CA INTERMEDIATE

Auditing and Ethics

Summary Module

Index

RJ = Practical Insight into Theoretical World

1

Nature, Objective & Scope of Audit

CHAPTER OVERVIEW:

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V. Meaning and Elements of an Assurance Engagement

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IX. Why are Standards Needed ?

X. Inherent Limitations of Audit (SA 200)

100% Question from this chap. (Atleast 1).

MEANING AND NATURE OF AUDITING

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

Analysis of the Definition

a. Auditor should be independent i.e. he should form his opinion without being affected by any influence.

b. FS audit are performed for all types of organization such as **proprietary concern, a partnership firm, a LLP, a private company, a public company, a society or a trust.**

c. Management is responsible to prepare and present FS.

d. The purpose of Audit is to express an opinion on the FS's.

Following points should be kept in mind while auditing FS's so that they don't mislead anybody:

a) The **accounts** have been drawn up with reference to **entries in the books of account;**

b) No **omission** of entries

c) All entries are **supported by sufficient and appropriate evidence**

d) FS presents a **true and fair picture**

e) Amounts are properly **classified, described and disclosed** in conformity with AS.

f) Information conveyed in FS is **clear and unambiguous**

OBJECTIVE OF AN AUDIT

SA 200

In conducting audit of FS's, objectives of auditor in accordance with SA-200 "**Overall Objectives of the Independent auditor** and the **conduct of an audit** in accordance with **SA's**" are:

a) To **obtain reasonable assurance** about whether the FS's as a whole are free from material misstatement; and whether due to fraud or error, thereby enabling the auditor to **express an opinion** on whether the FS's are prepared, in all material respects, in accordance with an **applicable FRF**; and

b) To **report on the FS's, and communicate as required by the SAs**, in accordance with the auditor's findings.

Two Imp. pts.

An analysis of above brings out following points clearly: -

1) Auditor's objective is to **obtain a reasonable assurance** whether FS's as a whole are free from material misstatement whether due to fraud or error.

2) Reasonable assurance is a **high-level of assurance** but it is **not absolute assurance (complete assurance)**. Therefore, auditor cannot give **guarantee** that FS are free from material misstatements.

3) Audit of FS's is carried out by the auditor with professional competence and skills in accordance with

SA. Audit procedures are applied in accordance with SA's, audit evidence is obtained and evaluated. On basis of that, conclusions are drawn and opinion is formed. It leads to **high level of assurance** which is called as **reasonable assurance** but it is not absolute assurance.

4) Misstatements can occur due to **fraud or error or both**.

5) The **opinion is reported and communicated** in accordance with audit findings through a written report as required by **SA**.

SCOPE OF AUDIT

The following points are included in scope of audit of FS:

1) **Coverage of all aspects of entity** relevant to the FS's being audited.
2) **Reliability and sufficiency of financial information**
   a) The auditor should be reasonably satisfied that **information contained in underlying accounting records and other source data** (like bills, vouchers, documents etc.) is **reliable and sufficient** basis for preparation of FS's.
   b) The auditor makes a judgment of reliability and sufficiency of financial information by making a study and assessment of accounting systems and internal controls and by **carrying out appropriate tests, enquiries and procedures**.
3) **Proper disclosure of financial information**
   a) Whether relevant information is **properly disclosed** in the FS's as per applicable statutory requirements and ensuring that FS properly **summarize transactions and events** recorded therein and by considering the **judgments made by management** in preparation of FS's.
   b) The management responsible for preparation and presentation of FS's **makes many judgments** in this process.
   c) The auditor evaluates **selection and consistent application of accounting policies** by management; whether such a selection is proper and whether chosen policy has been applied consistently on a period-to-period basis.
   d) Understand that FS's of an entity are **prepared on historical financial information basis**.

SCOPE OF AUDIT-WHAT IT DOES NOT INCLUDE

1) Auditor is **not expected** to perform duties which fall outside domain of his competence.
2) It is **not expected** from an auditor **to determine suitability** and life of civil structures like buildings. These require different skillsets which may be performed by qualified engineers in their respective fields.
3) An auditor is **not an expert** in authentication of documents. The genuineness of documents **cannot** be authenticated by him because he is **not an expert** in this field.
4) **An audit is not an official investigation into alleged wrong doing**. He does not have any specific legal powers of search or recording statements of witness on oath which may be necessary for carrying out

an official investigation.

AUDITING VS INVESTIGATION

1) **Audit is distinct from investigation.** Investigation is a critical **examination** of the accounts with a special purpose.

2) The **objective of audit** is to obtain **reasonable assurance** about whether the FS's as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion.

3) The **scope of audit is general and broad** whereas **scope of investigation is specific and narrow.**

4) Sometimes **investigation results from the prima facie findings of the auditor.**

AUDIT- MANDATORY OR VOLUNTARY?

1) It is not necessary that **audit is always legally mandatory**. There are entities like companies who are compulsorily required to get their accounts audited under law.

2) **Audit is not always mandatory.** Many entities may get their accounts audited voluntarily because of benefits from the process of audit.

WHAT IS AN ENGAGEMENT?

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

External audit engagements

The **purpose** is to enhance the **degree of confidence of intended users** of FS's. Such engagements are also reasonable assurance engagements.

For example, in India, companies are required to get their annual accounts audited by an external auditor.

BENEFITS OF AUDIT - WHY AUDIT IS NEEDED

1) Audited accounts **provide high quality information.** It gives confidence to users that information on which they are relying is qualitative and it is the outcome of an exercise carried out by following Auditing Standards recognized globally.

2) **In case of companies,** shareholders may or may not be involved in daily affairs of the company. The FS's are prepared by management consisting of directors. As **shareholders are owners** of the company, they **need an independent mechanism** so that financial information is qualitative and reliable. **Hence, their interest is safeguarded by an audit.**

3) **An audit acts as a moral check on employees** from committing frauds for the fear of being discovered by audit.

4) Audited FS's are **helpful to government authorities** for determining tax liabilities.

5) Audited FS's can be **relied upon by lenders, bankers** for making their credit decisions i.e. whether to lend or not to lend to a particular entity.
6) An audit may also **detect fraud or error or both.**
7) An audit reviews existence and operations of various controls operating in any entity. Hence, it is **useful at pointing out deficiencies.**

WHO APPOINTS AN AUDITOR?

1) Generally, an **auditor is appointed by owners** or in some cases by **constitutional or government authorities** in accordance with applicable laws and regulations.
   For example, in case of companies, auditor is appointed by members (shareholders) in Annual General Meeting (AGM). Shareholders are owners of a company and auditor is appointed by them in AGM.
2) In case of **government companies in India**, auditor is appointed by **Comptroller and Auditor General of India (CAG)**, an independent constitutional authority.
3) In case of firm, auditor is appointed by **partners of firm.**
4) Auditor may be appointed by a government authority in accordance with some law or regulation.

TO WHOM REPORT IS SUBMITTED BY AN AUDITOR?

The outcome of an audit is written audit report in which auditor expresses an opinion. The **report is submitted to person making the appointment.**

In case of companies, these are **shareholders** in case of a firm, to **partners** who have engaged him.

QUALITIES OF AUDITOR

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- Tact, caution, firmness, good temper, integrity, discretion, industry, judgment, patience, clear headedness and reliability.
- In short, all those personal qualities that go to make a good businessman contribute to the making of a good auditor.
- He must have the highest degree of integrity backed by adequate independence.
- An exhaustive knowledge of accounting is the sine qua non (essential) of auditing.
- He must know thoroughly all accounting principles and techniques.

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MEANING OF ASSURANCE ENGAGEMENT

"**Assurance engagement**" means an engagement in which a practitioner expresses a conclusion designed to **enhance the degree of confidence of the intended users** other than the responsible party about the outcome of the evaluation or measurement of a **subject matter against criteria.**

keyword

ELEMENTS OF AN ASSURANCE ENGAGEMENT

Following elements comprise an assurance engagement: -

1) A three party relationship involving a practitioner, a responsible party, and intended users

a) A **practitioner** is a person who provides the assurance. The term practitioner is **broader than auditor**. Audit is related to historical information whereas practitioner may provide assurance not necessarily related to historical financial information.

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b) A **responsible party** is the party responsible for **preparation of subject matter**.

c) **Intended users** are the persons for whom an assurance report is prepared. These persons may use the report in making decisions.

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2) An appropriate subject matter

It refers to the **information to be examined** by the practitioner. **For example**, financial information contained in FS's while conducting audit of FS's.

3) Suitable criteria

These refer to **benchmarks used to evaluate** the subject matter like **standards, guidance, laws, rules and regulations**.

4) Sufficient appropriate evidence

The practitioner performs an assurance engagement to obtain sufficient appropriate evidence. It is on the basis of evidence that conclusions are arrived and an opinion is formed by auditor.

Sufficient = Quantity and Appropriate = Quality

5) A written assurance report in appropriate form

A written report is provided containing **conclusion that conveys the assurance** about the subject matter. A written assurance report is the **outcome of an assurance engagement**.

Elements of an Assurance Engagement
↓
3 Parties

Responsible Party	Practitioner	Intended Users
↓	↓	↓
Management	Auditor	Users

MEANING OF REVIEW: AUDIT VS. REVIEW

1) Audit is a reasonable assurance engagement. It provides reasonable assurance.
2) Review is a limited assurance engagement. It provides lower level of assurance than audit.
3) Review involves fewer procedures and gathers sufficient appropriate evidence on the basis of which limited conclusions can be drawn up.
4) Both "audit" and "review" are related to FS's prepared on the basis of **historical financial information**.

REASONABLE ASSURANCE ENGAGEMENT VS LIMITED ASSURANCE ENGAGEMENT

1) Assurance engagements provide assurance to users. The difference is of degree.
2) **Reasonable assurance** engagement like audit provides reasonable assurance which is a **high level of assurance**.
3) **Limited assurance** engagement like review provides **lower level of assurance than audit**. It is only a **moderate level of assurance**.

Reasonable assurance engagement	Limited assurance engagement
1) Reasonable assurance engagement provides **high level of assurance**.	1) Limited assurance engage-ment provides lower level of assurance than reasonable assurance engagement.
2) It performs **elaborate and extensive procedures** to obtain sufficient appropriate evidence.	2) **It performs fewer procedures as compared to** reasonable assurance engagement.
3) It draws **reasonable conclusions** on the basis of sufficient appropriate evidence.	3) It involves obtaining sufficient **conclusions** appropriate evidence to **draw limited**.
4) Example of **reasonable assurance** engagement is an **audit engagement**.	4) Example of **limited assurance** engagement is **review engagement**.

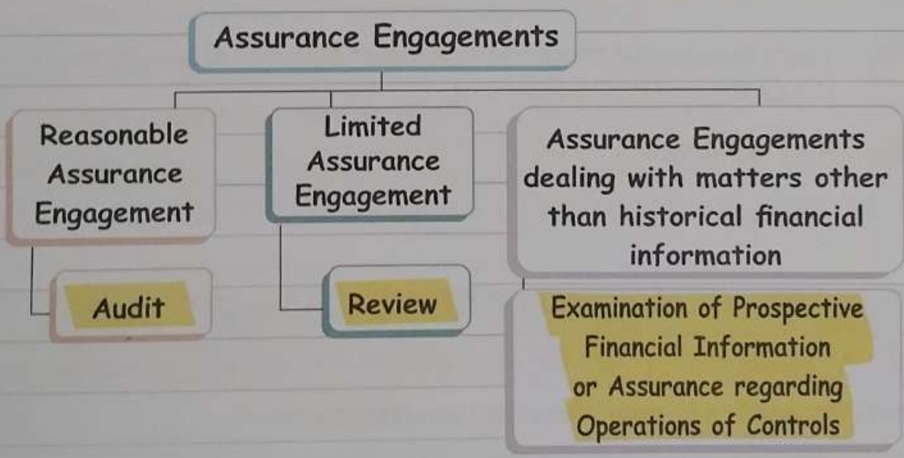
ASSURANCE ON OTHER THAN HISTORICAL FINANCIAL INFORMATION

1) There is another kind of assurance which is related to matters other than historical financial information. Such an assurance may relate to **prospective financial information and not to historical financial information**. It may relate to **providing assurance on internal controls** in anentity.
2) **"Prospective financial information"** means financial information **based on assumptions about events** that may occur in the **future and possible actions** by an entity. It can be in the form of a forecast or projection or combination of both.
3) Here, it is important to note the difference between **"Historical financial information"** and **"Prospective financial information."** The **former** relates to information expressed in financial terms of an entity about **economic events, conditions or circumstances occurring in past periods**. The

SAE eg:- 3400 & 3402

latter relates to financial information based on **assumptions about occurrence of future events and possible actions by an entity**.

4) Therefore, **historical financial information** is rooted in **past events** which have already occurred whereas **prospective financial information** is related to **future events**.
5) In assurance reports involving prospective financial information, the practitioner obtains **sufficient appropriate evidence** to the effect that **management's assumptions on which the prospective financial information** is based are not unreasonable, the prospective financial information is properly prepared on the basis of the assumptions and it is properly presented and all material assumptions are adequately disclosed.
6) **Prospective financial information relates to future events.** While evidence may be available to support the assumptions on which the prospective financial information is based, such evidence is itself generally future-oriented. The auditor is, therefore, **not in a position to express an opinion** as to whether the results shown in the prospective financial information will be achieved.
7) Therefore, in such **assurance engagements**, practitioner provides a **report assuring that nothing has come to practitioner's attention to suggest that these assumptions do not provide a reasonable basis for the projection.**
8) Hence, such type of assurance engagement provides only a "**moderate" level of assurance**.



ENGAGEMENT AND QUALITY CONTROL STANDARDS: AN OVERVIEW

The following Standards issued under authority of ICAI Council are collectively known as Engagement Standards: -

1) **Standards on auditing (SAs)** which apply in **audit of historical financial information**.
2) **Standards on review engagements (SREs)** which apply in **review of historical financial information**.
3) **Standards on Assurance engagements (SAEs)** which apply in **assurance engagements other than audits and review** of historical financial information.
4) **Standards on Related Services (SRSs)** which apply in **agreed upon procedures** to information, **compilation engagements** and other related service engagements.

Engagement Standards

SA's	SRE's	SAE's	SRS's
Standards on Auditing	Standards on Review Engagements	Standards on Assurance Engagements	Standards on Related Services

STANDARDS ON AUDITING (SA's)

1) SA's apply in the context of an **audit of FS's** by an independent auditor. SA's apply in **audit of historical information**. These establish high quality benchmarks and are followed by auditors in conducting audit of FS's.

2) Some **examples of SA's** are: -

   a) **SA 200** Overall Objectives of the Independent Auditor and the Conduct of an Audit in accordance with SA's

   b) **SA 230** Audit Documentation

   c) **SA 315** Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment

   d) **SA 500** Audit Evidence

STANDARDS ON REVIEW ENGAGEMENT (SRE's)

1) SRE's apply in the context of **review of FS's**. Review is a **limited assurance engagement** and it provides assurance which is **lower than that provided by audit**.

2) Review involves **fewer procedures as compared to audit**.

3) Since a review also provides assurance to users, it also involves obtaining sufficient appropriate evidence. For **example**, when an auditor performs review of interim financial information of an entity.

4) **Examples** of SRE's are:

   a) SRE 2400 (Revised) Engagements to Review Historical FS's

   b) SRE 2410 Review of Interim Financial Information Performed by the Independent Auditor of the Entity

5) Both SA's and SRE's apply to engagements involving **historical financial information**.

STANDARDS ON ASSURANCE ENGAGEMENTS (SAE's)

1) There is another set of standards which apply in assurance engagements dealing with subject matters other than historical financial information. Such assurance engagements do not include "audit" or "review" of historical financial information.
2) For example, an assurance engagement relating to examination of prospective financial information.
3) Examination is not of historical financial information or engagement may relate to providing assurance regarding non-financial matters like design and operation of internal control in an entity.
4) Examples of SAE's are:
   a) SAE 3400 The Examination of Prospective Financial Information
   b) SAE 3420 Assurance Engagements to Report on the Compilation of Pro Forma Financial Information Included in a Prospectus

STANDARDS ON RELATED SERVICES (SRS's)

1) It will apply in case of engagements either to perform agreed-upon procedures regarding financial information or to perform compilation of financial information.
2) In such engagement, we can also assist management in the preparation and presentation of historical financial information without obtaining assurance.
3) Therefore, while issuing report for compilation engagement, practitioner should clearly state that it is not an assurance engagement and no opinion is being expressed.
4) Examples of SRSs are: CA or client jo agree karege wo banayege (complie, prepare).
   a) SRS 4400 Engagements to perform agreed-upon procedures regarding financial information
   b) SRS 4410 (Revised) Compilation engagements

STANDARDS ON QUALITY CONTROL (SQC)

1) SQC's have been issued to establish standards and provide guidance regarding a firm's responsibilities for its system of quality control for the conduct of audit and review of historical financial information and for other assurance and related service engagements.
2) SQC 1 has been issued in this regard. It requires auditors/ practitioners to establish system of quality control so that firm and its personnel comply with professional standards and regulatory & legal requirements and reports issued are appropriate.
3) SQCs are to be applied for all services covered by Engagement Standards.

WHY ARE STANDARDS NEEDED?

Standards ensure carrying out of audit against **established benchmarks** at par with global practices.

Standards **improve quality of financial reporting** thereby helping users to make diligent decisions.

Standards **promote uniformity** as audit of FS's is carried out following these Standards.

Standards **ensure audit quality**.

Standards equip professional accountants with **professional knowledge and skill**.

DUTIES IN RELATION TO ENGAGEMENT AND QUALITY CONTROL STANDARDS

1) It is the duty of professional accountants to see that Standards are followed in engagements undertaken by them. Ordinarily, these are to be followed by **professional accountants**.
2) However, a situation may arise when a specific procedure as required in Standards would be **ineffective in a particular engagement**.
3) He is **required to document how alternative procedures performed** achieve the purpose of required procedure. Also, **reason for departure** has also to be documented unless it is clear.
4) Further, **his report should draw attention** to such departures. A **mere disclosure** in the report **does not absolve** a professional accountant from complying with applicable Standards.

INHERENT LIMITATIONS OF AUDIT (SA 200)

The process of audit suffers from certain **inbuilt limitations** because of which an **auditor cannot obtain an absolute assurance** on FS's or cannot reduce his audit risk to zero.

a) Nature of financial reporting –

i) Preparation of FS's **involves** use of **judgments by management**. **For example** use of accounting estimates while making provisions for doubtful debts, warranty provision, provision for pending litigation etc.

ii) These judgments may involve **subjective decisions** or a **degree of uncertainty**. Therefore, auditor may not be able to obtain absolute assurance that FS's are free from material misstatements due to frauds or errors.

iii) One of the premises for conducting an audit is that management acknowledges its responsibility of preparation of FS's **in accordance with applicable FRF** and for devising suitable internal controls.

iv) However, such **controls may not operate effectively** due to its inherent limitations.

MCQ + Question = [illegible] from Here.

b) The Nature of Audit Procedures:

i) The auditor may **plan and perform** his audit procedures in accordance with SAs but still there are practical and legal limitations on his ability of auditor to obtain sufficient and appropriate audit evidence.

ii) Auditor does not test all transactions and balances, he may use **sampling and analyzing review Procedures** to arrive at his conclusion. Therefore it is a **practical limitations**.

iii) **Management may not provide complete information** as requested by auditor. Auditor cannot force management to provide requested information, therefore it is a **legal limitations** on auditors ability.

iv) The management may consist of **dishonest and unscrupulous people** and may be, itself, involved in fraud. It may be engaged in concealing fraud by **designing sophisticated and carefully organized schemes** which may be possible for the auditor to detect in the ordinary course of audit.

v) **For Example** - It is quite possible that entity may have entered into some **transactions with related parties**. Such transactions may be only paper transactions and may not have actually occurred. The auditor may not be aware of such related party relationships or audit procedures may not be able to detect probable wrong doings in such transactions.

c) Not in nature of investigation:

Audit is not an official investigation therefore auditor **cannot** obtain absolute assurance that FS's are free from material misstatements due to frauds or errors.

d) Timeliness of financial reporting and decrease in relevance of information over time:

i) The **relevance** of information **decreases over time** and auditor cannot verify each and every matter. Therefore, he should **strike** a balance between **cost of obtaining the information** and reliability of information.

ii) There is always a time constraint in the statutory audit process but it cannot be used as an excuse for not performing an audit procedure for which there is no alternative procedure.

e) Future Events:

i) Future events or conditions may **affect** an entity **adversely**. Sometimes it may impact the entity's ability to continue as a going concern.

ii) The business may **cease to exist** in future due to **change in market conditions, emergence of new business** models or products or **due to onset** of some adverse events.

iii) Therefore, **an auditor cannot** provide a **guarantee** that FS's are free from material misstatements due to frauds or errors.

2

Audit Strategy, Audit Planning & Audit Programme

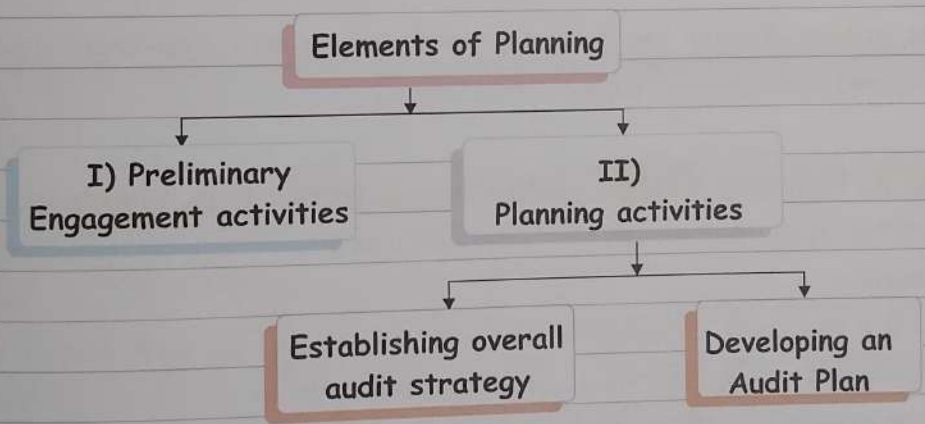
CHAPTER OVERVIEW:

SA 300- PLANNING AN AUDIT OF FINANCIAL STATEMENTS

WHY PLANNING AN AUDIT IS NECESSARY? ITS BENEFITS

1) Planning an audit is necessary **to carry out it effectively in a timely manner**. Besides ensuring compliance with professional standards, **it helps in performing** audit engagement effectively.
2) Adequate planning benefits the audit of FS's including the following:
   a) Helping the auditor to **devote appropriate attention** to **important areas** of the audit.
   b) Helping the auditor **identify and resolve potential problems** on a timely basis.
   c) Helping the auditor **properly organize and manage** the audit engagement.
   d) Assisting in the **selection of engagement team members** with appropriate levels of capabilities and competence.
   e) Facilitating the **direction and supervision of engagement team members** and the review of their work.
   f) Assisting, where applicable, in **coordination of work done** by auditors of **components and experts**.

PLANNING PROCESS- ELEMENTS OF PLANNING



I) Preliminary engagement activities

The auditor considers whether relationship with client should be continued and whether ethical requirements including independence continue to be complied with. It includes: -

A) **Performing procedures regarding the Continuance of Client Relationships and Audit Engagements (Note 1)**
B) **Evaluating compliance with ethical requirements including independence (Note 2)**
C) **Establishing an understanding of terms of engagement (Note 3)**

Note 1- Performing procedures regarding the Continuance of Client Relationships and Audit Engagements

Acceptance and Continuance of Client Relationships and Audit Engagements

1) It should be **ensured** that **appropriate procedures** regarding the **acceptance and continuance of client relationships** and audit engagements **have been followed** and that **conclusions** reached in this regard are **appropriate**.
2) The firm should **obtain information** considered necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client.
3) **Following Matters** may **need to be considered.**

4) Besides, in case of **initial engagements, communication with predecessor auditor** should be **made**, where there has been a change of auditors.

Note 2- Evaluating compliance with ethical requirements including independence

1) The auditor shall continuously evaluate compliance with ethical requirements including independence.
2) Throughout the audit engagement, the engagement partner shall **remain alert**, through **observation** and making **inquiries** as necessary, for **evidence of non-compliance** with relevant ethical requirements by members of the engagement team.
3) If **matters** come to the **engagement partner's** attention that **indicate** that members of the engagement team have **not complied** with relevant ethical requirements, the engagement partner, in consultation with others in the firm, shall **determine the appropriate action.**
4) The engagement partner shall **form a conclusion** on compliance with independence requirements. In doing so, the **engagement partner shall:-**
   a) **Obtain relevant information** from the firm to identify and evaluate circumstances and relationships that create threats to independence
   b) **Evaluate information** on identified breaches.
   c) **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 law or regulation.

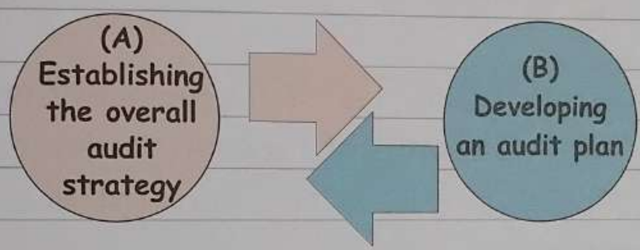
d) The engagement partner shall promptly report to the firm any inability to resolve the matter for appropriate action.

Note 3 - Establishing an understanding of terms of engagement

1) It is in the interests of both the entity and the auditor that the auditor sends an audit engagement letter before the commencement of the audit to help avoid misunderstandings with respect to the audit.

2) It ensures that there is no confusion with the client regarding terms of the engagement.

II) PLANNING ACTIVITIES



A) OVERALL AUDIT STRATEGY

The auditor shall establish an overall audit strategy that sets the scope, timing and direction of the audit, and that guides the development of the audit plan.

In establishing the overall audit strategy, the auditor shall: (Factors)

a) Auditor should identify the characteristics of the engagement that define its scope; (Note 1)

b) Auditor should ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required; (Note 2)

c) Auditor should consider the factors that are significant in directing the engagement team's efforts; (Note 3)

d) Auditor should also consider the results of preliminary engagement activities and, where applicable, whether knowledge gained on other engagements is relevant; and (Note 4)

e) Auditor should ascertain the Nature, timing & extent of resources necessary to perform the engagement. (Note 5)

Note 1- Identify the characteristics of the engagement that define its scope

1) It is important for auditor to identify scope of the engagement. Only a well identified scope can lead to establishment of a sound audit strategy.
2) There are many characteristics of engagement defining its scope. Some of characteristics are

Applicable FRF applicable to the entity

Nature of business segments to be audited including the need for specialized knowledge

Industry specific reporting requirements required by industry regulators

Expected use of audit evidence obtained in previous audits

Note 2 - Ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required.

It helps the auditor to plan timing of different audit procedures and also nature of communications. Some of the instances are given under: -

1) The entity's timetable for reporting
2) Organization of meetings to discuss of nature, timing and extent of audit work with management
3) Discussion with management regarding the expected type and timing of reports to be issued including the auditor's report
4) Discussion with management regarding the expected communications on the status of audit work throughout the engagement.
5) Expected nature and timing of communications among engagement team members.

Note 3 - Consider the factors that, in the auditor's professional judgment, are significant in directing the engagement team's efforts

1) The auditor needs to direct efforts of engagement team towards matters that in his professional judgment are significant.
2) More energies need to be devoted to significant matters to obtain desired outcomes. Few examples are listed as under: -
   a) Volume of transactions which may determine whether it is more efficient for the auditor to rely on internal control.
   b) Significant industry developments such as changes in industry regulations.
   c) Significant changes in the FRF.
   d) Other significant relevant developments.

Note 4 - 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

Considering results of preliminary engagement activities and knowledge gained from similar engagements **goes a long way** in establishing sound audit strategy.

Examples are listed as under: -

1) **Results of previous audits** that involved evaluating the operating effectiveness of internal control.
2) The manner in which the auditor emphasizes to engagement team members the **need to maintain a questioning mind** and to **exercise professional skepticism** in gathering and evaluating audit evidence.

Note 5 - Ascertain the nature, timing and extent of resources necessary to perform the engagement.

1) **Selection** of engagement team and **assignment** of audit work to team members is a **significant factor** in establishing overall audit strategy.
2) Experienced team members may be **assigned in areas** where there is **higher risk of material misstatement**.

BENEFITS OF OVERALL AUDIT STRATEGY

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

Employment of Qualitative Resources

The resources to deploy for specific audit areas, such as the use of appropriately **experienced team members for high risk areas** or the involvement of experts on complex matters.

Allocation of Quantity of Resources

Number of team members assigned to observe the inventory count, the extent of review of other auditors' work or the audit budget in hours to allocate to high risk areas.

Timing of Deployment of Resources

When these resources are to be deployed, such as whether at an **interim audit stage** or at **key cut-off dates**.

Management of Resources

How such resources are **managed, directed and supervised**, when team briefing and debriefing meetings are expected to be held, how engagement partner and manager reviews are expected to take place and whether to complete engagement quality control reviews.

B) DEVELOPMENT OF AUDIT PLAN

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

2) **Description of Audit Plan**

   The auditor shall develop an audit plan **that shall include** a description of:

   (a) The **nature, timing and extent of planned risk assessment procedures**, as determined under **SA 315**

   (b) The **nature, timing and extent of planned further audit procedures** at the assertion level, as determined under **SA 330**

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

3) The auditor **plans** what type of audit procedures are to be **performed**, their **timing** and **how much work** should be done taking into account sample size etc.

RELATIONSHIP BETWEEN OVERALL AUDIT STRATEGY AND AUDIT PLAN

1) Audit strategy **sets the broad overall approach** to the audit whereas audit plan **addresses** the various matters **identified** in the overall audit strategy.
2) Audit strategy determines **scope, timing and direction** of audit. Audit plan **describes how strategy** is going to **be implemented**.
3) The audit plan is **more detailed than** the overall audit strategy that includes the **nature, timing and extent** of audit procedures to be performed by engagement team members.
4) **Planning** for these audit procedures takes place **over the course of the audit** as the audit plan for the engagement develops.
5) The establishment of the overall audit strategy and audit plan are **not necessarily discrete or sequential processes**, but are **closely inter-related** since changes in one may result in consequential changes to the other.

OVERALL AUDIT STRATEGY AND THE AUDIT PLAN THE AUDITOR'S RESPONSIBILITY

The overall audit strategy and the audit plan remain **the auditor's responsibility**. It is the auditor who is **responsible** for establishing **overall audit strategy** and **developing audit plan**.

AUDIT PROGRAMME

An audit programme consists of a series of verification procedures to be applied to the FS's and accounts of a given company for the purpose of obtaining sufficient evidence to enable the auditor to express an informed opinion on such statements.

An audit programme is a detailed plan of applying the audit procedures in the given circumstances with instructions for the appropriate techniques to be adopted for accomplishing the audit objectives.

CONSTRUCTING AN AUDIT PROGRAMME

For the purpose of programme construction, the following points should be kept in mind:

a) Stay within the scope and limitation of the assignment.
b) Prepare a written audit programme.
c) Determine the evidence reasonably available and identify the best evidence for deriving the necessary satisfaction.
d) Apply only those steps and procedures which are useful in accomplishing the verification purpose in the specific situation.
e) Include the audit objectives for each area and sufficient details which serve as a set of instructions for the assistants involved in audit and help in controlling the proper execution of the work.
f) Consider all possibilities of error.
g) Co-ordinate the procedures to be applied to related items.

AUDIT PROGRAMME- DESIGNED TO PROVIDE AUDIT EVIDENCE

1) Evidence is the very basis for formulation of opinion and an audit programme is designed to provide for that by prescribing procedures and techniques.
2) An auditor picks up evidence from a variety of fields and it is generally of the following broad types:
   a) Documentary examination,
   b) Physical examination,
   c) Statements and explanation of management, officials and employees,
   d) Statements and explanations of third parties,
   e) Arithmetical calculations by the auditor,
   f) State of internal controls and internal checks,
   g) Inter-relationship of the various accounting data,
   h) Subsidiary and memorandum records,

i) Minutes,

j) Subsequent action by the client and by others.

ADVANTAGES AND DISADVANTAGES OF AN AUDIT PROGRAMME

Advantages

The advantages of an audit programme are:

a) It **provides the assistant** carrying out the audit with **total and clear set of instructions** of the work generally to be done.

b) To provide **a total perspective** of the work to be performed.

c) **Selection of assistants** for the jobs will **becomes easier** when the work is rationally planned, defined and segregated.

d) **Without a written and pre-determined programe**, work is necessarily to be carried out on the basis of some '**mental' plan.**

e) The assistants, by putting their signature on programe, **accept the responsibility** for the work carried out by them individually.

f) **The principal** can control the progress of the various audits.

g) It **serves as a guide** for audits to be carried out in the succeeding year.

h) A properly drawn up audit programe **serves as evidence** in the event of any charge of negligence being brought against the auditor.

Disadvantages

Some disadvantages are also there in the use of audit programmes but most of these can be removed by following some concrete steps.

a) The work may become **mechanical** and particular parts of the programme may be carried out **without any understanding of the object** of such parts in the whole audit scheme.

b) The programme often tends to become **rigid and inflexible** following set grooves; the business may change in its operation of conduct, but the old programme may still be carried on.

c) **Inefficient assistants** may take shelter behind the programme to defend deficiencies.

d) **A hard and fast** audit programme may **kill the initiative** of efficient and enterprising assistants.

EVOLVING ONE AUDIT PROGRAMME - NOT PRACTICABLE FOR ALL BUSINESSES

Businesses **vary in nature, size and composition**; work which is suitable to one business may not be suitable to others;

On account of such variations, **evolving one audit programme** applicable to all business under all circumstances is **not practicable.**

However, it becomes a necessity to specify in detail in the audit programme the **nature of work to be done** so that no time will be wasted on matters not pertinent to the engagement.

THE ASSISTANT TO KEEP AN OPEN MIND

1) **To start with**, an auditor should frame a programme which should aim at providing for a **minimum essential work** which may be termed as a **standard programme**.
2) As experience is gained by actually carrying out the work, the programme may be **altered** to take care of situations which were left out originally.
3) If any work originally provided for proves beyond doubt to be **unnecessary or irrelevant**, it may be dropped.
4) He should be instructed to **note and report significant matters** coming to his notice, to his seniors or to the partners or proprietor of the firm engaged for doing the audit.

PERIODIC REVIEW OF THE AUDIT PROGRAMME

1) There should be **periodic review** of the audit programme to assess whether the same continues to be adequate for obtaining requisite knowledge and evidence about the transactions.
2) Unless this is done, any change in the business policy of the client may **not be adequately** known, and consequently, audit work may be carried on, on the basis of an obsolete programme and, for this negligence, the whole audit may be held as **negligently conducted** and the auditor may have to face legal consequences.
3) The utility of the audit programme can be **retained and enhanced** by periodic review so that **inadequacies or redundancies** of the programme may be removed.
4) However, as a basic feature, audit programme not only lists the tasks to be carried out but also contains a few relevant instructions, like the **extent of checking, the sampling plan, etc.**

DOCUMENTATION

1) The overall audit strategy
2) The audit plan; and
3) Any significant changes made during the audit engagement to the overall audit strategy or the audit plan, and the reasons for such changes such changes.

CHANGES TO PLANNING DECISIONS DURING THE COURSE OF THE AUDIT

1) The auditor shall **update and change** the overall audit strategy and the audit plan as necessary during the course of the audit.
2) **As a result of**
   a) Unexpected events
   b) Changes in conditions
   c) The audit evidence obtained from the results of audit procedures.
3) The auditor may **need to modify** the **overall audit strategy and audit plan** and thereby the resulting planned nature, timing and extent of further audit procedures, based on the revised consideration of assessed risks.

PLANNING SUPERVISION & REVIEW OF WORK OF ENGAGEMENT TEAM MEMBERS

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

a) The **size and complexity** of the entity.
b) The **area** of the audit.
c) The **assessed risks of material misstatement**
d) The **capabilities and competence** of the individual team members performing the audit work.

NATURE OF AUDIT PLANNING - A CONTINUOUS AND ITERATIVE PROCESS

1) Planning is **not a discrete phase of an audit, but rather a continual and iterative process** that often begins shortly after (or in connection with) the completion of the previous audit and continues until the completion of the current audit engagement.
2) Planning, however, **includes** consideration of the timing of certain activities and audit procedures that need to be completed prior to the performance of further audit procedures.
3) **For example, planning includes the need to consider, prior to the auditor's identification and assessment of the risks of material misstatement, such matters as:**

a) The **analytical procedures** to be applied as risk assessment procedures.

b) Obtaining a **general understanding of the legal and regulatory framework applicable** to the entity and how the entity is complying with that framework.

c) The **determination** of materiality.

d) The **involvement** of experts.

e) The **performance** of other risk assessment procedures.

3

Risk Assessment and Internal Control

CHAPTER OVERVIEW:

I SA 315 - Identifying and Assessing the Risk of Material Misstatement Through Understanding the Entity and its Environment

II Audit Risk

III SA 320 - Materiality in Planning and Performing an Audit

IV SA 330 - The Auditor's Responses to Assessed Risks

V Unit 1 - Internal Control

VI Unit 2 - Automated Environment

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SA 315 - IDENTIFYING & ASSESSING THE RISK OF MATERIAL MISSTATEMENT THROUGH UNDERSTANDING THE ENTITY AND ITS ENVIRONMENT

INTRODUCTION

The **objective of the auditor is to identify** and assess the risks of material misstatement, **whether due to fraud or error**, at the FS's's and assertion levels, **through** understanding the entity and its environment, **including** the entity's internal control, **thereby providing a basis** for designing and implementing responses to the assessed risks of material misstatement.

RISK ASSESSMENT PROCEDURES AND RELATED ACTIVITIES [REFER NOTE 1]

1) The **risk assessment procedures** shall include the following:
   a) **Inquiries of management, and of others within the entity**
   b) **Analytical procedures.**
   c) **Observation and Inspection.**
2) The auditor shall consider whether information obtained from the **auditor's client acceptance or continuance process** is relevant.
3) Where **engagement partner** has performed **other engagements** for the entity, consider whether information obtained is relevant.
4) If auditor uses his **previous experience**, consider if changes have occurred since the previous audit.
5) The engagement partner and other key engagement team members shall discuss the **susceptibility of the entity's FS's to material misstatement.**
6) Risk assessment procedures by themselves, however, **do not provide sufficient appropriate audit evidence** on which to base the audit opinion.

THE REQUIRED UNDERSTANDING OF THE ENTITY & ITS ENVIRONMENT, INCLUDING THE ENTITY'S INTERNAL CONTROL [REFER NOTE 2]

The auditor shall obtain an understanding of the following:

1) **Relevant** industry, regulatory, and other external factors including AFRF
2) The **nature of the entity**, including:
   a) **Its operations;**
   b) **Its ownership and governance structures;**
   c) **The types of investments; and**
   d) **The way that the entity is structured and how it is financed;**

3) The entity's **selection and application** of accounting policies, including the reasons for changes thereto.
4) The **entity's objectives and strategies**, and those related business risks that may result in risks of material misstatement.
5) The **measurement and review** of the entity's financial performance.

OBJECTIVE OF THE AUDITOR

The auditor shall identify and assess the risks of material misstatement at:

a) The **FS's level**; and
b) The **assertion level** for classes of transactions, account balances, and disclosures;

To provide a basis for designing and performing further audit procedures.

For this purpose, the auditor shall:

Identify risks throughout the process of obtaining an understanding of the entity and its environment. → **Assess the identified risks**, and evaluate whether they relate more pervasively to the FS's as a whole. → **Relate the identified risks to what can go wrong** at the assertion level, and → **Consider the likelihood of misstatement**, including the possibility of multiple misstatements.

INFORMATION OBTAINED BY PERFORMING RISK ASSESSMENT PROCEDURES - USED AS AUDIT EVIDENCE

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

WHY UNDERSTANDING THE ENTITY AND ITS ENVIRONMENT IS SIGNIFICANT?

1) **Understanding** the entity and the environment in which it operates is very significant.
2) **It helps** the auditor in **planning** the audit and in **identifying** areas requiring **special attention**.
3) In fact, without adequate knowledge of client's business, a **proper audit** is **not possible**.

RISKS THAT REQUIRE SPECIAL AUDIT CONSIDERATION

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

a) Whether the risk is a **risk of fraud**;
b) Whether the **risk is related to recent significant economic, accounting, or other developments**;
c) The **complexity of transactions**;
d) Whether the **risk involves significant transactions with related parties**;

e) The degree of **subjectivity in the measurement** of financial information; and
f) Whether the **risk involves significant unusual transactions**.

RISKS FOR WHICH SUBSTANTIVE PROCEDURES ALONE DO NOT PROVIDE SUFFICIENT APPROPRIATE AUDIT EVIDENCE

Such risks may relate to the inaccurate or incomplete recording of routine and significant classes of transactions or account balances, the characteristics of which often permit **highly automated processing with little or no manual intervention**.

MATERIAL WEAKNESS IN INTERNAL CONTROL

The auditor shall communicate material weaknesses in internal control identified during the audit on a timely basis to management at an appropriate level of responsibility, and, as **required by SA 260 & 265**.

NOTE 1 - WHAT IS INCLUDED IN RISK ASSESSMENT PROCEDURES

A) Inquiries of Management and Others Within the Entity:

Much of the information obtained by the auditor's inquiries is obtained from management. However, the auditor may also obtain information, **through inquiries of others** within the entity and other employees with different levels of authority.

For Example :

- Inquiries directed toward **internal audit personnel** may provide information about internal audit procedures performed during the year.
- Inquiries of **employees involved in** initiating, processing or recording **complex** or **unusual transactions**.
- Inquiries directed toward **in-house legal counsel** may provide information about such matters as litigation, compliance with laws and regulations, knowledge of fraud or suspected fraud affecting the entity.
- Inquiries directed towards **marketing or sales personnel**.
- Inquiries directed to the **risk management function** may provide information about operational and regulatory risks
- Inquiries directed to **information systems personnel** may provide information about system changes, system or control failures.

B) Analytical Procedures:

a) It performed as risk assessment procedures may **identify aspects of the entity** of which the **auditor was unaware** and **may assist** in assessing the risks of material misstatement in order to provide a basis for designing and implementing responses to the assessed risks.

b) It performed as risk assessment procedures **may include both financial and non-financial information**.

c) It may help identify the **existence of unusual transactions or events**, and amounts, ratios, and trends that might indicate matters that have audit implications.

C) Observation and Inspection:

Observation and inspection may support inquiries of management and others and may also provide information about the entity and its environment.

Examples of such audit procedures include observation or inspection of the following:

a) The **entity's operations**

b) **Documents** (such as business plans and strategies), records, and **internal control manuals**

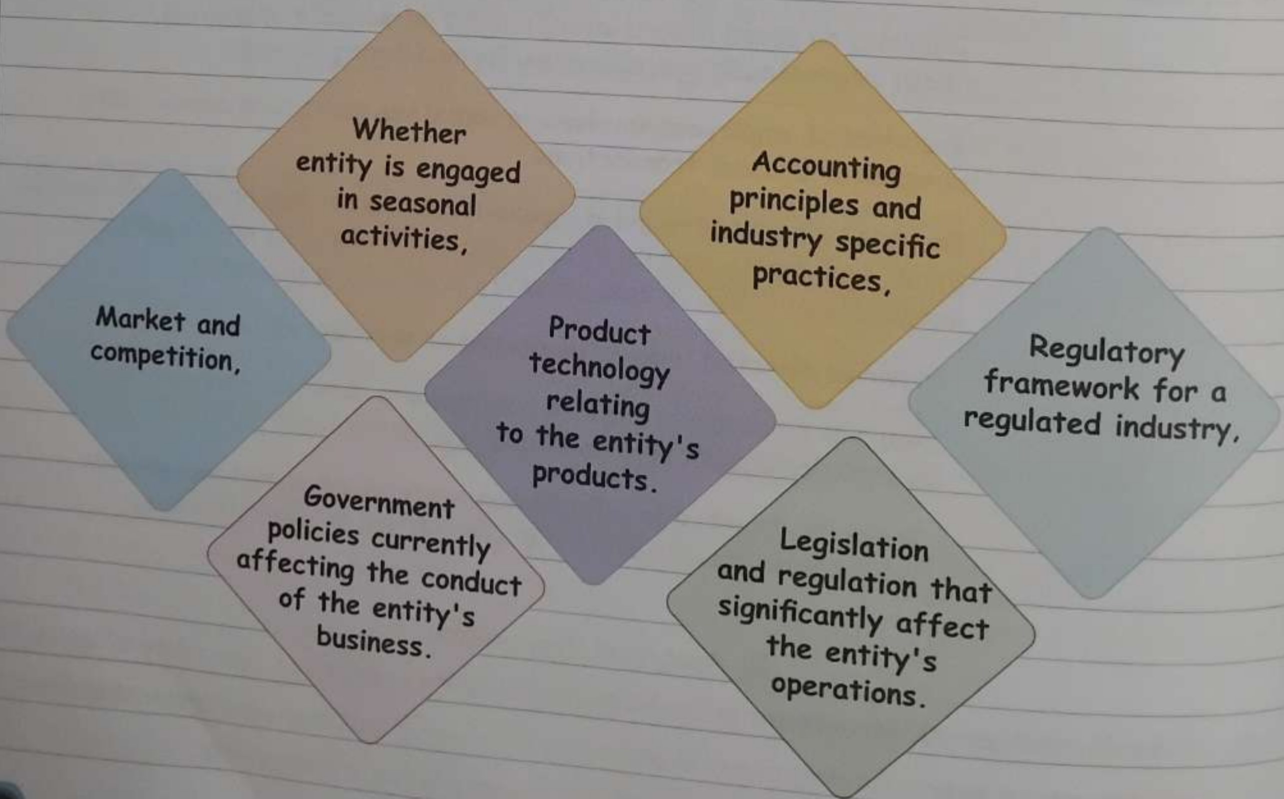
c) Reports prepared by management & TCWG

d) The **entity's premises** and **plant facilities**.

NOTE 2 - UNDERSTANDING THE ENTITY & ITS ENVIRONMENT

A) Relevant industry, regulatory and other external factors including the applicable financial reporting framework.

1) Relevant industry factors include **industry conditions** such as the competitive environment, supplier and customer relationships, and technological developments. **Examples** of **matters the auditor may consider include**



2) Examples of other external factors affecting the entity that the auditor may consider include
   a) The general economic conditions,
   b) Interest rates and availability of financing, and inflation.

B) The nature of the entity, including:

a) Its operations;
b) Its ownership and governance structures;
c) The types of investments that the entity is making and plans to make; and
d) The way that the entity is structured and how it is financed;

Note: Examples of matters that the auditor may consider while obtaining understanding of nature of entity include:

- Business operations such as nature of revenue sources, products or services, conduct of operations, location of production facilities, key customers and suppliers of goods and services
- Investment and investment activities such as capital investment activities and planned or recently executed acquisitions
- Financing activities such as major subsidiaries, debt structure etc.
- Financial reporting such as accounting principles and revenue recognition practices

C) The entity's selection and application of accounting policies, including the reasons for changes thereto.

The auditor shall evaluate whether the entity's accounting policies are appropriate for its business and consistent with the applicable FRF and accounting policies used in the relevant industry.

D) The entity's objectives and strategies, and those related business risks that may result in risks of material misstatement.

1) The entity's objectives and strategies may change over time.
2) An understanding of the business risks facing the entity increases the likelihood of identifying risks of material misstatement, since most business risks will eventually have financial consequences and, therefore, an effect on the FS's.
3) Examples of matters that the auditor may consider when obtaining an understanding of the entity's objectives, strategies and related business risks that may result in a risk of material misstatement of the FS's include: -
   a) Industry developments
   b) New products and services

c) Expansion of the business

E) The measurement and review of the entity's financial performance.

1) Management and others will **measure and review** those things they regard as important.

2) An understanding of the entity's performance measures **assists** the auditor in considering whether pressures to achieve performance targets may result in management actions that increase the risks of material misstatement, including those due to fraud.

3) **Examples for measuring and reviewing financial performance which may be used by an auditor may include: -**

Key performance indicators and key ratios, trends and operating statistics.	**Period-on-period** financial performance analyses.	**Budgets, forecasts**, variance analyses, and departmental or other level performance reports.	**Credit rating agency reports**

NOTE 3 - UNDERSTANDING OF THE ENTITY-A CONTINUOUS PROCESS

1) **Obtaining** an understanding of the entity and its environment, including the entity's internal control is a continuous, dynamic process of gathering, updating and analysing information throughout the audit.

2) The understanding **establishes a frame of reference** within which the auditor plans the audit and exercises professional judgment throughout the audit, **for example**, when:

   a) **Assessing** risks of material misstatement of the FS's;

   b) **Determining** materiality in accordance with **SA 320;**

   c) **Considering the appropriateness** of the selection and application of accounting policies;

   d) **Identifying** areas where special audit consideration may be necessary, for example, related party transactions;

   e) **Developing expectations** for use when performing analytical procedures;

   f) **Evaluating the sufficiency and appropriateness of audit evidence** obtained.

NOTE 4 - DOCUMENTING THE RISK

a) The **discussion among the engagement team** and the **significant decisions** reached;

b) Key elements of the understanding obtained regarding each of the aspects of the entity and its environment.

c) The **identified and assessed risks of material misstatement** at the FS's level and at the assertion level; and

d) The **risks identified, and related controls** about which the auditor has obtained an understanding

AUDIT RISK

INTRODUCTION

1) It means the **risk** that the **auditor gives an inappropriate audit opinion** when the FS's are **materially misstated**.
2) It means that an auditor **expresses an unmodified opinion** when FS's are **materially misstated**.
3) It is a **function** of the **risks of material misstatement** and **detection risk**.

RISKS OF MATERIAL MISSTATEMENT

What is meant by Misstatement:

It refers to a **difference between** the amount, classification, presentation, or disclosure of a **reported FS's item** and the amount, classification, presentation, or disclosure that is **required for** the item to be in **accordance with the applicable FRF**. Misstatements can arise from **error or fraud**.

The risks of material misstatement may exist at two levels:

a) The overall FS's level
b) The assertion level for classes of transactions, account balances, and disclosures.

COMPONENTS OF RISK OF MATERIAL MISSTATEMENT

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

Inherent risk:

It is the susceptibility of an assertion about a class of transaction, account balance or disclosure to a misstatement that could be **material, either individually or when aggregated with other misstatements before consideration of any related controls as** described in SA-200.

There is always a risk that before considering any existence of internal control in an entity, a particular transaction, balance of an account or a disclosure required to be made in the FS's of an entity have a **chance of being misstated** and such misstatement can be material. This risk is **known as inherent risk**.

Inherent risk is **higher** for some assertions and related classes of transactions, account balances, and disclosures than for others. **For example**, it may be higher for **complex calculations**.

Inherent risk **factors** are **considered** while **designing tests of controls and substantive procedures**.

Control risk

1) Control risk in accordance with SA-200, control risk is the risk that a misstatement that could occur in an assertion about a class of transaction, account balance or disclosure and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity's internal control.
2) It is a risk that internal control existing and operating in an entity would not be efficient enough to stop from happening, or find and then rectify in an appropriate time, any material misstatement relating to a transaction, balance of an account or disclosure required to be made in the FS's of that entity.
3) Therefore, in a way, it can be said that there exists an inverse relation between control risk and efficiency of internal control of an entity.

DETECTION RISK

1) It is the risk that the procedures performed by the auditor to reduce audit risk to an acceptably low level will not detect a misstatement that exists and that could be material, either individually or when aggregated with other misstatements.
2) Detection risk comprises sampling and non-sampling risk.
   a) Sampling risk is the risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure.
   b) Non-sampling risk is the risk that the auditor reaches an erroneous conclusion for any reason not related to sampling risk.
3) Detection risk may be reduced by increasing area of checking, testing larger samples and by including competent and experienced persons in the engagement team.

AUDIT RISK - WHAT IS NOT INCLUDED?

1) Audit risk is a technical term related to the process of auditing; it does not refer to the auditor's business risks such as
   a) Loss from litigation,
   b) Adverse publicity, or
   c) Other events arising in connection with the audit of FS's.
2) For the purpose of the SA's audit risk does not include the risk that the auditor might express an opinion that the FS's are materially misstated when they are not.

ASSESSMENT OF RISKS- A MATTER OF PROFESSIONAL JUDGMENT

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

2) The assessment of risks is a **matter of professional judgment**, rather than a matter capable of precise measurement.

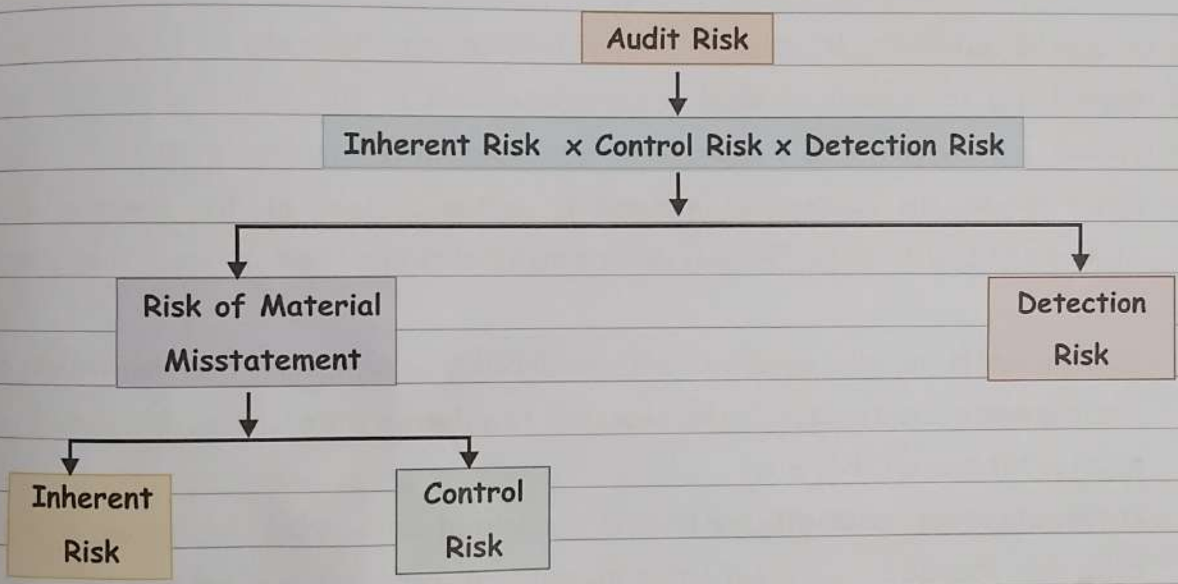
COMBINED ASSESSMENT OF THE RISK OF MATERIAL MISSTATEMENT

Audit Risk = Risk of Material Misstatement × Detection Risk...(1)

Risk of Material Misstatement= Inherent Risk × Control Risk ------ (2)

From (1) and (2)

Audit Risk = Inherent Risk × Control Risk × Detection Risk



SA 320 - MATERIALITY IN PLANNING AND PERFORMING AN AUDIT

WHAT IS MEANT BY MATERIALITY?

a SA 320 states that misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be **expected to influence the economic decisions of users** taken on the basis of the FS's.

b **Materiality** is not always a matter of relative size. **For example**, a small amount lost by fraudulent practices of certain employees can indicate a serious flaw in the enterprise's internal control system.

MATERIALITY IN PLANNING AND PERFORMING AN AUDIT-AUDITOR'S RESPONSIBILITY

1) The **concept of materiality** is applied by the auditor both in planning and performing the audit, and in evaluating the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the FS's and in forming the opinion in the auditor's report.
2) FRF often **discuss the concept of materiality** in the **context of the preparation and presentation of FS's**. Although FRF may discuss materiality in different terms, they generally explain that:
   a) **Misstatements**, including **omissions**, are considered to be material if they, **individually or in the aggregate**, could **reasonably be expected to influence** the economic decisions of users taken on the basis of the FS's;
   b) **Judgments about materiality** are made in the light of surrounding circumstances, and are affected by the size or nature of a misstatement, or a combination of both; and
   c) **Judgments about matters** that are **material to users** of the FS's are based on a consideration of the common financial information needs of users as a group.
   d) The **possible effect** of misstatements on specific individual users, whose needs may vary widely, is not considered.
3) In planning the audit, the auditor makes judgments about the size of misstatements that will be considered material. These judgments provide a basis for:
   a) **Determining** the nature, timing and extent of **risk assessment procedures**;
   b) **Identifying and assessing** the risks of material misstatement; and
   c) **Determining** the nature, timing and extent of **further audit procedures.**
4) The auditor has to **apply his professional judgement** in determining materiality, choosing appropriate benchmark and determining level of benchmark.

If there is any statutory requirement of disclosure, it is to be considered material irrespective of the value of amount. Examples are given below:

a) As per Division I of schedule III of Companies Act, 2013, any item of income or expenditure which exceeds one percent of the revenue from operations or ₹ 1,00,000, whichever is higher, needs to be disclosed separately.

b) A company should disclose in notes to accounts, shares in the company held by each shareholder holding more than 5 percent shares specifying the number of shares held as per requirements of Division I of Schedule III of Companies Act, 2013.

DETERMINATION OF MATERIALITY- A MATTER OF PROFESSIONAL JUDGMENT

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

a) Have a reasonable knowledge of business and economic activities and accounting;
b) Understand that FS's are prepared, presented and audited to levels of materiality;
c) Recognize the uncertainties inherent in the measurement of amounts based on the use of estimates, judgment and the consideration of future events; and
d) Make reasonable economic decisions on the basis of the information in the FS's.

PERFORMANCE MATERIALITY

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

It is set at a value lower than overall materiality. It lowers the risk that auditor will not be able to identify misstatements that are material when added together.

USE OF BENCHMARKS IN DETERMINING MATERIALITY FOR THE FS's AS A WHOLE

Factors that may affect identification of an appropriate benchmark

a) The elements of the FS's like assets, liabilities, equity, revenue, expenses
b) Whether there are items on which the attention of the users of the entity's FS's tends to be focused
c) The nature of the entity, where the entity is at in its life cycle, and the industry and economic environment in which the entity operates;
d) The entity's ownership structure and the way it is financed
e) The relative volatility of the benchmark.

EXAMPLES OF BENCHMARKS

Profit Before Tax, → Total Revenue, → Gross Profit and Total Expenses, → Total Equity or Net Asset Value.

CHOSEN BENCHMARK - RELEVANT FINANCIAL DATA

In relation to the chosen benchmark, relevant financial data ordinarily includes -

a) **Prior periods'** financial results and financial positions,

b) The **period to-date** financial results and financial position, and

c) **Budgets or forecasts** for the current period,

d) **Adjusted for significant changes** in the circumstances of the entity

DETERMINING A PERCENTAGE TO BE APPLIED TO A CHOSEN BENCHMARK INVOLVES THE EXERCISE OF PROFESSIONAL JUDGMENT

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

MATERIALITY LEVEL OR LEVELS FOR PARTICULAR CLASSES OF TRANSACTIONS, ACCOUNT BALANCES OR DISCLOSURES

Factors that may **indicate** the **existence** of one or more particular classes of transactions, account balances or disclosures for which **misstatements of lesser amounts than materiality** for the FS's as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the FS's include the following:

1) Whether **law, regulations or the applicable FRF** affect users' expectations regarding the measurement or disclosure of certain items.
2) The **key disclosures** in relation to the industry in which the entity operates.
3) Whether **attention is focused on a particular aspect** of the entity's business that is separately disclosed in the FS's.

REVISION IN MATERIALITY LEVEL AS THE AUDIT PROGRESSES

1) **Materiality** for the FS's as a whole may **need to be revised** as a result of a **change in circumstances** that occurred during the audit new information, or a change in the auditor's understanding of the entity and its operations as a result of performing further audit procedures.

2) If during the audit it appears as though **actual financial results** are likely to be **substantially different** from the anticipated period end financial results that were used initially to determine materiality for the FS's as a whole, the auditor revises that materiality.
3) If the auditor **concludes** that a **lower materiality** for the FS's as a whole than that initially determined is appropriate, **the auditor** shall **determine** whether it is **necessary to revise** performance materiality, and whether the **nature, timing and extent** of the further audit procedures **remain appropriate.**

DOCUMENTING THE MATERIALITY

The audit documentation shall include the following amounts and the factors considered in their determination:

a. **Materiality** for the FS's as a whole;

b. If applicable, the **materiality level or levels** for particular classes of transactions, account balances or disclosures;

c. **Performance materiality**; and

d. **Any revision of (a)-(c)** as the audit progressed

MATERIALITY AND AUDIT RISK

1) The concept of materiality is applied by the auditor **both in planning and performing** the audit, and in evaluating the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the FS's and in forming the opinion in the auditor's report.
2) The auditor obtains reasonable assurance by obtaining sufficient appropriate audit evidence **to reduce audit risk to an acceptably low level.**
3) Audit risk is the risk that the auditor expresses **an inappropriate audit opinion** when the FS's are **materially misstated.**
4) Audit risk is a **function of the risks of material misstatement and detection risk.**
5) Materiality and audit risk are considered throughout the audit, in particular, **when:**
   a) **Identifying and assessing** the risks of material misstatement;
   b) **Determining** the nature, timing and extent of further audit procedures; and
   c) **Evaluating the effect of uncorrected misstatements**, if any, on the FS's and in forming the opinion in the auditor's report.

SA 330 - THE AUDITOR'S RESPONSES TO ASSESSED RISKS

SCOPE

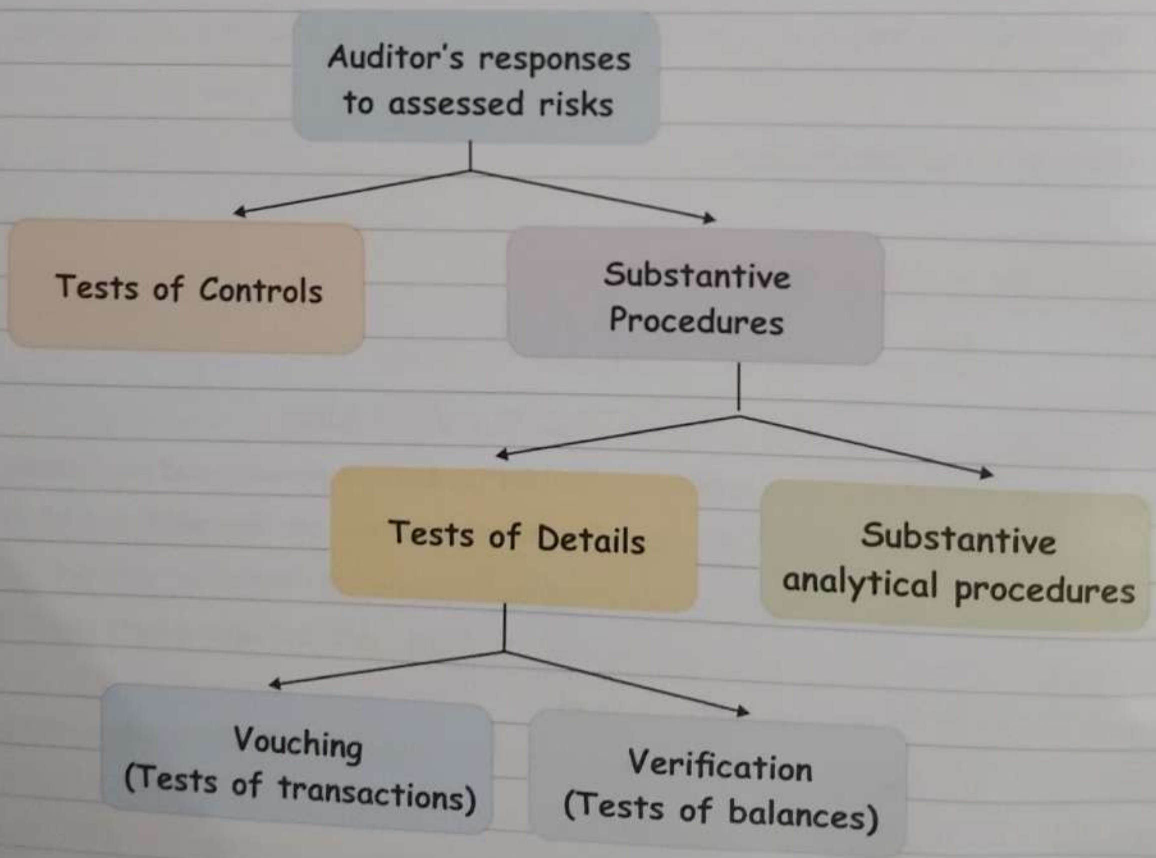
SA 330- The auditor's responses to assessed risks deals with the auditor's responsibility to design and implement responses to the risks of material misstatement identified and assessed by the auditor in accordance with SA 315, in a FS's audit.

OBJECTIVE

SA 330 states that: -

a) The auditor shall design and implement overall responses to address the assessed risks of material misstatement at the FS level.

b) The auditor shall design and perform further audit procedures whose nature, timing and extent are based on and are responsive to the assessed risks of material misstatement at the assertion level.



WHEN TO USE TEST OF CONTROLS

The auditor shall design and perform tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of relevant controls when:

- The auditor's assessment of risks of material misstatement at the assertion level includes an **expectation** that the **controls are operating effectively**; or
- Substantive procedures **alone cannot** provide **sufficient appropriate audit evidence** at the assertion level.
- In **designing and performing** tests of controls, the auditor shall **obtain more persuasive audit evidence** the greater the reliance the auditor places on the effectiveness of a control.
- A **higher level of assurance** may be sought about the **operating effectiveness of controls** when the approach adopted consists primarily of tests of controls.

NATURE AND EXTENT OF TEST OF CONTROLS

1) In designing and performing test of controls, the auditor shall:
   a) **Perform other audit procedures** in combination with inquiry to obtain audit evidence about the **operating effectiveness** of the controls, **including**:
      (i) **How the controls** were applied at relevant times during the period under audit.
      (ii) The **consistency** with which they were applied.
      (iii) **By whom or by what means** they were applied.
   b) **Determine** whether the **controls to be tested** depend upon other controls (indirect controls), and if so, whether it is **necessary** to obtain audit evidence supporting the effective operation of those indirect controls.
2) **Inquiry alone is not sufficient** to test the operating effectiveness of controls. Accordingly, other audit procedures are **performed in combination with inquiry**.
3) The **nature** of the **particular control influences the type of procedure** required to obtain audit evidence about whether the control was operating effectively.
4) When **more persuasive audit evidence** is needed regarding the **effectiveness of a control**, it may be **appropriate to increase the extent** of testing of the control as well as the degree of reliance on controls.

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

- The **frequency of the performance** of the control by the entity during the period.
- The **length of time** during the audit period that the auditor is relying on the operating effectiveness of the control.
- The **expected rate of deviation** from a control.

- The **relevance and reliability** of the audit evidence to be obtained regarding the operating effectiveness of the control at the assertion level.
- The **extent** to which audit evidence is obtained from tests of other controls related to the assertion.

TIMING OF TEST OF CONTROLS

1) **The auditor** shall test controls for the **particular time, or throughout the period**, for which the auditor intends to rely on those controls in order to provide an appropriate basis for the auditor's intended reliance.
2) If, on the other hand, the auditor **intends to rely on a control over a period**, tests that are capable of providing audit evidence that the **control operated effectively** at relevant times during that period are appropriate. Such tests may **include** tests of the entity's monitoring of controls.

USING AUDIT EVIDENCE OBTAINED IN PREVIOUS AUDITS

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

a) **The effectiveness** of other elements of internal control, including the control environment, the entity's monitoring of controls, and the entity's risk assessment process
b) The **risks arising** from the characteristics of the control, including whether it is manual or automated
c) The **effectiveness** of **general IT-controls**
d) The **effectiveness** of the **control and its application** by the entity, including the nature and extent of deviations in the application of the control noted in previous audits.
e) Whether the **lack of a change** in a particular control poses a risk due to changing circumstances and
f) The **risks of material misstatement and the extent of reliance** on the control.

EVALUATING THE OPERATING EFFECTIVENESS OF CONTROLS

When evaluating the operating effectiveness of relevant controls, **the auditor** shall **evaluate** whether misstatements that have been **detected** by substantive procedures **indicate** that **controls** are **not operating effectively.**

The **absence** of misstatements detected by substantive procedures, however, **does not provide** audit evidence that **controls related to the assertion** being tested are **effective.**

A material misstatement detected by the auditor's procedures is a **strong indicator** of the **existence of a significant deficiency** in internal control.

SPECIFIC INQUIRIES BY AUDITOR WHEN DEVIATIONS FROM CONTROLS ARE DETECTED

1) When **deviations** from controls upon which the auditor **intends to rely** are detected, **the auditor** shall make **specific inquiries** to understand these matters and their potential consequences, and shall **determine** whether:
   a) The **test of controls** that have been performed **provide an appropriate basis** for reliance on the controls
   b) **Additional test of controls** are necessary or
   c) The **potential risks of misstatement** need to be addressed using substantive procedures.
2) **Irrespective** of the assessed risks of material misstatement, **the auditor** shall **design and perform** substantive procedures for each material class of transactions, account balance, and disclosure.
3) Substantive procedures are **audit procedures designed to detect** material misstatements at the assertion level. **Substantive procedures comprise:**
   a) **Tests of details**, and
   b) **Substantive analytical procedures.**

NATURE AND EXTENT OF SUBSTANTIVE PROCEDURES

1) Depending on the circumstances, **the auditor may determine** that:
   a) Performing **only substantive analytical procedures** will be **sufficient** to reduce audit risk to an acceptably low level. For example, where the auditor's assessment of risk is supported by audit evidence from tests of controls.
   b) **Only tests of details** are **appropriate.**
   c) **A combination of substantive analytical procedures and tests of details are most responsive** to the assessed risks.

2) Because the assessment of the risk of material misstatement takes account of internal control, **the extent** of substantive procedures may **need to be increased** when the results from test of controls are unsatisfactory.
3) In **designing** tests of details, the **extent** of testing is ordinarily thought of in terms of the **sample size.**

TESTS OF DETAILS

1) Tests of details are further classified into **tests of transactions** i.e., vouching and **tests of balances** i.e., verification.
2) Such tests of transactions help in establishing the authenticity of transactions recorded in books of accounts.
3) Tests of balances consist of verification of assets as well as liabilities.

SUBSTANTIVE ANALYTICAL PROCEDURES

1) It refer to **analytical procedures used as substantive procedures** by auditor.
2) The term "**analytical procedures**" means **evaluations of financial information through analysis of plausible relationships among both financial and non-financial data.**
3) Analytical procedures also **encompass** such **investigation** as is **necessary** of identified fluctuations or relationships that are **inconsistent** with other relevant information.
4) Substantive analytical procedures are generally more **applicable to large volumes of transactions** that tend to be predictable over time.

UNIT 1- INTERNAL CONTROL

MEANING OF INTERNAL CONTROL

As per **SA-315, "Identifying and Assessing the Risk of Material Misstatement Through Understanding the Entity and its Environment"**, the internal control may be defined as the process **designed, implemented and maintained** by **those charged with governance, management** and other personnel to provide **reasonable assurance** about the **achievement of an entity's objectives** with regard to:

PURPOSE OF INTERNAL CONTROL

Internal control is **designed, implemented and maintained** to address identified **business risks** that threaten the achievement of any of the **entity's objectives** that concern:

1) The reliability of the entity's financial reporting;
2) The effectiveness and efficiency of its operations;
3) Its compliance with applicable laws and regulations; and
4) Safeguarding of assets.

Benefits of Understanding of Internal Control

An understanding of internal control assists the auditor in:

a) **Identifying** types of **potential misstatements**.
b) Identifying factors that affect the risks of material misstatement, and
c) **Designing** the **nature, timing, and extent** of further audit procedures.

LIMITATIONS OF INTERNAL CONTROL

Internal control can provide only reasonable assurance

Internal control, no matter how effective, can provide an entity with **only reasonable assurance** about achieving the entity's financial reporting objectives.

Human judgment in decision-making

Realities that human judgment in decision-making can be faulty and that **breakdowns** in internal control can occur because of human error.

Lack of understanding the purpose

The individual responsible for reviewing the information does not understand its purpose or fails to take appropriate action.

Collusion among People

Additionally, controls can be circumvented by the **collusion** of two or more people or inappropriate management override of internal control.

Judgements by Management

Further, in designing and implementing controls, management may make judgments on **the nature and extent** of the controls it chooses to implement, and the nature and extent of the risks it chooses to assume.

Limitations in case of Small Entities

Smaller entities often have fewer employees due to which segregation of duties is not practicable.

COMPONENTS OF INTERNAL CONTROL

The division of internal control into the following **five components** provides a useful framework for auditors to consider how different aspects of an entity's internal control may affect the audit:

(A) CONTROL ENVIRONMENT

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

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

What is included in Control Environment?

a) The **governance and management** functions and
b) The **attitudes, awareness, and actions** of those charged with governance and management.
c) The control environment **sets the tone of an organization**, influencing the control consciousness of its people.

Elements of the Control Environment

a) **Communication and enforcement of integrity and ethical values:**

The effectiveness of controls **cannot** rise above the integrity and ethical values of the people who **create, administer, and monitor** them.

b) **Commitment to competence:**

Matters such as management's consideration of the competence levels for particular jobs and how those levels translate into requisite skills and knowledge.

c) **Participation by those charged with governance:**

It includes attributes of those charged with governance such as their **independence from management**, **their experience** and stature, **the extent of their involvement** and the information they receive and the scrutiny of activities.

d) **Management's philosophy and operating style:**

Management's philosophy and operating style **encompass** a broad range of characteristics.

e) **Organisational structure:**

The **framework** within which an entity's activities for achieving its objectives are **planned, executed, controlled, and reviewed.**

f) **Assignment of authority and responsibility:**

Matters such as how authority and responsibility for operating activities are assigned and how reporting relationships and authorisation hierarchies are established.

g) **Human resource policies and practices:**

Policies and practices that relate to, **for example**, recruitment, orientation, training, evaluation, counselling, promotion, compensation, and remedial actions.

Note - Existence of a Satisfactory Control Environment-not an Absolute Deterrent to Fraud

1) **The existence** of a satisfactory control environment can be a positive factor when the auditor assesses the risks of material misstatement.
2) Conversely, **deficiencies** in the control environment may **undermine** the effectiveness of controls, in particular in relation to fraud.
3) The control environment in itself does **not prevent, or detect and correct**, a material misstatement. It may, however, influence the auditor's evaluation of the effectiveness of other controls.

(B) THE ENTITY'S RISK ASSESSMENT PROCESS

1) **The auditor** shall obtain an understanding of whether the entity has a process for:
   a) **Identifying business risks relevant to financial reporting objectives;**
   b) **Estimating the significance of the risks;**
   c) **Assessing the likelihood of their occurrence;**
   d) **Deciding about actions to address those risks.**
2) The entity's risk assessment process **forms the basis** for the risks to be managed.
3) **Risks can arise or change** due to factor such as new technology, new business models, products or activities, changes in operating environment etc.

(C) THE INFORMATION SYSTEM, INCLUDING THE RELATED BUSINESS PROCESSES, RELEVANT TO FINANCIAL REPORTING AND COMMUNICATION

The auditor shall obtain an **understanding of the information system**, including the following

- The classes of **transactions** in the entity's operations that are **significant to the FS's;**
- The **procedures** by which those transactions are initiated, recorded, processed, corrected as necessary, transferred ;
- The **related accounting records**, **supporting information** and specific accounts in the FS's that are used to **initiate, record, process & report transactions;**
- **How the information system captures events and conditions that are significant to the FS's;**
- **The financial reporting process used to prepare the entity's FS's;**
- **Controls surrounding journal entries.**

(D) CONTROL ACTIVITIES

1) The auditor shall obtain an **understanding of control activities relevant to the audit**, which the auditor considers necessary to assess the risks of material misstatement.
2) **Control activities are the policies and procedures that help ensure that management directives are carried out.**
3) Control activities relevant to audit generally include
   a) Policies and procedures relating to performance reviews
   b) Information processing
   c) Physical controls
   d) Segregation of duties

(E) MONITORING OF CONTROLS

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

1) **Monitoring of controls Defined:**
   It is a process to assess the effectiveness of internal control performance over time.
2) **Helps in assessing the effectiveness of controls on a timely basis:**
   It involves assessing the effectiveness of controls on a timely basis and taking necessary remedial actions.
3) **Management accomplishes monitoring through ongoing activities, separate evaluations etc.:**

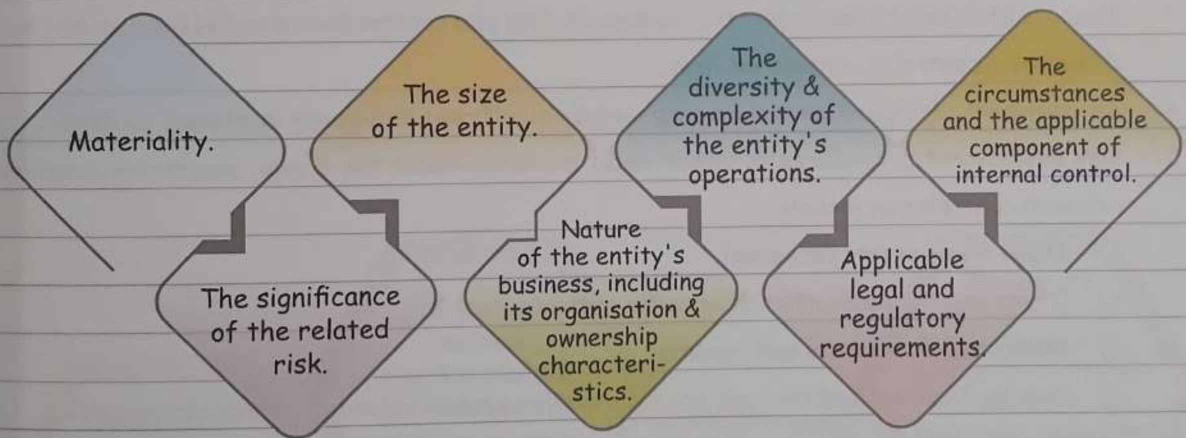
Management accomplishes monitoring of controls through **ongoing activities, separate evaluations, or a combination of the two.**

4) **Management's monitoring activities include:**
It may include using information from communications from external parties such as customer complaints and regulator comments that may indicate problems or highlight areas in need of improvement.

ARE ALL CONTROLS RELEVANT TO THE AUDIT?

1) There is a **direct relationship between an entity's objectives and the controls it implements** to provide reasonable assurance about their achievement.
2) The entity's objectives, and therefore controls, relate to financial reporting, operations and compliance; however, **not all of these objectives and controls are relevant to the auditor's risk assessment.**

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



CONTROLS OVER THE COMPLETENESS & ACCURACY OF INFORMATION

1) It produced by the entity **may be relevant to the audit if the auditor intends to make use of the information** in designing and performing further procedures.
2) Controls relating to **operations** and **compliance objectives** may also be **relevant to an audit if they relate to data the auditor evaluates or uses in applying audit procedures.**

INTERNAL CONTROL OVER SAFEGUARDING OF ASSETS

1) Internal control over safeguarding of assets against unauthorized acquisition, use, or disposition may include controls relating to both **financial reporting and operations objectives.**
2) The auditor's consideration of such controls is **generally limited** to those relevant to the reliability of financial reporting.

CONTROLS RELATING TO OBJECTIVES THAT ARE NOT RELEVANT TO AN AUDIT

1

An entity generally has controls relating to objectives that are not relevant to an audit and therefore **need not be considered.**

For example, an entity may rely on a sophisticated system of automated controls to provide efficient and effective operations (such as an **airline's system** of automated controls to maintain **flight schedules**), but these controls ordinarily would not be relevant to the audit.

2

Further, although internal control applies to the entire entity or to any of its operating units or business processes, an **understanding of internal control relating to each of the entity's operating units and** business processes **may not be relevant to the audit.**

NATURE AND EXTENT OF THE UNDERSTANDING OF RELEVANT CONTROLS

1) Evaluating the design of a control involves considering **whether the control**, individually or in combination with other controls, **is capable of effectively preventing, or detecting and correcting, material misstatements**
2) Implementation of a control means that the **control exists and that the entity is using it.**
3) There is little point in assessing the implementation of a control that is not effective, and so the **design of a control is considered first.**
4) An **improperly designed control** may represent a **significant deficiency** in internal control.
5) Risk assessment procedures to obtain audit evidence about the design and implementation of relevant controls may include-
   a) **Inquiring of entity personnel.**
   b) **Observing the application of specific controls.**
   c) **Inspecting documents and reports.**
   d) **Tracing transactions through the information system relevant to financial reporting.**
6) Inquiry alone, however, is not sufficient for such purposes.

RISKS THAT REQUIRE SPECIAL AUDIT CONSIDERATION

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

a) Whether the risk is a **risk of fraud**
b) Whether the **risk is related to recent significant economic, accounting, or other developments** like changes in regulatory environment, etc., and, therefore, requires specific attention;
c) The **complexity of transactions;**
d) Whether the risk involves **significant transactions with related parties;**
e) The **degree of subjectivity in the measurement of financial information** related to the risk, especially those measurements involving a wide range of measurement uncertainty; and

f) Whether the risk involves **significant transactions that are outside the normal course of business** for the entity, or that otherwise appear to be unusual.

Identifying Significant Risks

a) Significant risks often relate to significant **non- routine transactions or judgmental matters.**

b) Non-routine transactions are transactions that are **unusual, due to either size or nature**, and that therefore occur infrequently.

c) Judgmental matters may include the **development of accounting estimates** for which there is **significant measurement uncertainty**.

d) **Significant risks are inherent risks with both a higher likelihood of occurrence and a higher magnitude of potential misstatement.** The auditor assess assertions affected by a significant risk as higher inherent risk.

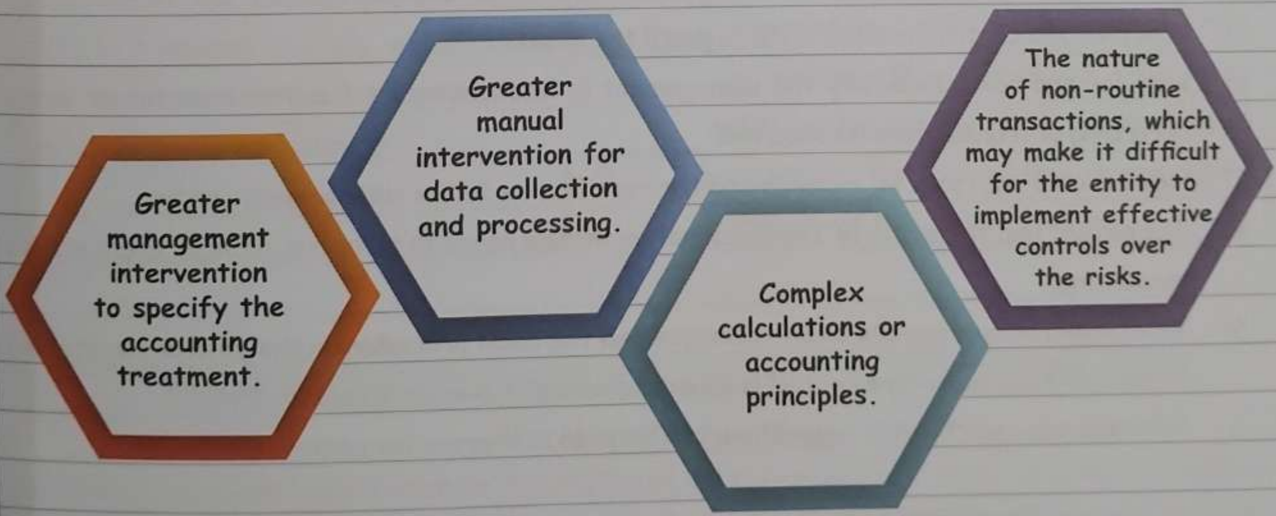
e) The following are always significant risks:

(i) **Risks of material misstatement due to fraud**

(ii) **Significant transactions with related parties that are outside the normal course of business for the entity**

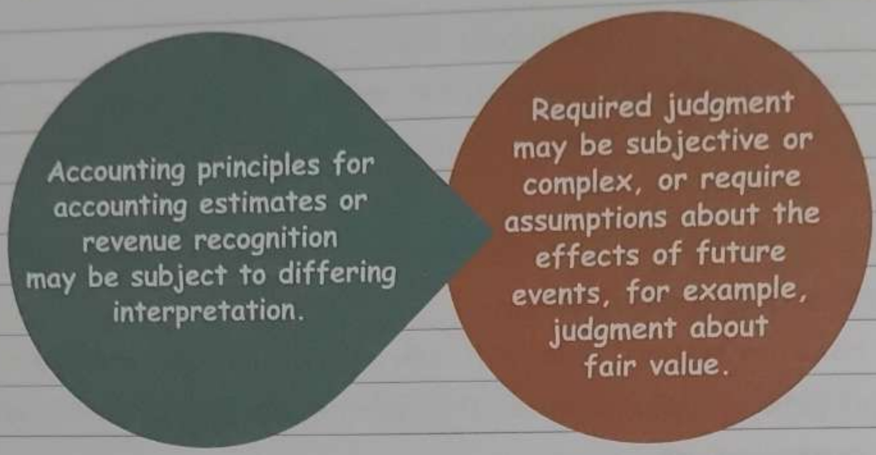
Risks of Material Misstatement - Greater for Significant Non-Routine Transactions

Arising from matters such as the following:



Risks of material misstatement –

Greater for Significant Judgmental Matters



EVALUATION OF INTERNAL CONTROL BY THE AUDITOR

Benefits of Evaluation of Internal Control to the Auditor

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

a) Whether errors and frauds are likely to be **located in the ordinary course of operations** of the business;

b) Whether an **adequate internal control system is in use and operating** as planned by the management;

c) Whether an **effective internal auditing department** is operating;

d) Whether the controls adequately **safeguard the assets;**

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

f) **How reliable the reports, records and the certificates to the management can be;**

g) The **extent and the depth of the examination** that he needs to carry out in the di erent areas of accounting;

h) What would be **appropriate audit technique and the audit procedure** in the given circumstances;

i) What are the **areas where control is weak and where it is excessive**; and

j) Whether some **worthwhile suggestions** can be given to improve the control system.

Formulate Audit Program after understanding Internal Control

a) The auditor can formulate his entire audit programme **only after** he has had a **satisfactory understanding of the internal control systems and their actual operation.**

b) If he does not care to study this aspect, it is very likely that his audit programme may become **unwieldy and unnecessarily heavy** and the **object of the audit may be altogether lost** in the mass of entries and vouchers.

c) It is also important for him to know **whether the system is actually in operation.**

d) **It would be better if the auditor can undertake the review of the internal control system of client.**

e) This will give him **enough time to assimilate the controls and implications** and will enable him to be **more objective** in the framing of the audit programme.

f) He will also be in a position to bring to the notice of the management the **weaknesses of the system and to suggest measures for improvement.**

g) At a further interim date or in the course of the audit, he may **ascertain how far the weaknesses have been removed.**

h) It can be concluded that the **extent and the nature of the audit programme is substantially influenced by the internal control system in operation.**

i) In deciding upon a plan of **test checking**, the **existence and operation** of internal control system is of great significance.

j) A **proper understanding of the internal control system** in its content and working also enables an auditor to decide upon the **appropriate audit procedure** to be applied in different areas to be covered in the audit programme.

EVALUATION OF INTERNAL CONTROL - METHODS

A **review of the internal control** can be done by a process of study, examination and evaluation of the control system installed by the management.

By **reading company manuals, studying organisation charts and flow charts** and by making suitable enquiries from the officers and employees, **the auditor may ascertain the character, scope and efficacy of the control system.**

SPECIFIC TOOLS TO REVIEW INTERNAL CONTROL SYSTEM

The Narrative Record

a) This is a **complete and exhaustive description** of the system as found in operation by the auditor.

b) It may be recommended in cases where **no formal control system is in operation** and would be more suited to small business.

c) **The basic disadvantages of narrative records are:**
   (i) **To comprehend the system in operation is quite difficult.**
   (ii) **To identify weaknesses or gaps in the system.**
   (iii) **To incorporate changes arising on account of reshuffling of manpower, etc.**

Check List

- ✓ This is a **series of instructions and/or questions** which a member of the auditing staff must follow and/or answer.
- ✓ When he completes instruction, he **initials the space against the instruction.**
- ✓ Answers to the check list instructions are usually **Yes, No or Not Applicable.**
- ✓ This is again an on the **job requirement and instructions** are framed having regard to the desirable elements of control.
- ✓ The complete check list is studied by the **Principal /Manager /Senior to ascertain existence of internal control** and evaluate its implementation and effciency.

Internal Control Questionnaire

a) This is a **comprehensive series of questions** concerning internal control.

b) **This is the most widely used form for collecting information about the existence, operation and efficiency of internal control in an organisation.**

c) With a proper questionnaire, all **internal control evaluation can be completed at one time** or in sections.

d) In the questionnaire, generally questions are so framed that a **'Yes'** answer denotes satisfactory position and a **'No'** answer suggests weakness.

e) In respect of **questions not relevant to the business, 'Not Applicable' reply is given.**

f) The questionnaire is **usually issued to the client** and the **client is requested to get it filled by the concerned executives and employees.**

g) If on a perusal of the answers, **inconsistencies or apparent incongruities are noticed, the matter is further discussed by auditor's staff with the client's employees for a clear picture.**

h) The concerned auditor then prepares a **report of deficiencies and recommendations for improvement.**

Note:

The Internal Control questionnaire is usually issued to the client and the client is requested to get it filled by the concerned executives and employees by giving replies as Yes/No/Not applicable along with explanatory notes, if any.

Flow Chart

a) **It is a graphic presentation of each part of the company's system of internal control.**

b) **The most concise way of recording the auditor's review** of the system.

c) **It minimises the amount of narrative explanation** and thereby achieves a consideration.

d) **It gives bird's eye view** of the system and the flow of transactions and integration.

e) **It is also necessary for the auditor to study the significant features of the business carried** on by the concern;

f) This will help him to understand and evaluate the internal controls in the correct perspective.

TESTING OF INTERNAL CONTROL (TEST OF CONTROLS)

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

a) **Design of the accounting and internal control systems,**

b) **Operation of the internal controls throughout the period.**

Test of controls may include

a) **Inspection of documents** supporting transactions and other events to gain audit evidence.

b) **Inquiries about, and observation** of, internal controls which leave no audit trail.

c) **Re-performance** involves the auditor's independent **execution of procedures or controls that were originally performed.**

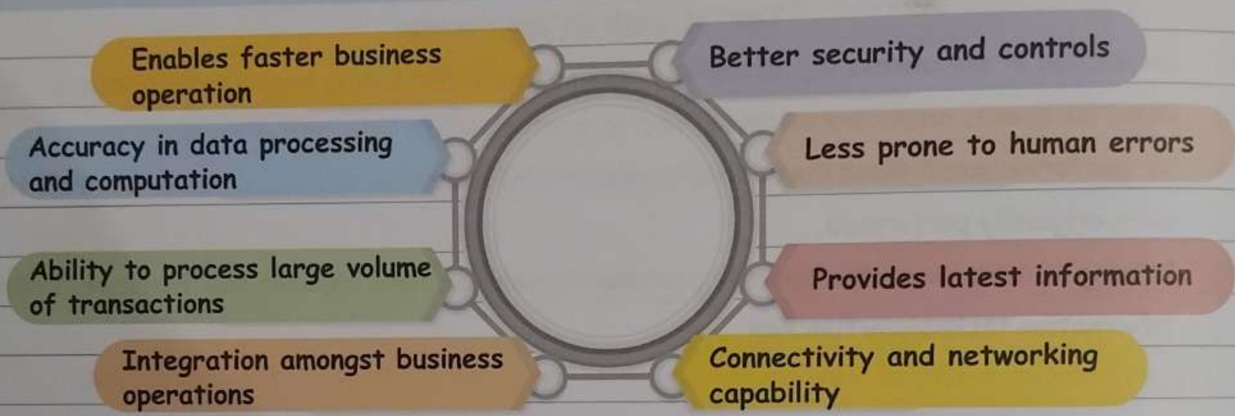
d) Testing of internal control operating on **specific computerised applications** or over the **overall information technology** function.

UNIT 2
AUTOMATED ENVIRONMENT

WHAT IS AN AUTOMATED ENVIRONMENT?

It basically **refers to** a **business environment** where the **processes, operations, accounting** and **even decisions** are **carried out** by using **computer systems - also known as Information Systems (IS)** or **Information Technology (IT)** systems.

KEY FEATURES OF AN AUTOMATED ENVIRONMENT



UNDERSTANDING AND DOCUMENTING AUTOMATED ENVIRONMENT

a) Understanding the entity and its automated environment **involves** understanding how **IT department** is organised, IT **activities**, the IT **dependencies**, relevant **risks and controls**.

b) Given below are some of the **points** that an **auditor should consider** to **obtain an understanding** of the company's automated environment:

(i) **Information systems** being used (one or more application systems and what they are)

(ii) Their purpose (financial and non-financial)

(iii) **Location** of IT systems - local vs global

(iv) Architecture

(v) Version

(vi) Interfaces within systems

(vii) In-house vs Packaged.

(viii) Outsourced activities (IT maintenance and support).

(ix) Key persons (CIO, CISO).

c) The **understanding** of a company's IT environment that is **obtained** should be **documented**.

RISKS ARISING FROM USE OF IT SYSTEMS

Given below are some such risks that should be considered:

a) **Inaccurate processing of data**, processing inaccurate data, or both.
b) **Unauthorized access** to data.
c) Direct data changes
d) **Excessive access**
e) Lack of adequate segregation of duties.
f) **Unauthorized changes** to systems or programs.
g) Failure to make necessary changes to systems or programs.
h) Loss of data.

IMPACT OF IT RELATED RISKS

The above risks have to be mitigated. If not mitigated, such risks, could have an impact on audit in different ways discussed as under: -

Impact on substantive checking:

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

Impact on controls:

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

Impact on reporting:

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

TYPES OF CONTROLS IN AN AUTOMATED ENVIRONMENT

(A) GENERAL IT CONTROLS

1) **General IT controls** are **policies and procedures** that **relate** to many applications and support the effective functioning of application controls.
2) General IT-controls that maintain the integrity of information and security of data commonly include controls over the following:
   a) Data centre and network operations
   b) Program change
   c) Access security
   d) Application system acquisition, development, and maintenance (Business Applications)
3) These are IT controls generally **implemented to mitigate the IT specific risks** and applied commonly **across multiple IT systems, applications and business processes**. Hence, General IT controls are known as **"pervasive"** controls or **"indirect"** controls.

(B) APPLICATION CONTROLS

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

(C) IT DEPENDENT CONTROLS

1

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

2

In this case, even though the control is performed manually, **the design and effectiveness of such controls depends on the reliability of source data.**

3

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

TESTING METHODS IN AN AUTOMATED ENVIRONMENT

1) There are basically **four types of audit tests** that should be used. These are
   a) **Inquiry,**
   b) **Observation,**
   c) **Inspection and**
   d) **Reperformance.**
2) **Inquiry is the most efficient audit test** but it also **gives** the **least audit evidence**. Hence, **inquiry should always be used in combination** with any one of the other audit testing methods. Inquiry alone is not sufficient.
3) **Reperformance is most effective** as an audit test and gives the best audit evidence. However, testing by reperformance could be very time consuming and least efficient most of the time.
4) Generally, applying **inquiry in combination with inspection gives the most effective and efficient** audit evidence.
5) **The auditor should document** the **nature of test** (or combination of tests) applied along with the **judgements** in the audit file. When testing in an automated environment, some of the more common methods are as follows:
   a) **Obtain an understanding** of how an automated transaction is processed by doing a walkthrough of one end-to-end transaction.
   b) **Observe** how a user processes transactions under different scenarios.
   c) **Inspect** the configuration defined in an application.

MANUAL ELEMENTS VS AUTOMATED ELEMENTS IN ENTITY'S INTERNAL CONTROL

1) **Manual elements** in internal control may be **more suitable** where judgment and discretion are required such as for the following circumstances:
   a) Large, unusual or non-recurring transactions.
   b) Circumstances where errors are difficult to define, anticipate or predict.
   c) In changing circumstances that require a control response outside the scope of an existing automated control.
   d) In monitoring the effectiveness of automated controls.
2) **Manual elements** in internal control may be **less reliable** than automated elements because they can be **more easily bypassed, ignored, or overridden** and they are also more prone to simple errors and mistakes.
3) Manual control elements may be **less suitable for the following circumstances:**
   a) **High volume or recurring transactions**, or in situations where errors that can be anticipated or predicted can be prevented, or detected and corrected, by control parameters that are automated.
   b) Control activities where the **specific ways** to perform the control can **be adequately designed and automated.**
4) The **extent and nature** of the risks to internal control **vary** depending on the nature and characteristics of the entity's information system.

AUDIT APPROACH IN AN AUTOMATED ENVIRONMENT

Risk Assessment	Understand and Evaluate	Test for Operating Effectiveness	Reporting
a) Identify significant accounts and disclosures b) Qualitative and Quantitative considerations c) Relevant FS's Assertions (FSA) d) Identify likely sources of mistatement e) Consider risk arising from use of IT systems	a) Document understanding of business processess using Flowcharts / Narratives b) Prepare Risk and Control Matrices (RCM) c) Understand design of controls by performing walkthroughts of end-to-end process d) Process wide considerations for Entity Level Controls, Segregation of Duties e) IT General Controls, Application Controls	a) Assess Nature, Timing and Extent (NTE) of controls testing b) Assess reliability of source data: completeness of population c) Testing of key reports and spreadsheets d) Sample testing e) Consider competence and independence of staff/team performing controls testing.	a) Evaluate Control Deficiencies b) Significant deficiencies, Material Weaknesses c) Remediation of control weaknesses d) Internal Controls Memo (ICM) or Management Letter e) Auditor's report

DATA ANALYTICS FOR AUDIT

1) The combination of processes, tools and techniques that are used to tap vast amounts of electronic data to obtain meaningful information is called data analytics.
2) The tools and techniques that auditors use in applying the principles of data analytics are known as Computer Assisted Auditing Techniques or CAATs in short.
3) Data analytics can be used in testing of electronic records and data residing in IT systems using spreadsheets and specialised audit tools viz., IDEA and ACL to perform the following:
   a) **Check completeness** of data and population that is used in either test of controls or substantive audit tests.
   b) **Selection of audit samples** - random sampling, systematic sampling.
   c) **Re-computation of balances** - reconstruction of trial balance from transaction data.
   d) **Reperformance of mathematical calculations** - deprecia-tion, bank interest calculation. Analysis of journal entries
   e) **Fraud investigation.**
   f) **Evaluating** impact of control deficiencies.

DIGITAL AUDIT

1) Entities are **embracing digitization** as part of their operations **to keep pace with changing times.** New technologies are helping companies revamp their operations and rethink the way business is conducted.
2) **Automation is key to digitization.**
3) **Auditors** are making use of artificial intelligence, data analytics and other latest technologies **to help understand business processes** in a better way.
4) By using such tools, **auditors** can **conduct audit** in a **better way** and devote more attention to areas requiring greater focus.
5) **Digital audit is helping auditors** to better identify risks making use of technology.

INTERNAL FINANCIAL CONTROLS AS PER REGULATORY REQUIREMENTS

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

a) **Reliability of financial reporting**
b) **Effectiveness and efficiency of operations**
c) **Compliance with applicable laws and regulations**
d) **Safeguarding of assets**
e) **Prevention and detection of frauds**

The term "internal financial controls" is used at some places in Companies Act, 2013 casting responsibilities as under: -

Relevant provision of Companies Act,2013	Nature of Responsibility
Section 134 (5)(e)	In case of listed Companies, the Directors' responsibility statement shall state that the Directors had laid down Internal financial controls to be followed by the company and that such Internal financial controls are **adequate** and were **operating effectively**.
Section 143(3) (i) of the Act	The auditor's report shall state whether the company has adequate Internal financial controls system in place and also on the operating effectiveness of such controls. **(Refer Chapter 8 for details)**
Section177 of the Act	Every audit Committee shall act in accordance with the terms of reference specified in writing by the Board which shall, inter alia, include - evaluation of internal financial controls and risk management systems.
As per Section 149(8) of the Act	The company and independent directors shall abide by the provisions specified in Schedule IV which lays down the **Code for independent Directors**.

ASSESS AND REPORT AUDIT FINDINGS

1) **Some points to consider are as follows:**
   a) Are there any weaknesses in IT controls?
   b) What is the impact of these weaknesses on overall audit?
   c) Report deficiencies to management - Internal controls memo or Management letter.
   d) Communicate in writing any significant deficiencies to those Charged with governance.
2) The auditor **needs to assess** each finding or exception **to determine impact** on the audit and evaluate if the exception results in a deficiency in internal control.
3) **A deficiency** in internal control **exists** if a **control is designed, implemented or operated** in such a way that it is **unable to prevent, or detect and correct, misstatements** in the FS's's on a timely basis; or the control is missing.
4) **Evaluation and assessment** of audit findings and control deficiencies **involves applying professional judgement** that include considerations for quantitative and qualitative measures.

4

Audit Evidence

CHAPTER OVERVIEW:

I SA 500 - Audit Evidence

II SA 501 - Audit Evidence- Specific Considerations for selected items

III SA 505 - External Confirmation

IV SA 510 - Initial Audit Engagements

V SA 520 - Analytical Procedures

VI SA 530 - Audit Sampling

VII SA 550 - Related Parties

VIII SA 610 - Using the work of another Auditor

SA 500 - AUDIT EVIDENCE

DEFINITION

Audit evidence may be defined as the **information used by the auditor** in arriving at the conclusions on which the auditor's opinion is based.

It includes both **information** contained in the accounting records underlying the **FS's and other information.**

Audit Evidence Includes

Information contained in the accounting records:	Other information that authenticates the accounting records and also supports the auditor's rationale behind the true and fair presentation of the FS's. For example
a) The records of initial accounting entries and supporting records, such as checks and records of electronic fund transfers; b) Invoices; c) Contracts;	a) Minutes of the meetings, b) Written confirmations from trade receivables and trade payables, c) Manuals containing details of internal control etc.

OBJECTIVE OF THE AUDITOR

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

TYPES OF AUDIT EVIDENCE

Depending upon nature

- **Visual**
  For example- Observing physical verification of inventory conducted by the client's staff.
- **Documentary**
  For example- Fixed deposit certificate, Loan agreement, Sales bill etc.
- **Oral**
  For example- Discussion with the management and various officers of the client.

Depending upon Source

- **Internal**
  Evidence which originates within the organisation being audited is internal evidence.
  For example- Sales invoice, goods receipt note, employee's wage sheets etc.
- **External**
  The evidence that originates outside the client's organization is external evidence.
  For example- Purchase invoice, Quotations, Confirmations, Bank statement etc.

RELEVANCE AND RELIABILITY OF AUDIT EVIDENCE

Reliability of Evidence

The reliability of information to be used as audit evidence, and therefore of the audit evidence itself, is influenced by **its source and its nature**, and the **circumstances under which it is obtained**, including the **controls over its preparation and maintenance** where relevant.

While recognizing that exceptions may exist, the following generalisations about the reliability of audit evidence may be useful:

a) The reliability of audit evidence is **increased** when it is obtained from **independent sources outside the entity.**

b) The reliability of **audit evidence that is generated internally** is **increased** when the **related controls**, including those over its preparation and maintenance, **imposed by the entity are effective.**

c) Audit evidence **obtained directly by the auditor** is **more reliable** than audit evidence **obtained indirectly or by inference.**

d) Audit evidence in **documentary form**, whether paper, electronic, or other medium, is **more reliable** than evidence obtained **orally.**

e) Audit evidence provided by **original documents** is **more reliable** than audit evidence provided by **photocopies or facsimiles**, or documents that have been **filmed**, **digitised** or otherwise transformed into electronic form.

Relevance

Relevance deals with the **logical connection** with, or **bearing upon**, the **purpose** of the audit procedure and, where appropriate, the assertion under consideration.

A given set of audit procedures may provide audit evidence that is **relevant to certain assertions**, but **not others.**

Similarly, obtaining audit evidence regarding a **particular assertion**, **For example**, the **existence of inventory**, is **not a substitute** for obtaining audit evidence regarding **another assertion**, **For example**, the **valuation of that inventory.**

CONCEPT OF MANAGEMENT'S EXPERT

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

a) **Evaluate the competence, capabilities and objectivity of that expert**

b) Obtain an understanding of the work of that expert

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

SUFFICIENCY OF AUDIT EVIDENCE

1) Sufficiency is the measure of the quantity of audit evidence.
2) The quantity of audit evidence needed is **affected by the auditor's assessment of the risks of misstatement** and also by the **quality of such audit evidence**.
3) **Factors affecting auditor's judgement as to sufficiency of audit evidence:**

   a) Materiality –

   Materiality may be defined as the significance of classes of transactions, account balances and presentation and disclosures to the users of the FS's. **Less evidence** would be required in case **assertions are less material to users** of the FS.

   b) Risk of material misstatement –

   It may be defined as the risk that the FS's are materially misstated prior to audit. **Less evidence** would be required in case **assertions that have a lower risk** of material misstatement.

   c) Size & characteristics of a population –

   It refers to the **number of items included** in the population. **Less evidence** would be required in case of **smaller, more homogeneous population** but on the other hand in case of **larger**, more **heterogeneous** populations, **more evidence** would be **required**.

APPROPRIATENESS OF AUDIT EVIDENCE

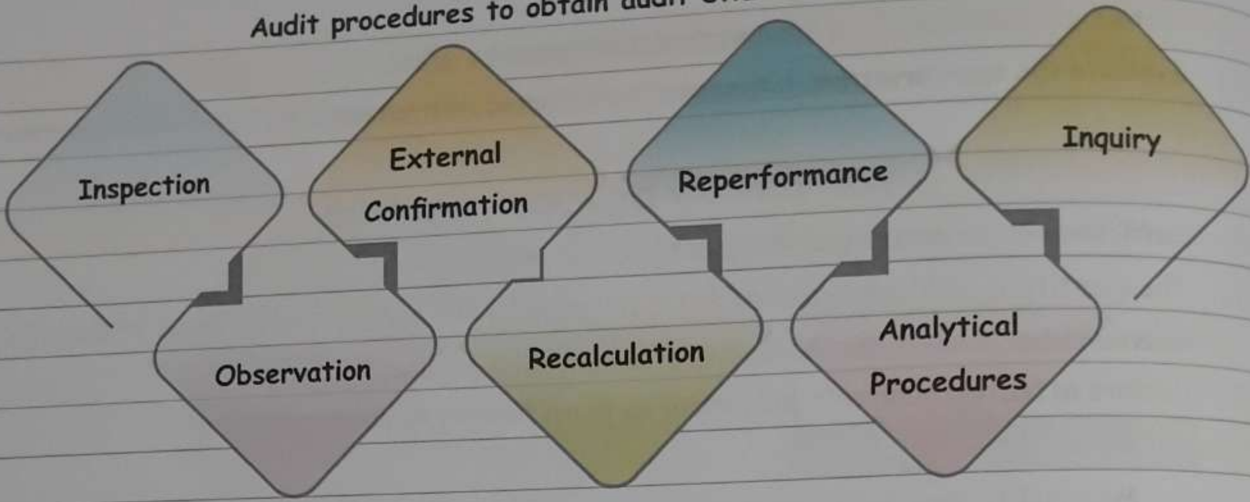
1) Appropriateness is the measure of the **quality of audit evidence**; that is, **its relevance and its reliability** in providing support for the conclusions on which the auditor's opinion is based.
2) The **reliability of evidence** is influenced by its **source and by its nature** and is dependent on the individual circumstances under which it is obtained.

AUDIT PROCEDURES TO OBTAIN AUDIT EVIDENCE

Audit evidence to draw reasonable conclusions on which to base the auditor's opinion is obtained by performing:

1) **Risk assessment procedures**; and **[Refer Note 1]**
2) **Further audit procedures**, which comprise: **[Refer Note 2]**
   a) **Test of controls**; and
   b) **Substantive procedures**,
      i) Tests of details
      ii) Substantive analytical procedures.

Audit procedures to obtain audit evidence can include:



Inspection

a) It examining records or documents, whether internal or external, in paper form, electronic form, or other media, or a physical examination of an asset.

b) Inspection of records and documents provides audit evidence of varying degrees of reliability.

Observation

a) It consists of looking at a process or procedure being performed by others.

b) It provides audit evidence about the performance of a process or procedure.

External Confirmation

An external confirmation represents audit evidence obtained by the auditor as a direct written response to the auditor from a third party (the confirming party), in paper form, or by electronic or other medium. (Refer SA 505 for details)

Recalculation

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

Re-performance

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

Analytical Procedures

Analytical procedures consist of evaluations of financial information made by a study of plausible relationships among both financial and non- financial data. (Refer SA 520 for details)

Inquiry

a) Inquiry consists of **seeking information of knowledgeable persons**, both financial and non-financial, within the entity or outside the entity.

b) Inquiries may range from **formal written inquiries to informal oral inquiries.**

c) Evaluating responses to inquiries is an integral part of the inquiry process. Responses to inquiries **may provide the auditor with information not previously possessed** or with corroborative audit evidence.

d) Although inquiry may provide important audit evidence, and may even produce evidence of a misstatement, **inquiry alone ordinarily does not provide sufficient audit evidence** of the absence of a material misstatement at the assertion level, nor of the operating effectiveness of controls.

NOTE 1 - RISK ASSESSMENT PROCEDURES

It refer to the audit procedures performed to obtain an **understanding of the entity and its environment**, including the entity's internal control, to identify and assess the risks of material misstatement, whether due to fraud or error, at the FS and assertion levels. **(Refer SA 315 for details)**

NOTE 2 - FURTHER AUDIT PROCEDURES

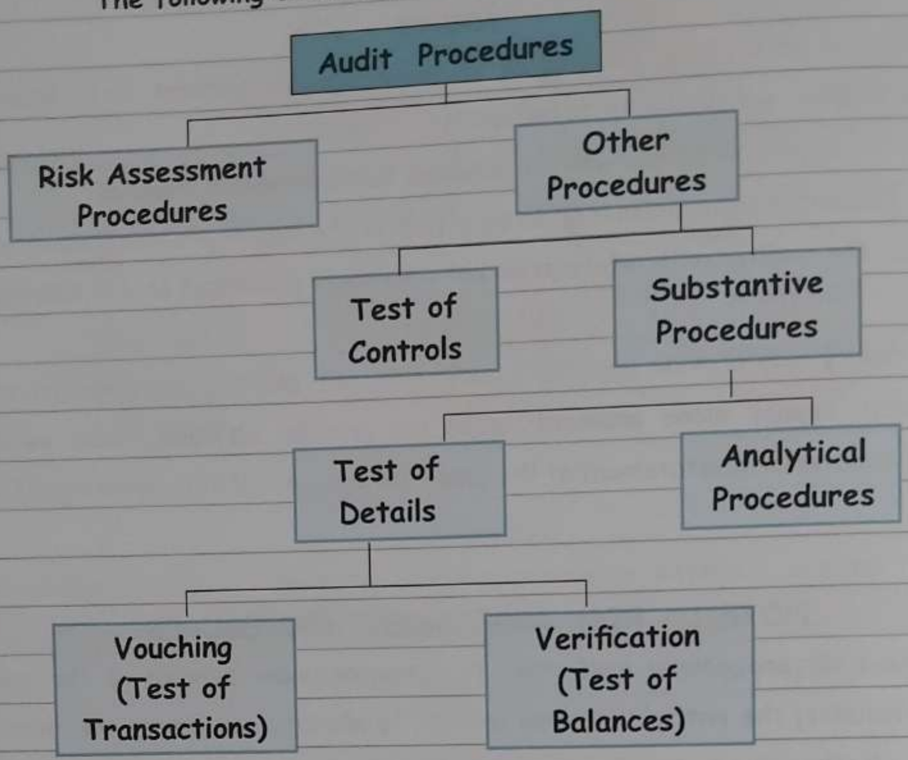
(A) Tests of controls

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

(B) Substantive Procedures

Substantive procedures are **designed to detect material misstatements** at the assertion level. They comprise **tests of details** and **substantive analytical procedures.**

The following chart illustrates different audit procedures:



NOTE 3 - AUDIT TRAIL

1) An audit trail is a **documented flow of a transaction**. It is used to investigate how a source document was translated into an account entry and from there it was inserted into FS of an entity.
2) It is used as audit evidence to **establish authentication and integrity** of a transaction. Audit trails help in **maintaining record of system** and **user activity**.
3) Audit trails are used to verify and track many types of transactions including accounting and financial transactions.
4) **Audit trails (or audit logs) act as record-keepers** that document evidence of certain events, procedures or operations, because their purpose is to reduce fraud, material errors, and unauthorized use. Audit trails help to **enhance internal controls and data security**.
5) Audit trails can **help in fixing responsibility**, **rebuilding events** and in **thorough analysis** of problem areas.

NOTE 4 - INFORMATION TO BE USED AS AUDIT EVIDENCE

When information to be used as audit evidence has been prepared using the work of a management's expert, the nature, timing and extent of audit procedures may be affected by such matters;

a) The **nature and complexity of the matter** to which the management's expert relates.
b) The **risks of material misstatement** in the matter.

c) The availability of alternative sources of audit evidence.
d) The nature, scope and objectives of the management's expert's work.
e) Whether the management's expert is employed by the entity, or is a party engaged by it to provide relevant services.
f) The extent to which management can exercise control or influence over the work of the management's expert.
g) Whether the management's expert is subject to technical performance standards or other professional or industry requirements.
h) The nature and extent of any controls within the entity over the management's expert's work.
i) The auditor's knowledge and experience of the management's expert's field of expertise.
j) The auditor's previous experience of the work of that expert.

When using information produced by the entity, the auditor shall evaluate whether the information is sufficiently reliable for the auditor's purposes, including as necessary in the circumstances:

a) Obtaining audit evidence about the accuracy and completeness of the information; and
b) Evaluating whether the information is sufficiently precise and detailed for the auditor's purposes.

NOTE 5 - SELECTING ITEMS FOR TESTING TO OBTAIN AUDIT EVIDENCE

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

Selecting All Items

a) The auditor may decide that it will be most appropriate to examine the entire population of items that make up a class of transactions or account balance.
b) 100% examination is unlikely in the case of tests of controls; however, it is more common for tests of details. 100% examination may be appropriate when,
c) For example:
   (i) The population constitutes a small number of large value items;
   (ii) There is a significant risk and other means do not provide sufficient appropriate audit evidence; or
   (iii) The repetitive nature of a calculation or other process performed automatically by an information system makes a 100% examination cost effective.

Selecting Specific Items

a) The auditor may decide to select specific items from a population.

b) In making this decision, **factors** that may be relevant include the **auditor's understanding of the entity**, the **assessed risks of material misstatement**, and the **characteristics of the population** being tested.

c) **Specific items selected may include:**

(i) **High value or key items.**

The auditor may decide to select specific items within a population because they are of **high value, or exhibit some other characteristic.**

(ii) **All items over a certain amount.**

The auditor may decide to examine items whose recorded values exceed a certain amount so as to verify a large proportion of the total amount of a class of transactions or account balance.

(iii) **Items to obtain information.**

The auditor may examine items to obtain information about matters such as the nature of the entity or the nature of transactions.

Audit Sampling

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

NOTE - 6 INCONSISTENCY IN OR DOUBTS OVER RELIABILITY OF AUDIT EVIDENCE

a) If Audit evidence obtained from one source is inconsistent with that obtained from another; or

b) The auditor has doubts over the reliability of information to be used as audit evidence,

c) The auditor shall determine what **modifications or additions** to audit procedures are necessary to **resolve the matter**, and shall consider the **effect of the matter**, if any, on other aspects of the audit.

SA 230 includes a specific documentation requirement if the auditor identified information that is inconsistent with the auditor's final conclusion regarding a significant matter.

SA 501 AUDIT EVIDENCE- SPECIFIC CONSIDERATIONS FOR SELECTED ITEMS

The objective of the auditor is to obtain sufficient appropriate audit evidence regarding the:

(a) Existence and condition of Inventory.

(b) Completeness of Litigation and Claims involving the entity; &

(c) Presentation and Disclosure of Segment Information in accordance with the applicable FRF.

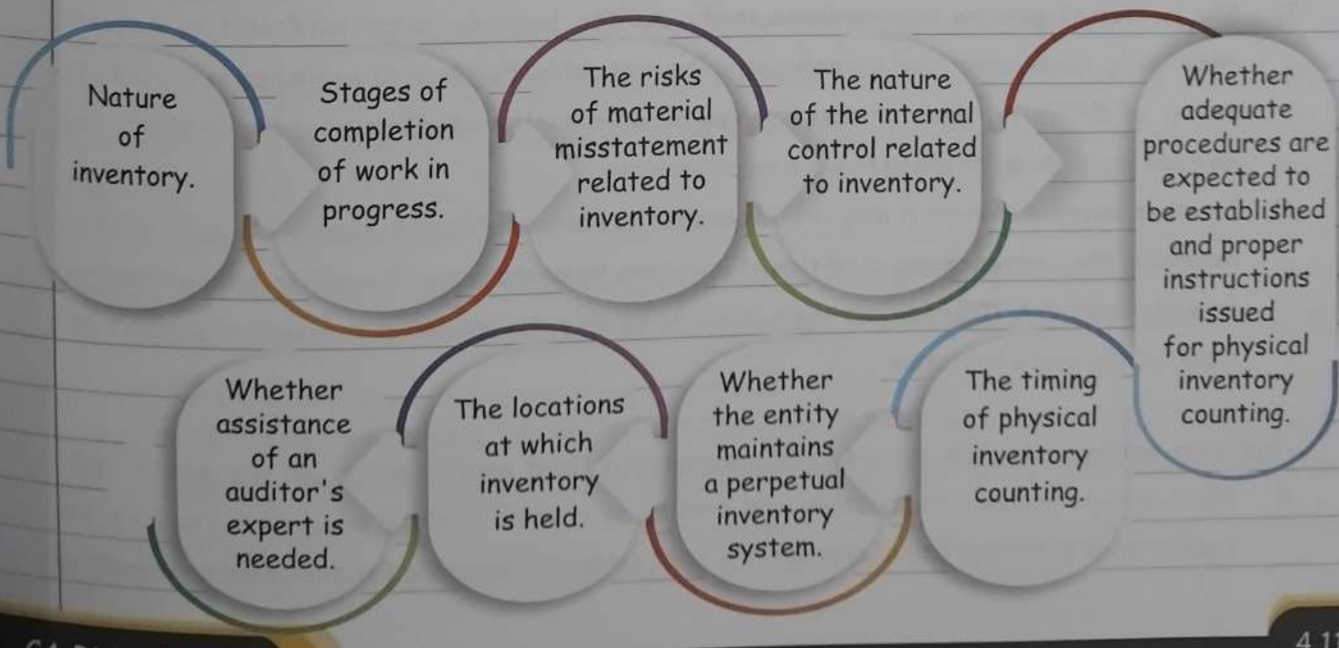
INVENTORY

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

Attendance at Physical Inventory Counting Involves

1) **Inspecting the inventory** to ascertain its existence and evaluate its condition, and performing test counts;
2) **Observing compliance with management's instructions** and the performance of procedures for recording and controlling the results of the physical inventory count; and
3) **Obtaining audit evidence** as to the reliability of management's count procedures.

Matters Relevant in Planning Attendance at Physical Inventory Counting



Physical Inventory Counting Conducted Other than at the Date of the FS's

1) If physical inventory counting is conducted **at a date other than the date of the FS's**, the auditor shall, in addition to the procedures required above, perform audit procedures to obtain audit evidence about whether **changes** in inventory between the count date and the date of the Fs's **are properly recorded**.
2) Relevant matters for consideration when designing audit procedures to obtain audit evidence about whether changes in inventory amounts between the count date, or dates, and the final inventory records are properly recorded include:
   a) Whether the **perpetual inventory records** are **properly adjusted**.
   b) **Reliability** of the entity's **perpetual inventory records**.
   c) **Reasons for significant differences** between the information obtained during the **physical count** and the **perpetual inventory records**.

If the Auditor is unable to Attend Physical Inventory Counting due to Unforeseen Circumstances

If the auditor is unable to attend physical inventory counting **due to unforeseen circumstances**, the auditor shall make or observe some physical counts on an **alternative date** and perform audit procedures on **intervening transactions**.

Attendance at Physical Inventory Counting Is Impracticable

1) If attendance at physical inventory counting is impracticable, the auditor shall perform **alternative audit procedures** to obtain sufficient appropriate audit evidence. If it is not possible to do so, the auditor **shall modify the opinion** in the auditor's report in accordance with **SA 705**.
2) **In some cases**, attendance at physical inventory counting may be **impracticable**. This may be due to factors such as the **nature and location** of the inventory,
3) The matter of **general inconvenience** to the auditor, however, is **not sufficient to support a decision** by the auditor that attendance is impracticable. Further, as explained in SA 200, the matter of **difficulty, time, or cost involved is not** in itself **a valid basis** for the auditor to omit **an audit procedure** for which there is **no alternative**.
4) **In other cases**, however, it may not be possible to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by performing alternative audit procedures. In such cases, **SA 705** requires the auditor to modify the opinion in the auditor's report as a result of the scope limitation.

When inventory under the custody and control of a third party- What will the auditor do?

1) When inventory under the **custody and control of a third party** is material to the FS's, the auditor shall obtain sufficient appropriate audit evidence regarding the **existence** and **condition**

of that inventory by performing one or both of the following:

a) **Request confirmation from the third party as to the quantities and condition of inventory held on behalf of the entity.**

b) **Perform inspection or other audit procedures appropriate in the circumstances.**

2) **Other audit procedure** may include -

- **Inspecting documentation** regarding inventory held by third parties.
- **Requesting confirmation** from other parties when inventory has been pledged as collateral.
- **Attending, or arranging for another auditor to attend,** the third party's physical counting of inventory, if practicable.
- **Obtaining another auditor's report, or a service auditor's report,** on the adequacy of the third party's internal control.

LITIGATION AND CLAIMS

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

   a) **Inquiry of management** and, where applicable, **others within the entity**, including **in-house legal counsel;**

   b) **Reviewing minutes of meetings** of those charged with governance and correspondence between the entity and its external legal counsel; and

   c) **Reviewing legal expense accounts.**

2) Litigation and claims involving the entity may have a material effect on the FS's and thus may be required to be **disclosed or accounted** for in the FS's.

If the Auditor Assesses a Risk of Material Misstatement regarding Litigation or Claims - Communication with the Entity's External Legal Counsel

1) The auditor shall, **in addition** to the procedures required by other SAs, seek **direct communication with the entity's external legal counsel.**

2) The auditor shall do so through **a letter of inquiry** requesting the **entity's external legal counsel** to **communicate directly** with the auditor.

3) **If law, regulation** or the respective legal professional body **prohibits** the entity's external legal counsel from communicating directly with **the auditor, the auditor shall perform alternative audit procedures.**

4) **In certain circumstances,** the auditor also may judge it **necessary to meet with the entity's external legal counsel** to discuss the likely outcome of the litigation or claims. This may be the case, for example, where:

   a) The auditor determines that the matter is a **significant risk.**

b) The matter is complex.
c) There is disagreement between management and the entity's external legal counsel.

Note 1: Further if

a) **Management refuses** to give the **auditor permission** to communicate or meet with the entity's external legal counsel, or the entity's external legal counsel refuses to respond appropriately to the letter of inquiry, or is prohibited from responding; and
b) The auditor is **unable to obtain sufficient appropriate audit evidence** by performing alternative audit procedures,
c) **The auditor shall modify the opinion in the auditor's report in accordance with SA 705.**

SEGMENT INFORMATION

Definition of segment- Information Segment refers to information about different types of **products and services** of an enterprise and its operations in different **geographical areas.**

AUDIT PROCEDURE

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

1) Obtaining an **understanding of the methods** used by management in determining segment information. Further,
   a) Evaluating whether **such methods** are likely to result in disclosure in accordance with the applicable FRF; and
   b) Where appropriate, testing the **application of such methods**; and
2) Performing **analytical procedures** or **other audit procedures** appropriate in the circumstances.

Auditor's responsibility regarding the presentation and disclosure of segment information

The auditor is not required to perform audit procedures that would be necessary to express an opinion on the segment information **presented on a standalone basis.**

Understanding of the Methods Used by Management

- Sales, transfers and charges between segments, and **elimination of intersegment amounts.**
- **Comparisons with budgets and other expected results**, for example, operating profits as a percentage of sales.
- The allocation of assets and costs among segments.
- **Consistency with prior periods**, and the **adequacy of the disclosures** with respect to inconsistencies.

SA 505 - EXTERNAL CONFIRMATION

INTRODUCTION

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

DEFINITION OF OTHER IMPORTANT TERMS

1) **External confirmation** - It may be defined as audit evidence obtained as a **direct written response to the auditor** from a third party (the confirming party), in paper form, or by electronic or other medium.
2) **Positive confirmation request** - A request that the confirming party respond directly to the auditor indicating whether the **confirming party agrees or disagrees** with the information in the request or **providing the requested information**.
3) **Negative confirmation request** - A request that the confirming party respond directly to the auditor **only if the confirming party disagrees** with the **information provided** in the request.
4) **Non-response** - A **failure** of the confirming party to respond, or fully respond, to a positive confirmation request, or a confirmation request **returned undelivered**.
5) **Exception** - A response that indicates a **difference** between **information requested to be confirmed**, or contained in the entity's records, and **information provided** by the confirming party. The exception needs to be assessed to the **entire population** after analyzing the reason for difference.

EXTERNAL CONFIRMATION PROCEDURES

When using external confirmation procedures, the auditor shall maintain control over external confirmation requests, including:

(a) **Determining the information** to be confirmed or requested;
(b) **Selecting** the appropriate **confirming party**;
(c) **Designing the confirmation requests**, including determining that requests are **properly addressed** and contain **return information** for responses to be sent directly to the auditor; &
(d) **Sending the requests**, including **follow-up requests** when applicable, to the confirming party.

(A) DETERMINING THE INFORMATION TO BE CONFIRMED OR REQUESTED

External confirmation procedures frequently are performed to confirm or request information regarding **account balances and their elements**. They may also be used to confirm

a) Terms of agreements,
b) Contracts, or
c) Transactions between an entity and other parties, or

d) To confirm the absence of certain conditions, such as a "side agreement".

(B) SELECTING THE APPROPRIATE CONFIRMING PARTY

Responses to confirmation requests provide **more relevant and reliable** audit evidence when confirmation requests are sent to a **confirming party** the auditor believes is **knowledgeable about the information to be confirmed.**

(C) DESIGNING CONFIRMATION REQUESTS

Factors to consider when designing confirmation requests include:

- Specific identified risks of material misstatement, including fraud risks.
- The layout and presentation of the confirmation request
- Prior experience on the audit or similar engagements.
- The assertions being addressed.
- The method of communication
- Management's authorization or encouragement to the confirming parties to respond to the auditor. Confirming parties may only be willing to respond to a confirmation request containing management's authorization
- The ability of the intended confirming party to confirm or provide the requested information

(D) FOLLOW-UP ON CONFIRMATION REQUESTS

The auditor may send an **additional confirmation request** when a reply to a previous request has **not been received** within a reasonable time.

POSITIVE CONFIRMATION REQUEST

a) A positive external confirmation request asks the confirming party to reply to the auditor **in all cases**, either by **indicating the confirming party's agreement** with the given information, or by **asking the confirming party to provide information.**

b) A response to a positive confirmation request ordinarily is expected to **provide reliable audit evidence.**

c) There is a risk, however, that a confirming party may reply to the confirmation request **without verifying** that the information is correct.

d) The auditor may reduce this risk by using positive confirmation requests that **do not state the amount** (or other information) on the confirmation request, and **ask the confirming party to fill in the amount** or furnish other information.

NEGATIVE CONFIRMATIONS

1) Negative confirmations provide **less persuasive audit evidence than positive confirmations.**
2) Accordingly, the auditor **shall not use negative confirmation requests as the sole substantive audit procedure** to address an assessed risk of material misstatement at the assertion level **unless all of the following are present:**
   a) The auditor has assessed the **risk of material misstatement as low** and has obtained sufficient appropriate audit evidence regarding the **operating effectiveness of controls** relevant to the assertion;
   b) The population of items subject to negative confirmation procedures comprises a **large number of small, homogeneous,** account balances, transactions or conditions;
   c) A **very low exception rate** is expected; and
   d) The auditor is **not aware of circumstances** or conditions that would cause recipients of negative confirmation requests to **disregard such requests.**
3) Accordingly, a failure of a confirming party to respond to a negative confirmation request **provides significantly less persuasive audit evidence** than does a response to a positive confirmation request.

EVALUATING THE EVIDENCE OBTAINED

When evaluating the results of individual external confirmation requests, the auditor may categorise such results as follows:

a) A response by the appropriate confirming party indicating **agreement** with the information provided in the confirmation request, or providing requested information without exception;

b) A **response deemed unreliable;**

c) A **non-response** ; or

d) A response indicating an **exception.**

MANAGEMENT'S REFUSAL TO ALLOW THE AUDITOR TO SEND A CONFIRMATION REQUEST - STEPS TAKEN BY AUDITOR

If management refuses to allow the auditor to send a confirmation request, the auditor shall:

(a) **Inquire as to management's reasons** for the refusal, and seek audit evidence as to their validity and reasonableness;

(b) **Evaluate the implications of management's refusal** on the **auditor's assessment of the relevant risks of material misstatement,** including the risk of fraud, and on the nature, timing and extent of other audit procedures; and

(c) Perform **alternative audit procedures** designed to obtain relevant and reliable audit evidence.

If the auditor concludes that management's refusal to allow the auditor to send a confirmation request is **unreasonable**, or the auditor is **unable to obtain** relevant and reliable audit evidence from **alternative audit procedures**, the auditor shall **communicate** with those charged with governance in accordance with **SA 260**.

The auditor also shall determine the implications for the audit and the **auditor's opinion in accordance with SA 705**. **[Refer Note-1 for Detailed Procedure]**

NOTE 1 - DETAILED PROCEDURE WHEN MANAGEMENT REFUSES

Reasonableness of Management's Refusal

a) The auditor is **required to inquire as to the reasons for the limitation.**

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

Implications for the Assessment of Risks of Material Misstatement

The auditor may conclude that it would be appropriate to **revise the assessment of the risks of material misstatement** at the assertion level and modify planned audit procedures.

Alternative Audit Procedures

Examples of alternative audit procedures the auditor may perform include:

a) For **accounts receivable balances** - examining specific **subsequent cash receipts, shipping documentation**, and sales near the period-end.

b) For **accounts payable balances** - examining **subsequent cash disbursements** or correspondence from third parties, and other records, such as **goods received notes**.

SA 510 -INITIAL AUDIT ENGAGEMENTS

DEFINITION

1) **Initial Audit Engagement** - An engagement in which either:
   a) The FS's for the **prior period were not audited**; or
   b) The FS's for the **prior period were audited** by a **predecessor auditor**.
2) **Opening balances** - **means** those account balances that exist at the beginning of the period.
3) **Predecessor auditor** - The auditor from a **different audit firm**, who audited the FS's of an entity in the **prior period** and who has been **replaced by the current auditor**.

OBJECTIVE OF AUDITOR WITH RESPECT TO OPENING BALANCES - INITIAL AUDIT ENGAGEMENT

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

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

OBTAINING SUFFICIENT APPROPRIATE AUDIT EVIDENCE ABOUT OPENING BALANCES BY THE AUDITOR

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

1) **Determining** whether the prior period's closing balances have been **correctly brought forward** to the current period.
2) **Determining** whether the opening balances **reflect** the **application** of appropriate accounting policies; and
3) **Performing one or more of the following:**
   a) Where the **prior** year FS's were **audited**, perusing the copies of the audited FS's including the other relevant documents relating to the prior period FS's;
   b) **Performed** in the current period provide evidence relevant to the opening balances; or
   c) **Performing specific audit procedures** to obtain evidence regarding the opening balances.

PROCEDURES ADOPTED BY THE AUDITOR TO OBTAIN AUDIT EVIDENCE REGARDING OPENING BALANCES

Nature and extent of Audit Procedures

The nature and extent of audit procedures necessary to obtain sufficient appropriate audit evidence regarding opening balances depend on such **matters** as:

- The **accounting policies** followed by the entity.
- The **nature of the account balances, classes of transactions and disclosures** and the risks of material misstatement in the current period's FS's.
- The **significance of the opening balances** relative to the current period's FS's.
- Whether the **prior period's** FS's **were audited** and, if so, whether the predecessor auditor's opinion was modified.

If the prior period's FS's were audited by a predecessor auditor

a) If the prior period's FS's **were audited** by a **predecessor auditor**, the auditor may be able to obtain sufficient appropriate audit evidence **regarding the opening balances** by perusing the copies of the audited FS's including the other relevant documents relating to the prior period FS's such as supporting schedules to the audited FS.

b) Ordinarily, the current auditor can **place reliance** on the closing balances contained in the FS's for the preceding period, except when during the performance of audit procedures for the current period the possibility of misstatements in opening balances is indicated.

For current assets and liabilities

a) For current assets and liabilities, some audit evidence about opening balances may be obtained as part of the current period's audit procedures.

b) **Additional audit procedures** may be necessary, and one or more of the **following** may provide sufficient appropriate audit evidence:

   i) **Observing** a current **physical inventory count** and reconciling it to the opening inventory quantities.

   ii) **Performing** audit procedures on the **valuation of the opening inventory** items.

   iii) **Performing** audit procedures on **gross profit and cut-off**.

For non- current assets and liabilities

For non-current assets and liabilities,

a) such as property plant and equipment, investments & long-term debt, some audit evidence may be obtained by **examining accounting records** & other information underlying the opening balances.

b) In certain cases, the auditor may be able to obtain some audit evidence regarding opening balances through confirmation with third parties.

CONSISTENCY OF ACCOUNTING POLICIES RELATING TO OPENING BALANCES

The auditor shall obtain sufficient appropriate audit evidence about whether the accounting policies reflected in the opening balances have been **consistently applied in the current period's FS's**, and whether **changes in the accounting policies** have been **properly accounted** for and **adequately presented and disclosed** in accordance with the applicable FRF.

RELEVANT INFORMATION IN THE PREDECESSOR AUDITOR'S REPORT

If the prior period's FS's were **audited by a predecessor auditor** and there was a **modification to the opinion**, the auditor shall **evaluate the effect of the matter** giving rise to the modification in assessing the risks of material misstatement in the **current period's FS's** in accordance with SA 315.

REPORTING BY THE AUDITOR

Regarding Opening Balances

1) If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor shall express a qualified opinion or a disclaimer of opinion, as appropriate, in accordance with **SA 705**.
2) If the auditor concludes that the **opening balances contain a misstatement** that materially affects the current period's FS's, and the **effect of the misstatement** is **not properly accounted** for or **not adequately presented or disclosed**, the auditor shall express a **qualified opinion** or an **adverse opinion**, as appropriate, in accordance with SA 705.

Consistency of Accounting Policies

If the auditor concludes that:

a) the **current period's accounting policies are not consistently applied** in relation to opening balances in accordance with the applicable FRF; or
b) a **change in accounting policies** is **not properly accounted** for or not **adequately presented** or **disclosed** in accordance with the applicable FRF,

the auditor shall express a **qualified opinion or an adverse opinion** as appropriate in accordance with SA 705(Revised).

Modification to the Opinion in the Predecessor Auditor's Report

If the **predecessor auditor's opinion** regarding the prior period's FS's included a **modification to the auditor's opinion** that remains **relevant and material** to the current period's FS's, the auditor shall **modify the auditor's opinion** on the current period's FS's in accordance with **SA 705(Revised)** and SA 710.

SA 520 - ANALYTICAL PROCEDURES

MEANING

The term "analytical procedures" means **evaluations of financial information** through analysis of **plausible relationships** among both **financial and non-financial data**.

Analytical Procedures may be segregated into following major types:

a) Comparison of client and industry data,
b) Comparison of client data with similar prior period data,
c) Comparison of client data with client-determined expected results,
d) Comparison of client data with auditor-determined expected results
e) Comparison of client data with expected results, using non financial data.

SCOPE AND OBJECTIVE

The objectives of the auditor are:

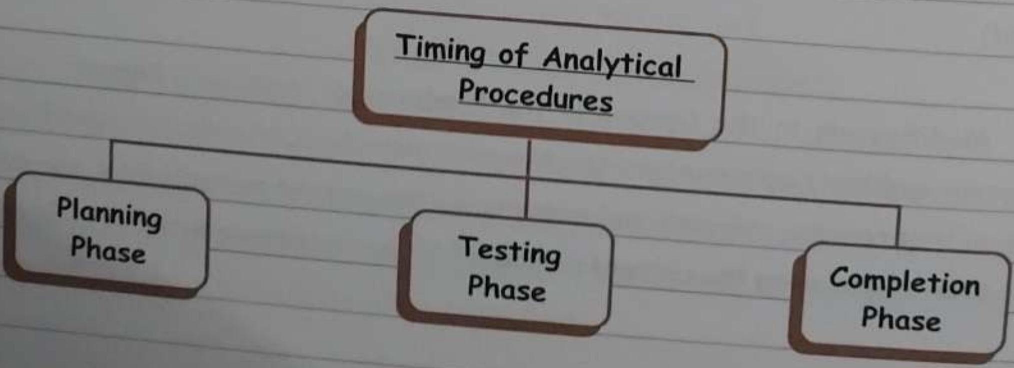
a) To obtain **relevant and reliable audit evidence** when using substantive analytical procedures; and

b) To **design** and **perform analytical procedures** near the **end of the audit** that assist the auditor when **forming an overall conclusion** as to whether the FS are consistent with the auditor's understanding of the entity.

PURPOSE AND TIMING OF ANALYTICAL PROCEDURES

Purpose of Analytical Procedures

1) Analytical procedures use **comparisons and relationships** to assess whether account balances or other data appear reasonable.
2) Analytical procedures may help **identify the existence of unusual transactions or events**, and amounts, ratios, and trends that might indicate matters that have audit implications.
3) **Unusual or unexpected relationships** that are **identified** may assist the auditor in identifying risks of material misstatement, especially risks of material misstatement due to fraud.



ANALYTICAL PROCEDURES IN PLANNING THE AUDIT

1) In the planning stage, analytical procedures assist the auditor in understanding the client's business and in identifying areas of potential risk by indicating aspects of and developments in the entity's business of which he was previously unaware.
2) This information will assist the auditor in determining the nature, timing and extent of his other audit procedures.
3) Analytical procedures in planning the audit use both financial data and non-financial information, such as number of employees, square feet of selling space, volume of goods produced and similar information.

ANALYTICAL PROCEDURES USED AS SUBSTANTIVE TESTS

The auditor shall:

- **Determine the suitability** of particular substantive analytical procedures for **given assertions**, taking account of the assessed risks of material misstatement and tests of details, if any, for these assertions;
- **Evaluate the reliability of data** from which the auditor's expectation of recorded amounts or ratios is developed, taking account of source, comparability, and nature & relevance of information available, & controls over preparation;
- **Develop an expectation** of recorded amounts or ratios and evaluate whether the expectation is sufficiently precise to identify a misstatement that may cause the FS to be materially misstated; and
- Determine the amount of any **difference of recorded amounts** from expected values that is acceptable without further investigation.

FACTORS TO BE CONSIDERED FOR SUBSTANTIVE ANALYTICAL AUDIT PROCEDURES

The auditor should consider the following factors for Substantive Audit Procedures:

1) **Availability of Data :**
   The availability of reliable and relevant data will facilitate effective procedures.
2) **Disaggregation :**
   The degree of disaggregation in available data can directly affect the degree of its usefulness in detecting misstatements
3) **Account Type :**
   a) Substantive analytical procedures are more useful for certain types of accounts than for others.
   b) Income statement accounts tend to be more predictable because they reflect accumulated transactions over a period, whereas balance sheet accounts represent the net effect of

transactions at a point in time or are subject to greater management judgment.

4) **Source :**
   a) Some classes of transactions tend to be more predictable because they consist of **numerous, similar transactions,**
   b) Whereas the transactions recorded by **non-routine and estimation SCOTs (Significant Classes of Transactions)** are often subject to management judgment and therefore **more difficult to predict.**

5) **Predictability :**
   Substantive analytical procedures are more appropriate when an account balance or relationships between items of data are **predictable**.

6) **Nature of Assertion :**
   Substantive analytical procedures may be **more effective** in providing evidence for some assertions (e.g., completeness or valuation) than for others (e.g., rights and obligations).

7) **Inherent Risk or "What Can Go Wrong" :** When we are designing audit procedures to address an inherent risk or "**what can go wrong**", we consider the nature of the risk of material misstatement in order to determine if a substantive analytical procedure can be used to obtain audit evidence.

TECHNIQUES AVAILABLE AS SUBSTANTIVE ANALYTICAL PROCEDURES

1) **Trend analysis :**
   a) A commonly used technique is the **comparison of current data with the prior period balance or with a trend** in two or more prior period balances.
   b) In other words, trend analysis **implies analysing** account fluctuations by comparing current year to prior year information and, also, to information derived over several years.

2) **Ratio analysis:**
   a) Ratio analysis is useful for **analysing asset and liability** accounts as well as revenue and expense accounts.
   b) Ratios can also be **compared over time** or to the ratios of **separate entities within the group**, or with the ratios of **other companies in the same industry.**
   c) **Example:**
      i) Trade receivables or inventory turnover
      ii) Freight expense as a percentage of sales revenue

3) **Reasonableness tests :**
   a) Unlike trend analysis, this analytical procedure does **not rely on events of prior periods**, but upon **non-financial data** for the audit period under consideration
   b) These tests are generally more **applicable to income statement accounts** and certain accrual or prepayment accounts.
   c) **Example:**
      i) **Interest expense** against interest bearing obligations
      ii) **Wastage & Scrap %** against production & raw material consumption (quantity)
4) **Structural modeling :** A modeling tool **constructs a statistical model** from **financial and/or non-financial data** of prior accounting periods to predict current account balances (e.g., linear regression).

THE RELIABILITY OF DATA

1) The reliability of data is **influenced by its source and nature** and is dependent on the circumstances under which it is obtained.
2) Accordingly, the following are relevant when determining whether data is reliable for purposes of designing substantive analytical procedures:
   a) **Source of the information available.**
   b) **Comparability of the information available.**
   c) **Nature and relevance of the information available.** and
   d) **Controls over the preparation of the information** that are designed to ensure its completeness, accuracy and validity.

EVALUATION OF WHETHER THE EXPECTATION IS SUFFICIENTLY PRECISE

Matters relevant to the auditor's evaluation of whether the expectation can be developed sufficiently precisely to identify a misstatement that, when aggregated with other misstatements, may cause the FS to be materially misstated, include:

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

AMOUNT OF DIFFERENCE OF RECORDED AMOUNT FROM EXPECTED VALUES THAT IS ACCEPTABLE

1) The auditor's determination of the **amount of difference** from the expectation that can be accepted without further investigation is **influenced by materiality** and the consistency with

the desired level of assurance, taking account of the possibility that a misstatement, individually or when aggregated with other misstatements, may cause the FS's to be materially misstated.

2) Accordingly, as the assessed risk increases, the achieve the amount of difference considered acceptable without investigation decreases in order to achieve the desired level of persuasive evidence.

INVESTIGATING RESULTS OF ANALYTICAL PROCEDURES

If analytical procedures performed in accordance with **SA 520** identify fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, the auditor shall investigate such differences by:

a) **Inquiring of management and obtaining appropriate audit evidence relevant to management's responses**

b) **Performing other audit procedures as necessary in the circumstances**

ANALYTICAL PROCEDURES THAT ASSIST WHEN FORMING AN OVERALL CONCLUSION

The conclusions drawn from the results of analytical procedures designed and performed in accordance with, are **intended to corroborate conclusions** formed during the audit of individual components or elements of the FS.

This **assists** the auditor to **draw reasonable conclusions** on which to base the **auditor's opinion**.

The results of such analytical procedures may **identify a previously unrecognized risk** of material misstatement.

In such circumstances, SA 315 requires the auditor to **revise** the auditor's assessment of the risks of material misstatement and **modify** the further planned audit procedures accordingly.

SA 530 - AUDIT SAMPLING

MEANING

According to SA 530 "Audit sampling", 'audit sampling' refers to the application of audit procedures to **less than 100% of items** within a population relevant under the audit, such that all sampling units (i.e., all the items in the population) have an equal chance of selection.

POPULATION

1) Population refers to the **entire set of data** from which a sample is selected and about which the auditor wishes to draw conclusions.
2) The auditor should select sample items in such a way that the sample can be expected to be **representative of the population.**

CHARACTERISTICS OF POPULATION

(a) Appropriateness

1) The auditor will need to determine that the population from which the sample is **drawn is appropriate** for the specific audit objective.
2) Appropriate means population from which the samples are drawn **shall be relevant** for the **specific objective** under audit.

(b) Completeness

The population also needs to be complete, which means that if the auditor intends to use the sample to draw conclusions about **whether a control activity is operated effectively** during the financial reporting period, the population **needs to include all relevant items** i.e., all the activities that form part of that relevant internal control, throughout the entire period.

(c) Reliable

1) When performing the audit sampling, the auditor performs audit procedures to ensure that the information upon which the audit sampling is performed **is sufficiently complete and accurate.**
2) If population is **not reliable** with respect to accuracy and source, the **sample drawn** will definitely **not be relevant** for the specific audit objective.

SAMPLING UNIT

1) The **individual items** that make up the population are known as sampling units. The population can be divided into sampling units in a variety of ways.
2) In simple words, **conclusions drawn on the sample becomes the conclusion of the population from where it is drawn.**

Sampling Process is performed on

Test of controls
To identify deviations from expected internal controls

Test of details
To identify misstatements of account balances and class of transactions

APPROACHES TO SAMPLING

1) Audit sampling can be applied using either
   a) **Non-statistical or**
   b) **Statistical sampling**
2) **Statistical sampling** is
   a) **An approach to sampling that has the random selection of the sample items; and**
   b) **The use of probability theory to evaluate sample results, including measurement of sampling risk characteristics.**
3) Sample is chosen by applying certain mathematical and statistical methods. A sampling approach that does not have above characteristics is considered **non-statistical sampling.**

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

STATISTICAL SAMPLING - MORE SCIENTIFIC

1) Audit testing done through this approach is more scientific than testing based entirely on the auditor's own judgment because it involves **use of mathematical laws of probability** in determining the appropriate sample size in varying circumstances.
2) Statistical sampling has reasonably wide application where a population to be tested consists of a large number of similar items.
3) There is **no personal bias** of the auditor in case of statistical sampling.
4) In larger organisations, with huge transactions, **statistical sampling is always recommended** as it is unbiased and the samples selected are not prejudged.

NON-STATISTICAL SAMPLING

Under this approach, the sample size and its composition are determined on the basis of the personal experience and knowledge of the auditor.

This approach has been in common application for many years because of its simplicity in operation.

An attempt would be made to avoid establishing a pattern of selection year after year to maintain an element of surprise as to what the auditor is going to check.

<u>The non-statistical sampling is criticized on the grounds that it is neither objective nor scientific:</u>

a) **The expected degree of objectivity cannot be assured in non-statistical sampling** because the risk of personal bias in selection of sample items cannot be eliminated.

b) The closeness of the **qualities projected by the sample results with that of the whole population cannot be measured**.

ADVANTAGES OF STATISTICAL SAMPLING

a) The amount of testing (sample size) **does not increase** in proportion to the increase in the size of the area (universe) tested.

b) The sample selection is **more objective** and thereby **more defensible**.

c) The method provides a **means of estimating the minimum sample size** associated with a specified risk and precision.

d) It provides a means for deriving a "**calculated risk**" and corresponding precision.

e) It may provide a **better description** of a large mass of data than a complete examination of all the data.

f) It is **widely accepted** way of sampling as it is more scientific, without personal bias and the result of sample can be evaluated and projected in more reliable way.

STRATIFICATION AND VALUE-WEIGHTED SELECTION

Stratification

Audit **efficiency** may be improved if the auditor stratifies a population by dividing it into discrete sub-populations which have an identifying characteristic.

The **objective of stratification is to reduce the variability of items** within each stratum and therefore allow sample size to be reduced without increasing sampling risk.

When performing tests of details, the population is often **stratified by monetary value.** This allows **greater audit effort to be directed to the larger value items**

Projected misstatements of each **stratum** will be combined together to consider the possible effect of misstatement in the account balances and class of transactions.

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.

A population may be stratified according to a **particular characteristic that indicates a higher risk of misstatement,**

Note: Dividing a population into discrete sub population which have identifying characteristics is called as **Stratification**. Each Sub population is called as **Stratum** and units under those sub population are referred to as **Strata**.

Value-Weighted Selection

1) When performing tests of details, it may be efficient to identify the sampling unit as the individual monetary units that make up the population. Having selected specific monetary units from within the population.
2) One benefit of this approach to defining the sampling unit is that audit effort is directed to the **larger value items** because they have a greater chance of selection and can result in smaller sample sizes.
3) This approach may be used in conjunction with the **systematic method of sample selection** and is most efficient when **selecting items using random selection**.

SAMPLE SECTION METHODS

RANDOM SAMPLING

(i) Simple Random Sampling

a) Under this method **each unit** of the whole population e.g. purchase or sales invoice has an equal chance of being selected.
b) It is considered that random number tables are **simple and easy to use** and also provide assurance that the auditors' bias does not affeect the selection.
c) Each item in a population is selected by **use of random number table** either with a help of

computer or picking up a number in a random way

d) This method is considered appropriate provided the **population to be sampled** consists of **reasonably similar units** and **fall within a reasonable range** i.e it is suitable for a **homogeneous population** having a similar range.

(ii) Stratified Sampling:

a) This method involves dividing the whole population to be tested in a few separate groups called **strata** and taking a sample from each of them. Each stratum is treated as if it was a **separate population** and if proportionate of items are selected from each of these stratum.

b) The number of groups into which the whole population has to be divided is determined on the basis of **auditor judgment**.

c) The reasoning behind the stratified sampling is that for a **highly diversified population**, weights should be allocated to reflect these differences. It can be seen that the **stratified sampling is simply an extension of simple random sampling.**

INTERVAL SAMPLING OR SYSTEMATIC SAMPLING

1) Systematic selection is a selection method in which the number of sampling units in the population is divided by the sample size to give a sampling interval, for example 50, and having determined a **starting point** within the first 50, each **50th sampling unit** thereafter is selected.

2) Although the starting point may be determined haphazardly, the sample is more likely to be **truly random** if it is determined by use of a **computerized random number generator** or random number tables.

3) When using systematic selection, the auditor would need to determine that sampling units within the population are **not structured** in such a way that the sampling interval **corresponds with a particular pattern** in the population.

4) To **minimize the effect of the possible known** buyers through a pattern in the population, **more than one starting point may be taken**. The **multiple random starting point** is taken because it **minimize the risk of interval sampling pattern** with that of the population being sampled.

MONETARY UNIT SAMPLING

It is a type of value-weighted selection in which **sample size, selection and evaluation results** in a conclusion in **monetary amounts**.

HAPHAZARD SAMPLING

1) Haphazard selection, in which the auditor **selects the sample without following a structured technique. Although no structured technique** is used, the auditor would nonetheless avoid any conscious bias or predictability (for example, **avoiding difficult to locate items**, or always

choosing or avoiding the first or last entries on a page) and thus attempt to ensure that all items in the population have a chance of selection.

2) Haphazard selection is not appropriate when using statistical sampling.

3) Haphazard sampling has no structured approach, does not involve judgement and does not even use the random number tables.

BLOCK SAMPLING

1) This method involves selection of a block(s) of contiguous items from within the population. Block selection cannot ordinarily be used in audit sampling because most populations are structured such that items in a sequence can be expected to have similar characteristics to each other, but different characteristics from items elsewhere in the population.

2) There is a close similarity between this method and non-statistical sampling.

3) It has similar characteristics, namely, simplicity and economy. On the other hand, there is a risk of bias & of establishing a pattern of selection which may be noted by the auditees.

EXAMPLES OF FACTORS AFFECTING SAMPLE SIZE

For Test of Controls

1) When there is an increase in the extent to which the auditor's risk assessment takes into account relevant controls.

   a) The more assurance the auditor intends to obtain from the operating effectiveness of controls, the lower the auditor's assessment of the risk of material misstatement will be, and the larger the sample size will need to be.

   b) Other things being equal, the greater the reliance the auditor places on the operating effectiveness of controls in the risk assessment, the greater is the extent of the auditor's tests of controls (and therefore, the sample size is increased). Thus, sample size will increase.

2) If there is an increase in the tolerable rate of deviation. Then sample size will decrease, as lower the tolerable rate of deviation, larger the sample size needs to be.
Note: Tolerable error is the maximum error in the population that auditor is ready to accept in a given sample size. Smaller the tolerable error, larger will be the sample size.

3) When there is an increase in the expected rate of deviation of the population to be tested then sample size will increase, as higher the expected rate of deviation, larger the sample size needs to be so that the auditor is in a position to make a reasonable estimate of the actual rate of deviation.

4) An increase in the auditor's desired level of assurance that the tolerable rate of deviation is not exceeded by the actual rate of deviation in the population will increase the sample size.

5) In case of large populations, the actual size of the population has little, if any, effect on sample size. For small populations however, audit sampling may not be as efficient as alternative means of obtaining sufficient appropriate audit evidence.

For Test of Details

1) The higher the auditor's assessment of the risk of material misstatement, the larger the sample size needs to be.
   a) In order to reduce audit risk to an acceptably low level, the auditor needs a low detection risk and will rely more on substantive procedures.
   b) Thus we can say that there will be an increase in sample size in case of an increase in the auditor's assessment of the risk of material misstatement.

2) The more the auditor is relying on other substantive procedures (tests of details or substantive analytical procedures) to reduce to an acceptable level the detection risk regarding a particular population, the less assurance the auditor will require from sampling and, therefore, the smaller the sample size can be.

3) An increase in the auditor's desired level of assurance that tolerable misstatement is not exceeded by actual misstatement in the population will increase the sample size.

4) An increase in tolerable misstatement will decrease the sample size as lower the tolerable misstatement, the larger the sample size needs to be.

5) The greater the amount of misstatement the auditor expects to find in the population, the larger the sample size needs to be in order to make a reasonable estimate of the actual amount of misstatement in the population.

6) When stratification of the population is appropriate then sample size will decrease as when there is a wide range (variability) in the monetary size of items in the population, it may be useful to stratify the population.

7) There will be negligible effect on sample size due to number of sampling units in the population.

SAMPLING AND NON-SAMPLING RISK

Sampling Risk

The risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure. This risk will **always be in existence** when auditor **uses sampling technique** in conducting his audit.

Sampling risk can lead to two types of erroneous conclusions:

a) In the case of a **test of controls**, that **controls are more effective than they actually are**, or in the case of a **test of details**, that a **material misstatement does not exist when in fact it does.** The auditor is primarily concerned with this type of erroneous conclusion because it **affects audit effectiveness** and is more likely to lead to an **inappropriate audit opinion**.

b) In the case of a **test of controls**, that **controls are less effective than they actually are**, or in the case of a **test of details**, that a **material misstatement exists when in fact it does not**. This type of erroneous conclusion **affects audit efficiency** as it would usually lead to **additional work to establish that initial conclusions were incorrect**.

IF THE ACCEPTABLE SAMPLING RISK IS LOW, LARGER SAMPLE SIZE IS NEEDED

Non-Sampling Risk

The risk that the auditor reaches an erroneous conclusion for any reason not related to sampling risk. Non-sampling risk can never be mathematically measured.

Sources of Non-Sampling risk are:

- **Human Mistakes**
- **Misinterpreting the sample results**
- **Applying audit procedures not appropriate to the objectives of audit**
- **Relying on erroneous information e.g., erroneous confirmation**

Examples of non-sampling risk include use of inappropriate audit procedures, or misinterpretation of audit evidence and failure to recognize a misstatement or deviation.

NATURE AND CAUSE OF DEVIATIONS AND MISSTATEMENTS

1) In analyzing the deviations and misstatements identified, auditor may observe that many have a **common feature, for example**, type of transaction, location, product line or period of time.
2) In such circumstances, the auditor may decide to **identify all items in the population** that **possess the common feature** and extend audit procedures to those items. In addition, such **deviations or misstatements** may be **intentional**, and may indicate the **possibility of fraud**.

3) Therefore, the auditor **shall investigate** the nature and causes of any deviations or misstatements identified and **evaluate their possible effect** on the purpose of the audit procedure and on other areas of the audit.

4) In the **extremely rare circumstances** when the auditor considers a misstatement or deviation discovered in a sample to be an **anomaly**, the auditor shall obtain a **high degree of certainty** that such **misstatement or deviation is not representative of the population.**

5) The auditor shall obtain this **degree of certainty** by performing additional audit procedures to obtain **sufficient appropriate audit evidence** that the misstatement or deviation **does not affect the remainder of the population.**

Note -Anomaly may be defined as a misstatement or deviation that is demonstrably not representative of misstatements or deviations in a population.

PROJECTING MISSTATEMENTS

1) The auditor is required **to project misstatements** for the population to obtain a **broad view** of the scale of misstatement but this projection **may not be sufficient** to determine an amount to be recorded.

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

FEW IMPORTANT TERMS TO MAKE THE UNDERSTANDING BETTER

Tolerable misstatement:

A monetary amount set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that the monetary amount set by the auditor is not exceeded by the actual misstatement in the population.

Tolerable rate of deviation:

A rate of deviation from prescribed internal control procedures set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that the rate of deviation set by the auditor is not exceeded by the actual rate of deviation in the population.

SA 550 - RELATED PARTIES

SCOPE

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

DEFINITION

A party that is either:

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

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

MEANING OF CONTROL AND SIGNIFICANT INFLUENCE IN REFERENCE TO RELATED PARTY

a) **Control is the power to govern** the financial and operating policies of an entity so as to obtain benefits from its activities; and
b) **Significant influence** (which may be gained by share ownership, statute or agreement) is the **power to participate in the financial and operating policy decisions** of an entity, but is not control over those policies.

The existence of the following relationships may indicate the presence of control or significant influence:

a) **Direct or indirect** equity holdings or other financial interests in the entity.
b) The entity's **holdings of direct or indirect equity or other financial interests** in other entities.
c) **Being part of TCWG or key management** (i.e., those members of management who have the authority and responsibility for planning, directing and controlling the activities of the entity).
d) **Being a close family member** of any person referred to in subparagraph (iii).
e) **Having a significant business relationship** with any person referred to in subparagraph (iii).

CONSIDERATIONS SPECIFIC TO SMALLER ENTITIES BY THE AUDITOR

Control environment in smaller entities is likely to be different from larger entities. In particular those charged with governance may not include an outside member, and the role of governance may be undertaken directly by the owner-manager where no other owner exists.

Control activities in smaller entities are likely to be less formal and smaller entities may have no documented processes for dealing with related party relationships and transactions.

For such entities, the auditor may obtain an understanding of the related party relationships and transactions, and any controls that may exist over these, through inquiry of management combined with other procedures, such as observation of management's oversight and review activities, and inspection of available relevant documentation.

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SA 610 - USING THE WORK OF INTERNAL AUDITOR

DEFINITION OF INTERNAL AUDIT FUNCTION

The **objectives and scope** of internal audit functions typically include assurance and consulting activities designed to evaluate and improve the effectiveness of the

a) Entity's governance processes,
b) Risk management and
c) Internal control

Activities Relating to Governance	Activities Relating to Risk Management	Activities Relating to Internal Control
The internal audit function may assess the governance process in its accomplishment of objectives.	The internal audit function may assist the entity be identifying and evaluating significant exposures to risk.	a) Evaluation of internal control b) Examination of financial and operating information. c) Review of operating activities. d) Review of compliance with laws and regulations.

WAYS IN WHICH THE EXTERNAL AUDITOR MAY MAKE USE OF THE FUNCTION FOR PURPOSES OF THE AUDIT

The **external auditor** may make use of the function for purposes of the audit in one or more of the **following ways:**

a) **To obtain** information that is **relevant to the external auditor's assessments** of the risks of material misstatement due to error or fraud.
b) **Unless prohibited, or restricted** to some extent, by law or regulation, the **external auditor,** after appropriate evaluation, may **decide** to use **work** that has been **performed by the internal audit function.**
c) **Unless prohibited, or restricted** to some extent, by law or regulation, the **external auditor** may **use** internal auditors to **perform audit procedures** under the direction, supervision and review of the external auditor.

SCOPE OF SA 610

SA 610 deals with the **external auditor's responsibilities** if using the work of internal auditors. This **includes**

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

EXTERNAL AUDITOR'S RESPONSIBILITY FOR THE AUDIT

1) **The external auditor** has **sole responsibility** for the audit opinion expressed, and that responsibility is **not reduced** by the external auditor's use of the work of the internal audit function or internal auditors to provide direct assistance on the engagement.
2) **Neither the internal audit function nor the internal auditors are independent** of the entity as is required of the external auditor in an audit of FS's in accordance with SA 200.

OBJECTIVES OF THE EXTERNAL AUDITOR, WHERE THE ENTITY HAS AN INTERNAL AUDIT FUNCTION

The **objectives of the external auditor**, where the entity has an internal audit function

To determine whether the work of the internal audit function **or direct assistance from internal auditors** can be used, and if so, in which areas and to what extent; and having made that determination:

If using the work of the internal audit function, **to determine** whether that work is **adequate for purposes of the audit**; and

If using internal auditors to **provide direct assistance**, to appropriately direct, supervise and review their work.

EVALUATING THE INTERNAL AUDIT FUNCTION

The external auditor shall **determine** whether the work of the internal audit function can be used for purposes of the audit by evaluating the following:

1) **The extent** to which the **internal audit function's organizational status** and **relevant policies and procedures** support the **objectivity of the internal auditors; (Note-1)**
2) The **level of competence** of the internal audit function; and **(Note-2)**
3) Whether the internal audit function **applies a systematic and disciplined** approach, including quality control. **(Note-3)**

NOTE 1 - OBJECTIVITY AND ITS EVALUATION

Objectivity refers to the ability to perform those tasks without allowing bias, conflict of interest or undue influence of others to override professional judgments.

Factors that may affect the external auditor's evaluation in relation to Objectivity include the following:

1) Whether the organizational status of the internal audit function, including the function's authority and accountability, **supports the ability of the function to be free from bias, conflict of interest or undue influence of others** to override professional judgments.
2) Whether those charged with governance **oversee employment decisions** related to the internal

audit function.

3) Whether there are **any constraints or restrictions** placed on the internal audit function by management or those charged with governance.

4) Whether the internal audit function is **free of any conflicting responsibilities**.

NOTE 2 - COMPETENCE AND ITS EVALUATION

1) **Competence** of the internal audit function refers to the **attainment and maintenance** of knowledge and skills of the function as a whole at the level required to enable assigned tasks to be performed diligently and in accordance with applicable professional standards.

2) **Factors** that may **affect the external auditor's determination** in relation to competence **include** the following:

   a. Whether the internal audit function is **adequately and appropriately resourced** relative to the size of the entity and the nature of its operations.

   b. Whether there are established policies for **hiring, training and assigning** internal auditors to internal audit engagements.

   c. Whether the internal auditors have **adequate technical training and proficiency** in auditing.

   d. Whether the internal auditors possess the required knowledge relating to the **entity's financial reporting** and the applicable FRF.

Objectivity and competence may be viewed as a continuum.

Objectivity and competence may be viewed as a **continuum**. The **more** the internal audit function's organizational status and relevant policies and procedures adequately support the objectivity of the internal auditors and **the higher** the level of competence of the function, the more likely the external auditor may make use of the work of the function and in more areas.

NOTE 3 - APPLICATION OF A SYSTEMATIC AND DISCIPLINED APPROACH

Factors that may affect the external auditor's determination of whether the internal audit function applies a systematic and disciplined approach include the following:

a) The **existence, adequacy and use** of documented internal audit procedures or guidance covering such areas as risk assessments, work programs, documentation and reporting, the nature and extent of which is commensurate with the size and circumstances of an entity.

b) Whether the internal audit function has **appropriate** quality control policies and procedures.

CIRCUMSTANCES WHEN WORK OF THE INTERNAL AUDIT FUNCTION CANNOT BE USED

The external auditor shall **not** use the work of the internal audit function if the external auditor determines that:

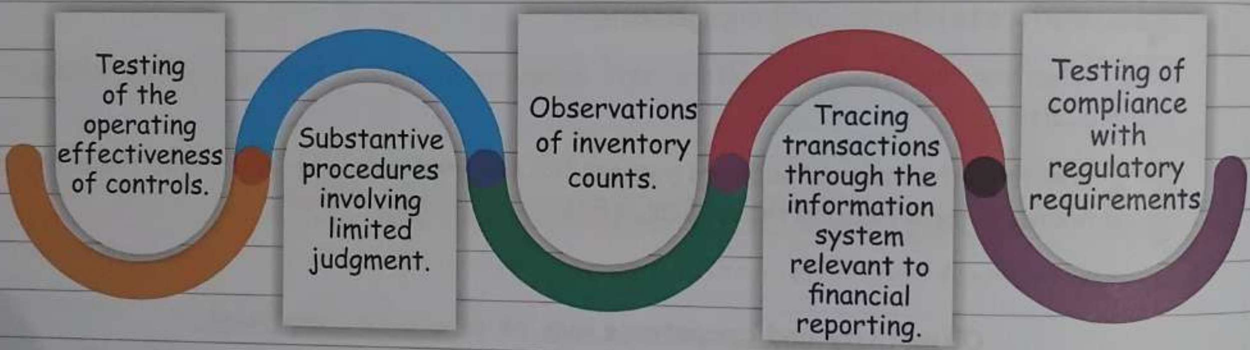
a) The function's **organizational status** and **relevant policies** and procedures do **not adequately** support the **objectivity of internal auditors**;

b) The function **lacks sufficient competence**; or

c) The function does **not apply** a systematic and disciplined approach, including quality control.

DETERMINING THE NATURE AND EXTENT OF WORK OF THE INTERNAL AUDIT FUNCTION THAT CAN BE USED

Examples of work of the internal audit function that can be used by the external auditor include the following:



CIRCUMSTANCES IN WHICH THE EXTERNAL AUDITOR SHALL PLAN TO USE LESS OF THE WORK OF THE INTERNAL AUDIT FUNCTION AND PERFORM MORE OF THE WORK DIRECTLY

The external auditor shall make all **significant judgments** in the audit engagement and, to **prevent** undue use of the work of the internal audit function, shall plan to use less of the work of the function and perform more of the work directly **if**:

a) The more judgment is involved in:

  (i) **Planning and performing** relevant audit procedures; and

  (ii) **Evaluating** the audit evidence gathered;

b) The **higher** the assessed risk of material misstatement at the assertion level, with special consideration given to risks identified as significant;

c) The **less** the internal audit function's organizational status and relevant policies and procedures adequately support the objectivity of the internal auditors; and

d) The **lower** the level of competence of the internal audit function.

USING THE WORK OF THE INTERNAL AUDIT FUNCTION

If the external auditor plans to use the work of the internal audit function, the external auditor shall

1) **Discuss** the planned use of its work with the function as a basis for coordinating their respective activities.
2) **Read the reports** of the internal audit function relating to the work of the function.
3) **Perform sufficient audit procedures** on the body of work of the internal audit function as a whole that the external auditor plans to use to determine its adequacy for purposes of the audit.

Discussion and Coordination with the Internal Audit Function

In **discussing the planned use** of their work with the internal audit function as a basis for coordinating the respective activities, it may be useful to address the following:

1) The **timing** of such work.
2) The **nature** of the work performed.
3) The **extent** of audit coverage.
4) **Materiality** for the FS's as a whole, and performance materiality.
5) **Proposed methods** of item selection and sample sizes.
6) **Documentation** of the work performed.
7) **Review and reporting** procedures.

Coordination between the external auditor and the internal audit function is effective when, for example;

1) **Discussions** take place at **appropriate intervals** throughout the period.
2) The external auditor informs the internal audit function of **significant matters** that may affect the function.
3) The external auditor is **advised of and has access** to relevant reports of the internal audit function and is informed of any significant matters that come to the attention of the function.

DETERMINING WHETHER, IN WHICH AREAS, AND TO WHAT EXTENT INTERNAL AUDITORS CAN BE USED TO PROVIDE DIRECT ASSISTANCE

1) **Direct assistance** refers to the use of **internal auditors to perform audit procedures** under the **direction, supervision and review of the external auditor**.
2) The external auditor may be **prohibited** by law or regulation from obtaining direct assistance from internal auditors.
3) If using internal auditors to provide direct assistance is **not prohibited** by law or regulation, the external auditor shall evaluate the existence and significance of threats to objectivity and the level of competence of the internal auditors who will be providing such assistance.

4) **The external auditor shall not use an internal auditor to provide direct assistance if:**
   a) There are **significant threats to the objectivity** of the internal auditor; or
   b) The internal auditor **lacks sufficient competence** to perform the proposed work.
5) **The external auditor shall not use internal auditors to provide direct assistance to perform procedures that:**
   a) **Involve** making significant judgments in the audit;
   b) **Relate to higher assessed risks** of material misstatement where the judgment required in performing the relevant audit procedures or evaluating the audit evidence gathered is more than limited;
   c) **Relate to work** with which the internal auditors have been involved and which has already been, or will be, reported to management or those charged with governance; or
   d) **Relate to decisions** the external auditor makes in accordance with this SA.
6) **Prior to using internal auditors to provide direct assistance for purposes of the audit, the external auditor shall:**
   a) Obtain **written agreement** from an **authorized representative** of the entity that the internal auditors will be allowed to follow the external auditor's instructions; and that the entity will not intervene in the work the internal auditor performs for the external auditor; and
   b) Obtain **written agreement** from the **internal auditors** that they will keep confidential specific matters as instructed by the external auditor and inform the external auditor of any threat to their objectivity.

BASICS OF INTERNAL FINANCIAL CONTROL AND REPORTING REQUIREMENTS

Distinction between Internal Financial Control and Internal Control over financial reporting

1) The term **Internal Financial Controls (IFC)** refers to the **policies and procedures** put in place by companies
   a) For **ensuring reliability** of financial reporting,
   b) **Effectiveness and efficiency** of operations,
   c) **Compliance with applicable laws and regulations,**
   d) **Safeguarding of assets** and prevention and detection of frauds.
2) On the other hand, Internal controls over financial reporting is required where **auditors** are **required to express an opinion** on the **effectiveness** of an entity's internal controls over financial reporting.
3) Therefore, "internal financial control" is a **wider term** where as "internal controls over financial reporting" is a **narrower term** restricted to entity's internal controls over financial reporting only.

5

Audit of Items of Financial Statements

CHAPTER OVERVIEW:

I. Chapter 5A: Introduction (Assertion)

II. Chapter 5B: Balance Sheet Captions (Liabilities)

III. Chapter 5C: Balance sheet Captions (Assets)

IV. Chapter 5D: Statement of Profit And Loss Captions

A- INTRODUCTION

ASSERTIONS

It refers to the **representations by management** either explicit or otherwise, that are **embodied in the FS's**; **auditor** will use these assertions **to consider** different types of **potential misstatements** that may occur.

ASSERTIONS MAY BE BROADLY CLASSIFIED INTO THE FOLLOWING TYPES:

1) Assertions for **Income Statement Captions** Comprising Revenue and Expense Balances.
2) Assertions for **Balance Sheet Captions** Comprising Assets, Liabilities and Equity Balances

INCOME STATEMENT CAPTIONS COMPRISING REVENUE & EXPENSE BALANCES

1) Occurrence

Transactions recognized in the FS's **have occurred** and **relate to the entity.**

2) Completeness

a) All transactions **that were supposed** to be recorded have been **recognized** in the FS's.

b) Transactions have **not been omitted.**

3) Cut-off

a) Whether all income and expenses are reported in the **correct accounting period.**

b) Cut-off is a **separate assertion** because the substantive procedures to verify it are typically different from those applied to the other components of completeness.

4) Measurement

Transactions have been recorded accurately at their appropriate amounts in the FS's.

There have been no errors while preparing documents or in posting transactions to ledger.

The figures and explanations are not misstated.

5) Presentation and Disclosure

a) Transactions have been classified and presented fairly in the FS's.

b) Transactions and events are appropriately segregated or disaggregated.

c) Presentation and disclosure assertions are considered during the course of the audit to determine that the disclosures are **complete and accurate.**

d) The disclosures that are **most susceptible to material misstatement** are those that require significant judgement and qualitative assessments.

e) Audit teams **assess the completeness and accuracy** of disclosures by determining that the disclosures provide **information in a manner that does not materially omit, distort or mislead the user.**

f) The description and disclosure of transactions are **relevant and easy to understand.**

BALANCE SHEET CAPTIONS COMPRISING ASSETS, LIABILITIES AND EQUITY BALANCES

1) Existence

Assets, liabilities and equity balances exist as at the period end

2) Completeness

All assets, liabilities and equity balances that were supposed to be recorded have been recognized in the financial statements.

3) Cut-off

Whether all assets and liabilities are reported in the appropriate period.

4) Valuation

a) Assets, liabilities and equity balances have been valued appropriately i.e. the amounts at which they are recorded are appropriate.

b) There has been no overstatement or understatement.

5) Rights & Obligations

Entity has the right to assets i.e. (whether the entity has ownership and legal title to assets) and the liabilities recognized in the FS's represent all the entity's obligations to repayment as at a given date.

6) Presentation and Disclosure

a) Whether particular items in the FS's are properly **classified, described and disclosed.**

b) Presentation and disclosure assertions are considered during the course of the audit to determine that disclosures are **complete and accurate.**

c) The balances have been appropriately segregated or disaggregated. The related disclosures are understandable in accordance with applicable FRF.

B- BALANCE SHEET CAPTIONS [LIABILITIES]

SHARE CAPITAL

I. Audit Procedure

Tally the **period- end share capital balance**- authorised, issued and paid up, to the previous year audited FS's.

In case there in no change during the year, **obtain a written confirmation/ representation** from the Company Secretary that there were no changes to entity's capital structure during the year.

In case there is **any change, verify** whether the paid up capital as at the period-end is within the limits of **authorised capital**, which can be **verified by examining MOA**.

Obtain the certified copies of relevant resolutions passed at the meetings of BOD, shareholders authorising increase / decrease in authorised / paid up share capital.

No shares have been **issued at Discount** (Sec. 53 of Companies Act).

Check if Shares are issued for cash or for **Consideration other than cash.**

II. Shares Issued at Premium

1) **Application of securities premium account can be made for the following purposes:**
   a) Towards the **issue of unissued shares** of the company to the members of the company as fully paid bonus shares;
   b) In **writing off the preliminary expenses** of the Company;
   c) In **writing off the expenses** of, or commission paid or discount allowed on, any issue of shares or debentures of the company;
   d) In providing for the **premium payable on the redemption of any redeemable preference shares** or of any debentures of the company; or
   e) For the **purchase of its own shares** or other securities under section 68.
2) **The auditor needs to verify [Audit Procedure]:**
   a) Whether premium received on shares, if any, has been transferred to a "**securities premium account**" and
   b) Whether application of any amount out of the said "securities premium account" is only for the **purposes mentioned above.**

III. Shares Issued at discount

According to **section 53** of the Companies Act, 2013,

1) A company **shall not issue shares at a discount**, except in the case of an issue of **sweat equity shares** given under Section 54 of the Companies Act, 2013.
2) Any share issued by a company at a discounted price **shall be void.**
3) **The auditor needs to check**

a) The **movement in share capital during the year** and wherever there is any issue,

b) He should verify that Company has not issued any of its shares at a discount by **reading the minutes of meeting** of its directors and shareholders authorizing issue of share capital and the issue price.

c) Further, auditor should also verify that whether the company has issued shares at a discount **to its creditors** when its debt is converted into shares in pursuance of any **statutory resolution plan or debt restructuring scheme**

IV. Issue of Sweat Equity Shares

The auditor needs to verify that the Sweat Equity Shares issued by the company are of a class of shares already issued and following conditions have been complied with:

a) The issue is authorised by a **special resolution** passed by the company;

b) The resolution specifies the **number of shares, the current market price, consideration**, if any, **and the class or classes of directors or employees** to whom such equity shares are to be issued;

c) Where the equity shares of the company are listed the sweat equity shares are issued in accordance with the regulations made by the SEBI in this behalf and if they are not so listed, the sweat equity shares are issued in accordance with such rules as may be prescribed.

V. Reduction of Capital

The auditor shall undertake the following audit procedures:

1) Verify that the meeting of the shareholder held to pass the **special resolution** was properly convened and that the proposal was circularized in advance to all the shareholders;
2) Verify that the **Articles of Association authorises** reduction of capital;
3) Examine that there has been **no default w.r.t repayment of deposits accepted** by company or **payment of interest on such deposits**. Reduction of capital shall not be affected if such default exists.
4) **Examine** the **order of the Tribunal** confirming the reduction and **verify** that **a copy** of the order and the minutes have been registered and filed with the Registrar of Companies;
5) **Check the Registrar's Certificate** as regards to reduction of capital;
6) Confirm whether the **revaluation of assets** has been **properly disclosed** in the Balance Sheet;

VI. Presentation & Disclosure

Ensure whether the following disclosure requirements of **Schedule III (Part 1) to Companies Act, 2013** have been complied with:

For each class of share capital:

a) The **number** and **amount of shares** authorised;

b) The number of shares **issued, subscribed and fully paid**, and subscribed but not fully paid;

c) Par value per share;

d) A reconciliation of the number of shares outstanding at the beginning and at the end of the reporting period;

e) A company shall disclose Shareholding of Promoters as below:

Shares held by promoters at the end of the year				% Change during the year
Sr. No.	Promoter Name	No. of shares	% of total shares	

RESERVE AND SURPLUS

Meaning

1) Reserves are **amounts appropriated out of profits** that are not intended

   a) To meet any liability,

   b) Contingency,

   c) Commitment or

   d) Diminution in value of assets known to exist as at the date of Balance Sheet.

2) Revenue reserves represent profits that are **available for distribution to shareholders or below purposes** such as:

   a) To supplement divisible profits in lean years,

   b) To finance an extension of business

   c) To augment the working capital of the business or

   d) To generally strengthen the company's financial position.

3) **Capital Reserve** represents a reserve which does **not include any amount regarded as free for distribution.**

1) Audit Procedures

Trace and tally the opening balance of reserves and surplus to the previous year audited FS's.

A) **Profit and Loss balance**

   1) **Trace the movement to surplus/ deficit** as per the Statement of profit and loss for the year under audit.

2) The **movement** should be **traced** in the **Statement of Changes in Equity.**
3) **Verify the resolution passed** by the board of directors regarding the recommendation of dividend, resolution passed by shareholders declaring the dividend.
4) As per **AS-4 (revised)** or **IND AS 10**, if dividends to holders of equity instruments are **proposed or declared after the balance sheet date**, an entity should **not recognize** those **dividends as a liability as at the balance sheet date.**
5) It should, however, **disclose the amount of dividends** that were proposed or declared after the balance sheet date, but before the financial statements were approved for issue.

B) <u>Securities Premium</u>

1) It needs to be **confirmed** that company has issued shares in **excess of the nominal value** of the shares and for the same, the auditor should **obtain and verify the resolution passed** by the board of directors.
2) **Utilisation** of securities premium account could be done only for **limited purposes**; auditor needs to **ensure** that same.

2) Presentation & Disclosure

Ensure whether the following disclosure requirements of **Schedule III (Part 1) to Companies Act, 2013** have been complied with:

Reserves and Surplus shall be classified as:

- Capital Reserves;
- Capital Redemption Reserve;
- Securities Premium [Omitted];
- Debenture Redemption Reserve;
- Revaluation Reserve;
- Share Options Outstanding Account;
- Other Reserves;
- Surplus

BORROWINGS

1) Liabilities are the **financial obligations** of an **enterprise** other than **owners' funds.** Liabilities include loans / borrowings, trade payables and other current liabilities, deferred payment credits and provisions.
2) **Verification** of liabilities is as important as that of assets, for, if any liability is **omitted (or understated) or overstated**, the **FS would not show a true and fair view** of the state of affairs of the company.

1) Existence

a) **Review board minutes** for approval of new lending agreements.
b) During review, **ensure** that new loan agreements or bond issuances were **authorized**.
c) **Ensure** that significant debt commitments were **approved** by the BOD.
d) **Agree details of loans recorded** (interest rate, nature and repayment terms) to the loan agreement. **Verify** that borrowing limits, if any, imposed by agreements are **not exceeded**.
e) **Roll out and obtain independent balance confirmations** in respect of all the borrowings from the lender.
f) When debt is retired, ensure that a **discharge is received on assets securing the debt**.

2) Completeness

a) **Obtain a schedule of short term and long-term borrowing** showing beginning and ending balances and borrowings taken and repaid during the year.
b) **Consider any evidence** of additional debt obtained through examination of minutes of the BOD, significant contracts, confirmations from banks/ lenders, support for subsequent cash disbursements etc.
c) **Trace the closing balances** as per the schedules to the general ledger.

3) Direct confirmation procedures

Roll out and obtain independent balance confirmations in respect of all the borrowings from the lender (banks / financial institutions etc.) and perform the following:

a) **Ascertain** that the confirmation asks for all information likely to be relevant to the **tests of debt** and **related interest balances** (**Example** applicable interest rates, due dates, the date to which interest has been paid, collateral and security interests).
b) **Send reminders** for non-replies.
c) **Compare** the balances are per the confirmations obtained to the books of the accounts. **Ask for reconciliations**, if there are any differences and test the supporting documents for the reconciling items on a test check basis.

4) Valuation

a) **Determine** that the accounting policies and methods of recording debt are **appropriate** and **applied consistently**.
b) **Agree loan balance and loan payables** to the loan agreement.
c) **Recompute** the interest, and discount or premium on redemption.
d) **Check computation** of the amortization of premium or discount, if any.
e) For foreign currency loans, check the **closing exchange rate(s) used** and verify the computations

of the restatements of foreign currency balances outstanding at year end.

5) Other Procedures

a) Examine the due dates on loans for **proper classification** between long-term and short- term.

b) Where instalments of long-term loans falling due within the next twelve months have been **disclosed in the FS's, verify the correctness of the amount of such instalments**.

c) Examine the debt agreements for any **restrictive covenants**.

d) He should carefully review the borrowings from related parties and ensure compliance with **AS 18 or IND AS 24**.

e) The auditor should also **verify that the amount borrowed** is within the borrowing powers of the company as laid down by the Articles of Association and Memorandum of Association.

f) Examine the **purpose for which the amount is borrowed** and ensure that the amount is not used against the interest of the company.

6) Presentation and Disclosure

A) Long- Term Borrowings

1) Long-term borrowings shall be classified as:
   a) Bonds/debentures;
   b) Term loans:
      i) From banks.
      ii) From other parties.
   c) Deferred payment liabilities;
   d) Deposits;
   e) Loans and advances from related parties;
   f) Long term maturities of finance lease obligations;
   g) Other loans and advances (specify nature).
2) Borrowings shall further be sub-classified as
   a) Secured and
   b) Unsecured.

   Nature of security shall be specified separately in each case.
3) Where loans have been guaranteed by directors or others, the aggregate amount of such loans under each head shall be disclosed.

B) Other Long-term Liabilities

Other Long-term Liabilities shall be classified as:

a) Trade Payables;

b) Others

C) Short Term Borrowings

1) Short-term borrowings shall be classified as:
   a) Loans repayable on demand;
      i) From banks.
      ii) From other parties.
   b) Loans and advances from related parties;
   c) Deposits;
   d) Other loans and advances (specify nature).
2) Borrowings shall further be sub-classified as secured and unsecured. Nature of security shall be specified separately in each case.
3) Where loans have been guaranteed by directors or others, the aggregate amount of such loans under each head shall be disclosed.

IMPORTANT NOTES

Note 1: Where the Company Has Borrowings from Banks or Financial Institutions on The Basis of Security of Current Assets, It Shall Disclose The Following:

a) Whether **quarterly returns or statements** of current assets filed by the Company with banks or financial institutions **are in agreement with the books of accounts.**

b) If not, summary of reconciliation and reasons of material discrepancies, if any to be adequately disclosed.

Note 2: Wilful Defaulter*

Where a company is a declared wilful defaulter by any bank or financial institution or other lender, following details shall be given:

a) Date of declaration as wilful defaulter,

b) Details of defaults (amount and nature of defaults),

Note 3: Registration of Charges or Satisfaction With Registrar of Companies

Where any charges or satisfaction yet to be registered with Registrar of Companies beyond the statutory period, details and reasons thereof shall be disclosed.

Note 4

Where the **Company has not used the Borrowings** from Banks and Financial Institutions for the **specific purpose** for which it was taken at the Balance Sheet Date, the Company shall **disclose the details** of where they have been used.

TRADE PAYABLES AND OTHER CURRENT LIABILITIES

Liabilities in addition to borrowings, **include** trade payables and other current liabilities, deferred payment credits and provisions.

A liability is considered to be **current** if it is **due to be paid within twelve months** and **held** primarily for the purpose of being **traded** in the entity's normal operating cycle. **Example** Short-term debt, dividends etc.

1) Existence

a) Check whether there are **controls in place** to ensure that any purchase / expense invoice does not get recorded more than once and payable balances are automatically recorded in the general ledger at the time of recording of expense.

b) Obtain the **accounts payable ageing report** and trace its balances to the general ledger.

2) Direct confirmation procedures (Refer Procedure as per SA 505)

a) An important audit activity is to **contact vendors directly/ independently** and ask them to confirm the amounts of accounts payable as of the end of the reporting period under audit.

b) The auditor employs **direct confirmation procedure** with the consent of the entity under audit.

c) There may be situations where the management of the entity requests the auditor **not to seek confirmation** from certain trade payables. In such cases, the auditor should consider whether there are **valid grounds** for such a request.

3) Completeness & Cut-Off

a) The auditor needs to perform the following **cut-off procedures**:

   i) For the **last 5 invoices received / recorded** at the end of **reporting date (cutoff date)** and which have been included in the trade payables; the **goods** should have been **received** / **risk and rewards of ownership** in goods should have been **transferred in favour of the entity;**

   ii) All goods received **prior to the period / year- end** should have been **booked** in the form of **purchases and included in trade creditors.**

b) **Test purchases / expenses** on a sample basis selecting the same from the accounts payable ledgers and checking their supporting documents to ensure that the purchases were recorded at the correct amounts and correct dates.

c) This can include an **examination** of purchase / expense invoices received **subsequent to the period being audited**, to see if they should have been included in the period under audit.

d) **Review subsequent expense vouchers.**

e) **Enquire from the entity's management** if there has been any **dispute with the customer** and if there is any additional liability to be recorded.

f) The auditor should **obtain and verify the challans for deposits** made subsequent to the period-end **for all statutory liabilities** as at the balance sheet date and also analyse the reasons.

g) He shall prepare a complete list of all statutory dues and consider his reporting requirements under CARO, 2020.

4) Valuation

a) **Review** the **process** followed by the Company to identify if **any old creditor balance / liability needs to be written back.**

b) **Obtain the ageing of payable balances**, split between current, **less than 30 days old, 30-60 days old, 60-180 days old, 180- 365 days old and more than 365 days old.**

c) **Check** that write backs in the liability balances assessed as no longer payable have been **approved by an appropriate and authorised member** of senior management, for example CEO / MD.

d) **Check** that the **restatement of foreign currency** trade payables has been done properly in accordance with **AS 11.**

5) Presentation & Disclosure Trade Payables due for payment

The following ageing schedule shall be given for Trade Payables due for payment:

Particulars	Outstanding for following periods from due date of payment				
	Less than 1 Year	1-2 Years	2-3 Years	More than 3 Years	Total
MSME					
Others					
Disputed Dues- MSME					
Disputed Dues Others					

Other Current Liabilities

Whether the amount disclosed under other current liabilities are classified as below:

a) Current maturities of finance lease obligations
b) Interest accrued but not due on borrowings
c) Interest accrued and due on borrowings
d) Income received in advance
e) Unpaid Dividends

f) Application money received for allotment of securities and due for refund and interest accrued thereon.

PROVISIONS AND CONTINGENT LIABILITIES

Meaning

1) **A provision** is a liability which can be measured only by **using a substantial degree of Estimation**. A provision is recognised when:
   a) An entity has a **present obligation** (legal or constructive) as a result of a past event;
   b) It is **probable that an outflow of resources** embodying economic benefits will be required to settle the obligation; and
   c) **A reliable estimate** can be made of the amount of the obligation. If the above conditions are not met, no provision is recognised.
2) **A contingent liability** is:
   a) A **possible obligation** that arises from **past events and whose existence** will be confirmed only by the **occurrence or non-occurrence** of one or more uncertain future events not wholly within the control of the entity; or
   b) A **present obligation** that **arises from past events** but is not recognized because:
      (i) It is **not probable that an outflow of resources** embodying economic benefits will be required to settle the obligation; or
      (ii) The amount of the obligation **cannot be measured** with sufficient reliability.

1) Existence, Completeness & Valuation

a) **Obtain** a list of all provisions and **compare** them with balances in the ledger.
b) **Inspect** the underlying arrangements like agreement with customers to assess warranty commitments, any legal and other claims on the entity i.e. litigations.
c) Wherever required, **obtain experts report, calculation and underlying working** for the provision amount
d) As per **SA 500- Audit Evidence**, issued by ICAI, when **using the work of a management's Expert**, audit evidence that the auditor should obtain include:
   i) **Evaluate the competence, capabilities and objectivity of that expert:**
      - Whether the expert is **employed** by the entity or is an outside party.
      - Whether the expert is **independent** in respect of the entity
      - **Auditor's previous experience** of the work of the expert
      - Knowledge of the **expert's qualification, membership** of a **professional body** or industry

association

ii) **Obtain an understanding of the work of that expert:**

- Whether the **auditor has expertise to evaluate** the work of the expert
- Evaluating the **assumptions and methods used** by the management.
- Evaluating the nature of **internal or external data used** by the expert

iii) **Evaluate the appropriateness of his work as audit evidence for the relevant assertion**

- **Relevance and reasonableness of the Expert's findings** or conclusions
- Evaluating the relevance, completeness and accuracy of the source data used by the Expert

2) Presentation & Disclosure

In terms of **AS 29, "Provisions, Contingent Liabilities and Contingent Assets"**, ensure whether following disclosures have been made:

a) **For each class of provision, an enterprise shall disclose:**

(i) The **carrying amount at the beginning** and **end** of the period

(ii) **Additional provisions** made in the period, including increases to existing provisions;

(iii) **Amounts used** during the period;

(iv) **Unused amounts reversed** during the period.

b) **An enterprise shall disclose the following for each class of provision:**

(i) **A brief description of the nature of the obligation** and the **expected timing of any resulting outflows** of economic benefits;

(ii) An indication of the uncertainties about the amount or timing of those outflows.

(iii) The **amount of any expected reimbursement**, stating the amount of any asset that has been recognized for that expected reimbursement.

c) **Unless the possibility of any outflow in settlement is remote, an enterprise should disclose for each class of contingent liability at the balance sheet date a brief description of the nature of the contingent liability and, where practicable:**

(i) An **estimate** of its financial effect

(ii) An indication of the uncertainties relating to the amount or timing of any outflow; and

(iii) The possibility of any reimbursement.

TRADE RECEIVABLES

Trade receivable are an essential part of any organization's balance sheet. often referred to as debtors.

Following points need to be considered in respect of trade receivables:

a) Only bona fide sales lead to trade receivables.
b) All such sales are made to approved customers.
c) All such sales are properly recorded in the books of accounts.
d) Segregation of duties at every point in sales transaction.
e) Debts are collected on time.
f) In case debtors are not collected in time, sending reminders and taking legal actions if required.
g) Balances are regularly reviewed.
h) A proper system of follow up exists and if necessary, adequate provision for bad debt should be made by preparing adequate ageing schedule of the debtors.

1) Existence

a) **Check** whether there are **controls in place** to ensure that invoices **cannot be recorded more than once**.
b) Ask for a **period-end accounts receivable aging report**.
c) **Check** whether realization is recorded **invoice- wise or not**.
d) If realization is made on account, **verify** whether the Company has obtained **confirmations from debtors** in respect of the same.
e) If any large balance is due for a long time, auditor should ask for **reasons and justification** for the same.

2) Direct Confirmation Procedures (Refer SA 505)

a) A significant and important audit activity is **to contact customers directly and ask them to confirm the amounts of unpaid accounts receivable** as of the end of the reporting period under audit.
b) This should **necessarily be done for all significant account balances** as at the period- end while certain random customers having smaller outstanding invoices should also be selected.
c) There may be situations where the **management of the entity requests the auditor not to seek confirmation** from certain trade receivables.
d) In such cases, the auditor should consider whether there are **valid grounds** for such a request.
e) The trade receivables may be requested to confirm the balances either

i) As at the date of the balance sheet, or

ii) As at any other selected date which is reasonably close to the date of the balance sheet.

f) The form of requesting confirmation from the trade receivables may be either

i) The form with balance outstanding amount as per the company, or

ii) The form without any balance mentioned therein. The use of the form without any balance is preferable.

g) The auditor should **maintain strict control** to ensure the correctness and proper dispatch of request letters.

h) It should be ensured that **confirmations as well as any undelivered letters are returned to the auditor** and not to the client.

i) Any **discrepancies** revealed by the confirmations received or by the **additional tests carried out by the auditor** may have a bearing on other accounts not included in the original sample.

j) **Where no reply is received**, the auditor should perform **alternate procedures** regarding the balances. This could include:

i) **Agreeing the balance to cash received subsequently;**

ii) **Preparing a detailed analysis of the balance, ensuring it consists of identifiable transactions and confirming that these revenue transactions actually occurred;**

k) If there are any **related party receivables**, review them for **collectability**, as well as whether they were **properly authorized** and the value of such transactions were reasonable and at **arm's length.**

3) Completeness & Cut-Off

a) The auditor needs to satisfy himself of **correct and proper cut-offs**. Without a correct cut-off, sales could be understated or overstated, hence, the need to perform the **following cut off tests:**

i) **For the invoices issued during the last few days** (last 5 days of the reporting year) i.e. cut-off date and which have been included in the debtors; check that the goods should have been dispatched and not lying with the Company;

ii) **Ensure** that all goods dispatched **prior to the period/ year-end** have been invoiced and included in debtors on a test check basis;

iii) **Ensure** that no goods dispatched **after the year- end** have been invoiced and included in debtors for the period under audit.

b) **Test** invoices listed in receivable report. Select few invoices from the accounts receivable ageing report and compare them to **supporting documentation** to see if they were billed with the correct **amounts**, to the **correct customers**, and on the correct dates.

4) Valuation

a) **Review the process** followed by the Company to derive an **allowance for doubtful accounts.**

b) **Obtain the ageing report** of accounts receivable (both Dr/Cr balance), split between not currently due, 30 days old, 30-60 days old, 60- 180 days old, 180- 365 days old and more than 365 days old.

c) **Obtain the list of debtors under litigation and compare with previous year.**

d) Scrutinize the analysis and **identify those debts which appear doubtful.**

e) Perform **further testing where any disputes exist.**

f) Check that **write-offs of the receivable balances** have been approved by an appropriate authority i.e. the Board of Directors in case of a company.

5) Presentation & Disclosure

a) **Check** that the **restatement of foreign currency** trade receivables has been done properly as per AS 11.

b) **Proper disclosure** of **Related Party Transactions** regarding receivables have been made as per AS 18 or IND AS 24.

c) Ensure whether the following disclosures as required under Schedule III (Part 1) to Companies Act, 2013 are made for each amount disclosed under the heading "Trade Receivables":

i) Trade Receivable ageing schedule **(Refer table 1)**

ii) Trade receivable shall be sub-classified as:

- Secured, considered good
- Unsecured, considered good
- Doubtful.

iii) Allowances for bad and doubtful debts shall be disclosed under the relevant heads separately.

iv) Debts due by

- Directors or Other officers of the company or Any of them either severally or Jointly with any other person
- Firms or Private companies respectively in which any director is a partner or director or member should be separately stated.

Trade Receivable ageing schedule (Table 1)

Particulars	Outstanding for following periods from due date of payments.					
	Less than 6 Months	6 Months 1 Year	1-2 Years	2-3 Years	More than 3 Years	Total
i) Undisputed TR - Considered Good.						
ii) Undisputed TR - Considered Doubtful.						
iii) Disputed TR - Considered Good.						
iv) Disputed TR - Considered Doubtful.						

CASH AND CASH EQUIVALENTS

1) Existence & Completeness

a) Special care is necessary in regard to **verification of cash balances** for unless they are checked by surprise.

b) **Cash should be checked not only on the last day of the year, but also checked again sometime after the close of the year without giving notice** of the auditor's visit either to the entity or to his staff.

c) It is desirable for **cashier to be present while cash is counted** and sign should be taken of cashier on statement prepared for such counting.

d) If **he is absent** at the time the cash is being verified, he may hold the **auditor responsible for the shortage**, if any, in cash.

e) The auditor should also **perform a cash sensitivity analysis** by compiling a summary of total cash receipts and payments each month and analyzing the trends to see if there have been variations.

f) The auditor needs to **obtain bank reconciliation statements** for all bank accounts maintained by the entity.

g) The auditor should ensure that BRS is signed by the **authorized personnel** so that he is able to assign responsibility in case of any errors.

2) Direct confirmation procedures

a) A significant and important audit activity is to **contact banks / financial institutions directly and ask them to confirm** the amounts held in current accounts, deposit accounts, EEFC account, cash credit accounts, restrictive use accounts like dividend, escrow accounts as of the end of the reporting period under audit.

b) This should necessarily be done **for all account balances** as at the period-end.

c) The Company should be **asked to investigate and reconcile the discrepancies**, if any including seeking written explanations / clarifications from the banks / financial institutions on any unresolved queries.

d) The auditor should **emphasize for confirmation of 100%** of bank account balances.

e) In remote situations where no reply is received, the auditor should perform additional testing regarding the balances.

f) **This testing could include:**

   i. Agreeing the balance to bank statement received by the Company or internet/ online login to account in auditor's personal presence;

   ii. **Sending the audit team member** to the **bank branch** along with the entity's personal to obtain balance confirmation from the bank directly.

3) Valuation

In addition to the procedures performed above, the auditor should **ensure** that all bank account **holding foreign currency** have been **restated at the closing exchange rates as per AFRF.**

4) Presentation & Disclosure

Ensure whether the following disclosures as required under **Schedule III (Part I) to Companies Act, 2013** have been complied:

a) **Cash and cash equivalents shall be classified as:**

   i) Balances with banks;

   ii) Cheques, drafts on hand

   iii) Cash on hand;

   iv) Others (specify nature)

b) Earmarked balances with banks.

c) Balances with banks to the extent held as margin money or security against the borrowings, guarantees, other commitments.

d) Repatriation restrictions, if any, shall be separately stated.

e) Bank deposits with more than 12 months' maturity shall be disclosed separately.

INVENTORIES

1) Existence

a) **Review** entity's plan for performing inventory count.

b) **Ensure** that consigned goods have been **segregated**.

c) Auditor should **participate in the inventory count** with the management.

d) Test counts of inventory by auditor should include:

i) Observing employees are adhering to the agreed plan.

ii) Assuring that there is appropriate supervision on the count procedure.

iii) Assuring that all items are properly tagged.

iv) Staying alert at all times and specifically being cautious about empty boxes, etc. and obsolete items.

v) Performing cut-off testing by documenting last 5-10 receiving reports and shipping documents as of the period end.

vi) Ensuring exclusion of third party stock and damaged or obsolete stock.

vii) Ensuring the accounting of all stock sheets.

viii) Investigating any significant differences between the physical stock take and the stock records as per books.

e) **Confirm or investigate** public warehouse inventory of clients and also **inventory lying with third parties**.

2) Completeness & Cut-Off

a) **Perform analytical procedures:**

i) **Compute inventory turnover ratio** (COGS/ average inventory)

ii) Perform **vertical analysis** (inventory/ total assets)

iii) Compare **budgetary expectations vs actuals**

b) Examine **non-financial information** related to inventory, such as weights and other measurement.

c) **Perform purchase and sales cut-off tests.** Trace shipping documents to accounting records immediately before and after year-end.

d) **Verify** the **clerical and arithmetical accuracy** of inventory listings.

3) Rights & Obligations

a) **Vouch** recorded purchases to underlying documentation. **Evaluate** the consigned goods. **Review** material purchase commitment agreements.

b) **Examine** client correspondence, sales and receivables records, purchase documents.

c) **Determine existence** of collateral agreements.

d) **Review** consignment agreements.

e) Auditor shall obtain confirmation for significant items of inventory as per SA 501.

f) **For instances of inventory held by third party**, the auditor should insist on **obtaining declaration from the third party on its business letterhead and signed by authorized personnel** of that third party confirming that the items of inventory belong to the entity and are being held by such third party on behalf of and for the benefit of the entity under audit.

4) Valuation

a) **For Raw materials and consumables**

i) **Ascertain** what elements of cost are included **example** carriage inward, non-refundable duties etc.

ii) If standard costs are used, **enquire** into basis of standards, **how these are compared** with actual costs and **how variances are analyzed and accounted** for / treated in accounting records.

iii) **Test check cost prices** used with purchase invoices received in the month(s) prior to counting.

b) **For Work in progress**

i) **Ascertain** how the various stages of production / value additions are **measured** and in case estimates are made, **understand the basis** for such estimates.

ii) **Ascertain** what elements of cost are **included.**

iii) **If overheads are included**, ascertain the **basis on which they are included** and compare such basis with the available costing and financial data / information maintained by the entity.

c) **For Finished goods and goods for resale**

i) **Enquire** as to what costs are included, **how these have been established** and **ensure** that the overheads included have been **determined** based on normal costs and appear reasonable in relation to the information disclosed in the FS's.

ii) **Ensure** that inventories are **valued at net realizable value** if they are **likely to fetch a value lower than their cost.**

iii) Carefully examine the valuation of obsolete and damaged inventory. For the purpose, request the client to provide **inventory ageing** split and between less than 30 days, 30-60 days old, 60-90 days old, 90-180 days old, 180-385 days old and more than 365 days old.

iv) **Examine vendor price** lists to determine if recorded cost is less than current prices.

v) **Calculate inventory turnover ratio.**

vi) **Verify the correct application of lower-of-cost-or-net realizable value principles.**

5) Presentation & Disclosure

Ensure whether the following disclosures as required under **Schedule III (Part 1) to the Companies**

Act, 2013 have been made:

a) Whether inventory has been classified as:
   i) Raw materials
   ii) Work-in-progress
   iii) Finished goods
   iv) Stock-in-trade (goods acquired for trading)
   v) Stores and spares
   vi) Loose tools
   vii) Others (specify nature).

b) Whether **goods-in-transit** have been disclosed separately under each sub-head of inventories.

c) Mode of valuation shall be stated.

LAND, BUILDING, PLANT & EQUIPMENT, FURNITURE & FIXTURES, VEHICLES, OFFICE EQUIPMENT, COMPUTERS ETC. REFERRED TO AS "PROPERTY, PLANT AND EQUIPMENT" ("PPE")

1) **Recognition Criteria for PPE:** The cost of an item of PPE should be recognised as an asset if, and only if:
   a) It is probable that **future economic benefits** associated with the item will flow to the **enterprise**, and
   b) The **cost of the item can be measured** reliably.

2) **Measurement at Recognition:** An item of property, plant and equipment that qualifies for recognition as an asset should be **measured at its cost**.

3) **Elements of Cost:** The cost of an item of property, plant and equipment comprises:
   a) Its **purchase price**, including **import duties and non -refundable purchase taxes**, after deducting trade discounts and rebates.
   b) Any costs directly attributable **to bringing the asset to the location and condition** necessary for it to be capable of operating in the manner intended by management.
   c) The initial estimate of the costs of dismantling, removing the item and restoring the site on which it is located, referred to as decommissioning, restoration and similar liabilities'.

1) Existence

a) **Review** client's plan for performing physical verification of PPE i.e. whether performed by **own staff** or by **a third party** and the policy regarding **periodicity**.

b) Obtain **PPE physical verification report** backed by the working sheets from the entity and perform the following procedures:
   i) **Assess if all items of PPE are properly tagged** and carry identification marks / numbers.

ii) **Reconciliation of items of PPE as physically verified with the fixed asset register** maintained by the entity as at the date/ period of undertaking physical verification.

iii) **Verify the discrepancies noted**, based on physical verification undertaken and the manner in which such discrepancies have been dealt with in the entity's books.

2) Completeness

a) **Verify movement in PPE schedule** compiled by management i.e. **Opening + Additions - Deletions = Closing** and **tally** closing balance to entity's books of account.

b) Check the **arithmetical accuracy** of the movement in PPE schedule, tally the opening balances to the previous year audited FS's.

c) **For additions during the period under audit Obtain a listing of all additions from the management and perform the following procedures:**

   i) For all **material additions**, verify if such expenditure meets the criteria of PPE as per **AS 10 (Revised).**

   ii) **Verify that the cost** of an item of property, plant and equipment **is as per AS 10 Revised.**

   iii) Ensure that the entity is **not recognizing costs of the day-to-day servicing** in the carrying amount of an item of property, plant and equipment.

   iv) **Test the purchase invoice**, installation certificate or report or other similar documentation maintained by the entity to verify the date of addition, for all additions samples of PPE during the period under audit.

   v) Verify whether the PPE additions have been approved by authorized personnel.

   vi) **Verify whether proper internal processes and procedures** like inviting competitive quotations/ floating tenders etc. were followed prior to finalizing the vendor for procuring items of PPE/ awarding of work contract for capital projects by checking the supporting documents of the samples selected.

d) **In relation to deletions to PPE**

   i) **Understand from the management the reason and rationale for deletion and the manner of disposal.**

   ii) Obtain the **management approval and discard note** authoring disposal of the asset from its active use.

   iii) Verify the process followed for sale of discarded PPE, **for example** inviting competitive quotes, tenders and the basis of calculation of sales proceeds.

   iv) **Verify that the management has accurately recorded the deletion of PPE** (original cost and accumulated depreciation up to the date of disposal) and the resultant gain/ loss on disposal of PPE item in the entity's books of account.

3) Valuation

a) It is a common understanding that the value of fixed assets / PPE depreciates due to **efflux of time, use and obsolescence**. The diminution of the value represents an item of cost to the entity for earning revenue during a given period.

b) **The auditor should:**

i) **Verify that entity has charged depreciation** on all items of PPE unless any item of PPE is non-depreciating like freehold land;

ii) **Assess** that depreciation method used **reflects pattern** in which asset's future economic benefits are expected to be consumed by entity.

iii) Auditor should also **verify** whether management has done an **impairment assessment** to determine whether an item of PPE is impaired as per **AS 28 - Impairment of Assets.**

4) Rights & Obligations

Verify that all PPE **purchase** invoices are in the **name of the entity** that entitles legal title of ownership to the respective entity.

The auditor should **insist and verify the original title deeds** for all immoveable properties held as at the balance sheet date.

In case the entity has given such immoveable property as **security** for any borrowings and the original title deeds are not available with the entity, the auditor should **request the entity's management** for **obtaining a confirmation** from the respective lenders that they are holding the original title deeds of immoveable property as security.

In addition, the auditor should also verify the **register of charges,** available with the entity to assess that any charge has been created against the PPE.

5) Presentation & Disclosure

Ensure whether the following disclosures as required under **Schedule III (Part 1)** to Companies Act, 2013 have been made

a) **Classification shall be given as:**

i) Land;

ii) Buildings;

iii) Plant and Equipment;

iv) Furniture and Fixtures;

v) Vehicles;

vi) Office equipment;

vii) Others (specify nature).

b) Assets under lease shall be separately specified under each class of asset.

c) A reconciliation of the gross and net carrying amounts of each class of assets at the beginning and end of the reporting period showing additions, disposals, acquisitions through business combinations, amount of change due to revaluation and other adjustments and the related depreciation and impairment losses / reversals shall be disclosed separately.

IMPORTANT NOTES

NOTE 1: Title deeds of Immovable Property not held in name of the Company

The company shall provide the details of all the immovable property whose **title deeds are not held in the name of the company** in format given below and where such immovable property is jointly held with others, details are required to be given to the extent of the company's share.

Relevant line item in the balance sheet	Description of item of property	Gross carrying value	Title deeds held in the name of	Whether title deed holder is a promoter, director or relative of promoter / director or employee promoter/ director	Property held since which date	Reason for not being held in the name of the company
PPE -	Land Building	-	-	-	-	also indicate if in dispute
Investment property	Land Building					
PPE retired from active use and held for disposal	Land Building					
Others						

Note 2: Where The Company Has Revalued Its Property, Plant And Equipment

The company shall disclose as to whether the revaluation is based on the valuation by a registered valuer.

Note 3: Capital-Work-In Progress (CWIP)

a) For Capital-work-in progress, following ageing schedule shall be given: CWIP ageing

CWIP	Amount in CWIP for a period of				Total
	Less than 1 Year	1-2 Years	2-3 Years	More than 3 Years	
Projects in Progress					
Projects temporarily suspended					

b) For capital-work-in progress, whose completion is overdue or has exceeded its cost compared to its original plan, following CWIP completion schedule shall be given :

CWIP	To be completed in			
	Less than 1 Year	1-2 Years	2-3 Years	More than 3 Years
Project1				
Project2				

INTANGIBLE ASSETS (COMPRISING GOODWILL, BRAND/ TRADEMARKS, COMPUTER SOFTWARE ETC.)

Meaning

1) An Intangible Asset is an **identifiable non-monetary asset**, without physical substance, **held for use in the production or supply of goods or services, for rental to others**, or for **administrative purposes.**
2) As per **AS 26 - Intangible Assets**, internally generated **goodwill should not be recognized** as an asset.
3) Some intangible assets may be contained in or on a **physical substance** such as a compact disk (in the case of computer software), legal documentation (in the case of a licence or patent) or film (in the case of motion pictures).
4) The **cost of the physical substance** containing the intangible assets **is usually not significant.** Accordingly, the physical substance containing an intangible asset, though tangible in nature, is **commonly treated as a part of the intangible asset** contained in or on it.
5) In some cases, an asset may incorporate both intangible and tangible elements that are, in practice, inseparable.
6) **For example**, computer software for a computer controlled machine tool that cannot operate without that specific software is an integral part of the related hardware and it is treated as a fixed asset. The same applies to the operating system of a computer. Where the software is not an integral part of the related hardware, computer software is treated as an intangible asset.

1) Existence

a) Since Intangible assets are **non-monetary assets** without physical substance, auditor should verify whether such intangible assets are in **active use or not.**
b) In case any intangible asset is not in active use, **deletion** should have been **recorded** in the books of

account **post approvals** by the entity's management and amortization charge should have ceased to be charged beyond the date of deletion.

2) Completeness

a) Verify **movement in the Intangible assets** schedule (asset class wise like software, designs / drawings, goodwill etc.) compiled by the management i.e. **Opening + Additions – Deletions = Closing** and **tally** the closing balance to the entity's books of account.

b) Check the **arithmetical accuracy** of the movement in intangible asset schedule, tally the opening balances to the previous year audited FS's.

c) For **additions during the period** under audit - Obtain a listing of all additions from the management and undertake the following procedures:

   i) For all material additions, **verify** whether such expenditure meets the criterion for recognition of an intangible asset as per **AS 26**.

   ii) **Ensure** that no intangible asset arising from research should be **recognised**.

   iii) **Verify** whether the additions (acquisitions) have been **approved by appropriate entity's personnel**.

   iv) Verify whether **proper internal processes and procedures** like inviting competitive quotations/ proper tenders etc. **were followed** prior to finalizing the vendor for procuring item of intangible assets by testing those documents on a sample basis.

d) In relation to **deletions** to intangible assets,

   i) Understand from the management the **reason and rationale** for deletion and the manner of disposal.

   ii) Obtain the **management approval and discard note** authoring discard of the asset from its active use.

   iii) **Verify** that the management has **accurately recorded** the deletion of intangible asset.

3) Valuation

a) The value of intangible assets may diminish due to efflux of time, use and/ or obsolescence. The diminution of the value represents cost to the entity for earning revenue during a given period.

b) The **auditor should verify** that:

   i) Entity has **charged amortization** on all intangible assets;

   ii) Amortization method used reflects the pattern in which the asset's future economic benefits are expected to be consumed by the entity.

   iii) Also verify that management has undertaken an **impairment assessment** to determine whether an intangible asset is impaired.

   iv) Whether management has applied **AS 28 - Impairment of Assets** for determining carrying amount and recoverable amount of assets to determine impairment losses if any.

4) Rights & Obligations

In addition to the procedures for **verifying completeness** of additions to intangible assets during the period under audit, the auditor while performing testing of additions should also **verify** that all expense invoices / purchase contracts are in the name of the entity that entitles legal title of ownership to the respective entity.

5) Presentation & Disclosure

Ensure that the following disclosures as required under **Schedule III (Part 1) to Companies Act, 2013** have been made

a) Classification shall be given as:

I) Goodwill

ii) Brands/trademarks

iii) Computer software

iv) Mastheads and publishing titles

v) Mining rights

vi) Copyrights, and patents and other intellectual property rights, services and operating rights

vii) Recipes, formulae, models, designs and prototypes

viii) Licenses and franchise

ix) Others

b) A reconciliation of the gross and net carrying amounts of each class of assets at the beginning and end of the reporting period showing additions, disposals, acquisitions through business combinations, amount of change due to revaluation.

NOTE 1: INTANGIBLE ASSETS UNDER DEVELOPMENT

a) **For Intangible assets under development, following ageing schedule shall be given:**

Intangible Assets under development ageing schedule

Intangible assets under development	Amount in CWIP for a period of				Total
	Less than 1 Year	1-2 Years	2-3 Years	More than 3 Years	
Projects in Progress					
Projects temporarily suspended					

b) **For Intangible assets under development, whose completion is overdue or has exceeded its cost compared to its original plan, following Intangible assets under development completion schedule shall be given:**

Intangible assets under development	To be completed in			
	Less than 1 Year	1-2 Years	2-3 Years	More than 3 Years
Project 1				
Project 2				

LOANS & ADVANCES AND OTHER CURRENT ASSETS

1) Loans and advances include loans and advances to
   a) Related parties,
   b) Security deposits,
   c) Capital advances,
   d) Amounts recoverable in cash or in kind or for value to be received.
2) Other current assets primarily include balances with statutory / government authorities etc.

1) Existence

For establishing existence of loans and advances, **direct confirmation procedures**, similar to those performed for ''**Accounts receivable**'' balances are should be performed with the only difference that while undertaking circularization of direct confirmations, in addition to the **principal amount, interest received / receivable**, if any, as per the agreed terms between the parties, may also be included as part of the balance to be confirmed.

2) Completeness

a) Obtain a **list of all advances and other current assets** and compare them with balances in the ledger. **Verify loan agreements** and acknowledgements of parties in respect of outstanding loans.
b) **Inspect the minutes of meeting** of BOD to confirm if all material loans and advances were approved by the BOD.
c) Verify that the **loan has been acknowledged by the party** and in addition, inspect if any security has been deposited against due repayment of the loan.
d) If there are any **related party loans and advances**, review whether they were **properly authorized** and the value of such transactions were reasonable and at **arm's length**. Verify whether **proper internal processes and procedures** like inviting competitive quotations/ proper tenders etc. **were followed** prior to finalizing the vendor for procuring item of intangible assets by testing those documents on a sample basis.

3) Valuation

a) **Assess** the allowance for doubtful accounts. **Review the process** followed by the Company.

b) Obtain the **ageing report** of loans and advances, split between not currently due, 30 days old, 30 - 60 days old, 60 - 180 days old, 180 - 365 days old and more than 365 days old.

c) Also, obtain the **list of loans and advance under litigation** and compare with previous year.

d) **Scrutinize the analysis** and identify those loans and advances that appear doubtful;

e) Check that the **restatement of foreign currency loans and advances** / other current assets has been done properly **in accordance with AS 11**.

4) Presentation & Disclosure

Ensure whether the following disclosures as required under Schedule III to Companies Act, 2013 have been made:

Long Term loans & Advances

a) Long-term loans and advances shall be classified as:

- Loans to **related parties**
- Capital advances
- Other loans and advances (specify nature).

b) The above shall also be separately sub- classified as:

- Secured, considered good
- Unsecured, considered good
- Doubtful.

c) Allowance for bad and doubtful loans and advances shall be disclosed.

d) Loans and advances due by

- Directors or other officers of the company or any of them either severally or jointly with any other persons or
- Amounts due by firms or private companies respectively in which any director is a partner or a director or a member should be separately stated.

Short Term loans & Advances

a) Short-term loans and advances shall be classified as:

- Loans and advances to **related parties**
- Others

b) The above shall also be separately sub- classified as:

- Secured, considered good
- Unsecured, considered good
- Doubtful.

c) Allowance for bad and doubtful loans and advances shall be disclosed.

d) Loans and advances due by

- Directors or other officers of the company or any of them either severally or jointly with any other persons or
- Amounts due by firms or private companies respectively in which any director is a partner or a director or a member should be separately stated.

IMPORTANT NOTE

Following disclosures shall be made where Loans or Advances in the nature of loans are granted to promoters, Directors, KMPs and the related parties either severally or jointly with any other person, that are:

a) Repayable on demand or

b) Without specifying any terms or period of repayment

Type of Borrower	Amount of loan or advance in the nature of loan outstanding	Percentage to the total Loans and Advances in the nature of loans
Promoters		
Directors		
KMPs		
Related		
Parties		

D: STATEMENT OF PROFIT AND LOSS CAPTIONS

SALE OF PRODUCTS AND SERVICES

Auditor needs to obtain a clear understanding about the organization and its revenue centers. To understand the same, he should consider the following:

1) An auditor needs to **obtain an understanding of the management control** in respect of sales process.
2) An auditor **tests the controls the entity** has set up for the sales cycle to **determine how strong and reliable they are**. If yes, then auditor can reduce the amount of transaction testing he must do.
3) **Performing substantive audit procedures is must**. It will consist of **sales trend analysis, comparison with previous accounting period, category wise sales** etc.
4) The auditor selects a **random sample of transactions and examines** the related customer purchase orders, invoices and customer statements to ensure that the control being tested is a numbered sales invoice. This will enable the auditor to determine the nature, timing and extent of his substantive procedures to be applied.

1) Occurrence

Specific question – Overstatement of revenue

a) Ensure revenue is **not overstated** by performing following audit procedures:
   i) **Check whether a single sales invoice is recorded twice or a cancelled sales invoice could also be recorded.**
   ii) **Test check few invoices with their relevant entries in sales journal.**
   iii) **Obtain confirmation from few customers to ensure genuineness of sales transaction.**
   iv) **Whether any fictitious customer and sale has been recorded.**
   v) **Whether unearned revenue recorded as earned.**
   vi) **Whether any substantial uncertainty exists about collectability.**
b) Calculate and review **ratio of sales return to overall sales** and compare it with previous year and note down the reason for increase/ decrease.
c) **Check** sales return with sales invoice, challan, credit note, stock register, etc.

2) Completeness & Cut-Off

a) **Perform appropriate cut-off** procedure to evaluate whether revenue transactions are recognized in appropriate accounting period.
b) **Cut-off errors will arise when companies recognise revenue based on the date on which the sales invoices are generated** rather than the date on which the risks and rewards are transferred

to the buyer.

c) Sometimes to achieve performance target, sales employee can make **fictitious / ghost sales.**

3) Measurement

a) **Trace** a few transactions from **inception to completion.**

b) If the client is engaged in export sales, then **compliance with AS 11** shall be ensured.

c) Auditor must understand **client's operations and related GAAP issues example** point of sale revenue recognition vs. percentage of completion, wherever applicable.

d) Compare the **rate of sales affected with related parties** and review them for collectability, whether they were **properly authorized** and the **value of such transactions** were reasonable and at **arm's length**

4) Presentation & Disclosure

Ensure whether the following disclosures as required under **Schedule III (Part II) to Companies Act, 2013** have been made:

A. In respect of a company other than a finance company revenue from operations shall disclose separately in the notes revenue from:

a) Sale of products;

b) Sale of services;

c) Other operating revenues;

Less:

d) Excise duty.

B. In respect of a finance company, revenue from operations shall include revenue from:

a) Interest; and

b) Other financial services.

OTHER INCOME COMPRISING INTEREST INCOME, DIVIDEND INCOME, GAIN / LOSS ON SALE OF INVESTMENTS ETC.

1) **Interest income on FD's** are recognized on a **time proportion basis** including the amount outstanding and the applicable interest rate.

2) **Dividends are recognised** in the statement of profit and loss only when:

   a) The entity's **right to receive payment** of the dividend is **established;**

   b) It is probable that the **economic benefits associated with the dividend will flow** to the entity; and

   c) Dividend amount can be **measured reliably.**

3) **Gain/(loss) on sale of investment in mutual funds** is recorded as other income on **transfer of title**

from the entity and is determined as the **difference between the redemption price and carrying** value of the investments.

1) Audit procedure for Interest Income [SQ]

For verifying interest income on FD's:

a) Obtain a **listing of FD's** opened during the period under audit along with the applicable interest rate and the number of days for which the deposit was outstanding during the period.

b) **Verify the arithmetical accuracy of the interest** calculation made by the entity by recomputing.

c) For deposits still outstanding, **trace the same to the direct confirmation** obtained from the respective bank/ financial institution.

d) Obtain a **confirmation of interest income** from the bank and verify that the interest income as per bank reconciles to the calculation.

e) Obtain a copy of **Form 26 AS** and reconcile the interest reflected therein to the calculation shared by client.

2) Audit procedure for Dividend Income

Verify that the dividends are recognised in the statement of profit and loss only when the entity's right to **receive payment of the dividend is established.**

3) Gain / (loss) on sale of Investment in Mutual Funds

1) Verify that **Gain / (loss) on sale of investment in mutual funds is recorded as other income** only on -

a) Transfer of title from the entity and

b) Is determined as the difference between the redemption price and carrying value of the investments.

2) For the purpose, obtain the mutual fund statement and trace the gain / loss as recorded in the books of account to the gain / loss as reflected in the statement

4) Presentation and Disclosure

Ensure whether the following disclosures as required under **Schedule III to Companies Act, 2013** have been made:

Whether **'other income'** has been classified as -

a) **Interest income**

b) **Dividend income**

c) **Net gain/loss on sale of investments**

d) **Other non-operating income (net of expenses directly attributable to such income)**

PURCHASES

1) An auditor tests the controls the entity has set up for the purchase cycle to **determine whether they are effective or not.**
2) **If the controls are effective, the auditor can reduce the extent of substantive testing.**
3) Common internal controls over the purchase cycle include -
   a) Inviting of competitive quotations for shortlisting the vendor,
   b) Numbered purchase orders,
   c) Purchase order authorization over a certain limit,
   d) 2 way / 3-way match,
   e) Authorization of purchase invoices.
4) **Performing substantive audit procedures is must.** Substantive analytical procedure will consist of **purchase trend analysis, comparison with previous accounting period, category wise purchases**
5) The auditor **selects a random sample of transactions and examines** the related purchase orders, GRN, purchase invoices, inward gate entry register and vendor reconciliation/ statements.

1) Occurrence

Ensure purchases are not understated/ overstated by performing following audit procedures:

a) Whether any **fictitious vendor and purchase** has been recorded by reviewing the vendor selection process followed by the entity and also performing procedures to ensure existence of the vendor.
b) Whether the **goods were received at the factory gate** and **whether there exists an entry in the security gate inward register**
c) Whether **quality inspection of goods** was done
d) Whether the **purchase invoice was approved** as per delegation of authority and whether a 3 or 2-way match was done.
e) Whether a **goods receipt note** was prepared and signed by an appropriate client personnel.
f) Whether **stock record** has been updated by the stores personnel.

2) Special considerations during audit of purchases

a) The purchase invoice received should be the "Original" copy (and not photocopy / carbon copy) against which the entity has recorded the purchase in its books of account.
b) Purchase invoice should have been booked only once risk and reward incidental to ownership has been transferred to the entity.
c) Purchase invoice should be in the name of entity. However, in case of different branches, it should be addressed to the appropriate branch.

3) Completeness & Cut-Off

a) Perform **cut-off test** to ensure that purchases are recognised in the **correct accounting period**.

b) The auditor should **examine material inward** records for few days say **last 5 days** prior to closing date to check that all corresponding invoices have been duly entered in the Purchases book and none have been omitted.

4) Measurement

Perform **analytical procedures** to obtain audit evidence as to overall reasonableness of purchase quantity and price which may include: **[SQ]**

a) **Consumption Analysis:** Auditor should scrutinize RM consumed during the year as per manufacturing account and compare the same with previous years with closing stock to identify if there are any material change.

b) **Stock Composition Analysis:** Auditor to collect the reports from management for composition of stock i.e. raw materials as a percentage of total stock and compare the same with previous year and ask for reasons from management in case of significant variations.

c) **Ratios:**

i) Auditor should compare the creditors turnover ratios and stock turnover ratios of the current year with previous years.

ii) Auditor should review quantitative reconciliation of closing stocks with opening stock, purchases and consumption.

5) Presentation & Disclosure

Ensure whether the following disclosures as required under **Schedule III (Part II)** to Companies Act, 2013 have been made:

a) Whether **purchases of stock-in-trade** has been specifically disclosed

b) Whether **changes in inventories** of finished goods, stock-in-trade and work- in-progress have been specifically disclosed.

c) Whether the **transactions with related parties** are appropriately disclosed in notes to accounts.

EMPLOYEE BENEFITS EXPENSE

Auditor needs to obtain a **clear understanding** about the **organisation and its hiring, appraisal and retirement process** in the following manner:

1) An auditor tests the controls the entity has enclosed employee benefit payment process to **determine how effective they are**. If they are **effective**, the auditor can reduce the **substantive testing**.

2) **Common internal controls** over the employee benefit payment cycle includes -

a) **Maintaining of attendance records**
b) **Employee master,**
c) **Authorisation and approval of monthly payroll processing and**
d) **Disbursement,**
e) **Computation of employee deductions like payroll taxes,**
f) **Accrual of other benefits like gratuity, leave encashment, bonus etc.**

3) **Performing substantive audit procedures is must.** Substantive analytical procedure will consist of **monthly expense reasonability, comparison with previous accounting period.**
4) The auditor selects a **random sample of transactions and examines** the related appointment letters, appraisal letters, attendance records, HR policies, employee master etc.

1) Occurrence & Completeness

a) **Obtain an understanding** of entity's process of capturing employee attendance.
b) There is always a risk that an entity could record expense for **fictitious employees.** The auditor may choose to **meet the employees in person**, on a sample basis.
c) Obtain a list of employees as at the period- end along with a monthly movement **split between new hires, leavers and continuing employees.**
d) For a sample (selected randomly) of **new hires, obtain the appointment letter.**
e) For a sample (selected randomly) of **resigned employees, obtain their full and final computation**

2) Measurement

a) **Obtain the monthly salary registers for all 12 months.** Compile a monthly payroll reasonability by calculating the average salary per employee per month and compare with the previous year and preceding month and analyses the reasons for variance.
b) Verify if **accrual/ provision** has been made for all employee benefits and obligations like bonus, gratuity, leave encashment etc.
c) **Perform analytical procedures** to obtain audit evidence as to overall reasonableness of employee benefit expense which may include production per employee analysis.

3) Presentation & Disclosure

Ensure whether the following disclosures as required under **Schedule III (Part II) to Companies Act, 2013** have been made:

Employee Benefits Expense

a) Salaries and wages
b) Contribution to provident and other funds,
c) ESOP and ESPP
d) Staff welfare expenses

DEPRECIATION AND AMORTISATION

Auditor **should keep in mind certain attributes while verifying D & A expenses.[SQ]**

a) Obtain the **understanding of entity's accounting policy** related to D & A.

b) Ensure the Company policy for charging D & A is **as per the relevant provisions of Companies Act, applicable accounting standards**.

c) Whether the depreciation has been calculated **after making adjustment** of residual value from the cost of the assets.

d) Whether D & A **charges are valid**.

e) Whether D & A charges are **accurately calculated and recorded**.

f) Whether all D & A charges are recorded in the **appropriate period**.

g) Ensure the parts (components) of each item of property, plant and equipment that are to be depreciated separately has been properly identified.

h) Whether the **most appropriate depreciation method** for each separately depreciable component has been used.

1) Completeness & Occurrence

a) Obtain an **understanding of entity's process** of charging D & A.

b) Obtain the **fixed asset register** maintained by the entity.

c) There is always a risk that an entity could capitalize expense of revenue nature to increase its profit or charge capital expenditure directly in income and expense statement to reduce its profit.

2) Measurement

1) Obtain a list of all **additions / deletions** along with their proper approval from the authorised person.

2) Select the **sample of assets** from the Fixed Assets Register, on materiality considerations and verify the rates of depreciation, depreciation calculation.

3) **Ensure** Intangible assets like patents, goodwill, copy rights have been **properly amortized over the period.**

4) Ensure depreciation is charged on the assets from the date when it is ready to use.

5) Ensure **depreciation on revalued amount** has been **properly accounted** from revaluation reserve.

6) **Perform analytical procedures** to obtain audit evidence as to overall reasonableness of Depreciation & Amortisation expense-

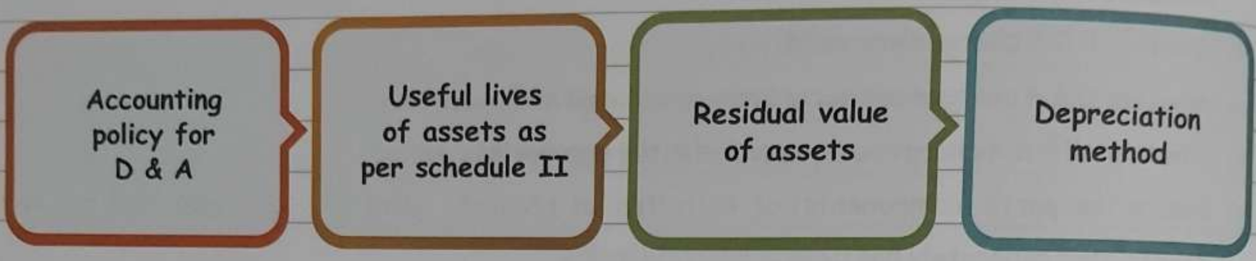
7) **Ensure** that the Depreciation & Amortisation has been **charged as per the useful lives of PPE and intangible assets.**

8) Ensure that **residual values** have been properly verified as that impacts the computation of depreciation.

9) **Ensure** that the Depreciation & Amortisation has been **computed prospectively** whenever there is any change in useful lives of PPE and intangible assets.

3) Presentation & Disclosure

Ensure whether the following disclosures as required under Schedule III to Companies Act, 2013 have been made:



OTHER EXPENSES LIKE POWER AND FUEL, RENT, REPAIR TO BUILDING, PLANT AND MACHINERY, INSURANCE, TRAVELLING, LEGAL AND PROFESSIONAL, MISCELLANEOUS EXPENSES.

While the auditor may choose to analyse the monthly trends for expenses like rent, power and fuel, an auditor generally prefers to **vouch** for other **expenses** to verify **following attributes:**

a) Whether the **expenditure pertained to current period** under audit;

b) Whether the **expenditure qualified as a revenue and not capital expenditure;**

c) Whether the **expenditure had a valid supporting documents** like travel tickets, insurance policy, third party invoice etc.;

d) Whether the **expenditure has been classified under the correct expense head;**

e) Whether the **expenditure was authorised** as per the delegation of authority matrix;

f) Whether the **expenditure was in relation to the entity's business and not a personal expenditure.**

1) Audit Procedures for Rent expense

1) Obtain a **month wise expense schedule** along with the rent agreements.
2) Verify if **expense has been recorded for all 12 months** and whether the rent amount is as per the underlying agreement.
3) Specific consideration should be given to **escalation clause** in the agreement to verify if the rent was to be increased/ adjusted during the period under audit.
4) Verify if the **agreement is in the name of the entity** and whether the expense pertains to premises used for running business operations of the entity.

2) Power and fuel expense

1) Obtain a **month wise expense** schedule along with the power bills.
2) Verify if expense has been recorded **for all 12 months**.
3) Compile a **month wise summary of power units consumed** and the applicable rate and check the arithmetical accuracy of the bill raised on monthly basis.
4) In relation to the units consumed, **analyse the monthly power units** consumed by linking it to units of FG's produced and investigate reasons for variance in monthly trends.

3) Insurance expense

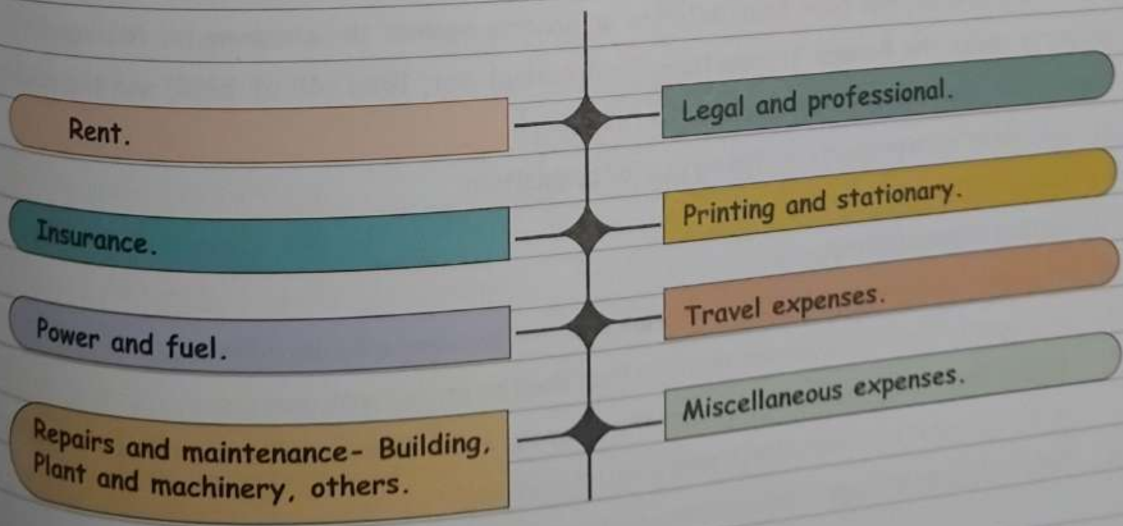
1) Obtain a summary of insurance policies taken along with their validity period.
2) Verify if the expense has been **correctly classified** between prepaid and expense for the period based on number of days.

4) Legal and professional expenses

1) Obtain a month wise and consultant wise summary.
2) In case of **monthly retainer ship agreements**, verify if the expenditure for all 12 months has been recorded correctly.
3) For non- **recurring expenses**, select a sample and vouch for the attributes discussed above.
4) The auditor should be cautious while vouching for legal expenses as the same may highlight a dispute for which the entity **may not** have made any provision

5) Presentation and Disclosure

Ensure other expense have been classified under:



IMPORTANT NOTES

Note 1: Corporate Social Responsibility (CSR)

Where the company covered under section 135 of the companies act, the following shall be disclosed with regard to CSR activities:

a) Amount required to be spent by the company during the year,
b) Amount of expenditure incurred,
c) Shortfall at the end of the year,
d) Total of previous years shortfall,
e) Reason for shortfall,
f) Nature of CSR activities,
g) Details of related party transactions, e.g., contribution to a trust controlled by the company in relation to CSR expenditure as per relevant Accounting Standard,
h) Where a provision is made with respect to a liability incurred by entering into a contractual obligation, the movements in the provision during the year should be shown separately.

Note 2: Details of Crypto Currency or Virtual Currency

Where the Company has traded or invested in Crypto currency or Virtual Currency during the financial year, the following shall be disclosed:

a) Profit or loss on transactions involving Crypto currency or Virtual Currency
b) Amount of currency held as at the reporting date,
c) Deposits or advances from any person for the purpose of trading or investing in Crypto Currency/ virtual currency.

Note 3 : Details of Benami Property Held

Where any proceedings have been initiated or pending against the company for holding any benami property under the Benami Transactions (Prohibition) Act, 1988 (45 of 1988) and the rules made thereunder, the company shall disclose the following:-

a) Details of such property, including year of acquisition,
b) Amount thereof,
c) Details of Beneficiaries,
d) If property is in the books, then reference to the item in the Balance Sheet,
e) If property is not in the books, then the fact shall be stated with reasons,
f) Where there are proceedings against the company under this law as an abetter of the transaction or as the transferor then the details shall be provided,
g) Nature of proceedings, status of same and company's view on same.

Note 4 : Relationship with Struck off Companies

Where the company has any transactions with companies struck off under section 248 of the Companies Act, 2013 or section 560 of Companies Act, 1956, the Company shall disclose the following details:-

Name of struck off Company	Nature of transactions with struck off Company	Balance outstanding	Relationship with the Struck off company, if any, to be disclosed
	Investments in securities		
	Receivables		
	Payables		
	Shares held by stuck off company		
	Other outstanding balances (to be specified)		

Note 5: Following Ratios to be disclosed:

a) Current Ratio,
b) Debt-Equity Ratio,
c) Debt Service Coverage Ratio,
d) Return on Equity Ratio,
e) Inventory turnover ratio,
f) Trade Receivables turnover ratio,
g) Trade payables turnover ratio,
h) Net capital turnover ratio,
i) Net profit ratio,
j) Return on Capital employed,
k) Return on investment.

The company shall explain the items included in numerator and denominator for computing the above ratios. Further explanation shall be provided for any change in the ratio by more than 25% as compared to the preceding year.

6 Audit Documentation

SA 230 - AUDIT DOCUMENTATION

Audit documentation refers to the record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached. (terms such as "working papers" or "work papers" are also sometimes used.)

OBJECTIVE OF THE AUDITOR

The objective of the auditor is to prepare documentation that provides:

A sufficient and appropriate record of the basis for the auditor's conclusion or report; and

Evidence that the audit **was planned** and **performed** in accordance with applicable SAs and regulatory requirements

PURPOSE OF AUDIT DOCUMENTATION

The following are the purpose of Audit documentation:

a) Assisting the engagement team **to plan and perform** the audit.

b) Assisting members of the engagement team **to direct and supervise** the audit work, and to discharge their review responsibilities.

c) Enabling the engagement team **to be accountable** for its work.

d) **Retaining a record** of matters of continuing **significance to future audits.**

e) Enabling the conduct of quality control reviews and inspections in **accordance with SQC 1.**

f) Enabling the **conduct** of external inspections in accordance **with applicable legal, regulatory or other requirements.**

FORM, CONTENT AND EXTENT OF AUDIT DOCUMENTATION

1) The auditor shall prepare audit documentation that is **sufficient** to enable an **experienced auditor**, having **no previous connection with the audit**, to understand:

   a) The **nature, timing and extent** of the audit procedures performed.

   b) The **results of the audit procedures performed**, and details of **audit evidences obtained** and

   c) **Significant matters** arising during the audit and the conclusions reached thereon and **significant professional judgements** made in reaching those conclusions.

2) Further in documenting the nature, timing and extent of audit procedures performed, the **auditor shall record:**

   a) **The identifying characteristics** of the specific items.

   b) **Who performed** the work and the **date such work** was completed; and

c) Who reviewed the work performed and the date and extent of such review.

3) If the auditor identified information that is inconsistent with the auditor's final conclusion, the auditor shall document how the auditor addressed the inconsistency.

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

a) The **size and complexity** of the entity.

b) The **nature of the audit procedures** to be performed.

c) The identified **risks of material misstatement**.

d) The significance of the **audit evidence** obtained.

e) The nature and extent of **exceptions** identified.

f) The **audit methodology** and tools used.

EXAMPLES OF AUDIT DOCUMENTATION

1) Audit documentation may be **recorded on paper or on electronic or other media.**

2) **Audit Documentation include:**

a) Audit programmes.

b) Analyses.

c) Issues memoranda.

d) Summaries of significant matters.

e) Letters of confirmation and representation.

f) Checklists.

g) Correspondence (including e-mail) concerning significant matters.

TIMELY PREPARATION OF AUDIT DOCUMENTATION

Preparing sufficient and appropriate audit documentation on a timely basis helps to enhance the **quality of audit** and facilitates **the effective review** and evaluation of the audit evidence obtained and conclusions reached before the auditor's report is finalized.

Documentation prepared **after the audit work** had been performed is likely to be less accurate than prepared at the time such work is performed.

AUDIT FILE

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

ASSEMBLY OF THE FINAL AUDIT FILE

1) The auditor shall assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis after the date of the auditor's report.
2) As per SQC - 1, audit firm should establish policies and procedures for the timely completion of the assembly of audit files.
3) **An appropriate time limit within which to complete the assembly of the final audit file is ordinarily not more than 60 days after the date of the auditor's report.**
4) The completion of the assembly of the final audit file after the date of the auditor's report is an **administrative process** that **does not** involve the **performance of new audit procedures** or the drawing of **new conclusions**.
5) Changes may, however, be made to the audit documentation **during the final assembly** process, if they are **administrative in nature.**
6) **Examples of such changes include:**
   a) **Deleting** or discarding superseded documentation.
   b) **Sorting**, collating and cross-referencing working papers.
   c) **Signing off on completion checklists** relating to the file assembly process.
   d) **Documenting** audit evidence that the auditor has obtained, discussed, and agreed with the relevant members of the engagement team **before the date of the auditor's report.**
7) **As per SQC - 1**, the **retention period** for audit engagements ordinarily is **no shorter than seven years** from the date of the auditor's report, or, if later, date of the group auditor's report.

DOCUMENTATION OF SIGNIFICANT MATTERS & RELATED SIGNIFICANT PROFESSIONAL JUDGMENTS

1) **Examples of significant matters include:** Matters that give rise to significant risks.
   a) **Results** of audit procedures indicating
      (i) That the FS's could be **materially misstated**, or
      (ii) **A need to revise** the auditor's previous assessment of the risks of material misstatement and the auditor's responses to those risks.
   b) Circumstances that cause the auditor **significant difficulty** in applying **necessary audit procedures.**
   c) **Findings** that could result in a **modification to the audit opinion** or the inclusion of an

Emphasis of Matter Paragraph in the auditor's report.

2) An **important factor** in determining the form, content and extent of audit documentation of significant matters is the **extent of professional judgment exercised** in performing the work and evaluating the results.

3) Documentation of the professional judgments made, where significant, serves to explain the auditor's conclusions and to reinforce the quality of the judgment.

COMPLETION MEMORANDUM OR AUDIT DOCUMENTATION SUMMARY

1) The auditor may consider it helpful to **prepare and retain** as part of the audit documentation a summary (sometimes known as a completion memorandum) that describes-
   a) The **significant matters** identified during the audit and
   b) **How they were addressed.**

2) Such a summary may **facilitate effective and efficient** review and inspection of the audit documentation, particularly **for large and complex audits.**

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

OWNERSHIP OF AUDIT DOCUMENTATION

1) **Standard on Quality Control (SQC) 1** provides that, unless otherwise specified by law or regulation, audit documentation is the **property of the auditor**.

2) He may at his discretion, **make portions of, or extracts from**, audit documentation available to **clients**, provided such disclosure does not undermine the validity of the work performed, or, in the case of **assurance engagements**, the **independence** of the auditor or of his personnel.

7

Completion and Review

CHAPTER OVERVIEW:

I. SA 260 - Communication with those Charged with Governance and Management

II. SA 265 - Communicating Deficiencies in Internal Control to those Charged with Governance and Management

III. SA 450 - Evaluation of Misstatements Identified during the Audit

IV. SA 560 - Subsequent Events

V. SA 570 - Going Concern

VI. SA 580 - Written Representations

SA 260 - (REVISED) COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE AND MANAGEMENT

OBJECTIVES OF AUDITOR IN ACCORDANCE WITH SA 260

The objectives of the auditor are: -

- To **communicate clearly** with TCWG the **responsibilities of the auditor** in relation to the FS audit, and an **overview of the planned scope and timing** of the audit;
- To **obtain** from TCWG information relevant to the audit;
- To **provide** TCWG with timely observations arising from the audit that are significant and relevant to their responsibility to oversee the financial reporting process and
- To **promote effective two-way communication** between the auditor and TCWG.

WHO ARE "THOSE CHARGED WITH GOVERNANCE"?

1) The person(s) or organization(s) (e.g., a corporate trustee) **with responsibility for overseeing the strategic direction** of the entity financial reporting process..
2) For some entities, **TCWG may include management personnel**.
3) In some entities, a **supervisory board exists that is separate from executive board**.
4) In some entities, TCWG hold positions that are an **integral part** of the entity's legal structure. **For example**, company directors.
5) In some smaller entities, however, one person may be charged with governance.

MATTERS TO BE COMMUNICATED BY AUDITOR

The auditor's responsibilities in relation to the financial statement audit

The auditor shall communicate with TCWG the responsibilities of the auditor in relation to the FS audit, including that:

a) The auditor is responsible for **forming and expressing** an opinion on the FS's that have been prepared by management with the oversight of TCWG and
b) It does **not** relieve management or TCWG of their responsibilities.

Planned scope and timing of the audit

The auditor shall **communicate** with TCWG an overview of the **planned scope and timing** of the audit, which includes communicating about the significant risks identified by the auditor.

Significant findings from the audit

The **auditor shall communicate** with TCWG: -

a) The **auditor's views** about **significant qualitative aspects** of the entity's accounting practices, including accounting policies, accounting estimates and FS disclosures.

b) *Significant difficulties*, if any, encountered during the audit;

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

(i) **Significant matters** arising during the audit that were **discussed**, or subject to **correspondence**, with management;

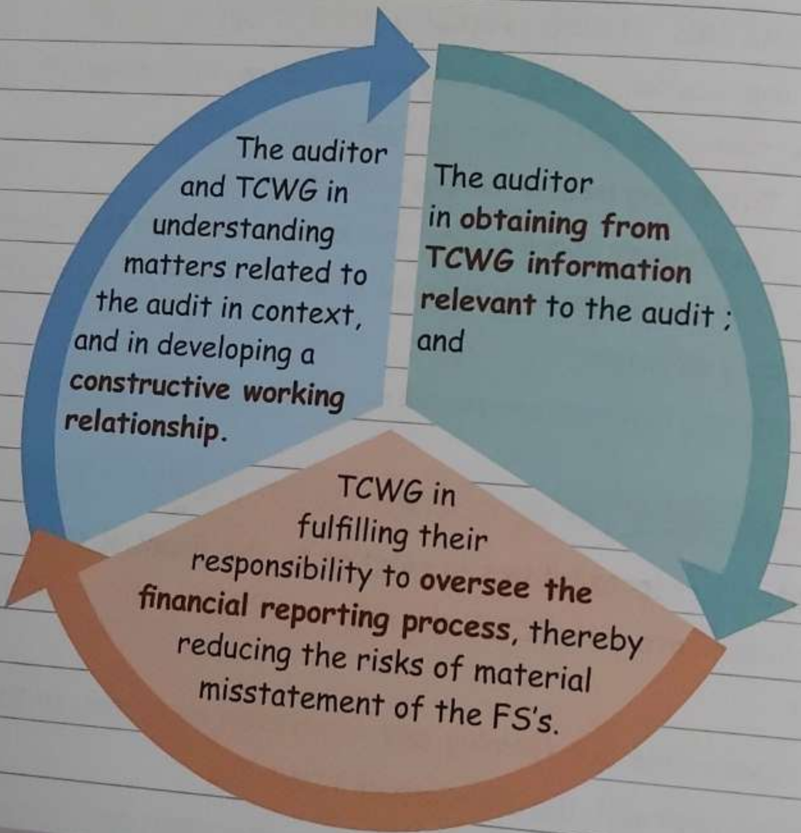
(ii) **Written representations** the auditor is requesting

d) **Circumstances** that affect the form and content of the auditor's report, if any and

e) Any other **significant matters** arising during the audit.

SIGNIFICANCE OF COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE

An effective two-way communication is important in assisting: -



COMMUNICATION OF AUDITOR'S INDEPENDENCE IN CASE OF LISTED ENTITIES

In the case of **listed entities**, the auditor shall communicate with TCWG: -

a) **A statement** that the engagement team and others in the firm, the firm have **complied** with relevant ethical requirements regarding independence and

b) (i) **All relationships and other matters** between the firm, network firms, and the entity that, in the auditor's professional judgment, may reasonably be thought to bear on independence. This shall include **total fees** charged during the period covered by the FS's for **audit and non-audit services** provided by the firm and network firms to the entity and components controlled by the entity and

(ii) The **related safeguards** that have been applied to **eliminate identified threats** to independence or **reduce them** to an acceptable level.

THE COMMUNICATION PROCESS

The auditor shall **communicate** with TCWG the **form, timing and expected** general content of communications.

The auditor shall **communicate in writing** with TCWG regarding **significant findings** from the audit.

The auditor shall **communicate in writing** with TCWG regarding **auditor independence** when required in case of **listed entities.**

ADEQUACY OF THE COMMUNICATION PROCESS

1) The auditor shall **evaluate** whether the **two-way communication** between the auditor and TCWG **has been adequate.**
2) **If it has not**, the auditor shall **evaluate the effect.**

SA 265 - COMMUNICATING DEFICIENCIES IN INTERNAL CONTROL TO THOSE CHARGED WITH GOVERNANCE AND MANAGEMENT

OBJECTIVE OF AUDITOR IN ACCORDANCE WITH SA 265

The **objective** of the auditor is to **communicate appropriately** to TCWG and management **deficiencies in internal control** that the auditor has **identified** during the audit and that, in the auditor's professional judgment, are of sufficient importance to merit their respective attentions.

MEANING OF "DEFICIENCY IN INTERNAL CONTROL" & "SIGNIFICANT DEFICIENCY IN INTERNAL CONTROL"

1) **Deficiency** in internal control - This **exists** when: -
   a) A control is **designed, implemented or operated** in such a way that it is unable to prevent, or detect and correct, misstatements in the FS's on a timely basis or
   b) A control necessary to **prevent, or detect and correct**, misstatements in the FS's on a timely basis is missing.
2) **Significant deficiency** in internal control - The significance of a deficiency or a combination of deficiencies in internal control **depends** not only on whether a **misstatement has actually occurred**, but also on the **likelihood that a misstatement** could occur and the potential magnitude of the misstatement.

EXAMPLES OF MATTERS THAT THE AUDITOR MAY CONSIDER IN DETERMINING WHETHER A DEFICIENCY OR COMBINATION OF DEFICIENCIES IN INTERNAL CONTROL CONSTITUTES A SIGNIFICANT DEFICIENCY

1) **Likelihood of the deficiencies** leading to material misstatements in the Fs's.
2) **Susceptibility to loss or fraud** of the related asset or liability.
3) **Subjectivity and complexity** of determining estimated amounts.
4) FS amounts **exposed** to the deficiencies.
5) **Volume of activity** that has occurred or could occur in the account balance or class of transactions.
6) **Importance of the controls** to the financial reporting process,
   - **Controls over the prevention and detection of fraud.**
   - **Controls over the selection and application of significant accounting policies.**
   - **Controls over significant transactions with related parties.**
   - **Controls over significant transactions outside the entity's normal course of business.**

7) Cause and frequency of the exceptions detected as a result of the deficiencies in the controls.
8) Interaction of the deficiency with other deficiencies in internal control.

EXAMPLES OF INDICATORS OF SIGNIFICANT DEFICIENCIES IN INTERNAL CONTROL

1) Evidence of ineffective aspects of the control environment, such as:
   a) **Indications** that significant transactions are not being appropriately scrutinised by TCWG.
   b) **Identification** of management fraud, whether or not material.
   c) **Management's failure to implement** appropriate remedial action on significant deficiencies previously communicated.
2) **Absence of a risk assessment process** within the entity.
3) **Evidence of an ineffective** entity risk assessment process, such as management's failure to identify a risk of material misstatement.
4) **Evidence of an ineffective response** to identified significant risks.
5) **Misstatements detected** by the auditor's procedures that were not prevented, or detected and corrected, by the entity's internal control.
6) **Disclosure** of a material misstatement due to error or fraud.
7) **Evidence of management's inability to oversee** the preparation of the FS's.

DETERMINATION OF SIGNIFICANT DEFICIENCIES IN INTERNAL CONTROL

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

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

COMMUNICATION OF SIGNIFICANT DEFICIENCIES IN INTERNAL CONTROL TO THOSE CHARGED WITH GOVERNANCE

1) The auditor shall **communicate in writing significant deficiencies** in internal control identified during the audit to TCWG on a timely basis.

2) The auditor shall also **communicate** to management.

   a) ***In writing***, significant deficiencies in internal control that the auditor has **communicated or intends to communicate** to TCWG, and

   b) **Other deficiencies** in internal control identified during the audit that have **not** been communicated to management by other parties.

3) **The auditor shall include in the written communication of significant deficiencies in internal control: -**

   a) **A description** of the deficiencies and an explanation of their potential effects; and

   b) **Sufficient information** to enable TCWG and management to understand the context of the communication.

4) **In particular, the auditor shall explain that:**

- **The purpose** of the audit was for the auditor to express an opinion on the FS's;
- The **audit included consideration of internal control** relevant to the preparation of the FS's in order to design audit procedures that are appropriate in the circumstances, and
- **The matters** being reported are limited to those deficiencies that the auditor has identified during the audit.

SA 450 - EVALUATION OF MISSTATEMENTS IDENTIFIED DURING THE AUDIT

OBJECTIVES OF AUDITOR IN ACCORDANCE WITH SA 450

The objective of the auditor is to evaluate: -

The effect of identified misstatements on the audit and

The effect of uncorrected misstatements, if any, on the FS's.

ACCUMULATION OF MISSTATEMENTS IDENTIFIED DURING THE AUDIT

1) The auditor shall **accumulate** misstatements identified during the audit, other than those that are clearly trivial.
2) A misstatement may **arise** from a **variety of factors**.

CONSIDERATION OF IDENTIFIED MISSTATEMENTS AS THE AUDIT PROGRESSES

1) **The auditor shall determine whether the overall audit strategy and audit plan need to be revised if: -**
   a) The **nature of identified misstatements** and the circumstances of their occurrence indicate that **other misstatements may exist** that, when aggregated with misstatements accumulated during the audit, could be material or
   b) The **aggregate of misstatements** accumulated during the audit approaches materiality determined in accordance with **SA 320**.
2) The auditor may **request management** to examine a class of transactions, account balance or disclosure in order for management to understand the **cause** of a misstatement identified by the auditor, **perform procedures to determine** the amount of the actual misstatement in the class of transactions, account balance or disclosure, and to make appropriate adjustments to the FS's.
3) If, at the auditor's request, management has examined a class of transactions, account balance or disclosure and corrected misstatements that were detected, the **auditor shall perform additional audit procedures** to determine whether misstatements remain.

COMMUNICATION AND CORRECTION OF MISSTATEMENTS

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

The auditor shall **request management** to correct those misstatements. Timely **communication** of misstatements to the appropriate level of management is **important** as it enables management **to evaluate** whether the items are misstatements, inform the auditor if it disagrees and take action as necessary.

The **correction** by management of all misstatements, including those communicated by the auditor, **enables management** to **maintain accurate accounting books and records.**

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

EVALUATING THE EFFECT OF UNCORRECTED MISSTATEMENTS

1) **Prior to evaluating** the effect of uncorrected misstatements, the auditor shall **reassess** materiality determined in accordance with **SA 320.**
2) The auditor shall **determine** whether **uncorrected misstatements** are material, **individually or in aggregate.** In **making** this determination, **the auditor shall consider:**
   a) The **size and nature** of the misstatements, both in relation to particular classes of transactions, account balances or disclosures and the FS's as a whole, and the particular circumstances of their occurrence and
   b) The **effect of uncorrected misstatements** related to **prior periods.**

COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE

1) The **auditor shall communicate** with TCWG regarding **uncorrected misstatements** and the effect that they, **individually or in aggregate**, may have on the opinion in the auditor's report, unless prohibited by law or regulation.
2) The auditor shall **request** that **uncorrected misstatements be corrected.**

WRITTEN REPRESENTATION FROM MANAGEMENT REGARDING EFFECTS OF UNCORRECTED STATEMENTS

The auditor shall **request a written representation** from management and, where appropriate, TCWG whether they believe the **effects of uncorrected misstatements are immaterial**, individually and in aggregate, to the FS's as a whole.

DOCUMENTATION REGARDING MISSTATEMENTS IDENTIFIED DURING AUDIT

The audit documentation shall include

The amount below which misstatements would be regarded as clearly trivial;

All **misstatements accumulated** during the audit and whether they have been corrected; and

The **auditor's conclusion** as to whether uncorrected misstatements are material, individually or in aggregate, and the basis for that conclusion.

SA 560 - SUBSEQUENT EVENTS

MEANING OF SUBSEQUENT EVENTS AND ITS EXAMPLES

FRF ordinarily identify **two types of events:**

- Those that provide **evidence of conditions that existed** at the date of the FS's; and
  - **Examples of events providing evidence of conditions that existed at the date of the FS's**
    - a) Declaration of insolvency of a major debtor of the entity between the date of FS's and the date of auditor's report.
    - b) Settling a legal claim outside the court at a reduced amount between the date of FS's and the date of auditor's report for which provision has already been made in FS's.
- Those that provide **evidence of conditions that arose after the date** of the FS's.
  - **Examples of events providing evidence of conditions that arose after the date of the Fs's**
    - a) Issue of new share capital.
    - b) Planned merger of the company.
    - c) Destruction of substan-tial inventories due to fire.

<u>Subsequent event as per SA 560</u> - Events occurring **between the date of the FS's and the date of the auditor's report**, and facts that become known to the auditor after the date of the auditor's report.

Subsequent Events

- Events occuring **between the date of the financial statements** and **the date of the auditor's report**
- Facts which become known to the auditor **after the date of the auditor's report** but before the date the financial **statements are issued**
- **Facts** which become known to the auditor **after the financial statements have been issued**

OBJECTIVES

The objectives of the auditor are to:

a) **Obtain sufficient appropriate audit evidence** about whether events occurring between the date of the FS's and the date of the auditor's report that require **adjustment of, or disclosure in,** the FS's are **appropriately reflected** in those FS's; and

b) Respond appropriately to facts that become known to the auditor after the date of the auditor's report, that, had they been known to the auditor at that date, may have caused the auditor to amend the auditor's report.

AUDIT PROCEDURES RELATING TO EVENTS OCCURRING BETWEEN THE DATE OF THE FINANCIAL STATEMENTS AND THE DATE OF THE AUDITORS REPORT

1) The auditor shall **perform audit procedures** designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the FS's and the date of the auditor's report that **require adjustment of, or disclosure in**, the FS's **have been identified.**
2) The auditor shall take into account the **Risk Assessment which includes the following:**
   a) **Obtain an understanding of any procedures management** has established to ensure that subsequent events are identified.
   b) **Inquiring of management** and TCWG as to whether any **subsequent events have occurred** which might affect the FS's.
   c) **Read minutes**, if any, of the **meetings**, of the entity's **owners, management and TCWG**, that have been **held after the date of the FS's** and inquiring about matters discussed at any such meetings for which minutes are not yet available.
   d) Read the **entity's latest subsequent interim FS's**, if any.
3) After evaluating his audit evidences, auditor should conclude whether management has complied with applicable FRF for all subsequent envents i.e. whether appropriate adjustments or disclosures have been made, accordingly, auditor should consider its effect on his opinon as per SA 700, SA 705 and SA 706

FACTS WHICH BECOME KNOWN TO THE AUDITOR AFTER THE DATE OF THE AUDITOR'S REPORT BUT BEFORE THE DATE THE FINANCIAL STATEMENTS ARE ISSUED

1) The auditor has **no obligation** to perform any audit procedures regarding the FS's after the date of the auditor's report.
2) However, when, after the date of the auditor's report but before the date the FS's are issued, a fact becomes known to the auditor that, **had it been known to the auditor at the date of the auditor's report**, may have caused the auditor to **amend the auditor's report**, the auditor shall:
   a) Discuss the **matter with management** and, TCWG.
   b) Determine whether the FS's **need amendment** and, if so,
   c) Inquire how **management intends to address** the matter in the FS's.

[Refer Note 2 for more details]

FACTS WHICH BECOME KNOWN TO THE AUDITOR AFTER THE FINANCIAL STATEMENTS HAVE BEEN ISSUED

1) After the FS's have been issued, the auditor has **no obligation** to perform any audit procedures.
2) However, when, **after the FS's have been issued**, a fact becomes known to the auditor that, had **it been known to the auditor** at the date of the auditor's report, **may have caused** the auditor to **amend the auditor's report**, the auditor shall:

Discuss the **matter with management** and, where appropriate, TCWG.	Determine whether the FS's **need amendment** and, if so,	Inquire how **management intends to address** the matter in the FS's.

[Refer Note 3 for more details]

WRITTEN REPRESENTATIONS WITH RESPECT TO SUBSEQUENT EVENTS

The auditor shall request management and, where appropriate, TCWG, to provide a written representation in accordance with **SA 580**, that **all events occurring subsequent to the date of the FS's** and for which the applicable **FRF requires adjustment or disclosure** have been adjusted or disclosed.

NOTE 1 - MEANING OF "DATE THE FINANCIAL STATEMENTS ARE ISSUED"

It **reflects** the **date** that the **auditor's report** and **audited FS's** are made available to **third parties**.

In some circumstances, the **date** the FS's are **issued** may be the **date that** they are **filed** with a **regulatory authority**.

NOTE 2 - AUDIT PROCEDURE FOR FACTS BECOME KNOWN AFTER AUDITOR'S REPORT DATE BUT BEFORE FS ISSUED DATE

1) If **management amends the FS's**, the Auditor shall
   a) **Carry out** the audit procedures necessary in the circumstances on the amendment.
   b) (i) **Extend** the audit procedures, already referred, to the date of the new auditor's report and
      (ii) **Provide** a new auditor's report on the amended FS's.

c) The new auditor's report shall not be dated earlier than the date of approval of the amended FS's.

2) When law, regulation or the FRF does not prohibit management from restricting the amendment the auditor is permitted to restrict the audit procedures on subsequent events to that amendment. In such cases, the auditor shall either: -

a) **Amend the auditor's report** to include an additional date restricted to that amendment or

b) **Provide a new or amended auditor's report** that includes a statement in an Emphasis of Matter paragraph or Other Matter(s) paragraph that conveys that auditor's procedures on subsequent events.

3) When **management does not amend** the FS's in circumstances where the **auditor believes** they **need to be amended**, then: -

a) If the auditor's report has not yet been provided to the entity, the auditor shall **modify the opinion** as required by **SA 705** and then provide the auditor's report or

b) If the auditor's report has already been provided to the entity, the auditor shall **notify management** and, TCWG, **not to issue** the FS's to third parties before the necessary amendments have been made. If the FS's are **issued** without the necessary amendments, the **auditor shall take appropriate action**, to seek to **prevent reliance** on the auditor's report.

NOTE 3 - AUDIT PROCEDURE FOR FACTS AFTER FS ISSUED DATE

1) If the **management amends the FS's, the Auditor shall**

a) **Carry out** the audit procedures necessary in the circumstances on the amendment.

b) **Review the steps** taken by management to ensure that anyone in receipt of the previously issued FS's together with the auditor's report thereon is informed of the situation.

c) (i) **Extend the audit procedures**, already referred, to the date of the new auditor's report, and the date the new auditor's report no earlier than the date of approval of the amended FS's and

(ii) **Provide a new auditor's report** on the amended FS's.

2) If **management does not** take the necessary steps to ensure that anyone in receipt of the previously issued FS's is informed of the situation and does not amend the FS's in circumstances where the auditor believes they need to be amended, the **auditor shall notify** management and, unless all of TCWG are involved in managing the entity, TCWG, that the **auditor will seek to prevent future reliance** on the auditor's report.

3) Management or TCWG **do not** take these necessary steps, the **auditor shall take appropriate action** to seek to **prevent reliance** on the auditor's report.

SA 570 - GOING CONCERN

MEANING OF GOING CONCERN AND ITS SIGNIFICANCE

Going concern is one of the fundamental accounting assumptions. The enterprise is normally viewed as a going concern, that is, as continuing in operation for the foreseeable future.

When the use of the going concern basis of accounting is appropriate, assets & liabilities are recorded on the basis that entity will be able to realize its assets and discharge its liabilities in the normal course of business.

When an enterprise is **not viewed** as a going concern, the FS's are **prepared on liquidation basis. For example**, inventories may need to be written down as these may be sold for a lower price. Assets may have to be recorded at the likely prices they will fetch.

OBJECTIVES OF THE AUDITOR REGARDING GOING CONCERN

The objectives of the auditor are:

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

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

c) To **report in accordance with this SA.**

RESPONSIBILITY FOR ASSESSMENT OF THE ENTITY'S ABILITY TO CONTINUE AS A GOING CONCERN

1) The preparation of the FS's requires **management to assess** the **entity's ability** to continue as a going concern.

2) Management's assessment of the entity's ability to continue as a going concern **involves making a judgment**, at a particular point in time. The following **factors** are relevant to that judgment:

   a) The **degree of uncertainty** associated with the outcome of an event or condition.

   b) The **size and complexity** of the entity, the nature and condition of its business and the degree to which it is affected by external factors.

c) **Any judgment** about the future is based on **information available** at the time at which the judgment is made.

RISK ASSESSMENT PROCEDURES AND RELATED ACTIVITIES

1) When performing risk assessment procedures as **required by SA 315**, the auditor shall consider whether events or conditions exist that may cast **significant doubt on the entity's ability** to continue as a going concern.
2) In so doing, the auditor shall determine whether **management has already performed a preliminary assessment** of the entity's ability to continue as a going concern, and:
   a) If such an **assessment has been performed**, the auditor shall **discuss the assessment** with management and determine whether management **has identified events or conditions** that, individually or collectively, may **cast significant doubt on the entity's ability** to continue as a going concern and, if so, **management's plans to address them**; or
   b) If such an **assessment has not yet been performed**, the auditor shall discuss with management the **basis for the intended use of the going concern basis** of accounting, and **inquire of management** whether **events or conditions exist** that, individually or collectively, **may cast significant doubt on the entity's ability** to continue as a going concern.
3) **SA 315 requires** the auditor to **revise the auditor's risk assessment** and **modify** the further planned audit procedures.

EVALUATING MANAGEMENT'S ASSESSMENT

1) **The auditor** shall evaluate management's assessment of the entity's ability to continue as a going concern.
2) Management's assessment of the entity's ability to continue as a going concern is a **key part** of the **auditor's consideration** of management's use of the going concern basis of accounting.
3) If management's assessment of the entity's ability to continue as a going concern **covers less than twelve months** from the date of the FS's, **the auditor** shall **request management** to extend its **assessment period to at least twelve months** from that date.

EXAMPLES OF EVENTS OR CONDITIONS THAT MAY CAST SIGNIFICANT DOUBT ON THE ENTITY'S ABILITY TO CONTINUE AS A GOING CONCERN

1) Financial

a) Net liability or **net current liability position.**

b) Fixed-term borrowings approaching maturity without realistic prospects of renewal or repayment; or excessive reliance on short-term borrowings to finance long-term assets.

c) Indications of **withdrawal of financial support** by **creditors.**

d) **Negative operating cash flows** indicated by historical or prospective FS's.

e) **Adverse key financial ratios.**

f) Inability to pay creditors on due dates

g) **Inability to comply** with the **terms of loan agreements**

2) Operating

a) **Management intentions to liquidate the entity** or to cease operations.

b) **Loss of key management** without replacement.

c) **Loss of a major market, key customer(s)**, franchise, license, or principal supplier(s).

d) Labor difficulties.

e) **Shortages** of important supplies.

f) Emergence of a highly successful competitor.

3) Other

a) **Non-compliance** with capital or other statutory or regulatory requirements, such as solvency or liquidity requirements for financial institutions.

b) **Pending legal or regulatory proceedings against the entity** that may, if successful, result in claims that the entity is unlikely to be able to satisfy.

c) **Changes in law or regulation** or government policy expected to adversely affect the entity.

d) **Uninsured or underinsured catastrophes** when they occur.

ADDITIONAL AUDIT PROCEDURES WHEN EVENTS OR CONDITIONS ARE IDENTIFIED

These procedures shall include:

a) Where management has **not yet performed an assessment** of the entity's ability to continue as a going concern, requesting management to make its assessment.

b) Evaluating **management's plans for future actions** in relation to its going concern assessment, whether the outcome of these plans is likely to improve the situation.

c) Where the **entity has prepared a cash flow forecast**, and analysis of the forecast is a significant factor in considering the future outcome of events or conditions in the evaluation of management's plans for future actions:

(i) **Evaluating the reliability** of the underlying data generated to prepare the forecast; and

(ii) **Determining** whether there is **adequate support** for the assumptions underlying the forecast.

d) **Considering** whether any **additional facts or information** have become available since the date on which management made its assessment.

e) **Requesting written representations** from management regarding their future action plans and the feasibility of these plans.

Examples of audit procedures when events or conditions have been identified that may cast significant doubt on the entity's ability to continue as going concern:

a) Analyzing and discussing cash flow, profit and other relevant forecasts with management.

b) Analyzing and discussing the entity's latest available interim FS's.

c) Reading minutes of the meetings of shareholders, TCWG and relevant committees.

d) Inquiring of the entity's legal counsel regarding the existence of litigation & claims and the reasonableness of management's assessments of their outcome and the estimate of their financial implications.

e) Confirming the existence, terms and adequacy of borrowing facilities.

f) Obtaining and reviewing reports of regulatory actions.

g) Determining the adequacy of support for any planned disposals of assets.

IMPLICATIONS FOR THE AUDITOR'S REPORT

(I) Use of Going Concern Basis of Accounting is Inappropriate

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

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

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

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

If adequate disclosure about the material uncertainty is made in the financial statements, the auditor shall express **an unmodified opinion** and the auditor's report shall include a separate section under the heading **"Material Uncertainty Related to Going Concern."**

a) **Draw attention to the note** in the financial statements that discloses such matters.

b) **State** that these events or conditions **indicate that a material uncertainty exists** that may cast significant doubt on the entity's ability to continue as a going concern and that the **auditor's opinion is not modified** in respect of the matter.

2) **Adequate Disclosure of a Material Uncertainty is Not Made in the Financial Statements:**

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

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

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

(III) Management unwilling to make or extend its assessment

a) If **management is unwilling** to make or extend its assessment when requested to do so by the auditor, the **auditor** shall **consider the implications** for the auditor's report.

b) In such a situation, a **qualified opinion or a disclaimer of opinion** in the auditor's report may be appropriate, because it may not be possible for the auditor to obtain sufficient appropriate audit evidence regarding management's use of the going concern basis of accounting in the preparation of the financial statements.

Going concern assumption being **inappropriate**, and management prepares FS's on Another basis (**For Example Liquidation basis**)	Use of Going Concern Basis of Accounting **Is Appropriate** but a **Material Uncertainty Exists & Adequate Disclosure** of a Material Uncertainty **Is Made** in the FS's	Use of Going Concern Basis of Accounting Is **Appropriate** but a Material Uncertainty **Exists & Adequate Disclosure** of a Material Uncertainty **Is Not Made** in the FS's	Going concern assumption being **inappropriate**, but management still prepares FS's on Going Concern Basis
Unmodified Opinion, & Emphasis of Matter Paragraph	**Unmodified Opinion, but with Material Uncertainty Related to Going Concern (As a separate heading)**	**Qualified Opinion or Adverse Opinion**	**Adverse Opinion**

SA 580 - WRITTEN REPRESENTATIONS

WRITTEN REPRESENTATION AS AUDIT EVIDENCE

1) SA 580 deals with the **auditor's responsibility** to obtain **written representations from management** and, where appropriate, TCWG.
2) Written Representations may be defined as a **written statement by management** provided to the auditor **to confirm certain matters** or to **support another Audit Evidence.**
3) Written representations provide audit evidence, **they do not provide sufficient appropriate audit evidence** on their own.
4) Furthermore, the fact that management has provided **reliable** written representations **does not affect** the nature or extent of **other audit evidence** that the auditor obtains about the fulfillment of management's responsibilities, or about specific assertions.
5) Written representations are **requested from those responsible** for the preparation and presentation of the FS's.

OBJECTIVES OF THE AUDITOR

1) **To obtain** written representations from management. Also that management believes that it has fulfilled its responsibility for the preparation of the FS's and for the completeness of the information provided to the auditor;
2) **To support** other audit evidence **relevant to the FS's or specific assertions** in the FS's by means of written representations; and
3) **To respond** appropriately to written representations provided by management or if management does **not** provide the written representations requested by the auditor.

FROM WHOM WRITTEN REPRESENTATION ARE REQUESTED BY AUDITOR?

The auditor shall **request** written representations **from management** with appropriate responsibilities.

DATE OF AND PERIODS COVERED BY WRITTEN REPRESENTATION

1) The date of the written representations shall be **as near as practicable** to, but not after, the **date of the auditor's report** on the FS's.
2) The written representations shall be for all FS's and periods referred to in the auditor's report.
3) Because written representations are **necessary audit evidence**, the auditor's **opinion cannot be expressed**, and the **auditor's report cannot be dated**, before the date of the written representations.
4) Furthermore, because the auditor is concerned with **events** occurring up to the **date of the auditor's report** that may require adjustment to or disclosure in the FS's, the **written**

representations are dated as near as practicable to, but not after, the date of the auditor's report on the FS's.

DOUBT AS TO THE RELIABILITY OF WRITTEN REPRESENTATION

1) If the auditor has concerns about the **competence, integrity, ethical values or diligence of management**, or about its **commitment** to or enforcement of these, the auditor shall determine **the effect that such concerns** may have on the **reliability of representations** (oral or written) and audit evidence in general.
2) In particular, if **written representations are inconsistent with other audit evidence**, the auditor shall perform audit procedures to attempt to resolve the matter.
3) If the matter **remains unresolved**, the auditor shall reconsider the assessment of the **competence, integrity, ethical values or diligence of management**, or of its commitment to or enforcement of these, and shall determine the **effect that this may have on the reliability of representations** (oral or written) and audit evidence in general.
4) If the **auditor concludes that the written representations are not reliable**, the auditor shall take appropriate actions, including determining the **possible effect on the opinion** in the auditor's report in accordance with **SA 705**.

REQUESTED WRITTEN REPRESENTATION NOT PROVIDED

If management does **not provide** one or more of the requested written representations, the auditor shall:

a) **Discuss** the matter with management;
b) **Re-evaluate** the integrity of management and evaluate the effect that this may have on the reliability of representations (oral or written) and audit evidence in general; and
c) **Take appropriate actions**, including determining possible effect on the opinion in the auditor's report in accordance with SA 705 having regard to the requirement of disclaimer of opinion.

DISCLAIMER OF OPINION IN FOLLOWING CASE

The auditor shall **disclaim an opinion** on the FS's in accordance with **SA 705** if:

a) The auditor **concludes** that there is **sufficient doubt** about the **integrity of management** such that the written representations about management fulfilling its **responsibilities** regarding **preparation of FS's** and **about information provided** and **completeness of transactions** are not **reliable**; or
b) **Management does not provide the written representations** relating to fulfilling its responsibilities regarding preparation of FS's and about information provided and completeness of transactions.

NOTE 1: WRITTEN REPRESENTATIONS ABOUT MANAGEMENT'S RESPONSIBILITIES

Written representation about management's responsibilities **involves confirmation of fulfilment** of management's responsibilities in following areas: -

Preparation of the financial statements

1) The auditor shall **request** management **to provide** a written representation that it has fulfilled its responsibility for the preparation of the FS's in **accordance with the applicable FRF**.
2) However, management may decide to **make inquiries** of others who participate in **preparing and presenting** the FS's and assertions therein, including individuals.
3) Such individuals may **include**:
   a) **An actuary** responsible for actuarially determined accounting measurements.
   b) **Staff engineers** who may have responsibility for and specialized knowledge about environmental liability measurements.
   c) **Internal counsel** who may provide information essential to provisions for legal claims.

Information provided and Completeness of transactions

The auditor shall request management **to provide** a written representation that:

a) It has **provided the auditor with all relevant information** and access as agreed in the terms of the audit engagement and
b) **All transactions have been recorded** and are **reflected** in the FS's.

NOTE 2 - WHY WRITTEN REPRESENTATIONS ABOUT MANAGEMENT RESPONSIBILITIES ARE NECESSARY?

1) The auditor may also ask management **to reconfirm** its acknowledgement and understanding of those responsibilities in written representations.
2) This is **particularly appropriate when**:

- **Those who signed** the terms of the audit engagement on behalf of the entity **no longer** have the relevant responsibilities;
- The **terms** of the audit engagement were **prepared** in a previous year;
- There is **any indication** that management misunderstands those responsibilities; or
- **Changes** in circumstances make it appropriate to do so.

NOTE 3 - OTHER WRITTEN REPRESENTATIONS

1) Other SAs require the auditor to request written representations. If, in addition to such required representations, the auditor determines that it is necessary to obtain one or more written representations to support other audit evidence relevant to the FS's or one or more specific assertions in the FS's, the auditor shall request such other written representations.
2) They may include representations about the following:
   a) Whether the selection and application of accounting policies are appropriate; and
   b) Whether matters such as the following, have been recognized, measured, presented or disclosed in accordance with that framework:
      (i) Plans or intentions that may affect the carrying value or classification of assets and liabilities;
      (ii) Liabilities, both actual and contingent;
      (iii) Title to, or control over, assets, the liens or encumbrances on assets, and assets pledged as collateral; and
      (iv) Aspects of laws, regulations and contractual agreements

NOTE 4 - ADDITIONAL WRITTEN REPRESENTATIONS ABOUT INFORMATION PROVIDED TO THE AUDITOR

The auditor may consider it necessary to request management to provide a written representation that it has communicated to the auditor all deficiencies in internal control of which management is aware.

8

Audit Report

CHAPTER OVERVIEW:

I. SA 700 - Forming an Opinion & Reporting on Financial Statements

II. SA 701 - Communicating Key Audit Matters in the Independent Auditor's Report

III. SA 705 - Modification to the Opinion in the Independent Auditor's Report

IV. SA 706 - Emphasis of Matter Paragraph & other Matter Paragraph in the Independent Auditor's Report

V. SA 710 - Comparative Information - Corresponding figures and Comparative Financial Statements

VI. SA 600 - Using the work of another Auditor

VII. SA 299 - Responsibility of Joint Auditors

VIII. Section 143 - Duties of Auditors

IX. CARO - 2020

SA 700 - FORMING AN OPINION AND REPORTING ON FINANCIAL STATEMENTS

OBJECTIVE OF THE AUDITOR

The objectives of the auditor as per SA 700 (Revised) are:

a) **To form an opinion on the FS's** based on an evaluation of the conclusions drawn from the audit evidence obtained; and

b) **To express clearly that opinion through a written report.**

TO FORM AN OPINION - AUDITOR TO OBTAIN REASONABLE ASSURANCE

1) The auditor shall **form an opinion** on whether the FS are prepared, in all material respects, in accordance with the **applicable financial reporting framework**.

2) In order to form that opinion, the auditor shall **conclude** as to whether the auditor has obtained reasonable assurance about whether the FS's as a whole are free from material misstatement, whether due to fraud or error.

3) That conclusion shall take into account:

   a) Whether **sufficient appropriate audit evidence** has been obtained;

   b) Whether **uncorrected misstatements are material**, individually or in aggregate;

   c) The **evaluations**

FORM OF OPINION

Unmodified Opinion

The auditor shall express an unmodified opinion when the **auditor concludes** that the **FS's are prepared, in all material respects**, in accordance with the applicable FRF

Modified Opinion

The auditor shall modify the opinion in the auditor's report in accordance with SA 705 if the auditor:

Concludes that, based on the audit evidence obtained, **the FS's as a whole are not free from material misstatement; or**

Is unable to obtain sufficient appropriate audit evidence to conclude that the FS's as a whole are free from material misstatement.

AUDITOR'S REPORT

- Title
- Addressee
- Auditor's Opinion
- Basis for Opinion
- Going Concern
- Key Audit Matters
- Responsibilities for the FS's
- Auditor's Responsibilities for the Audit of the FS's
- Location of the description of the auditor's responsibilities
- Other Reporting Responsibilities
- Signature of the Auditor
- Place of Signature
- Date of the Auditor's Report

1) Title (Independent Auditor's Report)

The auditor's report shall have **a title** that clearly **indicates** that it is the report of an independent auditor.

2) Addressee (To the Members of the Company)

a) The auditor's report is **normally addressed** to those for whom the report is prepared, often either to the **shareholders** or to **TCWG** of the entity whose FS's are being audited.

b) In case of a company, the report is addressed to the **shareholders** of the company.

3) Auditor's Opinion

Para ①

The **first section of the auditor's report** shall include the auditor's opinion, and shall have the heading "**Opinion**."

The **Opinion section** of the auditor's report shall also:

a) **Identify** the entity whose FS's have been audited;

b) **State** that the FS's have been audited;

c) **Identify the title** of each statement comprising the FS's;

d) **Refer to the notes**, including the summary of significant accounting policies; and

e) **Specify the date of**, or **period covered** by, each FS comprising the FS's.

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4) Basis for Opinion

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The auditor's report shall include a section, directly following the Opinion section, with the heading "Basis for Opinion", that:

a) States that the audit was conducted in accordance with SA.
b) Refers to the section of the auditor's report that describes the auditor's responsibilities under the SAs;
c) Includes a statement that the auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit and has fulfilled the auditor's other ethical responsibilities in accordance with these requirements.
d) States whether the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's opinion.

4 Points

5) Going Concern

Where applicable, the auditor shall report in accordance with SA 570 (Revised).

6) Key Audit Matters

Refer SA 701

7) Management's Responsibilities for the Financial Statements

SA 210

The auditor's report shall include a section with a heading "Responsibilities of Management for the FS's."

This section of the auditor's report shall describe management's responsibility for:

a) Preparing the FS's in accordance with the applicable FRF, and for such internal control as management determines is necessary to enable the preparation of FS's that are free from material misstatement, whether due to fraud or error.
b) Assessing the entity's ability to continue as a going concern and whether the use of the going concern basis of accounting is appropriate as well as disclosing, if applicable, matters relating to going concern.

SA 570

8) Auditor's Responsibilities for the Audit of the Financial Statements

The auditor's report shall include a section with the heading "Auditor's Responsibilities for the Audit of the FS's." (Refer Note 1 discussed below.)

9) Location of the Description of the Auditor's Responsibilities for the Audit of the Financial Statements

The description of the auditor's responsibilities for the audit of the FS's required by this SA shall be included:

a) **Within the body** of the auditor's report;

b) **Within an appendix** to the auditor's report, in which case the auditor's report shall include a reference to the location of the appendix; or

c) By a specific reference within the auditor's report to the location of such a description on a **website of an appropriate authority**, where law, regulation or national auditing standards expressly permit the auditor to do so.

10) Other Reporting Responsibilities (Report on other legal & regulatory requirements)

a) If the auditor addresses other reporting responsibilities in the auditor's report on the FS's that are in addition to the auditor's responsibilities under the SAs, these other reporting responsibilities shall be addressed in a separate section in the auditor's report with a heading titled-

11) Signature of Auditor

a) The auditor's report shall be signed. The report is **signed by the auditor** (i.e. the engagement partner) in his **personal name**.

b) Where the **firm is appointed** as the auditor, the report is signed in the **personal name of the auditor** and in the **name of the audit firm**.

c) The partner/proprietor signing the audit report also needs to mention the **membership number** assigned by the Institute of Chartered Accountants of India.

d) They also include the **registration number of the firm**, wherever applicable, as allotted by ICAI, in the audit reports signed by them.

12) Place of Signature (Auditor's Address)

The auditor's report shall name specific location, which is ordinarily the city where the audit report is signed.

13) Date of Auditor's Report

The auditor's report shall be dated no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor's opinion on the FS's.

NOTE 1: AUDITOR'S RESPONSIBILITIES FOR AUDIT OF FINANCIAL STATEMENTS

(I) This section of the auditor's report shall state:

1) That the **objectives of the auditor** are to:
   a) **Obtain reasonable assurance** about whether the Financial statements as a whole are free from material misstatement, whether due to fraud or error; and
   b) **Issue an auditor's report** that includes the auditor's opinion.
2) **That reasonable assurance is a high level of assurance, but is not a guarantee** that an audit conducted in accordance with SAs will always detect a material misstatement when it exists; and
3) **That misstatements can arise from fraud or error, and either:**
   a) **Describe** that they are **considered material** if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these Financial statements; or
   b) **Provide a definition or description** of materiality in accordance with the applicable financial reporting framework.

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

- **Auditors responsibility section to further**
  - State that auditor exercises professional judgement and maintains professional skepticism
  - Describe an audit by stating that auditors responsibilities are
    - To identify and assess the risks of material misstatement
    - To obtain an understanding of the internal control system
    - To evaluate the appropriateness of accounting policies
    - To conclude the appropriateness of management's use of going concern
    - To evaluate the overall presentation, structure and content of Financial Statements
  - Describe auditor's responsibility in group audit

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

1) State that the auditor communicates with TCWG
2) A statement that the auditor has complied with relevant ethical requirement regarding independence
3) Key audit matters are communicated in accordance with SA 701

Imp

NOTE 2: SPECIFIC EVALUATIONS BY THE AUDITOR

Specific Evaluations
- FS adequately discloses significant accounting policies
- Accounting policies selected & applied are consistent
- Accounting estimates made by management are reasonable ([illegible] reasonable [illegible])
- Information in FS is relevant, reliable, comparable & understandable
- FS provides adequate disclosures
- Terminology used in FS is appropriate

NOTE 3: QUALITATIVE ASPECTS OF THE ENTITY'S ACCOUNTING PRACTICES

1) Management makes a number of judgments about the amounts and disclosure in the FS's.
2) **SA 260 (Revised)** contains a discussion of the qualitative aspects of accounting practices.
3) In considering the **qualitative aspects** of the entity's accounting practices, the auditor may become **aware of possible bias** in management's judgments.

NOTE 4 - DEFINITION

1) **General purpose Financial Statements** - FS's prepared in accordance with a general purpose framework.
2) **General purpose framework** - A FRF designed to meet the common financial information needs of a wide range of users. The FRF may be a **fair presentation framework or a compliance framework.**

a) Fair presentation framework

The term "fair presentation framework" is used to refer to a FRF that requires compliance with the requirements of the framework and:

(i) Acknowledges explicitly or implicitly that, to achieve fair presentation of the FS's, it may be necessary for management to provide disclosures beyond those specifically required by the framework; or

(ii) Acknowledges explicitly that it may be necessary for management to depart from a requirement of the framework to achieve fair presentation of the FS's. Such departures are expected to be necessary only in extremely rare circumstances.

For example - FS's of a company under Companies Act 2013.

b) Compliance framework

FRF requiring compliance with requirements of the framework that does not contain acknowledgement as above.

The term **"compliance framework"** is used to refer to a FRF that requires compliance with the requirements of the framework, but does not contain the acknowledgements in (i) or (ii) above.

Fair Presentation Framework.
↓
AS/Ind AS + Sch III
(comply)
&
If required you can deviate from FRF.
(means agar isse accha tareeka hoga toh iske beyond jaao).
eg:- dep ya amortization vendra tarika accha hai toh...

Compliance Framework
↓
As it is karo.
Never go beyond.
& never deviate.

SA 701 - COMMUNICATING KEY AUDIT MATTERS IN THE INDEPENDENT AUDITOR'S REPORT

DEFINITION

Those matters that, in the auditor's **professional judgment** were of **most significance** in the audit of the Fs's of the current period. Key audit **matters are selected from matters communicated** with TCWG.

OBJECTIVES OF THE AUDITOR REGARDING KEY AUDIT MATTERS

To determine key audit matters and, having formed an opinion on the FS's, **communicate those matters** by describing them in the auditor's report.

PURPOSE OF COMMUNICATING KEY AUDIT MATTERS

a) The **purpose of communicating key audit** matters is **to enhance the communicative value of the auditor's report** by providing **greater transparency** about the audit that was performed.

b) It provides **additional information to intended users of the FS's to assist them in understanding those matters that**, in the auditor's professional judgment, were of most significance in the audit of the FS's of the current period.

c) It may also **assist intended users in understanding the entity and areas of significant management judgment** in the audited FS's.

DETERMINING KEY AUDIT MATTERS

In making this determination, the auditor shall take into account the following:

a) **Areas of higher assessed risk of material misstatement**, or **significant risks identified in accordance with SA 315.**

b) **Significant auditor judgments** relating to areas in the financial statements that involved **significant management judgment**, including accounting estimates that have been identified as having high estimation uncertainty.

c) The **effect on the audit of significant events or transactions** that occurred during the period.

Note - Subsequent events will go to SA 706 (EOM)

COMMUNICATING KEY AUDIT MATTERS

The auditor shall describe each key audit matter, using an appropriate subheading, in a separate section of the auditor's report under the heading **"Key Audit Matters"**. The introductory language in this section of the auditor's report shall state that:

a) Key audit matters are those matters that, in the auditor's professional judgment, **were of most significance** in the audit of the FS's [of the current period]; and

b) These matters were addressed in the context of the audit of the FS's as a whole, and in forming the auditor's opinion thereon, and the **auditor does not provide a separate opinion** on these matters.

COMMUNICATING KEY AUDIT MATTERS IN THE AUDITOR'S REPORT IS NOT

- A substitute for **disclosures in the FS's** that the applicable FRF requires management to make, or that are otherwise necessary to achieve fair presentation;
- A substitute for the auditor **expressing a modified opinion** when required by the circumstances of a specific audit engagement in accordance with SA 705 (Revised);
- A substitute for **reporting in accordance with SA 570 when a material uncertainty exists** relating to events or conditions that may cast significant doubt on an entity's ability to continue as a going concern; or
- **A separate opinion on individual matters.**

COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE

The auditor shall communicate with TCWG:

a) Those matters the auditor has determined to be the key audit matters; or

b) If applicable, the auditor's determination that **there are no key audit matters** to communicate in the auditor's report.

APPLICABILITY OF SA 701

1) This **SA applies** to audits of complete sets of general purpose FS's of :
   a) **Listed entities** and
   b) **Circumstances** when the auditor otherwise decides to communicate key audit matters in the auditor's report and
   c) Required by law or regulation to communicate key audit matters in the auditor's report
2) However, **SA 705** (Revised) **prohibits** the auditor from communicating key audit matters when **the auditor disclaims an opinion** on the FS's, unless such reporting is required by law or regulation

SA 705 - MODIFICATION TO THE OPINION IN THE INDEPENDENT AUDITOR'S REPORT:

OBJECTIVE OF THE AUDITOR (CIRCUMSTANCES WHEN A MODIFICATION TO THE AUDITOR'S OPINION IS REQUIRED)

As per **SA 705** the objective of the auditor is to **express clearly an appropriately modified opinion** on the FS's when:

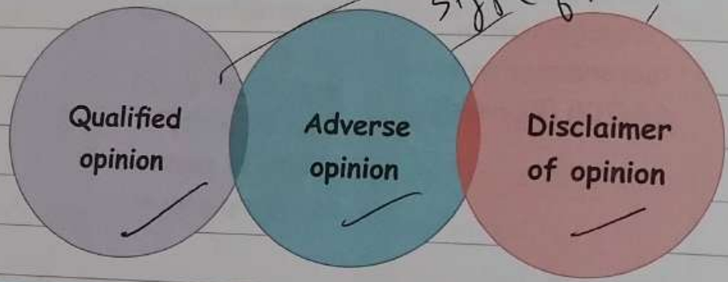
a) The **auditor concludes** based on the audit evidence obtained, that the **FS's as a whole are not free from material misstatements**; or MM

b) The **auditor is unable to obtain sufficient appropriate audit evidence** to conclude that the FS's as a whole are free from material misstatements. → Possible MM

2 Type of opinion = Modified or Unmodified.

TYPES OF MODIFIED OPINIONS

3 type of modification.



NATURE OF MATTER GIVING RISE TO THE MODIFICATION

Nature of matter giving rise to the modification	Auditor's judgment about the pervasiveness of the effects or possible effects of the matter on financial statements	
	Material but not pervasive	**Material and pervasive**
Financial statements are materially misstated	**Qualified Opinion**	**Adverse Opinion**
Inability to obtain sufficient and appropriate evidence	**Qualified Opinion**	**Disclaimer of Opinion**

i) Substantial part of FS
ii) Relating to disclosure
iii) effects on multiple areas.

DESCRIPTION OF AUDITOR'S RESPONSIBILITIES FOR THE AUDIT OF THE FINANCIAL STATEMENTS

When the auditor disclaims an opinion on the FS's due to an inability to obtain sufficient appropriate audit evidence, the auditor shall **amend the description of the auditor's responsibilities** required by SA 700 (Revised) to **include only the following:**

WHEN THE AUDITOR DISCLAIMS AN OPINION ON THE FINANCIAL STATEMENTS

a) A statement that the auditor's responsibility is to conduct an audit of the entity's FS's in accordance with SA and to issue an auditor's report;

b) A statement that, however, **because of the matter(s)** described in the Basis for Disclaimer of **Opinion section**, the auditor was **not able to obtain sufficient appropriate audit evidence** to provide a basis for an audit opinion on the FS's; and

c) The statement about auditor independence and other ethical responsibilities required by SA 700 (Revised).

CONSIDERATIONS WHEN THE AUDITOR DISCLAIMS AN OPINION ON THE FINANCIAL STATEMENTS

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

COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE

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

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NOTE 1: DEFINITION OF PERVASIVE

A term used, in the **context of misstatements**, to describe the **effects on the FS's** of **misstatements** or **the possible effects** on the FS's of misstatements, if any, that are **undetected due** to an inability to obtain sufficient appropriate audit evidence.

Pervasive effects on the FS's are those that, in the auditor's judgment:

a) **Are not confined** to specific elements, accounts or items of the FS's;

b) If so **confined, represent or could represent** a substantial proportion of the FS's; or

c) In relation to disclosures, are **fundamental to users'** understanding of the FS's. Eg:- Summary of Significant acc policies

NOTE 2: MEANING OF QUALIFIED, ADVERSE AND DISCLAIMER OF OPINION [AS PER ICAI MODULE]

Table

Qualified Opinion

The auditor shall express a qualified opinion when:

a) The auditor, **having obtained sufficient appropriate audit evidence**, concludes that **misstatements, individually or in the aggregate, are material**, but **not pervasive**, to the FS's; or

b) The auditor is **unable to obtain sufficient appropriate audit evidence** on which to base the opinion, but the auditor concludes that the possible effects on the FS's of undetected misstatements, if any, could be material but not pervasive.

Adverse Opinion

The auditor shall express an adverse opinion when the auditor, having obtained su cient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the FS's.

Disclaimer of Opinion

a) The auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the FS's of undetected misstatements, if any, could be both material and pervasive.

b) The auditor shall disclaim an opinion when, in extremely rare circumstances involving multiple uncertainties, the auditor concludes that, notwithstanding having obtained sufficient appropriate audit evidence regarding each of the individual uncertainties, it is not possible to form an opinion on the FS's due to the potential interaction of the uncertainties and their possible cumulative effect on the FS's.

FORM & CONTENT OF AUDITOR'S REPORT WHEN THE OPINION IS MODIFIED

Wordings of Qualified Opinion

1) When the auditor expresses a qualified opinion due to a material misstatement in the FS's, the auditor shall state in the opinion paragraph that, in the auditor's opinion, except for the effects of the matters described in the Basis for Qualified Opinion paragraph:
"The FS's present fairly, in all material respects (or give a true and fair view) in accordance with the applicable FRF when reporting in accordance with a fair presentation framework;" or

2) When the modification arises from an inability to obtain sufficient appropriate audit evidence, the auditor shall use the corresponding phrase "except for the possible effects of the matter(s)..." for the modified opinion.

Wordings of Adverse

When the auditor expresses an adverse opinion, the auditor shall state that, In the auditor's opinion, because of the significance of the matter(s) described in the Basis for Adverse Opinion paragraph:
"The FS's do not present fairly (or give a true and fair view) in accordance with the applicable FRF when reporting in accordance with a fair presentation framework;"

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Wordings of Disclaimer of Opinion

When the auditor **disclaims an opinion** due to inability to obtain sufficient appropriate audit evidence, the auditor shall:

a) State that the auditor **does not express an opinion** on the accompanying FS.

b) State that, because of the **significance of the matter(s) described in the Basis for Disclaimer of Opinion section**, the auditor has not been able to obtain SAAE to provide a basis for an audit opinion on the FS's.

c) **Amend the statement** in the **opinion section**, which indicates that the FS's have been audited, to state that the **auditor was engaged** to **audit** the FS's.

NOTE 4 - WHICH TYPE OF OPINION IS APPROPRIATE?

The decision regarding which type of modified opinion is appropriate depends upon:

a) The **nature of the matter** giving rise to the modification, that is, whether the FS's are materially misstated or, in the case of an inability to obtain sufficient appropriate audit evidence, may be materially misstated; and

b) The **auditor's judgment about the pervasiveness** of the effects or possible effects of the matter on the FS's.

NOTE 5 - BASIS FOR OPINION

When the auditor modifies the opinion on the FS's, the auditor shall, in addition to the specific elements required by SA 700 (Revised):

a) Amend the heading **"Basis for Opinion"** required by para of SA 700 (Revised) to **"Basis for Qualified Opinion," "Basis for Adverse Opinion," or "Basis for Disclaimer of Opinion,"** as appropriate; and

b) Within this section, include a description of the matter giving rise to the modification.

Following points should be kept in mind while including content under "Basis for Opinion" Paragraph:

1) If there is a material misstatement of the FS's that **relates to specific amounts** in the FS's the auditor shall include in the Basis for Opinion section **a description and quantification** of the financial effects of the misstatement, unless impracticable.

2) If it is **not practicable to quantify the financial effects**, the auditor shall so state in this section.

3) If there is a material misstatement of the FS's that relates to the non-disclosure of information required to be disclosed, the auditor shall:

   a) **Discuss** the **non-disclosure** with those charged with governance;

   b) **Describe** in the Basis for Opinion section the **nature of the omitted** information; and

4) When the auditor **expresses a qualified or adverse opinion**, the auditor shall **amend** the **statement** about whether the audit evidence obtained is sufficient and appropriate to provide a basis for the auditor's opinion required by SA 700 (Revised) to include the word **"qualified"**, or **"adverse"**, as appropriate.

5) When the auditor **disclaims an opinion** on the FS's, the auditor's report shall not include the following elements required by SA 700 (Revised).
   a) **A reference** to the section of the auditor's report where the auditor's responsibilities are described; and
   b) **A statement** about whether the audit evidence obtained is sufficient and appropriate to provide a basis for the auditor's opinion.

6) Even if the auditor has **expressed an adverse opinion or disclaimed an opinion** on the FS's, the auditor shall **describe** in the Basis for Opinion section the **reasons for any other matters** of which the auditor is aware that would have required a modification to the opinion, and the effects thereof.

NOTE 6: CONSEQUENCE OF AN INABILITY TO OBTAIN SUFFICIENT APPROPRIATE AUDIT EVIDENCE DUE TO A MANAGEMENT-IMPOSED LIMITATION AFTER THE AUDITOR HAS ACCEPTED THE ENGAGEMENT

SP

Imp

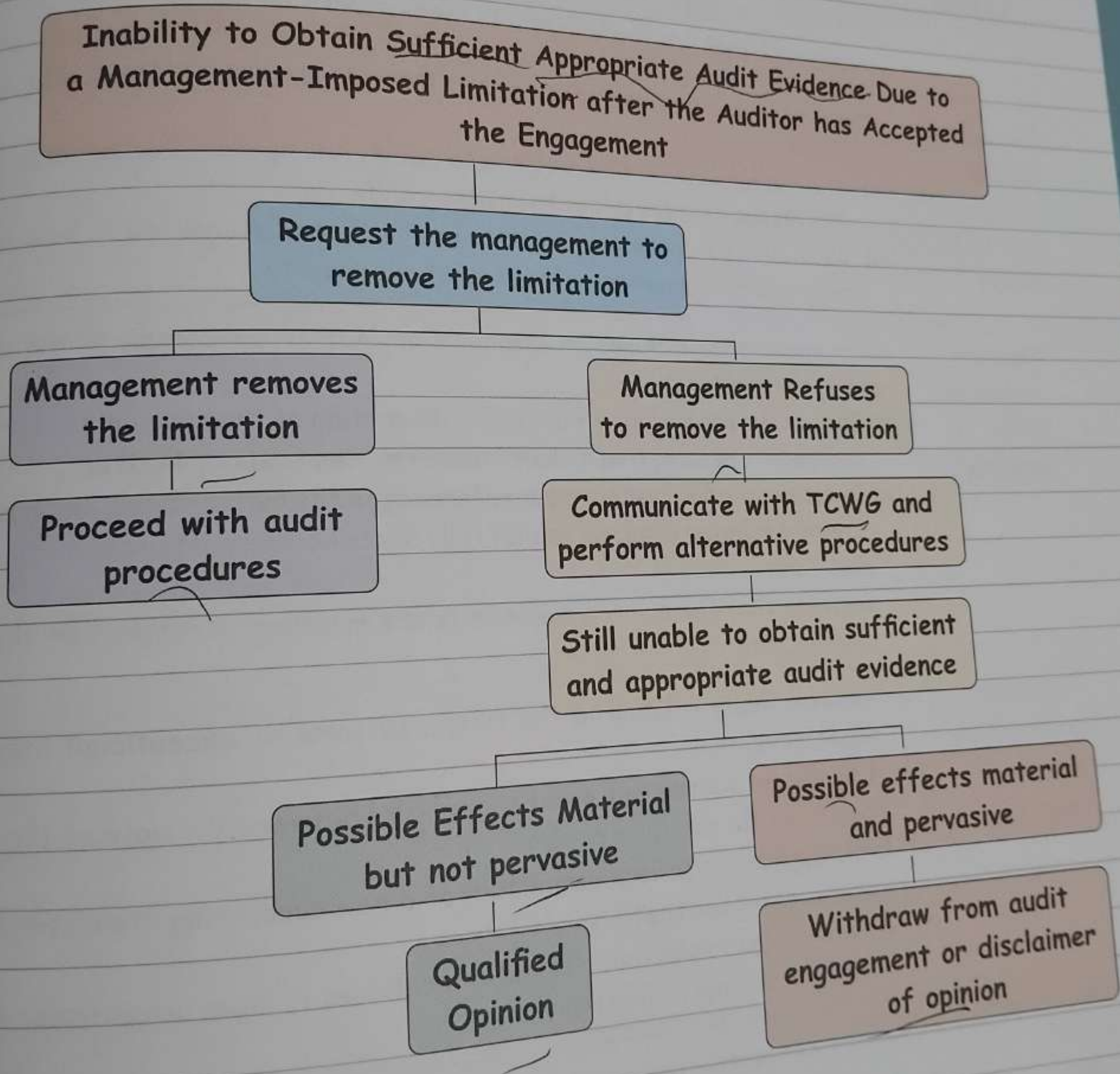
1) If, **after accepting** the engagement, the **auditor becomes aware** that management has **imposed a limitation** on the scope of the audit that the auditor considers likely to result in the need to express a qualified opinion or to disclaim an opinion on the FS's, the auditor shall request that management remove the limitation.

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

3) If the **auditor is unable** to obtain sufficient appropriate audit evidence, the auditor shall **determine the implications** as follows:
   a) If the auditor **concludes** that the **possible effects** on the FS's of undetected misstatements, if any, could be **material but not pervasive**, the auditor shall **qualify the opinion**; or
   b) If the auditor concludes that the possible effects on the FS's of undetected misstatements, if any, could be both **material and pervasive** so that a qualification of the opinion would be inadequate to communicate the gravity of the situation, **the auditor shall:**
      (i) **Withdraw from the audit**, where practicable and possible under applicable law or regulation; or

(ii) If **withdrawal** from the audit before issuing the auditor's report is not practicable or possible, **disclaim an opinion** on the FS's.

4) If the auditor **withdraws as contemplated above**, before withdrawing, the auditor shall communicate to TCWG any matters regarding misstatements identified during the audit that would have given rise to a modification of the opinion.



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SA 706-EMPHASIS OF MATTER PARAGRAPH & OTHER MATTER PARAGRAPH IN THE INDEPENDENT AUDITOR'S REPORT

EMPHASIS OF MATTER PARAGRAPH

Meaning	A paragraph included in the auditor's report that refers to a **matter appropriately presented or disclosed in the FS's** that in the auditor's judgment, is of such importance that it is **fundamental to users understanding of the FS's.**
Emphasis of Matter Paragraphs in the Auditor's Report	The auditor shall include an Emphasis of Matter paragraph in the auditor's report provided: a) The auditor would not be required to modify the opinion in **accordance with SA 705 (Revised)** as a result of the matter; 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.
Separate section for EOM paragraph	**When the auditor includes an Emphasis of Matter paragraph in the auditor's report, the auditor shall:** a) Include the paragraph within a separate section of the auditor's report with an appropriate heading that includes the term **"Emphasis of Matter"**; b) Include in the paragraph a clear reference to the matter being emphasized and to where relevant disclosures that fully describe the matter can be found in the FS's.; and c) Indicate that the auditor's opinion **is not modified** in respect of the matter emphasized.
Examples where EOM may be necessary	a) An **uncertainty** relating to the future outcome of **exceptional litigation** or regulatory action. b) A **significant subsequent event** that occurs between the date of the FS's and the date of the auditor's report. c) **Early application (where permitted) of a new accounting standard** that has a material effect on the FS's. d) A **major catastrophe** that has had, or continues to have, a significant effect on the **entity's financial position.**
The inclusion of an EOM paragraph does not affect the auditor's opinion	An Emphasis of Matter paragraph is **not a substitute** for: a) A **modified opinion** in accordance with **SA 705** (Revised). b) **Disclosures in the FS's**; or c) Reporting in accordance with **SA 570 (Revised)** when a **material uncertainty** exists. EOM ↓ To understand FS OM ↓ To understand ~~Auditor~~ report or auditors Responsibility.

OTHER MATTER PARAGRAPH

mera responsibily (Auditor ka)
→ eg:- Pvt ka 1st Audit report kisi & toh year last karo kyu

Meaning	A paragraph included in the auditor's report that refers to a matter other than those presented or disclosed in the FS's that in the auditor's judgment, is relevant to users understanding of the audit, the auditor's responsibilities or the auditor's report.
OM Para in the Auditor's Report	The auditor shall include an Other Matter paragraph in the auditor's report, provided: a) This is not **prohibited** by law or regulation; and b) When **SA 701 applies, the matter has not been determined to be a key audit matter** to be communicated in the auditor's report.
Examples	**Refer SA 510, 710, 600, 560**

& om is last option.

Agar Matter 705 mein nahi aara
toh 701 me jayega. (1st pref) if not fit in 701 (KAM)
the matter will be in 706. (EOM) last option

SA 710-"COMPARATIVE INFORMATION - CORRESPONDING FIGURES AND COMPARATIVE FINANCIAL STATEMENTS

MEANING

Comparative information

The amounts and disclosures included in the FS's in respect of one or more prior periods in accordance with the applicable FRF.

Comparative Financial Statements

Comparative information where amounts and other disclosures for the prior period are included **for comparison** with the FS's of the current period but, if audited, are referred to in the auditor's opinion.

Corresponding figures

Comparative information where amounts and other disclosures for the prior period are included **as an integral part** of the current period FS's and are **intended to be read only** in relation to the amounts and other disclosures relating to the current period.

AUDIT REPORTING (DIFFERENCE BETWEEN TWO APPROACHES)

The essential **audit reporting differences** between the approaches are:

a) **Comparative Financial Statements:** Auditor's Opinion **refers to each period** for which FS's are presented and on which an audit opinion is expressed.

b) **Corresponding Figures:** Auditor's Opinion on FS's **refers to current period only**.

OBJECTIVES

As **per SA 710, the objectives of the auditor** are:

a) **To obtain sufficient appropriate audit evidence** about whether the comparative information included in the FS's has been presented, in all material respects, in accordance with the requirements for comparative information in the applicable FRF; and

b) **To report** in accordance with the auditor's reporting responsibilities.

AUDIT PROCEDURE REGARDING COMPARATIVE INFORMATION

1) The auditor shall **determine** whether the **FS's** include the comparative information required by **the applicable FRF** and whether such information is **appropriately classified**. For this purpose, **the auditor shall evaluate whether:**

a) The comparative information agrees with the amounts and other disclosures presented in the prior period; and

b) The accounting policies reflected in the comparative information are consistent with those applied in the current period.

2) **Evaluating the impact on FS's:** If the auditor becomes aware of a possible material **misstatement** in the comparative information while performing the current period audit,

a) the auditor shall **perform** such **additional audit procedures** as are necessary in the circumstances to obtain sufficient appropriate audit evidence to determine whether a material misstatement exists.

b) If the auditor had **audited the prior period's** FS's, the auditor shall also follow the relevant requirements of **SA 560**

3) **Written Representation:** As required by **SA 580**, the auditor should also request written representation for all the period referred in the auditor's opinion.

AUDIT REPORTING REGARDING CORRESPONDING FIGURES

When corresponding figures are presented, the auditor's opinion shall not refer to the corresponding figures except in the following circumstances:

1) **If the auditor's report on the prior period, as previously issued, included a qualified opinion, a disclaimer of opinion, or an adverse opinion** and the matter which gave rise to the modification is **unresolved**, the auditor shall **modify** the auditor's opinion on the **current period's FS's**. In the **Basis for Modification paragraph** in the auditor's report, the auditor shall either:

a) **Refer to both the current period's figures and the corresponding figures** in the description of the matter giving rise to the modification when the effects or possible effects of the matter on the current period's figures are material; or.

b) In other cases, **explain** that the audit **opinion** has been **modified** because of the **effects or possible effects** of the unresolved matter.

2) **If the auditor obtains audit evidence that a material misstatement exists in the prior period** FS's on which an **unmodified opinion** has been previously issued, the auditor shall **verify** whether the misstatement has been dealt with as required under the applicable FRF and, if that is not the case, the auditor shall **express a qualified opinion or an adverse opinion** in the auditor's report on the current period FS's, **modified** with respect to the corresponding figures included therein.

3) **Prior Period FS's Not Audited** - If the prior period FS's were not audited, the auditor shall state in an **Other Matter paragraph** in the auditor's report that the corresponding figures are unaudited.

Prior Period FS's Audited by a Predecessor Auditor

If the FS's of the **prior period** were **audited** by a **predecessor auditor** and the auditor is permitted by law or regulation to refer to the predecessor auditor's report on the corresponding figures and decides to do so, the auditor shall state in an **Other Matter paragraph** in the auditor's report:

a) That the FS's of the prior period were audited by the predecessor auditor;
b) The type of opinion expressed by the predecessor auditor and, if the opinion was modified, the reasons therefore; and
c) The date of that report.

AUDIT REPORTING REGARDING COMPARATIVE FINANCIAL STATEMENTS

When reporting on prior period financial statements in connection with the current period's audit.

If the auditor's opinion on such prior period FS's **differs from the opinion the auditor previously expressed**, the auditor shall **disclose the substantive reasons** for the different opinion in an **Other Matter paragraph** in accordance with **SA 706**.

Prior Period Financial Statements Audited by a Predecessor Auditor

1) If the FS's of the prior period were audited by a predecessor auditor, in addition to expressing an opinion on the current period's FS's, the auditor shall state in **an Other Matter paragraph**:
   a) That the FS's of the prior period **were audited by a predecessor auditor;**
   b) The **type of opinion** expressed by the **predecessor auditor** and, if the **opinion was modified**, the reasons therefor; and
   c) The **date of that report**,
2) If the auditor **concludes** that a material misstatement exists that affects the prior period FS's on which the predecessor auditor had **previously reported** without modification, the auditor shall communicate the misstatement with the appropriate level of management and those charged with governance and request that the predecessor auditor be informed.
3) If the prior period FS's are **amended**, and the predecessor auditor **agrees to issue** a new auditor's report on the amended FS's of the prior period, the auditor shall report only on the current period.

Prior Period Financial Statements Not Audited

If the prior period FS's were **not audited**, the auditor shall state in an Other Matter paragraph that the comparative FS's are unaudited.

Such a statement **does not**, however, relieve the auditor of the requirement to obtain sufficient appropriate audit evidence that the opening balances do not contain misstatements that materially affect the current period's FS's.

SA 600 - USING THE WORK OF ANOTHER AUDITOR

DEFINITION

Principal auditor means the auditor with responsibility for reporting on the financial information of an entity when that financial information includes the financial information of one or more components audited by another auditor.

Other auditor means an auditor, other than the principal auditor, with responsibility for reporting on the financial information of a component which is included in the financial information audited by the principal auditor.

Component means a division, branch, subsidiary, joint venture, associated enterprises or other entity whose financial information is included in the financial information audited by the principal auditor.

USING THE WORK OF ANOTHER AUDITOR

1) It makes **clear** that in certain situations, the statute governing the entity may **confer a right** on the principal auditor **to visit a component and examine** the books of account and other records of the said component, if he thinks it necessary to do so.
2) Where **another auditor** has been **appointed** for the component, the **principal auditor would normally be entitled to rely** upon the work of such auditor **unless there are special circumstances** to make it essential for him to visit the component and/or to examine the books of account and other records of the said component.
3) Further, it requires that the principal auditor should perform procedures to obtain sufficient appropriate audit evidence, that the **work of the other auditor is adequate** for the principal auditor's purposes, in the context of the specific assignment.
4) **When using the work of another auditor, the principal auditor should ordinarily perform the following procedures:**
   a) **Advise** the other auditor of the use that is to be made of the other auditor's work and report and make sufficient arrangements for co-ordination of their efforts at the planning stage of the audit.
   b) The **principal auditor** would inform the other auditor of matters such as are as requiring special consideration, procedures for the identification of inter -component transactions that may require disclosure and the time-table for completion of audit; and
   c) Advise the other auditor of the significant accounting, auditing and reporting requirements and obtain representation as to compliance with them.
5) The **principal auditor** might **discuss** with the **other auditor** the audit procedures applied or **review** a written summary of the other auditor's procedures and findings which may be in the

form of a completed **questionnaire or check-list.**

6) The principal auditor may also **wish to visit the other auditor**. The **nature, timing and extent of procedures** will depend on the circumstances of the engagement and the principal auditor's knowledge of the professional competence of the other auditor.

NOTE 1 - SECTION 143(8)- BRANCH AUDIT

1) Further, **sub-section (8) of section 143** of the Companies Act, 2013, prescribes the duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor.
2) Where a company has a **branch office**, the accounts of that office shall be audited either
   a) By the **auditor appointed for the company** (herein referred to as the company's auditor) under this Act or
   b) By **any other person qualified** for appointment as an auditor of the company under this Act appointed as such under section 139, or
   c) Where the **branch office** is situated in a **country outside India**, the accounts of the branch office shall be **audited** either
      (i) By the **company's auditor** or
      (ii) By an **accountant** or
      (iii) By any other person duly qualified to act as an auditor of the accounts of the branch office in accordance with the laws of that country and
   d) The **duties and powers** of the company' s auditor with reference to the audit of the branch and the branch auditor, if any, shall be such as may be prescribed:
3) It may be noted that the **branch auditor** shall **prepare a report** on the accounts of the branch examined by him and **send it to the auditor** of the company who shall deal with it in his report in such manner as he considers necessary.
4) Further as per **Rule 12 of the Companies (Audit and Auditors) Rules, 2014**, the branch auditor shall submit his report to the company's auditor and reporting of fraud by the auditor shall also extend to such branch auditor to the extent it relates to the concerned branch.

SA 299 - (REVISED) RESPONSIBILITY OF JOINT AUDITORS

DEFINITION

A joint audit is an audit of FS's of an entity by **two or more auditors** appointed with the objective of issuing the audit report. Such auditors are described as joint auditors.

AUDIT PLANNING, RISK ASSESSMENT AND ALLOCATION OF WORK

1) The joint auditors **shall jointly establish an overall audit strategy** that sets the **scope, timing and direction of the audit**, and that guides the development of the audit plan.
2) Prior to the commencement of the audit, the joint auditors shall discuss and develop a joint audit plan. **In developing the joint audit plan, the joint auditors shall:**
   a) **Identify division of audit areas and common audit areas**
   b) Ascertain the **reporting objectives of the engagement**
   c) Consider and **communicate among all joint auditors** the factors that are significant
   d) Consider the **results of preliminary engagement activities** or similar engagements performed earlier.
   e) Ascertain the **nature, timing and extent of resources** necessary to accomplish the engagement.

DOCUMENTATION OF WORK ALLOCATED

a) The joint auditors shall discuss and document the nature, timing, and the extent of the audit procedures for **common and specific allotted areas of audit to be performed** by each of the joint auditors.
b) The joint auditors shall obtain **common engagement letter and common management representation letter**.
c) After identification and allocation of work among the joint auditors, **the work allocation document shall be signed by all the joint auditors.**

RESPONSIBILITY OF JOINT AUDITORS

1) In respect of audit work divided among the joint auditors, **each joint auditor shall be responsible only for the work allocated** to such joint auditor including **proper execution of the audit procedures.**
2) On the other hand, all the **joint auditors shall be jointly and severally responsible** for:
   a) The audit **work which is not divided** among the joint auditors and is carried out by all joint auditors;
   b) **Decisions taken by all the joint auditors** under **audit planning in respect of common audit areas** concerning the NTE of the audit procedures to be performed by each of the joint

auditors.

c) 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 on such matters.

d) Examining that the FS of the entity comply with the requirements of the relevant statutes;

e) Presentation and disclosure of the FS as required by the applicable FRF;

f) Ensuring that the audit report complies with the requirements of the relevant statutes, the applicable SA and the other relevant pronouncements issued by ICAI.

AUDIT CONCLUSION AND REPORTING

a) Joint auditors are required to **issue common audit report**.

b) However, **in case of any disagreement** among joint auditors 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**.

c) **A joint auditor is not bound by the views of the majority of the joint auditors** regarding the opinion or matters to be covered in the audit report and shall express opinion formed by the said joint auditor in **separate audit report** in case of disagreement.

d) **In case of separate reports**, the audit report(s) issued by the **joint auditor(s) shall make a reference to the separate audit report(s)** issued by the **other joint auditor(s)**. Such reference shall be made under the heading **"Other Matter Paragraph" as per SA 706**.

REVIEW OF WORK BY OTHER JOINT AUDITOR

Each joint auditor is entitled to assume that the other joint auditors have carried out their part of the audit work and the work has actually been performed in accordance with the SA's.

COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE

a) When the joint auditors expect to modify the opinion in the auditor's report, they shall **communicate with TCWG the circumstances** that led to the expected modification and the **proposed wording of the modification** to ensure compliance with SA 705.

b) If the joint auditors expect to include an **EOM or an OM paragraph** in the auditor's report, the **joint auditors shall communicate with TCWG** regarding this expectation and the **proposed wording** of this paragraph to ensure compliance with SA 706.

ADVANTAGES AND DISADVANTAGES OF JOINT AUDIT

Advantages

In specific terms the advantages that flow may be the following:

a) Sharing of expertise.
b) Advantage of mutual consultation.
c) Lower workload.
d) Better quality of performance.
e) Improved service to the client.
f) Lower staff development costs.
g) Lower costs to carry out the work.
h) A sense of healthy competition towards a better performance.

Disadvantages

The general disadvantages may be the following:

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

SECTION 143 - DUTIES OF AUDITORS

REPORTING REQUIREMENT RELATING TO MATTERS STATED IN SECTION [SEC.143(1)]

a Whether **loans and advances** made by the company on the basis of security have been **properly secured** and whether the terms on which they have been made are **prejudicial** to the interests of the company or its members.

b Whether **transactions** of the company which are represented merely by **book entries** are **prejudicial** to the interests of the company.

c Where the **company not being an investment company** or a **banking company**, whether so much of **the assets** of the company as consist of shares, debentures and other securities have been sold at a **price less** than that at which they were purchased by the company.

d Whether **loans and advances** made by the company have been shown as **deposit**.

e Whether **personal expenses** have been charged to **revenue account**.

f Where it is stated in the books and documents of the company that any shares have been **allotted for cash**, whether cash has actually been **received** in respect of such allotment, and if **no cash** has actually been so received, whether the position as stated in the account books and the balance sheet is **correct**, regular and not misleading.

Note

The opinion of the Research Committee of the Institute of Chartered Accountants of India on section 143(1) is reproduced below:

i) The auditor is not required to report on the matters specified in sub- section (1) unless he has any special comments to make on any of the items referred to therein.

ii) **Therefore, it could be said that the auditor should make a report to the members in case he finds answer to any of these matters in adverse.**

REPORTING ON ACCOUNTS EXAMINED SEC. 143(2)

a) Under provisions of Section 143(2), the auditor shall make a report to the members of the company on the accounts examined by him and on FS

b) The report shall after taking into account the provisions of this Act, the accounting and auditing standards and matters which are required to be included in the audit report.

DUTY TO REPORT ON PRINCIPAL ASSERTIONS [SEC.143 (3)]

a) Whether he has **sought and obtained all the information** and **explanations** which to the best of his knowledge and belief were necessary for the purpose of his audit and if not, details thereof and the effect of such information on the FS's.

b) Whether, in his opinion, **proper books of account** as **required by law** have been kept by the company so far as appears from his examination of those books and proper returns, adequate for the purposes of his audit have been received from branches not visited by him.

c) Whether the **report** on the accounts of any **branch office** of the company audited by a person other than the company's auditor has been sent to him and the manner in which he has dealt with it in preparing his report.

d) Whether the company's balance sheet and profit and loss account dealt with in the **report** are in **agreement** with the books of account and returns.

e) Whether, in his opinion, the FS's comply with the **accounting standards**.

f) The observations or comments of the auditors on financial transactions or matters which have any **adverse effect** on the functioning of the company.

g) Whether any director is **disqualified** from being appointed as a director under **sub - section (2) of section 164**.

h) Any qualification, reservation or adverse **remark** relating to the maintenance of accounts and other matters connected therewith.

i) Whether the company has **adequate Internal Financial Control with reference to FS's** in place and **the operating effectiveness** of such controls.

<u>Applicability of Reporting on IFC's under Section 143(3)(i)</u>

Section 143(3)(i) shall not apply to a private limited company which is:

(i) A one-person company or

(ii) A small company or

(iii) Company having **turnover less than rupees fifty crore** as per latest audited FS <u>AND</u> Which has **aggregate borrowings** from banks or financial institutions or anybody corporate at any point of time during the financial year **less than rupees twenty-five crore**.

j) Such other matters as are **prescribed in Rule 11** of the Companies (Audit and Auditors) Rules, 2014

RULE 11 SEC.143(3)(j)

The auditor shall include in his report, his views and comments on the following matters:

a) Whether the company has disclosed the impact, if any, of **pending litigations** on its financial position in its FS's.

b) Whether the company has made **provision**, as required under any law or accounting standards, for **material foreseeable losses, if any, on long term contracts including derivative contracts.**

c) Whether there has been any **delay** in transferring amount, required to be transferred, to the

Investor Education and Protection Fund by the company.

d)

i) Whether the **management has represented** that, to the best of it's knowledge and belief other than as **disclosed in the notes** to the accounts, **no funds have been advanced or loaned or invested** by the company to or in any other person(s) or entity(ies), including **foreign entities** ("Intermediaries"), with the understanding, **whether recorded in writing** or otherwise, that the Intermediary shall, whether, **directly or indirectly lend or invest** in other persons or entities identified in any manner **whatsoever by or on behalf of the company ("Ultimate Beneficiaries")** or provide any **guarantee, security** or the like on behalf of the Ultimate Beneficiaries;

ii) Whether the **management has represented**, that, to the best of it's knowledge and belief, **other than as disclosed in the notes** to the accounts, **no funds have been received by the company** from any person(s) or entity(ies), **including foreign entities ("Funding Parties")**, with the understanding, whether recorded in writing or otherwise, that the company shall, **whether, directly or indirectly, lend or invest** in other persons or entities identified in any manner whatsoever by or **on behalf of the Funding Party ("Ultimate Beneficiaries")** or **provide any guarantee, security** or the like on behalf of the Ultimate Beneficiaries; and

iii) **Based on such audit procedures** that the auditor has considered reasonable and appropriate in the circumstances, **nothing has come to their notice that has caused them to believe** that the representations under sub-clause (i) and (ii) **contain any material mis-statement.**

e) Whether the **dividend declared or paid** during the year by the company **is in compliance with section 123** of the Companies Act, 2013.

f) Whether the company, **has used such accounting software for maintaining its books of account** which has a **feature of recording audit trail (edit log) facility** and the same has been operated throughout the year for all transactions recorded in the software and the **audit trail feature has not been tampered** with and the audit trail has been preserved by the company as per the statutory requirements for record retention.

DUTY TO STATE THE REASONS FOR QUALIFICATION OR NEGATIVE REPORT [SEC. 143(4)]

Where any of the matters required to be included in the audit report is answered in the **negative or with a qualification**, the report shall state the reasons thereof.

POWER TO APPOINT GOVERNMENT COMPANY AUDITOR [SEC.143(5)]

a) In the case of a Government company, CAG shall **direct the auditor** the **manner** in which the accounts of the Government company are required to be audited.

b) The auditor shall **submit a copy** of his audit report to CAG.

c) The audit report shall, among other things, include the directions, if any, issued by CAG, the **action taken** thereon and its **impact** on the accounts and FS of the company.

POWER TO CONDUCT SUPPLEMENTARY AUDIT & COMMENT THEREUPON [SEC. 143 (6)]

CAG shall, **within 60 days** from the date of receipt of the audit report, have the following rights:

Supplementary Audit

To conduct a supplementary audit under section 143(6)(a), of the FS of the company

a) By **such person or persons** as he may authorize in this behalf; and

b) For the purposes of such audit, require information or additional information to be furnished to any person or persons, so authorised, on such matters,

c) **By such person or persons, and in such form**, as the CAG of India may direct;

Supplementary Comment

a) **Comment upon or Supplement** such audit report under section 143(6)(b).

b) It may be noted that any comments given by the CAG of India upon, or supplement to, the audit report **shall be sent by the company to every person** entitled to copies of audited FS under sub-section (1) of section 136 i.e. and Also be placed before the AGM of the company at the same time and in the same manner as the audit report.

TEST AUDIT [SEC. 143 (7)]

CAG of India may, in case of any company covered under sub-section (5) or sub-section (7) of section 139, if he considers necessary, by an order, **cause test audit to be conducted of the accounts of such company**

DUTY TO COMPLY WITH AUDITING STANDARDS [SEC.143(9)]

Every auditor shall comply with the auditing standards.

REPORTING ON ANY OTHER MATTER SPECIFIED BY CENTRAL GOVERNMENT: [SEC. 143(11)]

As per section 143(11), the **Central Government** may, in consultation with the **National Financial Reporting Authority**, by general or special order, direct, in respect of such class or description of companies, as may be specified in the order, that the auditor's report shall also include a statement on such matters as may be specified therein

REPORTING ON FRAUDS [SEC. 143(12)]

a) Reporting to the Central Government-

As per **section 143(12)** of the Companies Act, 2013 read with **Rule 13** of the Companies (Audit and Auditors) Rules, 2014, if an auditor of a company in the course of the performance of his duties as auditor, has reason to believe that an offence of fraud, which involves or is expected to involve individually an amount of **Rs. 1 crore or above**, is being or has been committed in the company by its officers or employees, the auditor shall report the matter to the Central Government within such time and in such manner as prescribed.

b) Reporting to the Audit Committee or Board-

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 prescribed.

c) Besides, auditor has also to report matters pertaining to fraud at point **(xi) of paragraph 3** of CARO,2020

Fraud Reporting
[Section 143(12) of Companies Act, 2013]

- **Fraud involving amount of less than ₹ 1 crore**
  - **Auditor to Report to Board Audit Committee**
    - Within 2 days of knowledge of fraud

      Report the following matters :
      a) Nature of Fraud with description
      b) Approximate amount involved; and
      c) Parties involved
  - **Company bound to disclose certain specified details in Board's Report such as :**
    a) Nature of Fraud with description
    b) Approximate amount involved,
    c) Parties involved, if remedial action not taken; and
    d) Remedial actions taken
- **Fraud involving amount of ₹ 1 crore or above**
  - **Auditor to Report to Central Government in following manner :**
    - Within 2 days of knowledge of fraud,
      ↓
      Report to Board / Audit Committee
    - Seek reply within 45 days
      - Reply/observations received within stipulated time
        - Forward Report + Reply / observations + Comments to CG within 15 days of receipt of such reply/observations
      - Reply/observations not received within stipulated time
        - Forward Report + Note containing details of report for which failed to receive any reply/observations to CG

Applicability of the Order

The CARO, 2020 is an additional reporting requirement. The order applies to every company including a foreign company as defined in the Companies Act, 2013.

However, the Order specifically exempts the following classes of companies:

1) A banking company
2) An insurance company
3) A company licensed to operate under **section 8** of the Companies Act;
4) A One Person Company ; and
5) A **private limited company,**
   a) Not being a **subsidiary or holding company of a public company,**
   b) Having a **paid up capital and reserves and surplus** not more than **one crore rupees** as on the balance sheet date and
   c) Which does not have **total borrowings exceeding one crore rupees** from any bank or financial institution **at any point of time** during the financial year and
   d) Which does not have a **total revenue as disclosed in Scheduled III** to the Companies Act **(including revenue from discontinuing operations) exceeding ten crore rupees** during the financial year as per the FS.

MATTERS TO BE INCLUDED IN AUDITOR'S REPORT

The auditor's report on the accounts of a company to which this Order applies shall include a statement on the following matters, namely:

(i) Property, Plant and Equipment

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

(B) Whether the company is **maintaining proper records** showing full particulars of **intangible assets;**

b) Whether these **Property, Plant and Equipment** have been **physically verified by the management** at reasonable intervals; whether any **material discrepancies were noticed** on such verification and if so, whether the same have been **properly dealt** with in the books of account;

c) Whether the **title deeds** of all the **immovable properties** disclosed in the FS are **held in the name of the company**, if not, provide the details thereof in the format below:

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

d) Whether the company has **revalued its Property, Plant and Equipment** or **intangible assets** or both during the year and, if so, whether the revaluation is based on the **valuation by a Registered Valuer**; specify the amount of change, **if change is 10% or more** in the aggregate of the **net carrying value of each class of Property, Plant and Equipment or intangible assets**;

e) Whether **any proceedings** have been initiated or **are pending against** the company for holding any **benami property**, if so, whether the company has appropriately disclosed the details in its FS's

(ii) <u>Inventory</u>

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

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

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

a) Whether during the year the company has provided loans or provided advances in the nature of loans, or stood guarantee, or provided security to any other entity if so, indicate-

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

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

b) Whether the **investments made, guarantees provided, security given** and the terms and conditions of the grant of all loans and advances in the nature of loans and guarantees provided are **not prejudicial** to the company's interest;

c) In respect of **loans and advances** in the nature of loans, whether the **schedule of repayment of principal and payment of interest** has been stipulated and whether the **repayments or receipts are regular;**

d) If the **amount is overdue**, state the **total amount overdue** for **more than ninety days**, and whether **reasonable steps** have been taken by the company **for recovery of the principal and interest;**

e) Whether any loan or advance in the nature of loan granted which has fallen due during the year, has been **renewed or extended or fresh loans granted to settle the overdues of existing loans given to the same parties**, if so, specify the **aggregate amount of such dues renewed or extended or settled by fresh loans** and the percentage of the aggregate to the total loans or advances in the nature of loans granted during the year.

f) Whether the company has granted any loans or advances in the nature of loans either **repayable on demand or without specifying any terms** or **period of repayment**, if so, specify the aggregate amount, percentage thereof to the total loans granted, **aggregate amount of loans granted** to **Promoters, related parties** as defined under Companies Act, 2013;

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

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

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

(vii) Statutory Dues

a) Whether the company is **regular in depositing undisputed statutory dues** including

(i) Goods and Services Tax,
(ii) Provident fund,
(iii) Employees' state insurance,
(iv) Income-tax,
(v) Sales-tax,
(vi) Service tax,
(vii) Duty of customs,
(viii) Duty of excise,
(ix) Value added tax,
(x) Cess and any other statutory dues

to the appropriate authorities and if not, the **extent of the arrears of outstanding** statutory dues as on the **last day of the financial year** concerned **for a period of more than six months** from the **date they became payable**, shall be indicated;

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

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

(ix) Default in Repayment

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

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

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

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

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

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

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

(x) Usage of Funds

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

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

(xi) Frauds

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

b) Whether any report under **sub-section (12) of section 143** of the Companies Act has been filed by the auditors in **Form ADT-4** with the Central Government;

c) Whether the auditor has considered **whistle-blower complaints**, if any, received during the year by the company;

(xii) Nidhi Company

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

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

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

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

(xiv) **Internal Audit**

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

b) Whether the **reports of the Internal Auditors** for the period under audit were considered by the statutory auditor;

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

(xvi) **NBFC**

a) Whether the company is required to be **registered under section 45-IA of** the Reserve Bank of India Act, 1934 (2 of 1934) and if so, whether the **registration has been obtained**;

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

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

d) Whether the Group has **more than one CIC as part of the Group**, if yes, indicate the number of CICs which are part of the Group;

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

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

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

(xx)

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

b) Whether any **amount remaining unspent** under sub-section (5) of section 135 of the Companies Act, pursuant to any ongoing project, **has been transferred to special account** in compliance with the provision of sub- section (6) of section 135 of the said Act;

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

REASONS TO BE STATED FOR UNFAVOURABLE OR QUALIFIED ANSWERS

1 Where, in the auditor's report, the answer to any of the questions referred to in paragraph 3 is **unfavourable or qualified**, the auditor's report shall also state the **basis for such unfavourable or qualified answer**, as the case may be.

2 Where the auditor **is unable to express any option** on any specified matter, his report shall indicate such fact together with the reasons as to **why it is not possible for him to give his opinion in the same**.

9

Special Features of Audit of Different Types of Entities

CHAPTER OVERVIEW:

I 9A - Audit Of Different Types Of Entities

II 9B - Government Audit

III 9C - Audit Of Co - Operative Societies

IV 9D - Audit Of Trust & Societies

9A - AUDIT OF DIFFERENT TYPES OF ENTITIES

AUDIT OF LOCAL BODIES

A) Background

1) A municipality can be defined as a unit of **local self-government in an urban area.**
2) **'Local self-government'** ordinarily means the administration of a locality - a village, a town, a city or any other area smaller than a state.
3) It raises its **revenue through local taxation** and spends its income on services which are regarded as local and therefore, distinct from state and central services.
4) Municipal government in India covers five distinct types of urban local authorities:
   a) **The municipal corporations,**
   b) **The municipal councils,**
   c) **The notified area committees**
   d) **The town area committees**
   e) **The cantonment committees**
5) **Expenditure** incurred by the municipalities and corporations can be broadly classified under the following heads:
   a) General Administration and Revenue Collection,
   b) Public health,
   c) Public safety,
   d) Education,
   e) Public works, and
   f) Others such as interest payments, etc.

B) Types of Grants

1) **General purpose grants:** These are primarily intended to substantially bridge gap between needs & resources of local bodies.
2) **Specific purpose audit:** These grants which are tied to provisions of certain services/performance of certain task.
3) **Statutory & compensatory grants:** These grants under various enactments are given to local bodies as compensation on account of loss of any revenue on taking over a tax by state Govt. from local Govt.

C) Financial administration of local bodies comprises of following

1) **Budgetary Procedure:**
   a) Objective of local bodies budgetary procedure are

(i) *Financial accountability*

(ii) *Control of expenditure*

b) *Main objective is to ensure that funds are raised and moneys are spent by departments as per rules & regulations and within limits of sanction & authorisation by council.*

2) **Expenditure in Control:**

a) The system of financial control existing in the state and central government level is conditioned by the fact that there is a **clear demarcation between the legislature and executive.**

b) The integration of legislation and executive powers in the municipal council makes it difficult for its executive to function as its inquisitorial body as well.

3) **Accounting system:**

a) Municipal accounting and budget format have been criticised as neither **simple nor comprehensible**, sometimes providing inadequate information.

b) Both these situations are not **conducive to a proper system** of management information.

D) Audit Programme for Local Body

1) **Appointment:**

The **Local Fund Audit Wing of the State Govt.** is generally in-charge of the audit of municipal accounts. Sometimes bigger Muncipal Corporations e.g. Delhi, Mumbai etc. have **power to appoint their own auditors** for regular external audit.

2) **Auditor's Concerns:**

The auditor while auditing the local bodies should report on the

a) **Fairness** of the contents and presentation of financial statements,

b) The **strengths and weaknesses** of system of financial control,

c) The **adherence** to legal and/or administrative requirements;

d) Whether **value** is being **fully received** on money spent.

e) **To detect** errors and fraud and **misuse** of resources.

3) **Rules & Regulations:**

The auditor should ensure that the **expenditure incurred conforms to the relevant provisions of the law** and is in accordance with the financial rules and regulations framed by the competent authority

4) **Authorizations:** He should **ensure** that all types of sanctions, either special or general, **accorded by the competent authority.**

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

from the provision and the same has been authorized by the competent authority.

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

E) Objective of Audit of Local Body:

1) Reporting on fairness of content & presentation of FS's.
2) Reporting upon strengths & weakness of system of financial controls.
3) Reporting on adherence to legal and/or administrative requirements.
4) Reporting upon whether value is being fully received on money spent and
5) Detection & prevention of error, fraud & misuse of resources.

AUDIT OF NGO

A) Background

1) **NGOs** can be defined as **non-profit making organizations which raise funds from members, donors or contributors** apart from receiving donation of time, energy and skills **for achieving their social objectives** like imparting education, providing medical facilities, economic assistance to poor, managing disasters and emergent situation.
2) **Some examples** of NGOs operating in India include **Child Relief and You (CRY), NORAD, UNICEF, Godhuli, Vidya, Concern India Foundation., etc.**
3) The NGOs which are not registered under the Companies Act, 2013 are allowed to maintain accounts either an accrual basis or cash basis.

B) Sources and Applications of Funds

1) The **main sources of funds** include grants and donations, fund raising programmes, advertisements, fees from the members, technical assistance fees / fee for services rendered, subscriptions, gifts, sale of produce or publications, etc.
2) Donations and grants received in the **nature of promoter's contribution are in the nature of capital receipts and shown as liabilities in the Balance Sheet of NGO**. These may either be in the form of **corpus contribution or a contribution towards revolving fund.**
3) The donors are generally required to specify whether the donation/grant given by him shall form part of the corpus of the NGO.
4) Many a times NGOs receive contributions in kind. These contributions include assets such as land, buildings, vehicles, office equipment, etc.

C) Provisions Relating to Audit

1) The auditors of an NGO registered under the Societies Registration Act, 1860 or the Indian Trusts Act 1882 are normally appointed by the Management of the Society or Trust.
2) The auditors of NGO registered under section 8 of the Companies Act, 2013 are appointed by the members of the company.
3) The Foreign Contribution (Regulation) Act 1976 has prescribed the format and requires that same be furnished to the Ministry of Home Affairs within 60 days from the close of the financial year i.e. by May 30 each year.

Points to be concentrated while planning audit of NGO:

a) Knowledge of NGO's work, its mission & vision, areas of operations and environment in which it operates.
b) Updating knowledge of relevant statutes especially with regard to recent amendments, circulars, judicial decisions viz. FCRA, 1976, Societies Registration Act, 1860, Income Tax Act 1961 etc. and Rules related to statutes.
c) Reviewing legal form of Organization & its MOA, AOA, Rules and Regulations.
d) Reviewing NGO's Organization chart, then Financial and Administrative Manuals, Project and Programme Guidelines, Funding Agencies Requirements and formats, budgetary policies if any.
e) Examination of minutes of Board/Managing Committee/Governing Body/ Management & Committees thereof to ascertain impact of any decisions on financial records.
f) Study accounting system, procedures, internal controls and internal checks existing for NGO & verify their applicability.
g) Setting of materiality levels for audit purposes.
h) The nature and timing of reports or other communications.
i) The involvement of experts and their reports.
j) Review the previous year's Audit Report.

The audit programme should include in a sequential order all assets, liabilities, income and expenditure ensuring that no material item is omitted.

a) Corpus Fund: The contributions / grants received towards corpus be vouched with special reference to the letters from the donor(s). The interest income be checked with Investment Register and Physical Investments in hand.
b) Reserves: Vouch transfers from projects / programmes with donor's letters and board resolutions of NGO. Also check transfer of gross value of asset sold from capital reserve to general reserve and adjustments during the year.
c) Ear-marked Funds: Check requirements of donor's institutions, board resolution of NGO, rules

and regulations of the schemes of the ear-marked funds.

d) **Project / Agency Balances:** Vouch disbursements and expenditure as per agreements with donors for each of the balances.

e) **Loans:** Vouch loans with loan agreements, counterfoil of receipt issued.

f) **Fixed Assets:** Vouch all acquisitions / sale or disposal of assets including depreciation and the authorisations for the same.

g) **Investments:** **Check Investment Register** and the investments physically ensuring that investments are in the name of the NGO

The receipt of income of NGO may be checked on the following lines:

1) **Contribution & Grants for projects and programmes:** **Check agreement with donors & grants letters** to ensure that funds received have been accounted for.
2) **Receipts from Fund raising Programmes:** **Verify** in detail **internal control system** and ascertain who are the person responsible for collection of funds and mode of receipts.
3) **Membership fees:** **Check fees received with membership register**. Ensure proper classification is made between entrance and annual fees and life membership fees.
4) **Subscriptions:** **Check with subscription register and receipts issued**. Check the receipts with subscription rate schedule.
5) **Interest and Dividend:** **Check interest and dividend received and receivable** with investment held during the year.

AUDIT OF SOLE TRADER

1) **A sole trader is under no legal obligation to have his accounts audited.** However, many such individuals get their financial statement audited **due to regulatory requirements, such as inventory brokers or on a specific instructions of the bank for approval of loans, etc.**
2) **Appointment of Auditor:** Auditors of sole- proprietary concern shall be **appointed by the sole proprietor himself.** In case of change of auditor, it would be **duty of incoming auditor to communicate with the previous auditor**. As such, sole proprietor can determine the scope of the audit as well as the conditions under which it will be carried out.
3) On these considerations, it is **desirable that the contract of appointment of auditor in such a case should be in writing**; also, that it should **clearly define the scope of the work** which the auditor is expected to carry out. This helps to prevent misunderstanding.

AUDIT OF FIRM

A) Appointment of Auditor

1) The auditor to a firm is usually **appointed by the partners** either on the basis of a decision taken

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11

Ethics and Terms of Audit Engagements