has obtained SAAE

Auditor's Report for Audits Conducted as per both SA Issued by ICAI and ISAs or SA of Any Other Jurisdiction:

Q3

Auditor may be required to conduct an audit in accordance with, in addition to SA issued by ICAI, ISAs or SA of any other jurisdiction.

If this is the case, auditor's report **may refer** to SA in addition to ISAs or SA of such other jurisdiction, but auditor **shall do so only if**:

- (a) There is **no conflict** b/w requirements in ISAs or such auditing standards of other jurisdiction & those in SAs that would lead auditor
- (i) **to form a different opinion**, or
 - (ii) **not to include an EOM Para or OM Para** that, in particular circumstances, is required by SAs; and
- (b) Auditor's report includes, at a **minimum, each of elements set out** in Auditor's Report Prescribed by L/R when auditor uses layout/ wording specified by SA, Auditor's report shall thereby identify such SA.

When auditor's report refers to both, ISAs or auditing standards of a specific jurisdiction & SA issued by ICAI, auditor's report shall **clearly identify same** including jurisdiction of origin of other auditing standards.

Supplementary Information Presented with F.S.

Q5

If supplementary info. presented with audited F.S that is **not required** by applicable FRF is -

- (a) Auditor shall evaluate whether supplementary info. is **integral part of F.S.** When it is an **integral part** of F.S., supplementary info. **shall be covered by auditor's opinion.**
- (b) **Not considered integral part of audited F.S.**, evaluate whether such supplementary info. is presented in a way that **sufficiently & clearly differentiates** it from audited F.S.

If this is **not the case**, then auditor shall ask Mgt. to change how **unaudited supplementary info.** is presented. If Mgt. **refuses** to do so, **identify unaudited supplementary info. & explain in auditor's report that such supplementary info. has not been audited.**

SA 701 Communicating KAM in the independent auditor's report

KAM are those matters that, in auditor's professional judgment, were of **most significance in audit of F.S. of current period**. KAM are selected from matters communicated with TCWG.

Examples of KAM:

- Assessment of Impairment,
- Provision for losses and contingencies,
- Valuation of financial instruments,
- Matters relating to Revenue recognition,
- Taxation matters (multiple tax jurisdictions, deferred tax assets).

Objective

- To **enhance communicative value** of auditor's report by **providing greater transparency** about audit.
- To **assist user in understanding those matters that, were of most significance** in audit of F.S. of current period.

Applicability

SA applies to audits of **complete sets of general purpose F.S. of listed entities**.

However, **SA 705 prohibits** auditor from communicating KAM when auditor **disclaims opinion** on F.S, unless such reporting is required by L/R.

Scope

Communicating KAM in auditor's report is **not**:

- 1) Substitute for **disclosures in F.S.** that applicable FRF.
- 2) Substitute for auditor expressing **modified opinion** (SA 705);
- 3) Substitute for reporting as per **SA 570** when material uncertainty exists relating to events or conditions that may cast significant doubt on entity's **ability to continue as going concern**; or
- 4) A **separate opinion on individual matters**.

Descriptions of Individual KAM Q12

Description of each KAM in KAM section of auditor's report shall **include a reference to related disclosure(s)**, if any, in F.S. & **shall address**:

- Why matter** was considered to be one of most significance in audit & therefore determined to be a KAM; &
- How matter** was addressed in audit.

Circumstances in Which a Matter Determined to Be KAM is Not Communicated in AR Q12

- Law or regulation precludes public disclosure** about matter; or
- If, Auditor determines that matter should **not be communicated** in AR because **adverse consequences of doing so** would reasonably be **expected to outweigh public interest benefits of such communication**. This shall not apply if entity has publicly disclosed information about matter.

Determining KAM-Factors Q8

In making this determination, auditor shall take into account following:

- Areas of higher assessed ROMM**, or **significant risks identified** in accordance with SA 315
- Significant auditor judgments** relating to **areas in F.S** that involved **significant Mgt. judgment**, including A/E that have been identified as having high estimation uncertainty.
- Effect on audit of significant events** or transactions that occurred during period.

Communicating KAM Q12

Introductory language in this section of report shall state that:

- KAM are **those matters** that, in auditor's professional judgment, were of most significance in audit of F.S. [of current period]; &
- These matters were addressed in context of audit of F.S. as a whole, & auditor **doesn't provide a separate opinion on these matters**.

Placement of KAM in AR Q10 (c)

- **After Basis for Opinion paragraph and before Management's Responsibility paragraph.**
- In case, 'Material uncertainty relating to GC' section is required as per SA570, then **KAM section is placed after that section.**

Further, regarding placement of KAM section, SA 706,

When a KAM section is presented in auditor's report, an EOMP **may be presented either directly before or after Key Audit Matters section**, based on auditor's judgment as to significance of info. included in EOMP.

Auditor may also add further context to the heading "Emphasis of Matter", such as "Emphasis of Matter - Subsequent Event", to differentiate EOMP from the individual matters described in KAM's section.

Matter other than disclosed in FS Q9

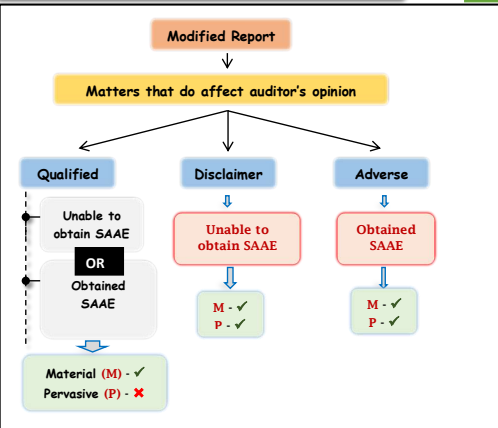
When communicating KAM the fact that there are **no disclosures in the financial statements related to a matter determined to be a KAM doesn't relieve the auditor** from the requirement to communicate it.

An auditor **may determine a key audit matter related to the audit for which relevant disclosure requirements do not exist** in the applicable FRF.

For ex- implementation of a new IT system during the period may be an area of significant auditor attention, in particular, if such a change had a significant effect on the auditor's overall audit strategy or related to significant risk.

SA 705 Modification to the opinion in the independent auditor's report

Q



Pervasive: Pervasive is a term used in the context of misstatements, to describe the effects on the FS of misstatements or the possible effects on FS of misstatements.

Pervasive effects on the FS are those that in the auditor's judgment:

- Are not confined to specific elements, accounts or items of FS;
- If so confined, represent/could represent a substantial proportion of FS; or
- In relation to disclosures, are fundamental to users' understanding of FS.

Type of Modification

Q

Qualified Opinion: Auditor shall express a qualified opinion when:

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

Adverse Opinion: Auditor shall express an adverse opinion when the auditor, having obtained SAAE, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the FS.

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

Special consideration needed for expressing Qualified Opinion

Q

State that, in auditor's opinion, except for the effects of the matter(s) described in the Basis for Qualified Opinion section:

- When reporting in accordance with fair presentation framework, the accompanying FS present fairly, in all material respects (or give a true and fair view of) [...] in accordance with [the applicable FRF]; or
- When reporting in accordance with a compliance framework, the accompanying FS have been prepared, in all material respects, in accordance with [the applicable FRF].

When the modification arises from an inability to obtain SAAE, he shall use the corresponding phrase "except for the possible effects of the matter(s)..." for the modified opinion.

Unless required by L/R, when auditor disclaims an opinion on FS, auditor's report shall not include a Key Audit Matters section in accordance with SA 701.

Special consideration needed for expressing Adverse Opinion

Q

When auditor expresses an adverse opinion, auditor shall state that, in the auditor's opinion, because of the significance of the matter(s) described in the Basis for Adverse Opinion section:

- When reporting in accordance with a fair presentation framework, the accompanying FS don't present fairly (or give a true and fair view of) [...] in accordance with [the applicable FRF]; or
- When reporting in accordance with a compliance framework, the accompanying FS have not been prepared, in all material respects, in accordance with [the applicable FRF].

Special consideration needed for expressing Disclaimer of Opinion

Q

When auditor disclaims an opinion due to an inability to obtain SAAE, auditor shall:

- State that auditor doesn't express an opinion on accompanying FS;
- State that, because of the significance of the matter(s) described in the Basis for Disclaimer of Opinion section, auditor has not been able to obtain SAAE to provide a basis for an audit opinion on the FS; and

Amend the statement required in SA 700, which indicates that the FS have been audited, to state that auditor was engaged to audit the FS.

Consequence of an Inability to Obtain SAAE Due to a Management-Imposed Limitation after Auditor Has Accepted the Engagement

Q

He considers likely to result in the need to express a qualified opinion or to disclaim an opinion - request that management remove the limitation.

If management refuses to remove limitation - Communicate matter to TCWG and determine whether it is possible to perform alternative procedures to obtain SAAE.

If auditor is unable to obtain SAAE, he shall determine the implications as follows:

- If auditor concludes that possible effects on the FS of undetected misstatements, could be material but not pervasive, he shall qualify the opinion; or
- If auditor concludes that the possible effects on the FS of undetected misstatements, could be both material and pervasive so that a qualification of the opinion would be inadequate to communicate the gravity of the situation, he shall:
 - Withdraw from audit, where practicable and possible under applicable L/R; or
 - If withdrawal from audit before issuing the auditor's report is not practicable or possible, disclaim an opinion on the FS.

Where Auditors' withdrawal is not permitted:

Listing agreement and SEBI of India's directive on the resignation of auditor doesn't permit withdrawing from the engagement without issuing the audit / review report.

Situation	Then Auditor shall before such resignation
If auditor resigns within 45 days from the end of a quarter of a FY	Issue the limited review/ audit report for such quarter.
If auditor resigns after 45 days from the end of a quarter of a FY	Issue the limited review/ audit report for such quarter as well as the next quarter.
If auditor has signed the limited review/ audit report for the first 3 quarters of a FY	Issue the limited review/ audit report for the last quarter of such financial year as well as the audit report for such FY.

ICAI announcement on the Resignation of Auditor: ICAI has made an announcement that auditor of an unlisted company shall not mention "professional pre-occupation" as a reason for the resignation.

He shall mention the reasons clearly for the resignation in the resignation letter issued to Company.

SA 706 Emphasis of Matter Paragraphs and Other Matter Paragraphs in Independent Auditor's Report

Emphasis of Matter paragraph

Q 30

A paragraph included in auditor's report that refers to a matter **appropriately presented or disclosed in FS** that, in auditor's judgment, is of such importance that it is fundamental to users' understanding of the FS.

Ex: Circumstances where auditor may consider it necessary to include an EOMP are:

- An uncertainty relating to the future outcome of exceptional litigation or regulatory action.
- A significant subsequent event that occurs between the date of FS and date of the auditor's report.
- Early application (where permitted) of a new accounting standard that has a material effect on the FS.
- A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position.

When to give EOMP in Auditor's Report?

Q 31

If auditor considers it necessary to draw users' attention to a matter presented or disclosed in FS that, in his judgment, is of such importance that it is fundamental to users' understanding of FS, he shall include an EOMP provided:

- (a) Auditor would **not be required to modify the opinion** in accordance with SA 705 as a result of the matter; and
- (b) When SA 701 applies, matter **has not been determined to be a key audit matter** to be communicated in the auditor's report.

Ex- These circumstances may include:

Q 30

- When a FRF prescribed by L/R would be **unacceptable** but for the fact that it is prescribed by L/R.
- To alert users that FS are prepared in accordance with a **special purpose framework**.
- When facts become known to auditor after date of auditor's report and auditor provides a new or amended auditor's report (i.e., **subsequent events**).

When auditor includes EOMP in audit report, he shall

- (a) Include the paragraph within a separate section of the auditor's report with an appropriate heading that includes 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 FS. The paragraph shall refer only to information presented or disclosed in FS; and
- (c) Indicate that auditor's opinion is not modified in respect of the matter emphasized.

Other Matter paragraph

A paragraph included in auditor's report that refers to matters **other than those presented or disclosed in FS** that, in auditor's judgment, is relevant to users' understanding of the audit, auditor's responsibilities or auditor's report.

Ex- Branch is audited by another auditor

When to issue OMP in Auditor's Report?

If auditor considers it necessary to communicate a matter other than those that are presented or disclosed in the FS that, in auditor's judgment, is relevant to users' understanding of audit, auditor's responsibilities or auditor's report, auditor shall include an Other Matter paragraph in the auditor's report, provided:

- (A) This is **not prohibited** by L/R; 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.

When auditor includes an OMP in auditor's report, he shall include the paragraph within a separate section with heading "Other Matter," or other appropriate heading.

SA 710 Comparative Information - Corresponding Figures and Comparative FS

Comparative information

Amounts and disclosures included in the FS in accordance with the applicable FRF. It includes:

- 1) Corresponding Figures
- 2) Comparative FS

Corresponding figures

Comparative info. where amounts and other disclosures for the prior period are included as an **integral part of the current period FS**, & are intended to be read only in relation to the amounts & other disclosures relating to current period figures.

Comparative FS

Comparative info. where amounts and other disclosures for the prior period are included for **comparison with the FS** of the current period but, if audited, are referred to in the auditor's opinion

Audit Procedures for Comparative Information Q 34

Q- Auditor's responsibilities for Corresponding figures

For determining that FS contains appropriately classified comparative information, auditor should:

- Ensure that **comparative info.** agrees with the amount and other disclosure presented in the prior period.
- **Accounting policies applied** are consistent with those applied in current period.
- If **there have been any changes** in the application of accounting policies than they are properly disclosed and presented.

If auditor becomes aware of any **possible misstatement** in the comparative info., then:

- **Perform necessary audit procedures** to obtain SAAE.
- If **auditor had audited prior period's FS** than he should follow the relevant requirements of SA 560.

As per SA 580, auditor should also request WR. He should also obtain a specific WR regarding any prior period item that is disclosed in current year's FS.

Audit Reporting

(A) Corresponding figures

When corresponding figures are presented, **auditor's opinion shall not refer to corresponding figures except in following circumstances:**

- If auditor's report of previous period **contains other than an unqualified opinion**.
- If auditor is of the opinion, and he has sufficient evidence in this regard, **that a MM exists in FS of prior period**, which was not addressed earlier.

If prior period FS are not audited, then he should obtain SAAE that the opening balance does not contain any MM

(B) With Reference to Comparative FS

- Auditor's opinion shall refer to **each period** for which the FS are presented.
- When reporting on **current period's audit**, if auditor's opinion on **such prior period FS differs from the opinion previously issued on such FS**, he shall disclose the substantive reason for the different opinion in OMP in his report.
- If auditor concludes that a **MM is present** in the previously audited figures of FS, he should:
 - report it to the appropriate level of the management and
 - request that the predecessor auditor be informed.

If then prior years statements are amended with new report by predecessor auditor, then auditor shall report only on current period.

(C) Reporting treatment common to both (for corresponding figures and comparative information)

1. If the FS of the prior period were audited by a predecessor auditor, auditor (is permitted by L/R to refer to the predecessor audit report - on case of corresponding figures and decides to do so) shall state in his audit report:
 - That FS of prior period were audited by predecessor auditor;
 - **Type of the opinion expressed by predecessor auditor**;
 - **Date of that audit report**.
2. If **prior period FS were not audited** than he shall report same in **other matter paragraph** in audit report that corresponding /comparative figures are unaudited. However, disclosure does not relieve him from his responsibility of obtaining SAAE that opening balances do not contain misstatements that materially affect the current period's FS.

Q Auditor's responsibility in cases where audit report for an earlier year is qualified Q 33

As per SA 710, when the auditor's report on the prior period, as previously issued, included a qualified opinion, a disclaimer of opinion, or an adverse opinion and the matter which gave rise to the modified opinion is **resolved and properly accounted for or disclosed** in FS in accordance with applicable FRF, auditor's opinion on the current period need not refer to the previous modification.

If auditor's report on the prior period, included a qualified opinion and the matter which gave rise to the modification is unresolved, he shall modify auditor's opinion on current period's FS.

In the Basis for Modification paragraph in auditor's report, he shall either:

- Refer to both current period's figures and the corresponding figures in the description of the matter when the effects or possible effects of the matter on the current period's figures are material; or
- In other cases, explain that the audit opinion has been modified because of the effects or possible effects of the unresolved matter on the comparability of the current period's figures and the corresponding figures.

SA 720 The auditor's responsibilities relating to other information

Deals with auditor's responsibilities relating to other info., whether financial or non-financial, included in entity's annual report.

This SA doesn't apply to:

- Preliminary announcements of financial information or
- Securities offering documents, including prospectuses

Other information:

Financial or non-financial information (other than FS and auditor's report thereon) included in an entity's annual report.

Objectives

- To consider whether there is a **material inconsistency** between other info. & FS.
- To consider whether there is a **material inconsistency** between other info. & auditor's knowledge obtained in audit;
- To **respond appropriately** to such material inconsistencies.

Examples of amounts and other items that may be included in other info.

Q 36

Amounts

- Items in a summary of key financial results**, such as net income, earnings per share, dividends, sales and other operating revenues, and purchases and operating expenses.
- Financial measures or ratios**, such as gross margin, return on average capital employed, current ratio, interest coverage ratio and debt ratio.
- Liquidity and capital resource info.**, such as cash, cash equivalents and marketable securities; dividends;
- Capital expenditures** by segment or division.
- Amounts involved in guarantees, contractual obligations**, legal or environmental claims, and other contingencies.
- Selected operating data**, such as income from continuing operations by major operating area, or sales by geographical segment or product line.

Other Items

- Explanations of **critical accounting estimates** and related assumptions.
- Identification of **related parties** and descriptions of transactions with them.
- General descriptions of the business environment and outlook.**
- Overview of strategy.**
- Descriptions of **guarantees, indemnifications, contractual obligations**, litigation or environmental liability cases, and other contingencies.
- Descriptions of **changes in legal or regulatory requirements**, such as new tax or environmental regulations, that have materially impacted the entity's operations or fiscal position.
- Descriptions of **trends in market prices** of key commodities or raw materials.

Responding When the Auditor Concludes That a MM of the Other Info. Exists

Q 35/37

If auditor concludes that a MM of other information exists,

Auditor shall request Mgt. to correct the other info. If Mgt.:

- Agrees** to make correction, he shall determine that correction has been made; or
- Refuses** to make correction, he shall communicate matter with TCWG and request that correction be made.

If auditor concludes that a MM exists in other information Obtained prior to date of auditor's report, and other info. is not corrected after communicating with TCWG, auditor shall

- Considering implications for auditor's report and communicating with TCWG about how auditor plans to address the MM in auditor's report.
- Withdrawing from engagement, where withdrawal is possible.

If auditor concludes that a MM exists in other information Obtained after date of auditor's report, he shall:

- If other info. is corrected - perform procedures necessary in the circumstances; or
- If other info. is not corrected after communicating with TCWG - take appropriate action considering auditor's legal rights & obligations, to seek to have the uncorrected MM appropriately brought to attention of users for whom auditor's report is prepared.

[A] Reporting Under CARO 2020**Applicability of CARO, 2020:**

Q 7

CARO, 2020 shall apply to **every company** including foreign company except:

- Banking company;
- Insurance company;
- Section 8 company;
- OPC and a Small Company and
- Private limited company, not being a subsidiary or holding of a public company, having

Q 8/9

Paid up share capital and Reserves & Surplus	Total borrowings from any Bank or FI	Total revenue (including revenue from disclosed operations)
≤1 crore	≤1 crore	≤10 crore
As on Balance Sheet date	At any point of time during the FY	As per FS

Notes :**1. For calculation**

Paid up capital and Reserves & surplus	Borrowings	Revenue
(- Share application)	(- interest accrued but not due)	(-Advance Received)
(-call in advance)	(-loan from individual)	(-Excise /GST)
(- call in arrears)	(+ Interest accrued as well as due)	
(- P&L Debit Balance)		
(+ P&L Credit balance)		
(+ ESOP Reserve)		
(+Amount originally paid up on forfeited shares)		

- CARO 2020- Not applicable to CFS except Para3(xxi).
- Small company- Other than public company

Paid-up Share Capital	Does not exceed Rs. 4 Crores
Turnover (Previous F.Y)	Does not exceed Rs. 40 Crores

(It should not be holding or subsidiary of any company)

PARA 3: Matters to be included in Auditor's Report:**Para 3(i): Property, Plant and Equipment**

Q 2

(a) Adequacy of Records:

- Whether company is **maintaining proper records** showing full particulars, including **quantitative details & situation of PPE**.
- Whether company is maintaining proper records showing full particulars of **Intangible assets**.

(b) Physical verification:

- Whether these PPE have been **physically verified** by management **at reasonable intervals**;
- Whether **any material discrepancies** were noticed on such verification & if so, Whether the **same have been properly dealt** with in Books of Account.

Note: **Reasonable interval:** depends upon circumstance of each case i.e., location, value of asset. **Annual verification** may be reasonable but it may be impracticable to carry verification in some cases. Even in such cases, **verification programme** should be such that all assets are verified at least **once in every 3 years**.

(c) Title Deeds:

Q 3

- Whether title deeds of **all immovable properties** (Other than properties where the company is lessee & lease agreements are duly executed in favour of lessee) **disclosed** in F.S. are **held** in name of company.
- If **not**, **provide details** thereof in below mentioned format.

Description of property	Gross Carrying value	Held in name of	whether promoter, director or their relative or employee	Period held	Reason for not being held in name of co.*

*also indicate if in dispute.

(d) Revaluation of Property, Plant & Equipment:

Q 6

- Whether company has **revalued its PPE** (including Right of Use assets) or intangible assets or both during the year &, if so, Whether revaluation is **based on valuation** by a **Registered Valuer**;
- Specify **Amt. of change**, if **change is 10% or more** in aggregate of net carrying value of each class of PPE or intangible assets.

(e) Benami Property:

Q 7

- Whether **any proceedings** have been initiated or are pending against company **for holding** any benami property under **Benami Transactions (Prohibition) Act, 1988** & rules made thereunder
- Whether company has appropriately **disclosed** details in its **F.S.**

Para 3(ii): Inventories -

Q 5

a) Physical verification

- Whether **physical verification** of inventory has been conducted **at reasonable intervals** by Mgt. & whether coverage & procedure of such verification by Mgt. is appropriate;
- Whether any **discrepancies of 10% or more in aggregate** for each class of inventory were noticed & if so, whether they have been **properly dealt** with in books of account;

b) Working capital limit

Q 4/6

- Whether during **any point of time**, company has been **sanctioned working capital limits in excess of ₹ 5 crore, in aggregate**, from banks or F.I. on **basis of security of current assets**;
- Whether the **quarterly returns or statements** filed by company with such banks or F.I. are in **agreement with books of account of Company, if not, give details.**

Para 3(iii): Investments, Guarantee / Security, Loans or Advances

Whether **during the year**, 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, LLPs or any other parties, if so,**

- Whether during the year, **company has provided loans or 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-
 - aggregate amount during the year, and balance outstanding at B/S date** w.r.t. such loans or advances and guarantees or security **provided to subsidiaries, joint ventures and associates**;
 - aggregate amount during the year, and balance outstanding at B/S date** w.r.t. such loans or advances and guarantees or security **to parties other than subsidiaries, JVs & associates**;
- Whether investments made, guarantees provided, security given and **T&C** of grant of all loans & advances in nature of loans & guarantees provided **are not prejudicial to company's interest**;
- In respect of loans & advances in nature of loans, **whether schedule of repayment** of principal and payment of interest has been stipulated and whether **repayments or receipts are regular**;
- If the amount is overdue, state total amount **overdue for > 90 days**, and whether **reasonable steps** have been taken by the company **for recovery of the principal & 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, if so, Specify
- aggregate amount of such dues renewed or extended or settled by fresh loans and
 - the % of aggregate to total loans or advances in nature of loans granted during the year
- [not applicable to Co whose principal business is to give loans];
- (f) whether company has granted any loans or advances in nature of loans either repayable on demand or without specifying terms of repayment, if so, specify:
- aggregate amount,
 - % thereof to total loans granted,
 - aggregate amount of loans granted to Promoters and RPs.

Para 3(iv): Compliance of provisions of Sec. 185 & 186

In respect of loans, investments, guarantees, and security whether provisions of Sections 185 and 186 have been complied with. If not, provide details thereof.

Para 3(v): Public Deposits -

In respect of deposits accepted by the company, whether directives issued by RBI & provisions of secs. 73 to 76 or any other relevant provisions of Companies Act & rules framed thereunder, have been complied with. If not, the nature of such contraventions be stated.

If an order has been passed by CLB or NCLT or RBI or any Court or any other Tribunal, whether same has been complied with or not?

Para 3(vi): Cost Records -

Whether maintenance of cost records has been specified by CG u/s 148(1) & whether such accounts & records have been made & maintained

Para 3(vii): Statutory Dues -

- (a) Whether co. is regular in depositing undisputed statutory dues including GST, PF, ESI, I-tax (advance tax), sales-tax, service tax, duty of customs, duty of excise, VAT, cess & any other statutory dues to appropriate authorities and if not, the extent of the arrears of o/s statutory dues as at the last day of FY for a period of more than 6 months from date they became payable, shall be indicated.
- (b) Where statutory dues referred above 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 concerned Department shall not be treated as a dispute).

Para 3(viii): Unrecorded Income -

Q 1

Whether any transactions not recorded in books of account have been surrendered or disclosed as income during the year in 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.

Para 3(ix): Repayment of Dues -

Q 10/11/12/13

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

Nature of borrowing, including debt securities	Name of lender*	Amount not paid on due date	Whether Principal or interest	No. of delays or unpaid	Remarks, if any

*Lender wise details to be provided in case of defaults to banks, FI and Government.

- (b) Whether company is a declared wilful defaulter by any bank or FI 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; in the books of account during the year;
- (e) whether company has taken any funds from any entity or person on account of or to meet the obligations of its subsidiaries, associates or JVs, if so, details thereof with nature of such transactions & amount in each case;
- (f) Whether company has raised loans during the year on the pledge of securities held in its subsidiaries, JVs or associate companies, if so, give details thereof and also report if the company has defaulted in repayment of such loans raised.

Note- submitting restructuring/re- scheduling application does not mean that default has occurred.

Para 3(X): Application of Money raised by public issue and preferential allotment -

- (a) Application of Money raised by public issue:

Whether moneys raised by way of IPO or FPO (including debt instruments) during the year were applied for purposes for which those are raised, if not, details together with delays or default & subsequent rectification, if any, as may be applicable, be reported.

- (b) Preferential allotment:

Whether 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 requirements of Sec. 42 & Sec. 62 of Co. Act, 2013 have been complied with & funds raised have been used for purposes for which the funds were raised, if not, provide details in respect of amount involved & nature of non-compliance;

Para 3(xi): Fraud -

Q 14

- (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 u/s 143(12) of Companies Act has been filed by auditors in Form ADT-4 as prescribed under rule 13 of Companies (Audit and Auditors) Rules, 2014 with the C.G.
- (c) Whether auditor has considered whistle-blower complaints, if any, received during the year by the company.

Para 3(xii): Nidhi Companies -

- (a) Whether the Nidhi Company has complied with the Net Owned Fund to Deposits in the ratio of 1: 20 to meet out the liability.
- (b) Whether Nidhi Company is maintaining 10% unencumbered term deposits as specified in the Nidhi Rules, 2014 to meet out 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.

Para 3(xiii): Transactions with related Parties -

Whether all transactions with RPs are in compliance with Section. 177 and 188 of Companies Act, 2013 where applicable and details have been disclosed in the F.S. etc. as required by applicable AS.

Para 3(xiv): Internal Audit System -

- (a) Whether Co. has an internal audit system commensurate with size & nature of its business;
- (b) Whether the reports of the Internal Auditors for the period under audit were considered by the statutory auditor.

Para 3(xv): Non cash transactions with directors – Q 3/15

Whether company has entered into any non-cash transactions with directors or persons connected with him & if so, whether provisions of Sec. 192 of Companies Act, 2013 have been complied with.

Para 3(xvi): Registration. with RBI –

- Whether company is required to be registered u/s 45IA of RBI Act, 1934 & if so, whether the registration has been obtained.
- Whether company has conducted any Non-Banking Financial or Housing Finance activities without a valid Certificate of Registration (COR) from the RBI as per the RBI Act, 1934.
- Whether company is a Core Investment Company (CIC) as defined in regulations made by the RBI, 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.
- Whether the Group has more than one CIC as part of the Group, if yes, indicate No. of CICs which are part of the Group.

Para 3(xvii): Cash Losses – Q 7

Whether company has incurred cash losses in the FY and in the immediately preceding FY, if so, state the amount of cash losses.

Para 3(xviii): Resignation of statutory auditors – Q 7

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

Para 3(xix): Existence of Material uncertainty-company ability to meet its liabilities –

On the basis of financial ratios, ageing & expected dates of realisation of financial assets & payment of financial liabilities, other information accompanying the F.S., the auditor's knowledge of the BoD and mgt plans, whether 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 B/S as and when they fall due within a period of one year from the balance sheet date.

Para 3(xx): Transfer of unspent CSR amount –

- Whether, in respect of other than ongoing projects, company has transferred unspent amount to a Fund specified in Schedule VII to the Companies Act within a period of 6 months of expiry of FY in compliance with 2nd proviso to Sec. 135(5) of the said Act.
- Whether any amount remaining unspent u/s 135(5) of Companies Act, pursuant to any ongoing project, has been transferred to special account in compliance with provision of Sec. 135(6).

Para 3(xxi): Qualifications or adverse remarks in CARO Reports of group companies – Q 16

Whether there have been any qualifications or adverse remarks by respective auditors in CARO reports of Co. included in CFS, if yes, indicate Details of companies & Para no. of CARO report containing qualifications or adverse remarks.

Para 4: Reasons to be stated for Unfavourable or Qualified remarks

- Where, in auditor's report, answer to any of questions referred to in Para 3 is unfavourable or qualified - auditor's report shall also state the basis for such unfavourable or qualified answer.
- Where auditor is unable to express any opinion on any specified matter, his report shall indicate such fact together with reasons as to why it is not possible to give opinion.

[B] Duties of Auditor – Company Audit**Sec 143 (1): Duty of Auditor to Inquire on certain matters Q 17**

- Whether the terms on which secured loans and secured advances have been made are prejudicial to the interests of the company or its members.
- Whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company.
- Whether investment of companies, other than a banking or an investment company, in the form of shares, debentures and other securities have been sold at a price lower than the cost.
- Whether loans and advances made by the company have been shown as deposits. Again, considering the propriety element, rationalizing the proper disclosure of loans and advance given by company is made.
- Whether personal expenses have been charged to revenue.
- In case it is stated in the books and papers of the company that shares have been allotted for cash, whether cash has actually been received in respect of such allotment, and if no cash actually received, whether the position in books of account and balance sheet so stated is correct, regular and not misleading.

Sec 145: Duty to Sign Audit Report

Person appointed as auditor of company shall sign auditor's report or sign or certify any other document of company, as per provisions of sec 141 (2).

Any Qualifications, observations or comments on financial transactions or matters, which have any adverse effect on functioning of Co. mentioned in auditors' report shall be read before company in GM & shall be open to inspection by any member of company.

Duty to Comply with Accounting Standard

Sec 143(9) of Co. Act, 2013 Auditors must adhere to AS.

Section 143(10) empowers CG to prescribe AS based on recommendations from ICAI & NFRA.

Until officially notified, any auditing standards specified by the ICAI are considered applicable.

Sec 143(3): Duty to Audit Report

Auditor's report shall also state-

- (a) Whether he has sought & **obtained all information** & explanations which to the best of his knowledge & belief were necessary for purpose of his audit & if not, details thereof & effect of such information on F.S;
- (b) Whether, in his opinion, proper **Books of account** as required by law have been kept by Co. so far as appears from his examination of those books & proper returns adequate for purposes of his audit have been received from branches not visited by him;
- (c) Whether report on the accounts of any **Branch** office of company audited under Sec 143(B) by a person other than company's auditors has been sent to him under proviso to that sub-section & manner in which he has dealt with it in preparing his report;
- (d) whether the company's **B/S & P&L** A/c dealt with in the report are in agreement with the books of account and returns;
- (e) whether, in his opinion, **FS Comply** with AS's;
- (f) Observations/**Comments** of auditors **on financial transactions** or matters which have any adverse effect on the functioning of the co.;
- (g) whether any **Director** is disqualified from being appointed as a director under Sec 164(2);
- (h) **any qualification, reservation or adverse remark** relating to **maintenance of accounts** & other matters connected therewith;
- (i) whether company has **adequate internal Financial controls** with reference to F.S. in place & operating effectiveness of such controls;

Note:

Clause (i) Sec143(3) shall not apply to Private company: -

- (i) which is a **OPC or small company**; or
- (ii) which has **Turnover** less than Rs **50 Cr** as per latest audited F.S. & which has aggregate **Borrowings** from banks or financial institutions or anybody corporate at **any point of time** during F.Y. less than Rs **25 Cr.**

(j) **Such other matters** as may be prescribed, **Rule 11** of Co. (Audit & Auditors) Rules, 2014 prescribes other matters to be included in auditor's report. Auditor's report shall also include their views & comments on the following matters, namely:-

1. whether company has **disclosed the impact**, if any, of **pending litigations** on its financial position in its FS;
2. whether Co. has **made provision**, as required under any law or accounting standards, for **material foreseeable losses**, if any, on **long term contracts** including derivative contracts;
3. whether there has been any **delay in transferring** amounts, required to be transferred, to **Investor Education and Protection Fund** by the company.
- 4.

(4)

- (i) Whether **Mgt. has represented** that, to the best of it's knowledge & belief, other than as disclosed in notes to accounts, **no funds have been advanced/loaned/invested by Co.** to or in **any other person(s) or entity(ies), including foreign entities ("Intermediaries"), with understanding**, (in writing or otherwise,) that Intermediary shall, whether, directly or indirectly **lend or invest in other persons or entities** identified in any manner whatsoever by or on behalf of Co. ("Ultimate Beneficiaries") or provide **any guarantee, security** or the like on behalf of the Ultimate Beneficiaries;
- (ii) Whether **Mgt. has represented**, that, to the best of it's knowledge & belief, other than as disclosed in notes to accounts, **no funds have been received by Co.** from any person(s) or entity(ies), including foreign entities ("Funding Parties"), with understanding, (in writing or otherwise), that Co. shall, whether, directly or indirectly, lend or invest in other persons or entities identified in any manner whatsoever by or on behalf of Funding Party ("Ultimate Beneficiaries") or provide any guarantee, security or like on behalf of Ultimate Beneficiaries; &
- (iii) **Based on such audit procedures** that auditor has considered **reasonable & appropriate** in circumstances, **nothing has come to their notice** that has caused them to believe that **representations under sub-clause (i) and (ii) contain any MM.**

5. Whether **dividend declared or paid** during the year by Co. is in **compliance with section 123** of Co. Act, 2013.

6. Whether Co. has **used such accounting software** for maintaining its BOA which has a **feature of recording audit trail** (edit log) facility & same **has been operated throughout the year** for all transactions recorded in software & audit trail **feature has not been tampered with** & audit trail has been **preserved by Co. as per statutory requirements** for record retention.]

Audit Trail means, a step-by-step sequential record which provides evidence of documented history of financial transactions to its source. Auditor can trace every step of, financial data of a particular transaction right from general ledger to its source document with help of the audit trail.

197(16) of Co Act, 2013 that requires as under:

"Auditor of Co. shall, in his report,

- **make a statement as to whether remuneration paid by co. to its directors is in accordance with provisions of this section,**
- whether **remuneration paid to any director is in excess of limit laid down under this section** & give such other details as may be prescribed".

Reporting requirement : For auditors of public Co. needs to be cover in auditor's report under the Section "**Report on Other Legal & Regulatory Requirements**".

Duty to report on frauds**[A] Reporting to the Central Government -**

As per Sec 143(12) of Co. Act, 2013, if auditor of Co. in the course of performance of his duties as auditor, has reason to believe that an offence of fraud involving such amount or amounts as may be prescribed, is being or has been committed in Co. by its officers or employees, auditor shall report the matter to **CG** within such time & in such manner as may be prescribed.

In this regard, Rule 13 of Co. (Audit & Auditors) Rules, 2014 has been prescribed. Sub-rule (1) of Rule 13 states that if auditor of a Co., in the course of performance of his duties as statutory auditor, has reason to believe that an offence of fraud, which involves or is expected to involve individually an amount of ` **1 crore or above**, is being or has been committed against Co. by its officers or employees, auditor shall report matter to **CG**.

Manner of reporting the matter to **CG** is as follows:

- (a) Auditor shall **report the matter** to Board or Audit Committee, immediately but **not later than 2 days** of his knowledge of fraud, seeking their **reply or observations within 45 days**;
- (b) on receipt of such reply or observations, auditor shall **forward his report & reply or observations** of Board or Audit Committee along with his comments (on such reply or observations of Board or Audit Committee) to **CG within 15 days** from the date of receipt of such reply or observations;
- (c) in case auditor **fails to get any reply or observations** from Board or Audit Committee within stipulated period of 45 days, he shall forward his report to **CG** along with a note containing details of his report that was earlier forwarded to Board or Audit Committee for which he has not received any reply or observations;
- (d) report shall be **sent to Secretary, Ministry of Corporate Affairs** in a sealed cover by Registered Post with Acknowledgement Due or by Speed Post followed by an e-mail in confirmation of the same;
- (e) report shall be on letter-head of auditor containing postal address, e-mail address & contact telephone number or mobile number & be signed by auditor with his seal & shall indicate his Membership Number; and
- (f) Report shall be in form of statement as specified in **Form ADT-4**.

[B] Reporting to the Audit Committee or Board -

Section 143(12) of the Companies Act, 2013 further prescribes that in case of a fraud involving lesser than the specified amount [i.e. less than ` 1 crore], the auditor shall report the matter to the audit committee constituted under section 177 or to the Board in other cases within such time and in such manner as may be prescribed.

In this regard, sub-rule (3) of Rule 13 of the Companies (Audit and Auditors) Rules, 2014 states that in case of a fraud involving lesser than the amount specified in sub-rule (1) [i.e. less than ` 1 crore], the auditor shall report the matter to Audit Committee constituted under section 177 or to the Board immediately but not later than 2 days of his knowledge of the fraud and he shall report the matter specifying the following:

(a) Nature of Fraud with description;	(b) Approximate amt involved; and	(c) Parties involved.
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[C] Disclosure in the Board's Report:

Section 143(12) of the Companies Act, 2013 furthermore prescribes that the companies, whose auditors have reported frauds under this sub-section (12) to the audit committee or the Board, but not reported to the Central Government, shall disclose the details about such frauds in the Board's report in such manner as may be prescribed.

In this regard, sub-rule (4) of Rule 13 of the Companies (Audit and Auditors) Rules, 2014 states that the company is required to disclose in the Board's Report the following details of each of the fraud reported to the Audit Committee or the Board under sub-rule (3) during the year:

(a) Nature of Fraud with description;	(b) Approximate Amount involved;
(c) Parties involved, if remedial action not taken; and	(d) Remedial actions taken.

NOTES ON ACCOUNTS v/s QUALIFICATIONS

Mgt. explain their view point & assessment on all matters involving difference of opinion b/w them & auditors by way of **notes in F.S.**,

for better understanding of facts of matters by users of F.S. Such **notes** represents management's stand on matter while auditor records his disagreement on the matters by way of **qualifications** in the auditor's report.

Client & auditor are two separate independent parties, client Mgt. may insist upon auditor for not modifying his audit opinion considering Mgt. has disclosed full facts & assessment of matter through notes on F.S.

However, auditor needs to exercise his professional judgement & assess if disclosure alone would suffice or in case, he also needs to modify his audit report by either inserting a qualification or EOM. (it is clarified that EOM is not a substitute for modification of opinion).

EOM is to be made in respect of something which is appropriately presented & for which auditor has obtained SAAE.

Once auditor concludes that modification of his report in relation to specific matter under question, is warranted, he may choose to refer to specific note given by Mgt. & thereafter, continue explaining more facts & his assessment on matter including quantification & impact on various F.S. captions, to the extent possible.

Auditor must express nature of qualification, in a clear & unambiguous manner. Where Auditor answers any of statutory affirmations in negative or with a qualification, his report shall state the reasons for such answer. All qualifications should be contained in the Auditor's Report.

AUDIT REPORT v/s CERTIFICATE

Certificate	Audit report
Certificate is a written confirmation of accuracy of facts stated therein and does not involve any estimate or opinion term 'certificate' is, therefore, used where auditor verifies accuracy of facts	Term 'report' is used where an expression of opinion is involved. A report, on other hand, is a formal statement usually made after enquiry, examination or review of specified matters under report & includes the reporting auditor's opinion thereon.
An auditor may thus, certify the circulation figures of a newspaper or the value of imports or exports of a company.	Reporting auditor gives a report, he is responsible for ensuring that report is based on factual data, that his opinion is in due accordance with facts, & that it is arrived at by the application of due care & skill.
An auditor's certificate represents that he has verified certain figures and is in a position to vouch safe their accuracy as per his examination of documents and books of account.	'Report' involves expression of opinion which may differ from one professional to another., There is no question of exactitude in case of a report since info. contained therein is based on estimates & involves judgement element
Under Co. Act, 2013, No. of situations are there where an auditor is required to issue a certificate, like under Se 66 of Co. Act, 2013, an auditor is required to file a certificate in tribunal where company is proposing for reduction of capital.	However, report under Sec 143 of Co. Act, 2013, is an opinion-based report & is not a certificate .

SA 800 dealing with audit of FS prepared in accordance with special purpose framework

What is Special Purpose framework?

A FRF designed to meet the:	
Common financial information needs of a wide range of users is known as "General purpose framework"	Financial information needs of specific users is known as "Special purpose framework"

FRF may be a fair presentation framework or a compliance framework.

Examples of Special purpose frameworks are: -

- Financial reporting provisions of a contract, such as a bond indenture, a loan agreement, or a project grant.
- Cash receipts & disbursements basis of accounting for cash flow info. that an entity may be requested to prepare for creditors.
- Financial reporting provisions established by a regulator to meet the requirements of that regulator.

Considerations When Accepting Such Engagement

- Applicable FRF provide **financial reporting standards established by organisation** that is **authorised or recognised** those standards will be **presumed acceptable** if org. follows an established and **transparent process**.
- **Some L/R may prescribe FRF** to be used in preparation of special purpose FS for a certain type of entity.
- Applicable FRF may provide **financial reporting provisions of a contract or sources other than those described above**.
In that case, **acceptability of FRF** is determined by considering **whether framework exhibits attributes normally exhibited by acceptable FRFs**.

Considerations When Planning and Performing Such Audit

- a) To obtain an understanding of the entity's selection and application of accounting policies. Auditor shall obtain an understanding **of any significant interpretations of contract** that mgt. made in the preparation of those FS.
- b) Compliance of all SAs relevant to audit, auditor may depart from a relevant requirement in an SA by performing **alternative audit procedures** to achieve the aim of that requirement. (SA 200)
- c) Application of some of requirements of the SAs in an audit of special purpose financial statements may **require special consideration** by auditor. For ex, in SA 320, judgments about matters are based on common financial info. needs of users as a group. In special purpose FS those judgments are based financial info. needs of **intended users**.
- d) In special purpose FS, **mgt. may agree with intended users on a threshold below which misstatements identified during audit will not be corrected or otherwise adjusted**. Existence of such a threshold **does not relieve** auditor from requirement to determine materiality (SA 320).
- e) Communication with TCWG in accordance with SAs is based on **relationship between TCWG and FS subject to audit, whether TCWG are responsible for overseeing the preparation of those FS**. In case of special purpose FS, TCWG may not have such a responsibility. (SA260)

Description of the Applicable FRF

In case of FS prepared as per provisions of a **contract**, auditor shall evaluate whether the FS adequately **describe any significant interpretations of contract**.

SA 700 deals with form and content of the auditor's report. In the case of an auditor's report on special purpose FS: -

- a) Auditor's report shall also **describe purpose** for which the FS are prepared and, **intended users**, or **refer to a note** in special purpose FS that contain that info.; and
- b) If **mgt. has a choice of FRFs** in preparation of such FS, **explanation of management's responsibility** shall **make reference to its responsibility for determining that applicable FRF is acceptable**.

Alerting Readers that the FS Are Prepared in Accordance with a Special Purpose Framework

Special purpose FS may be used for purposes other than those for which they were intended. For ex- a regulator may require certain entities to place the special purpose FS on public record.

Auditor alerts users that FS are prepared as per SPF and may not be suitable for another purpose.

Restriction on Distribution or Use

- Auditor may consider it **appropriate to indicate** that auditor's report is **intended solely for specific users**.
- This may be achieved by restricting the distribution or use of the auditor's report.
- **Paragraph alerting readers may be expanded to include these other matters, and the heading modified accordingly**.

SA 805 - Special considerations audits of single FS and specific elements, accounts or items of FS

- o A single FS is to be **distinguished from a complete set of FS**. For ex., a cash flow statement is a single financial statement.
- o "Element of a FS" or "element" means an **"element, account or item of a FS."** For ex- trade receivables or cash & bank balances

Examples of Specific Elements, Accounts or Items of a FS are:	Accounts receivable, allowance for doubtful accounts receivable, inventory.
	Schedule of externally managed assets and income of a private pension plan.
	Schedule of net tangible assets,
	Schedule of disbursements in relation to a lease property.

- o A single FS or a specific element of a FS **includes related notes** comprising a **summary of significant accounting policies** & other explanatory info.
- o SA 800 & 805 don't override requirements of other SA's.

Considerations When Accepting Such Engagement

Application of Sa's

Q6

(I) General:

- o SA 200 requires auditor to **comply with all SAs relevant** to audit. This applies **irrespective of whether auditor is also engaged to audit entity's complete set of FS**.
- o If auditor is **not engaged to audit entity's complete set of FS**, determine whether audit of a single FS or of a specific element of those FS in accordance with SAs is practicable.

(II) Ethical Requirement:

- o SA 200 requires auditor to comply with -
 - a) Relevant ethical requirements including independence, and
 - b) All SAs relevant to audit.
- o Auditor to **comply with each requirement of an SA unless, entire SA is not relevant or requirement is not relevant** because it is conditional & condition doesn't exist
- o Auditor may **depart** from a relevant requirement in an SA by **performing alternative audit procedures** to achieve aim of requirement.

(III) Challenges:

- o Compliance with requirements of SAs **may not be practicable when auditor is not also engaged to audit complete set of FS**.
- o In such cases, auditor **doesn't have same understanding** of entity & its environment, including its IC, as an auditor who also audits complete set of FS.
- o Auditor **doesn't have audit evidence about general quality of accounting records or other accounting info.** that would be acquired in an audit of complete set of FS.
- o In audit of a specific element of a FS, **certain SAs require audit work that may be disproportionate to element being audited.**

(IV) May not be practicable:

- o If audit of a single FS or of a specific element of a FS as per SAs may not be practicable, he may **discuss with mgt. whether another type of engagement might be more practicable.**

Acceptability of the FRF

- o SA 210 requires auditor to determine **acceptability of FRF** applied in preparation of FS.
- o Whether **application of FRF will result in a presentation that provides adequate disclosures to enable intended users to understand info. conveyed.**
- o A single FS or a specific element of a FS may be prepared as per **applicable FRF that is based on a FRF established** by an authorised or recognised standards setting organisation. If this is the case, **determination of acceptability of applicable framework** involve considering whether that framework includes all requirements of framework that are relevant to presentation of a single FS or of a specific element of a FS that provides adequate disclosures.

Considerations When planning & performing the Audit

- o Auditor shall adapt **all SAs** relevant to the audit as necessary.
- o When auditing a single FS or a specific element of a FS in conjunction with audit of entity's complete set of FS, auditor may be able to use **audit evidence** obtained as part of audit of entity's complete set of FS in the audit of FS or element. SAs require to obtain SAAE on which to base opinion on FS or on element.

- o Individual FS that comprise a complete set of FS, and many of elements of those FS, including related notes, are **interrelated**. Auditor may not be able to consider FS or element in isolation. So, he may need to perform procedures in relation to **interrelated** items to meet the objective of audit.
- o **Materiality** determined for a single FS or for a specific element of a FS may be **lower** than materiality determined for complete set of FS; this will affect NTE of the audit procedures.

Forming an Opinion & Reporting Considerations

Apply requirements of SA 700.

Separate Opinion

If auditor **undertakes an engagement of SA 805 in conjunction with an engagement to audit entity's complete set of FS**, shall **express a separate opinion for each engagement.**

Differentiation

An audited single or an audited specific element of a FS may be **published together** with entity's audited complete set of FS.

If **presentation of a single FS or of specific element of a FS doesn't differentiate it sufficiently** from complete set of FS, auditor shall ask mgt. to **rectify situation.**

Auditor shall also **differentiate opinion** on single FS or on specific element of a FS from opinion on complete set of FS.

Not to issue auditor's report until satisfied with differentiation.

Modified Opinion or Emphasis of Matter in Complete Set of FS

If opinion in auditor's report on an entity's complete set of **FS is modified**, or that report **includes an EOMP or OMP**, auditor shall determine **effect** that this may have on auditor's report on a single FS or on a specific element of those FS.

Adverse Opinion or Disclaimer on Complete Set of FS

If it is necessary to **express an adverse opinion or disclaim an opinion on entity's complete set of FS as a whole.**

SA 705 **doesn't permit** auditor to include in same auditor's report an **unmodified opinion on a single FS or on specific element** that forms part of those FS.

Because such an **unmodified opinion would contradict** adverse opinion or disclaimer of opinion on entity's complete set of FS whole.

Separate audit of Specific Element in context of Adverse Opinion

If auditor express an adverse opinion or disclaimer of opinion on entity's complete set of FS as a whole but, **in audit of a specific element**, auditor considers it appropriate to express an unmodified opinion on that element, auditor shall only do so if:

Q7

- (a) Auditor is **not prohibited by L/R** from doing so;
- (b) That opinion is expressed in an auditor's report that is **not published together with auditor's report** containing adverse opinion or disclaimer of opinion; and
- (c) Specific element **doesn't constitute a major portion** of entity's complete set of FS.

Auditor shall **not express an unmodified opinion** on a **single FS of complete set of FS** if auditor has expressed an adverse opinion or disclaimed an opinion on complete set of FS as a whole

This is the case **even if auditor's report on single FS is not published together with auditor's report containing adverse opinion or disclaimer of opinion.**

This is because a single FS is deemed to **constitute a major portion** of those FS.

SA 810 – Engagements to report on summary financial statements

SA 810 deals with auditor's responsibilities when undertaking an engagement to report on summary FS derived from FS audited in accordance with SAs **by that same auditor**.

What do Summary FS Reflect?

Summary FS reflect historical financial info. that is derived from FS, but **that contains less detail** than FS while still **providing a structured representation consistent with FS** of entity.

Before accepting an engagement to report on summary FS, auditor shall:

(A) Determine whether **applied criteria** are acceptable

- Applied criteria - criteria applied by mgt. in preparation of summary FS.
- Mgt. is responsible for **determination of info.** that needs to be reflected in summary FS so that they are **consistent** in all material respects, with or **represent a fair summary** of audited FS.
- Risk increases when established criteria for preparation of summary FS don't exist.

Factors affecting the auditor's determination of the acceptability of the applied criteria:

- Nature of entity
- Purpose of summary FS
- Info. needs of intended users of summary FS and
- Whether applied criteria will result in summary FS that are **not misleading**.

Points to be noted:

- Where **established criteria don't exist**, criteria may be developed by mgt., for ex, based on practice in a particular industry.
- If applied criteria are **unacceptable** or is **unable to obtain agreement of mgt.**, auditor **shall not accept** engagement unless required by L/R to do so.

(B) Obtain agreement

Obtain **agreement of management** that it **acknowledges & understands its responsibility**:

1. For **preparation of summary FS** in accordance with **applied criteria**.
2. To make **audited FS available** to the **intended users** of summary FS **without undue difficulty**.

3. To include auditor's report on summary FS in any document that **contains summary FS** and that indicates that auditor has reported on them

(C) Agree with management on the form of opinion to be expressed on the summary FS

Nature of Procedures to be performed by Auditor

Auditor shall perform following procedures, as the basis for auditor's opinion on summary FS:

- (a) Evaluate whether summary FS are prepared in **accordance with applied criteria**.
- (b) Evaluate whether summary FS adequately **disclose applied criteria**.
- (c) Evaluate whether summary FS **adequately disclose** their **summarised nature and identify audited FS**.
- (d) When summary FS are **not accompanied by audited FS**, evaluate whether they describe clearly:
 - From whom or where audited FS are available; or
 - L/R that specifies that audited FS **need not be made available to intended users** of summary FS.
- (e) Evaluate whether **audited FS are available to intended users** of summary FS without undue difficulty.
- (f) Evaluate, in view of **purpose of summary FS**, whether summary FS **contain info. necessary, and are at an appropriate level of aggregation**, so as not to be **misleading**.
- (g) **Compare summary FS with related info.** in audited FS to determine whether summary FS **agree with or can be re-calculated** from related info. in audited FS.

Form of Opinion

- When **unmodified opinion** on summary FS is appropriate, auditor's opinion shall, use one of the following phrases:
 - (a) **Summary FS are consistent**, in all material respects, **with audited FS**, in accordance with **applied criteria** or
 - (b) Summary FS are a **fair summary** of audited FS, in accordance with **applied criteria**.
- If L/R prescribes wording of opinion that are **different from described above**, auditor shall:
 - (a) **Apply procedures** discussed earlier & any further procedures necessary to enable auditor **to express prescribed opinion** &;
 - (b) Evaluate whether **users of summary FS** might **misunderstand auditor's opinion** and, if so, **whether additional explanation** in report can **mitigate possible misunderstanding**.

If **additional explanation can't mitigate possible misunderstanding**, he shall **not accept** engagement.

Modifications to the Opinion, EOMP or OMP in Auditor's Report on Audited FS

Q 11

When auditor's report on **audited FS contains a qualified opinion, an EOMP, or an OMP**, but auditor is satisfied that **summary FS are consistent**, in all material respects, with or **are a fair summary of audited FS**, in accordance with applied criteria, auditor's report on summary FS shall, also contain followings:

- (a) **State** auditor's report on audited FS **contains** a qualified opinion, an EOMP, or an OMP; and
- (b) Describe:
 - **Basis for qualified opinion** on audited FS, and **that qualified opinion**; or **EOMP or OMP** in auditor's report on audited FS; &
 - **Effect** thereof on the summary FS, if any.

When auditor's report on audited FS **contains an adverse opinion or a disclaimer of opinion**, auditor's report on summary FS shall, additionally: -

- (a) **State** that auditor's report on audited FS **contains** an adverse opinion or disclaimer of opinion;
- (b) **Describe basis** for that adverse opinion or disclaimer of opinion; &
- (c) **State** that, as a **result of the adverse opinion or disclaimer of opinion**, it is **inappropriate** to express an opinion on summary FS.

Modified Opinion on the Summary FS

If summary FS are **not consistent**, in all material respects, with or are **not a fair summary** of audited FS, in accordance with **applied criteria**, and mgt. **doesn't agree to make necessary changes**, auditor shall **express an adverse opinion** on summary FS.

Auditor's Report on Summary FS

Elements of the Auditor's Report: -

- (a) A **title** clearly indicating it as the report of an independent auditor
- (b) An **addressee**: If addressee of the summary FS is **not the same as the addressee of auditor's report** on audited FS, **evaluate** appropriateness of using a different addressee.
- (c) An **introductory** paragraph:
 - ❑ **Identifies summary FS including title of each statement**
 - ❑ **Identifies audited FS**
 - ❑ A statement that **summary FS doesn't contain all the disclosures**
- (d) A **description** that mgt. is responsible for preparation of summary FS in accordance with applied criteria.
- (e) A **statement** that auditor is responsible for expressing an opinion on summary FS.
- (f) A **paragraph** expressing an opinion.
- (g) Auditor's **signature** along with firm registration number.
- (h) **Date** of auditor's report
- (i) **Place** of signature

Restriction on Distribution or Use or Alerting Readers to the Basis of Accounting

Auditor's report on audited FS alerts readers that audited FS are prepared in accordance with a special purpose framework, **include a similar restriction or alert in the auditor's report on summary FS.**

Comparatives

If audited FS contain comparatives, but summary FS don't, Auditor shall determine:

- ❑ Whether **such omission is reasonable.**
- ❑ **Effect of an unreasonable omission** on the auditor's report on summary FS.

If summary FS contain comparatives that were reported on by another auditor, auditor's report on summary FS shall also **contain the matters that SA 710 requires auditor to include** in auditor's report on audited FS.

Unaudited Supplementary Info. Presented With Summary FS

- ❑ Evaluate whether **any unaudited supplementary info. presented with summary FS is clearly differentiated** from the summary FS.
- ❑ If presentation of unaudited supplementary info. **is not clearly differentiated** from the summary FS, ask mgt. to **change presentation** of unaudited supplementary info.
- ❑ If mgt. **refuses to do so**, auditor shall **explain** in auditor's report on summary FS that **such info. is not covered by that report.**

Other Information in Documents Containing Summary Financial Statements

- ❑ Auditor shall **read other info. included in a document containing summary FS & related auditor's reports** to consider whether there is a **material inconsistency** between other info. & summary FS.
- ❑ If auditor **identifies a material inconsistency**, he shall determine whether summary FS or the other info. **needs to be revised.**
- ❑ If, auditor **becomes aware that other info. needs to be revised**, he shall **discuss the matter with mgt.**

Auditor Association

If **entity plans to state** that auditor has reported on summary FS in a document containing summary FS, but **doesn't plan to include related auditor's report**, auditor shall **request mgt. to include** auditor's report in document.

If **management doesn't do so**, auditor shall **determine and carry out other appropriate actions** designed to **prevent mgt. from inappropriately associating auditor** with summary FS in that document
Auditor **maybe** engaged to **report** on **FS** of an entity, while not engaged to report on **summary FS**.

In this case, **entity plans to make a statement** in a document that **refers to auditor and fact that summary FS are derived from FS audited by auditor**, auditor shall be satisfied that:

- (A) **Reference to auditor is made in the context of auditor's report on the audited FS;** and
- (B) **Statement doesn't give the impression that auditor has reported on the summary FS.**

If (a) or (b) are not met, auditor shall **request mgt. to change statement** to meet them, or **not to refer to the auditor** in document.

If mgt. **doesn't change the statement** -

- ✓ **Delete reference** to auditor, or
- ✓ **Include on auditor's report on summary FS** in document containing summary FS,
- ✓ **Advise mgt. that auditor disagrees with reference**, and
- ✓ shall **determine and carry out other appropriate actions** designed to prevent mgt. from inappropriately referring to the auditor

Timing of Work and Events Subsequent to the Date of Auditor's Report on the Audited FS

When auditor reports on summary FS **after completion of audit** of FS, he is **not required to obtain additional audit evidence** on audited FS, or report on **effects of events that occurred subsequent to the date of the auditor's report** on the audited FS.