

## NATURE, SCOPE AND OBJECTIVE OF AUDIT

### NATURE AND MEANING

- **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

**But how to ensure that FS is not misleading?**

1. accounts have been drawn up with reference to entries in the **books of account**;
2. the entries in the books of account are **adequately supported by sufficient and appropriate evidence**;
3. none of the entries in the books of account has been **omitted**
4. the information conveyed by the statements is **clear and unambiguous**;
5. amounts are **properly classified, described and disclosed in conformity with AS**; and
6. the statement of accounts presents a **true and fair picture**

### OBJECTIVE

- (a) To obtain **reasonable assurance** about whether the financial statements as a whole are **free from material misstatement, whether due to fraud or error**, thereby enabling the auditor to express an **opinion** on whether the financial statements are prepared, in all material respects, in accordance with an **applicable financial reporting framework**; and
- (b) To report on the financial statements, and **communicate as required by the SAs**, in accordance with the auditor's findings.

### SCOPE

#### INCLUSIONS

- **Reliability and sufficiency** of financial information [ BOOKS OF ACCOUNTS - SOURCE DOCUMENT]
- **Coverage of all aspects** of entity [ RELATED TO FS]
- **Proper disclosure** of financial information [RESULTING FROM FS]

#### EXCLUSIONS

- Auditor is not expected to perform duties which **fall outside domain of his competence**.
- An audit is **not an official investigation** into alleged wrong doing

AUDIT	INVESTIGATION
Objective - to obtain reasonable assurance about fs	Objective - critical examination with a special purpose
Scope of audit is general and broad	Scope of investigation is specific and narrow.

Understand that financial statements of an entity are prepared on **historical financial information basis**.

**BUT WHY DOES THE AUDITOR GIVE REASONABLE ASSURANCE AND NOT GUARANTEE?**

**INHERENT LIMITATIONS OF AUDIT -**

**- Nature of financial reporting**

Preparation of financial statements involves making many **judgments by management**.  
Controls related to FS may not have operated to produce reliable financial information due to their own limitations

**- Nature of Audit procedures**

Practical limitation - Auditor **does not test all transactions** and balances  
Legal limitation - **Management may not provide complete information** as requested by auditor

**- Not in nature of investigation**

Audit is **not an official investigation**. Hence, auditor cannot obtain absolute assurance

**- Timeliness of financial reporting and decrease in relevance of information over time**

The relevance of information **decreases over time** and auditor cannot verify each and every matter

**- Future events**

Future events or conditions may **affect an entity adversely**. Adverse events may seriously affect ability of an entity to continue its business.

**INTERDISCIPLINARY NATURE OF AUDITING**

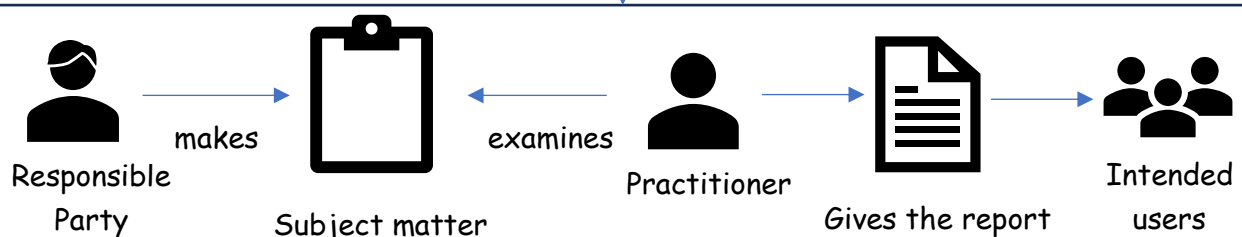
Accounting, Law, Economics, Behavioural science, Statistics and mathematics, Data processing, Financial Management, Production

**WHAT IS THE BENEFIT OF AUDIT?**

- Audited accounts provide **high quality information**.
- **Interest of shareholders is safeguarded** by an audit.
- An audit acts as a **moral check on employees**
- Audited FS are **helpful to government authorities** for determining tax liabilities.
- Audited FS can be **relied upon by lenders, bankers** for making their credit decisions
- An audit may also **detect fraud or error or both**.
- An audit **reviews existence and operations of various controls** operating in any entity.

**ASSURANCE ENGAGEMENT**

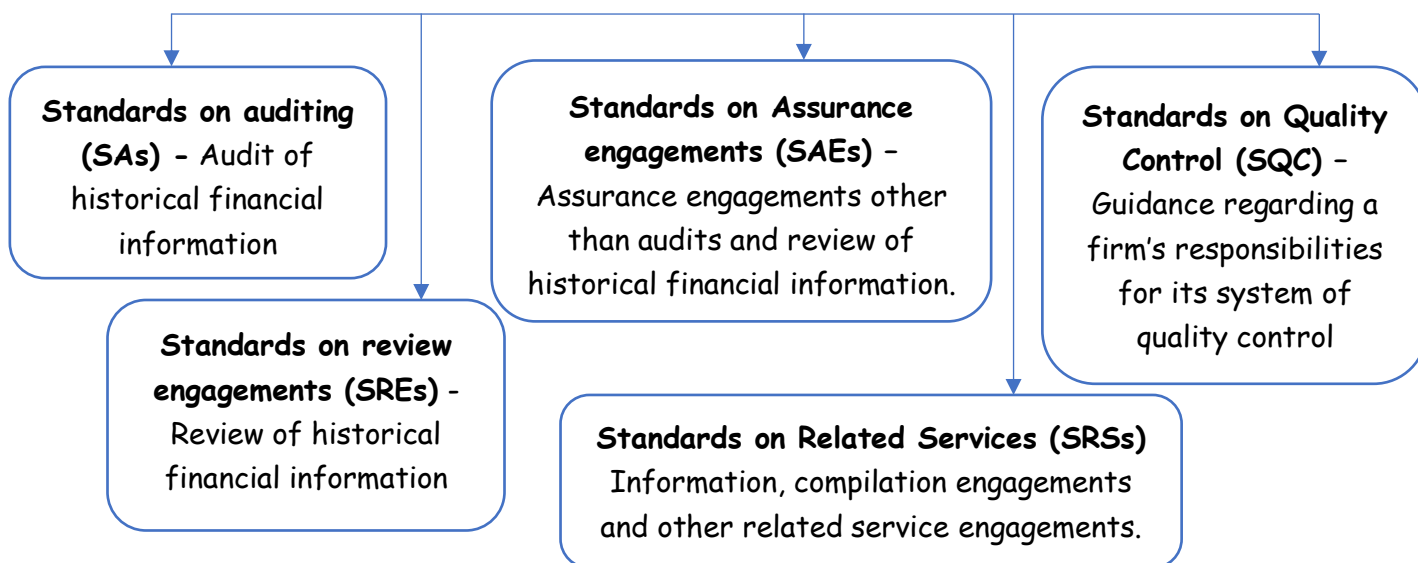
An engagement in which a **practitioner** expresses a **conclusion** designed to **enhance the degree of confidence** of the intended users other than the responsible party about the **outcome of the evaluation or measurement** of a **subject matter** against **criteria**.



## TYPES OF ASSURANCE ENGAGEMENT

Reasonable assurance engagement (AUDIT)	Limited assurance engagement (REVIEW)	Assurance Engagements dealing with matters other than historical financial information
Applies to <b>Historical FI</b>	Applies to <b>Historical FI</b>	Applies to <b>Prospective FI</b>
Reasonable assurance engagement provides <b>high level of assurance</b>	Limited assurance engagement provides <b>lower level of assurance</b> than reasonable assurance engagement.	Such type of assurance engagement provides only a <b>"moderate" level of assurance</b>
It performs elaborate and extensive procedures to obtain sufficient appropriate evidence and <b>draws reasonable conclusions</b>	It performs fewer procedures to obtain sufficient appropriate evidence and <b>draws limited conclusions</b>	The practitioner obtains sufficient appropriate evidence to the effect that <b>management's assumptions on which the prospective financial information is based are not unreasonable</b>

## ENGAGEMENT AND QUALITY CONTROL STANDARDS



## DUTIES IN RELATION TO ENGAGEMENT AND QUALITY CONTROL STANDARDS

- Ensure that **standards are followed in engagements** undertaken by them.
- If situation arises when a **specific procedure as required in Standards would be ineffective in a particular engagement**.
  - Document how **alternative procedures performed** achieve the purpose of required procedure.
  - Also, **reason for departure** has also to be documented unless it is clear.
  - Further, his **report should draw attention** to such departures.

### WHY ARE STANDARDS NEEDED?

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



### QUALITIES OF AUDITOR

- Tact, caution, firmness, good temper, integrity, discretion, industry, judgement, patience, clear headedness and reliability
- Shine of culture
- Highest degree of integrity
- Basic human qualities apart from the technical requirement of professional training and education.
- An exhaustive knowledge of accounting in all its branches.

**Work Hard in Silence,  
let the success make the noise**

## ETHICS AND TERMS OF AUDIT ENGAGEMENT

### MEANING

moral principles which govern a person's behaviour or his conducting of an activity

### FUNDAMENTAL PRINCIPLES

INTEGRITY	<ul style="list-style-type: none"> <li>Accountant to be <u>straightforward and honest</u></li> <li>implies <u>fair dealing and truthfulness</u></li> <li><u>not knowingly</u> be associated where the accountant believes that the <u>information contains a materially false or misleading statement</u></li> </ul>
OBJECTIVITY	Not to compromise professional judgment because of <u>bias, conflict of interest or undue influence</u>
PROFESSIONAL COMPETENCE AND DUE CARE	<ul style="list-style-type: none"> <li>Ensure that a client receives <u>competent professional service, based on current technical and professional standards and relevant legislation</u>; and</li> <li><u>Act diligently</u> and in accordance with applicable standards</li> </ul>
CONFIDENTIALITY	<ul style="list-style-type: none"> <li>accountant to respect the <u>confidentiality of information acquired as a result of professional or business relationships</u>.</li> <li>However, such confidential information may be disclosed, for example, when it is <u>required by law</u></li> </ul>
PROFESSIONAL BEHAVIOUR	<ul style="list-style-type: none"> <li>It requires an accountant to comply with <u>relevant laws and regulations</u> and</li> <li>avoid any <u>conduct that the accountant knows or should know might discredit the profession</u>.</li> </ul>

### PROFESSIONAL SKEPTICISM

- Attitude that includes a
  - questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence.
- Maintaining professional skepticism throughout the audit is necessary if the auditor is to reduce the risks of:
  - Overlooking unusual circumstances, over generalising when drawing conclusions from audit observations and using inappropriate assumptions in determining the nature, timing, and extent of the audit procedures and evaluating the results thereof
- **Example of Professional skepticism**
  - Audit evidence that contradicts other audit evidence obtained, information that brings into question the reliability of documents, fraud indicator conditions

## INDEPENDENCE

### MEANING

implies that the **judgement of a person is not subordinate** to the wishes or direction of another person

#### INDEPENDENCE OF MIND

the state of mind that **permits the provision of an opinion without being affected by influences**

#### INDEPENDENCE OF APPEARANCE

avoidance of facts and circumstances that are so significant that a reasonable and informed third party would reasonably conclude **firms or a member objectivity is compromised**

### THREATS TO INDEPENDENCE

<b>Self-interest threats</b>	When an auditing firm, its partner or associate could benefit from a financial interest in an audit client EXAMPLE - Direct financial interest with client, loan or guarantee to/from client, <b>undue dependence</b> on a client's fees, close business relationship
<b>Self-review threats</b>	It occurs when during a review of any judgement or conclusion reached in a previous audit or non-audit engagement EXAMPLE - Auditor having recently been a director, auditors perform services which are subject matters of audit
<b>Advocacy threats</b>	It occurs when the auditor promotes, a client's opinion to a point where people may believe that objectivity is getting compromised, EXAMPLE - Auditor deals with shares or securities of company, becomes client's advocate in litigation
<b>Familiarity threats</b>	When auditors form relationships with the client where they end up being too sympathetic to the client's interests EXAMPLE - Close relative of the auditor, long association between partner and auditor, acceptance of significant gifts or hospitality
<b>Intimidation threats</b>	It occurs when <u>auditors are deterred from acting objectively</u> EXAMPLE - threat of replacement over disagreements, pressure to reduce audit fees, being threatened with litigation.

### SAFEGUARDS TO INDEPENDENCE

Before taking on any work, an auditor must **conscientiously consider whether it involves threats to his independence**. -----> When such threats exist, the auditor should either desist from the task or eliminate the threat or at the very least, put in place safeguards which reduce the threats to an acceptable level. -----> If the auditor is unable to fully implement credible and adequate safeguards, then he must not accept the work.



**SQC 1 - "QUALITY CONTROL FOR FIRMS THAT PERFORM AUDITS AND REVIEWS OF HISTORICAL FINANCIAL INFORMATION, AND OTHER ASSURANCE AND RELATED SERVICES ENGAGEMENTS"**

**OBJECTIVE -**

establish a system of quality control designed to provide it with reasonable assurance that the firm and its **personnel comply with professional standards and regulatory and legal requirements** and the report issued is appropriate in circumstances

**ELEMENTS OF QUALITY CONTROL**

<b>LEADERSHIP RESPONSIBILITIES FOR QUALITY WITHIN THE FIRM</b>	Such policies and procedures should require the <b>firm's CEO or the MD to assume ultimate responsibility</b> for the firm's system of quality control. Further, persons assigned operational responsibilities for the firm's quality control system should have <b>sufficient and appropriate experience, ability and the necessary authority to assume that responsibility</b>
<b>ETHICAL REQUIREMENTS</b>	The firm should establish policies and procedures designed to ensure that the firm and its personnel comply with relevant ethical requirements contained in the Code of ethics issued by ICAI. Also, <b>Observance of "Independence"</b> in all engagements is the basic requirement.
<b>ACCEPTANCE AND CONTINUANCE OF CLIENT RELATIONSHIPS AND SPECIFIC ENGAGEMENTS</b>	A firm before accepting an engagement should acquire vital information about the client. Such an information should help firm to decide about: - <ul style="list-style-type: none"> <li>• <b>Integrity</b> of Client</li> <li>• <b>Competence</b> (including capabilities, time and resources) to perform engagement</li> <li>• <b>Compliance with ethical requirements</b></li> </ul>
<b>HUMAN RESOURCES</b>	Firm should establish policies and procedures designed to provide it with reasonable assurance that it has sufficient personnel with the <b>capabilities, competence, and commitment to ethical principles</b> to perform the engagement
<b>ENGAGEMENT PERFORMANCE</b>	<p>Consultation should take place in difficult or contentious matters pertaining to an engagement</p> <p>Significant judgments made in an engagement should be reviewed by an engagement quality control reviewer</p> <p>The report should only be issued after <b>resolution of such differences of opinion</b></p> <p>Establish policies and procedures to complete the assembly of final engagement files on a <b>timely basis after the engagement reports have been finalized</b></p>
<b>MONITORING</b>	The firm should ensure that policies and procedures relating to the <b>system of quality control are relevant, adequate, operating effectively and complied with in practice</b>

**SA 220 - QUALITY CONTROL FOR AN AUDIT OF FINANCIAL STATEMENTS**

**OBJECTIVE -**

Ensure that audit complies with **professional standards and regulatory and legal requirements** and the auditor's report issued is **appropriate** in the circumstances

**ELEMENTS OF QUALITY CONTROL**

<b>LEADERSHIP RESPONSIBILITIES FOR QUALITY ON AUDITS</b>	<p>The actions of the engagement partner and engagement team, <b>emphasise</b> the importance to <b>audit quality</b> of: -</p> <ul style="list-style-type: none"> <li>- Performing work that complies with <b>professional standards and regulatory and legal requirements</b>;</li> <li>- Complying with the <b>firm's quality control policies and procedures</b></li> <li>- Issuing <b>auditor's reports</b> that are appropriate in the circumstances;</li> <li>- The engagement team's <b>ability to raise concerns without fear of reprisals</b>.</li> <li>- The fact that <b>quality is essential</b> in performing audit engagements.</li> </ul>
<b>RELEVANT ETHICAL REQUIREMENTS</b>	<ul style="list-style-type: none"> <li>- <b>Identifying a threat to independence</b> that <b>safeguards may not be able to eliminate</b> or reduce to an acceptable level and reporting by engagement partner to the relevant persons within the firm to determine appropriate action, [<b>eliminating the threat, or withdrawing from the audit engagement</b>]</li> </ul>
<b>ACCEPTANCE AND CONTINUANCE OF CLIENT RELATIONSHIPS AND AUDIT ENGAGEMENTS</b>	<p>Following information assist engagement partner like</p> <ul style="list-style-type: none"> <li>- <b>integrity</b> of principal owners,</li> <li>- <b>competence</b> of engagement team and</li> <li>- <b>consideration of necessary capabilities</b> including time and resources,</li> <li>- compliance with <b>relevant ethical requirements</b> and</li> <li>- <b>significant matters</b> arisen during current or previous audit engagement and their implications</li> </ul>
<b>ASSIGNMENT OF ENGAGEMENT TEAMS</b>	<p>Engagement team must have appropriate <b>competence and capabilities to perform the engagement in accordance with professional standards and regulatory and legal requirement</b></p>
<b>ENGAGEMENT PERFORMANCE</b>	<p>For audits of FS of listed entities, and those other audit engagements, if any, for which the firm has determined that an <b>engagement quality control review [EQCR]</b> is required, the engagement partner shall determine that an EQCRer <b>has been appointed</b>, <b>discuss significant matters arising during the audit engagement</b> with the EQCRer and <b>not date the auditor's report</b> until the completion of the EQCR.</p>
<b>MONITORING</b>	<p>The engagement partner should ensure that policies and procedures relating to the <b>system of quality control are relevant, adequate, operating effectively and complied with in practice</b></p>



## SA 210 - AGREEING THE TERMS OF AUDIT ENGAGEMENTS

### OBJECTIVE -

- (A) Establishing **whether the preconditions for an audit are present**
- (B) Confirming that there is a **common understanding between the auditor and management** and, where appropriate, those charged with governance of the terms of the audit engagement

### Preconditions for an audit ---->

- (a) Determine whether the **financial reporting framework is acceptable** and
- (b) Obtain the agreement of management that it **acknowledges and understands its responsibility**:
  - For the **preparation of the FS in accordance with the applicable FRF**
  - For such **internal control as management considers necessary to enable the preparation of FS** and
  - To provide the auditor with:
    - **Access to all information of which management is aware** that is relevant to the preparation of the FS
    - **Additional information that the auditor may request from management** for the purpose of the audit; and
    - **Unrestricted access to persons within the entity** from whom the auditor determines it necessary to obtain audit evidence.

### Content of engagement letter---->

- The **objective and scope of the audit of the FS**
- The responsibilities of the **auditor**
- The responsibilities of **management**
- **Identification of the applicable FRF** for the preparation of the FS and
- Reference to the **expected form and content** of any reports to be issued by the auditor and a statement that there may be circumstances in which a report may differ from its expected form and content.

If law or regulation prescribes in sufficient detail the terms of the audit engagement, the **auditor need not record them in a written agreement**

### RECURRING AUDIT

The auditor **does not send a new audit engagement letter each period**. However, the following factors may make it appropriate to revise the terms of the audit engagement:

- Any indication that the entity **misunderstands the objective and scope of the audit**.
- Any **revised or special terms** of the audit engagement.
- A recent change of **senior management**.
- A significant change in **ownership**.
- A significant change in **nature or size of the entity's business**.
- A change in **legal or regulatory requirements**.
- A change in the **FRF adopted in the preparation of the FS**.
- A change in other **reporting requirements**

**IF THE MANAGEMENT REQUEST FOR CHANGE IN TERMS OF ENGAGEMENT**

**Change results from -**

- a **change in circumstances** affecting the need for the service,
- a **misunderstanding** as to the nature of an audit as originally requested or
- a **restriction on the scope of the audit engagement**, whether imposed by management or caused by other circumstances.

If the auditor is unable to agree to a change of the terms of the audit engagement -

- (a) **Withdraw from the audit engagement** where possible under applicable law or regulation
- (b) **Determine whether there is any obligation to report** the circumstances to other parties or TCWG

**Change in the audit engagement -**

to an engagement that conveys a **lower level of assurance**

The auditor shall determine whether there is **reasonable justification** for doing so. ---→  
If yes, the auditor shall ensure **work required to be performed and the report to be issued** would be those appropriate to the revised engagement ---→

In order to avoid confusing the reader, the report on the related service would not include reference to:

- (a) The **original audit engagement** or
- (b) Any **procedures** that may have been performed in the original audit engagement, except in case of agreed-upon procedures

**THE AUDITOR SHALL NOT ACCEPT THE ENGAGEMENT**

If the management or TCWG impose a limitation on the scope of the auditor's work and limitation will result in the auditor **disclaiming an opinion on the financial statements**

If **FRF** is not acceptable or if the **engagement agreement** has not been obtained.

If **preconditions to audit** are not present

You won't always be motivated  
So, you must learn to be disciplined

## AUDIT STRATEGY, PLANNING AND PROGRAMME

### AUDIT PLANNING

#### MEANING (SA 300)

plan the audit so that it will be performed in an effective manner.

#### NATURE

Planning is not a discrete phase of an audit, but rather a continual and iterative process.

It includes consideration of the timing of certain activities and audit procedures that need to be completed prior to the performance of further audit procedures.

Planning includes the need to consider, prior to the auditor's identification and assessment of the risks of material misstatement, such matters as: - **(RAP)**

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

### ELEMENTS OF PLANNING

#### (I) PRELIMINARY ENGAGEMENT ACTIVITIES

**(A) Performing procedures regarding the Continuance of Client Relationships and Audit Engagements, Acceptance and Continuance of Client Relationships and Audit Engagements**

Matters such as -

**integrity** of principal owners and key management, **competence** of engagement team to perform the audit engagement and **implications** of matters that have arisen during current and previous audit engagement. Besides, in case of initial engagements, **communication with predecessor auditor should be made**

**B) Evaluating compliance with ethical requirements including independence**

Obtain **relevant information from the firm** to identify and evaluate circumstances and relationships that create threats to independence--→ **Evaluate information on identified breaches** to determine whether they create a threat to independence for the audit engagement --→ **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

**(C) Establishing an understanding of terms of engagement**

It is in the interests of both the entity and the auditor that the auditor sends an audit engagement letter before the commencement of the audit to **help avoid misunderstandings**

#### (II) PLANNING ACTIVITIES

Planning activities involve: -

- [A] Establishing the overall audit strategy
- [B] Developing an audit plan

## AUDIT STRATEGY (FIRST)

- sets the **scope, timing and direction** of the audit, and
- guides the **development of the more detailed audit plan**

## FACTORS TO BE TAKEN INTO CONSIDERATION BY AUDITOR FOR ESTABLISHING AUDIT STRATEGY

**(a) Identify the characteristics of the engagement that define its scope**

**Applicable FRF** for to the entity, **Nature of business segments** to be audited, **Industry specific reporting requirements** required by industry regulators, **expected use of audit evidence** obtained in previous audits

**(b) Ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required.**

The entity's **timetable for reporting**, **Organization of meetings** to discuss of NTE of audit work with management, **Discussion with management** regarding the expected type and timing of reports and **expected communications** on the status of audit work, **Expected nature and timing** of communications among engagement team

**(c) Consider the factors that, in the auditor's professional judgment, are significant in directing the engagement team's efforts**

**More energies need to be devoted to significant matters** to obtain desired outcomes. Examples- **Volume of transactions**, **Significant industry developments**, **Significant changes in the FRF**, **Other significant relevant developments**

**(d) 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**

**Results of previous audits**, the manner in which the auditor **emphasizes to engagement team members the need to maintain a questioning mind** and to exercise professional **Skepticism**.

**(e) Ascertain the nature, timing and extent of resources necessary to perform the engagement.**

**Selection of engagement team** and assignment of audit work to team members, Similarly, **engagement budgeting and devotion of more time** to areas of higher risk of material misstatement are to be kept in mind.

## DEVELOPING AN AUDIT PLAN

— **Components of audit plan**

- The nature, timing and extent of **planned risk assessment procedures**
- The nature, timing and extent of **planned further audit procedures** at assertion level
- **Other planned audit procedures** that are required to be carried out so that the engagement complies with SAs.
- The **audit plan is more detailed than the overall audit strategy**
- Planning for these audit procedures takes place over the **course of the audit as the audit plan develops**. However, **execution of FAP depends on outcome of RAP**
- Further, auditor may **begin the execution of further audit procedures before planning all remaining further audit procedures**.

## AUDIT PLANNING AND AUDIT STRATEGY

### BENEFITS

AUDIT PLAN	AUDIT STRATEGY
<ul style="list-style-type: none"> <li>Devote appropriate attention to <b>important areas of the audit</b>.</li> <li>Identify and <b>resolve potential problems on a timely basis</b>.</li> <li>Properly organize and manage the audit engagement so that it is <b>performed in an effective and efficient manner</b>.</li> <li><b>Assisting in the selection of engagement team members</b> with appropriate levels of capabilities and competence</li> <li>Facilitating the <b>direction and supervision and review</b> of engagement team members</li> <li><b>Coordination of work done</b> by others such as experts</li> </ul>	<ul style="list-style-type: none"> <li>The <b>resources to deploy</b> for specific audit areas, such as the use of appropriately experienced team members for high-risk areas</li> <li>The <b>amount of resources to allocate to specific audit areas</b>, the extent of review of other auditors' work in the case of group audits</li> <li><b>When these resources are to be deployed</b>, such as whether at an interim audit stage or at key cut-off dates</li> <li><b>How such resources are managed, directed and supervised</b>, such as when team briefing and debriefing meetings are expected to be held</li> </ul>

### RELATIONSHIP

AUDIT STRATEGY →	← AUDIT PLANNING
Sets the broad overall approach to the audit	Addresses the various matters identified in the overall audit strategy
Determines scope, timing and direction of audit	Describes how strategy is going to be implemented
Less detailed	More detailed
First, Overall audit strategy establishes	Then, Audit plan can be developed

The establishment of the overall audit strategy and the detailed 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.**

### IMPORTANT QUESTIONS

Question	Answer
Who makes the plan?	Engagement partner and other key members of the engagement team in planning the audit draws on their <b>experience and insight to make the plan</b>
Is the plan required to be shared with management?	The auditor may decide to discuss elements of planning with the entity's management to <b>facilitate the conduct and management of the audit engagement however</b> , care is required in order not to compromise the effectiveness of the audit.



Does planning include supervision and review of team members	The auditor shall plan the nature, timing and extent of <b>direction and supervision of engagement team members and the review of their work</b> . The extent of which depends on the following factors- — The size and complexity of the entity. — The area of the audit. — The assessed risks of material misstatement — The capabilities and competence of the individual team members performing the audit work.
What should the auditor document in regard to audit planning and strategy	<b>The auditor shall document:</b> - (a) the overall audit strategy - (b) the audit plan and (c) any significant changes made during the audit engagement to the overall audit strategy or the audit plan, and the reasons for such changes.
Why should the above be documented	<b>Audit strategy</b> - To keep a record of the <b>key decisions considered</b> necessary to properly plan the audit and to communicate significant matters to the engagement team. <b>Audit Plan</b> - To keep a record of the <b>planned nature, timing and extent</b> of RAP and FAP at the assertion level in response to the assessed risks. Also, it serves as a record of the <b>proper planning of the audit procedures</b> <b>Changes</b> - To explain <b>why the significant changes were made</b> , and the overall strategy and audit plan finally adopted for the audit. It also reflects the <b>appropriate response to the significant changes</b> occurring during the audit.

## AUDIT PROGRAMME

### MEANING

An audit programme consists of a

- **series of verification procedures** to be applied to the FS and accounts of a given entity
- for the purpose of obtaining **sufficient evidence** to enable the auditor to
- express an **informed opinion** on financial statements.

### CONSTRUCTION OF AUDIT PROGRAMME -

- Stay within the **scope and limitation** of the assignment.
- Ensure procedures that are **needed to implement the audit plan**.
- Determine the **evidence reasonably available** and identify the best evidence
- **Apply only those steps and procedures** which are useful in accomplishing the verification purpose in the specific situation.
- **Include the audit objectives for each area** and sufficient details which serve as a set of instructions
- Consider **all possibilities** of error.

### PURPOSE OF AUDIT PROGRAMME

- To obtain audit evidence

Programme → Evidence → Opinion  
Transactions are varied in **nature and impact**;

Evidence is weighed to ascertain its weight to **prove or disprove** the assertion

Auditor would be in a position to identify the evidence that brings the **highest satisfaction**



ADVANTAGES OF AUDIT PROGRAMME	DISADVANTAGES OF AUDIT PROGRAMME
<p>(a) It provides the assistant carrying out the audit with <b>total and clear set of instructions of the work</b> generally to be done.</p> <p>(b) Provides a total <b>perspective of the work to be performed</b>.</p> <p>(c) <b>Selection of assistants for the jobs on the basis of capability becomes easier</b></p> <p>(d) <b>Danger of ignoring or overlooking certain books and records is significantly less</b> and the audit can proceed systematically</p> <p>(e) The assistants, by putting their signature on programme, accept the responsibility and, if necessary, the <b>work done may be traced back to the assistant</b>.</p> <p>(f) The principal can control the progress of the various audits in hand by examination of audit programmes</p> <p>(g) It serves as a guide for audits to be carried out in the succeeding year.</p> <p>(h) Serves as evidence in the event of any charge of negligence being brought against the auditor.</p>	<p>(a) The <b>work may become mechanical</b> and particular parts of the programme may be carried out without any understanding of the object of such parts in the whole audit scheme.</p> <p>(b) The <b>programme often tends to become rigid and inflexible</b> following set grooves; the business may change in its operation of conduct, but the old programme may still be carried on.</p> <p>(c) <b>Inefficient assistants may take shelter behind the programme</b> i.e., defend deficiencies in their work on the ground that no instruction in the matter is contained therein.</p> <p>(d) A hard and fast audit programme may <b>kill the initiative of efficient and enterprising assistants</b>.</p>

### IMPORTANT QUESTIONS

Question	Answer
Is a single audit programme practical for all businesses	Businesses vary in nature, size and composition; work which is suitable to one business may not be suitable to others; etc. are the factors that <b>vary from assignment to assignment</b> . On account of such variations, one audit programme applicable to all business under <b>all circumstances is not practicable</b> .
What should be the attitude of assistant making the programme	The assistant engaged in the job should be encouraged to <b>keep an open mind</b> beyond the programme given to him. He should be <b>instructed to note and report significant matters coming to his notice</b> . The programme may be altered to take care of situations which were left out <b>originally</b> , but are found relevant for the particular concern. Similarly, if any work originally provided for proves beyond doubt to be <b>unnecessary or irrelevant</b> , it may be dropped
Is there any review of audit programme required?	There should be <b>periodic review of the audit programme</b> to assess whether the same continues to be adequate for obtaining requisite knowledge and evidence about the transactions. Unless this is done, <b>any change in the business policy of the client may not be adequately known</b> , and consequently, audit work may be carried on, on the basis of an obsolete programme The utility of the audit programme can be retained and enhanced by ensuring that <b>inadequacies or redundancies of the programme may be removed</b> .

Stop Doubting yourself.  
Work hard and make it happen

## RISK ASSESSMENT AND INTERNAL CONTROL

### AUDIT RISK

Risk that the auditor gives an inappropriate audit opinion when the financial statements are materially misstated.

### RISK OF MATERIAL MISSTATEMENT (ROMM)

#### INHERENT RISK

Inherent risk is the susceptibility of an assertion about a class of transaction, account balance or disclosure to a misstatement that could be material, before consideration of any related controls

#### CONTROL RISK

Control risk is the risk that a misstatement that could occur in an assertion about a class of transaction, account balance or disclosure, will not be prevented, or detected and corrected, on a timely basis by the entity's internal control.

### DETECTION RISK

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

#### EXCLUSIONS

- Audit risk does not refer to the auditor's business risks
- For purposes of the SAs, audit risk does not include the risk that the auditor might express an opinion that the financial statements are materially misstated when they are not.

### IDENTIFYING AND ASSESSING THE RISK OF MATERIAL MISSTATEMENT

Identify risks throughout the process of obtaining an understanding of the entity and its environment and internal control

Assess the identified risks, and evaluate whether they relate more pervasively to the financial statements

Relate the identified risks to what can go wrong at the assertion level

Consider the likelihood of misstatement, including the possibility of multiple misstatements and material misstatement

## RISK ASSESSMENT PROCEDURE

### INQUIRY

### ANALYTICAL PROCEDURES

### OBSERVATION AND INSPECTION

- Helps in identifying **aspects of the entity** of which the auditor was unaware.
- It includes both financial and non-financial information.
- However, the results of those analytical procedures only provide a broad initial indication

Observation and inspection may support inquiries of management and others. Audit procedures include the following:

- The entity's operations.
- Documents, records, and internal control manuals.
- Reports prepared by management and TCWG
- The entity's premises and plant facilities

#### INQUIRY OF

#### INQUIRY ABOUT

Internal audit personnel

**Internal audit procedures** performed during the year relating to the design and effectiveness of the **entity's internal control** and whether management's response on that

Employees involved in initiating, processing or recording complex or unusual transactions

Appropriateness of the selection and application of certain **accounting policies**.

In-house legal counsel

**Litigation, compliance with laws and regulations**, knowledge of fraud or suspected fraud affecting the entity, warranties, post-sales obligations, arrangements (such as joint ventures)

Marketing or sales personnel

Changes in the entity's **marketing strategies, sales trends, or contractual arrangements** with its customers

Risk management function

**Operational and regulatory risks** that may affect financial reporting

Information systems personnel

System **changes**, system or control **failures**, or other **information system-related risks**.

The understanding entity and its environment, including the entity's internal control establishes a frame of reference within which the auditor plans the audit and exercises **professional judgement** throughout the audit, for example, when:

- **Assessing risks of material misstatement** of the financial statements
- Determining **materiality** in accordance with SA 320
- **Considering the appropriateness** of the selection and application of accounting policies
- **Identifying areas where special audit consideration** may be necessary,
- **Developing expectations for use** when performing analytical procedures
- **Evaluating the sufficiency and appropriateness of audit evidence**

## UNDERSTANDING THE ENTITY AND ITS ENVIRONMENT

Relevant industry, regulatory, and other external factors including the applicable financial reporting framework	<ul style="list-style-type: none"> <li>• Relevant industry factors include industry conditions such as the <b>competitive environment, supplier and customer relationships, and technological developments.</b></li> <li>• The industry in which the entity operates may give rise to <b>specific risks of material misstatement.</b></li> <li>• <b>The regulatory environment includes, among other matters, the applicable financial reporting framework and the legal and political environment.</b></li> </ul>
The nature of the entity	<ul style="list-style-type: none"> <li>• its operations;</li> <li>• its ownership and governance structures;</li> <li>• the types of investments that the entity is making and plans to make, including investments in special-purpose entities; and</li> <li>• the way that the entity is structured and how it is financed;</li> </ul> <p>An understanding of nature of <b>entity enables the auditor to understand whether entity has a complex structure, matters relating to the ownership, and relations between owners and other people or entities, related party transactions have been identified and accounted for appropriately.</b></p>
The entity's selection and application of accounting policies, including the reasons	The auditor shall evaluate whether the <b>entity's accounting policies are appropriate for its business and consistent</b> with the applicable financial reporting framework and accounting policies used in the relevant industry.
The entity's objectives and strategies, and those related business risks that may result in risks of material misstatement.	<p>The entity's <b>management define objectives, which are the overall plans</b> for the entity. Strategies are the approaches by which management intends to achieve its objectives. The entity's <b>objectives and strategies may change over time.</b></p> <p>An understanding of the business risks facing the entity increases the likelihood of identifying risks of material misstatement, <b>since most business risks will eventually have financial consequences and,</b> therefore, an effect on the financial statements.</p>
The measurement and review of the entity's financial performance	Performance measures, whether external or internal, <b>create pressures on the entity.</b> These pressures, in turn, may motivate management to take action to improve the <b>business performance or to misstate the financial statements.</b> Accordingly, an understanding of these assists the auditor in considering whether pressures to achieve performance targets <b>may result in management actions that increase the risks of material misstatement</b>

## SIGNIFICANT RISK

Significant risks often relate to **significant non-routine transactions or judgmental matters.** Significant risks are **inherent risks** with both a higher likelihood of occurrence and a higher **magnitude of potential misstatement**

<b>Risks of Material Misstatement – Greater for Significant Non-Routine Transactions</b> <b>[REASONS]</b> <ul style="list-style-type: none"> <li>• Greater management intervention</li> <li>• Greater manual intervention</li> <li>• Complex calculations or accounting principles.</li> <li>• The nature of non-routine transactions, which may make it difficult for the entity to implement effective controls over the risks.</li> </ul>	<b>Risks of material misstatement– Greater for Significant Judgmental Matters [REASONS]</b> <ul style="list-style-type: none"> <li>• Accounting principles for accounting estimates or revenue recognition may be subject to differing interpretation.</li> <li>• Required judgment may be subjective or complex, or require assumptions about the effects of future events, for example, judgment about fair value.</li> </ul>
<b>Factors to be considered by auditor for significant risk –</b> <ol style="list-style-type: none"> <li>Whether the risk is a risk of fraud</li> <li>Whether the risk is related to recent significant economic, accounting, or other developments like changes in regulatory environment,</li> <li>The complexity of transactions</li> <li>Whether the risk involves significant transactions with related parties</li> <li>The degree of subjectivity and uncertainty in the measurement of financial information related to the risk</li> <li>Whether the risk involves significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual.</li> </ol>	

## MATERIALITY

<b>What is meant by materiality?</b> 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. Materiality is not always a matter of relative size. Further, if there is any statutory requirement of disclosure, it is to be considered material irrespective of the value of amount.	
<b>How does materiality help in planning the audit?</b> <ol style="list-style-type: none"> <li>Determining the nature, timing and extent of risk assessment procedures;</li> <li>Identifying and assessing the ROMM; and</li> <li>Determining the nature, timing and extent of further audit procedures</li> </ol>	<b>What is the significance of materiality?</b> The auditor has to obtain reasonable assurance that FS as a whole are free from material misstatement whether due to fraud or error.
<b>Assumptions of auditor while calculating materiality regarding users: –</b> <ol style="list-style-type: none"> <li>They have a reasonable knowledge of business and economic activities and accounting;</li> <li>They understand that FS are prepared, presented and audited to levels of materiality;</li> <li>They recognize the uncertainties inherent in the measurement of amounts based on the use of estimates, judgment and the consideration of future events; and</li> <li>They make reasonable economic decisions on the basis of the information in the FS.</li> </ol>	<b>Materiality Level or Levels for Particular Classes of Transactions, Account Balances or Disclosures</b> <ol style="list-style-type: none"> <li>Whether law, regulations or the applicable FRF affect users' expectations regarding that particular item</li> <li>The key disclosures in relation to the industry in which the entity operates</li> <li>Whether attention is focused on a particular aspect of the entity's business</li> </ol>



**% of chosen benchmark = Materiality for FS**

Factors that may affect the identification of an appropriate benchmark include the following	<ul style="list-style-type: none"> <li>The <b>elements of the financial statements</b></li> <li>Whether there are items on which the <b>attention of the users of the particular entity's financial statements tends to be focused.</b></li> <li>The <b>nature of the entity, where the entity is at in its life cycle, and the industry and economic environment in which the entity operates, the entity's ownership structure and the way it is financed.</b></li> <li>The <b>relative volatility of the benchmark.</b></li> </ul>
Chosen Benchmark - Relevant financial data	<ul style="list-style-type: none"> <li><b>Prior periods'</b> financial results and financial positions,</li> <li>The <b>period to-date</b> financial results and financial position, and</li> <li><b>Budgets or forecasts</b> for the current period,</li> <li><b>Adjusted for significant changes</b> in the circumstances of the entity</li> </ul>
Examples of Benchmark	<ul style="list-style-type: none"> <li>Profit before tax, Gross profit</li> <li>Total revenue, Total expenses, Total equity</li> <li>Net asset value.</li> </ul>
Relationship between percentage and chosen benchmark	Amount ↓ Percentage ↑ and vice versa

**PERFORMANCE MATERIALITY**

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

**Revision in Materiality level as the Audit Progresses**

Materiality may need to be revised as a result of

- a **change in circumstances** that occurred during the audit,
- new information,**
- or a **change in the auditor's understanding of the entity and its operations** as a result of performing further audit procedures.

If the auditor concludes that a **lower materiality for the financial statements as a whole** than that initially determined is appropriate, the auditor shall determine

- whether it is necessary to **revise performance materiality,** and
- whether the **nature, timing and extent** of the further audit procedures remain appropriate

**Documentation of materiality**

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

- Materiality for the **financial statements as a whole**
- If applicable, the materiality level or levels for particular **classes of transactions, account balances or disclosures**
- Performance materiality** and
- Any revision** of (a)-(c) as the audit progressed

**Materiality and Audit Risk**

There is a **inverse relationship between materiality and audit risk.** They are considered when -

- Identifying and assessing** the risks of material misstatement;
- Determining the **nature, timing and extent** of further audit procedures; and
- Evaluating the **effect of uncorrected misstatements**



## INTERNAL CONTROL

### Meaning of Internal Control

The internal control may be defined as "the process designed, implemented and maintained by TCWG, management and other personnel to provide reasonable assurance about the achievement of an entity's objectives with regard [SAFE]

- to reliability of financial reporting,
- effectiveness and efficiency of operations,
- safeguarding of assets, and
- compliance with applicable laws and regulations

### Benefits of Understanding of Internal Control

An understanding of internal control assists the auditor in: -

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

### Limitations of Internal Control

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

## IMPORTANT POINTS IN RELATION TO INTERNAL CONTROL

Are all Controls Relevant to the audit?	Factors <b>relevant to the auditor's judgment about whether a control</b> , individually or in combination with others, is relevant to the audit may include such matters as the following: <b>Materiality</b> , the significance of the <b>related risk</b> , the <b>size</b> of the entity, the nature of the <b>entity's business</b> , including its <b>organisation and ownership</b> characteristics, the <b>diversity and complexity</b> of the entity's operations, <b>Applicable legal and regulatory</b> requirements, the <b>circumstances and the applicable component</b> of internal control.
Are controls over the completeness and accuracy of information produced by the entity relevant to the audit?	Only if the auditor <b>intends to make use of the information</b> in designing and performing further procedures
Are internal control over safeguarding of assets against unauthorised acquisition relevant to audit?	<b>These controls may include controls relating to both financial reporting and operations objectives.</b> The auditor's consideration of such controls is generally limited to those relevant to the reliability of financial reporting
Are controls relating to objectives that are not relevant to an audit to be considered by the auditor?	An entity generally has controls relating to objectives that are not relevant to an audit and therefore need not be considered. However, in certain circumstances, the <b>statute or the regulation governing the entity may require the auditor to report on compliance with certain specific aspects of internal controls as a result</b> , the auditor's review of internal control may be broader and more detailed.
Should the audit program be evaluated after understanding of internal control?	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. If he does not care to study this aspect, it is very likely that <b>his audit programme may become unwieldy and unnecessarily heavy</b> and the object of the audit may be altogether lost

## COMPONENTS OF INTERNAL CONTROL

### A) Control Environment

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

The control environment includes:

- (i) the **governance and management functions** and
- (ii) the attitudes, awareness, and actions of **those charged with governance and management.**
- (iii) 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, (b) Commitment to competence,
- (c) Participation by those charged with governance, (d) Management's philosophy and operating style,
- (e) Organisational structure, (f) Assignment of authority and responsibility, (g) Human resource policies and practices,

### (B) The Entity's Risk Assessment Process

It assists the auditor in identifying risks of material misstatement.

It involves - (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

### C) The information system, including the related business processes, relevant to financial reporting and communication

An information system consists of infrastructure (physical and hardware components), software, people, procedures, and data.

The auditor shall obtain of following areas: -

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

### D) Control Activities

Control activities are the policies and procedures that help ensure that management directives are carried out.

Control activities relevant to audit generally include -

1. **Policies and procedures** relating to performance reviews, 2. **Information processing**, 3. **Physical controls**, 4. **Segregation of duties**

### (E) Monitoring of Controls

Monitoring of controls is a process to assess the **effectiveness of internal control performance over time and take necessary remedial actions.**

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

**REMEMBER -**

The existence of a satisfactory control environment can be a positive factor when the auditor assesses the ROMM. However, although it may help reduce the risk of fraud, a satisfactory control environment is **not an absolute deterrent to fraud**.

**EVALUATION OF INTERNAL CONTROL**

**DESIGN**

**IMPLEMENTATION**

**(A) The Narrative Record**

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

**DISADVANTAGE -**

- (i) To **comprehend the system** in operation is quite difficult.
- (ii) To **identify weaknesses or gaps** in the system.
- (iii) To **incorporate changes** is difficult

**(C) Flow Chart**

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

**ADVANTAGE -**

- It **minimises** the amount of **narrative explanation**
- It **gives bird's eye view** of the system and the flow of transactions and integration and in documentation, can be easily spotted and improvements can be suggested.
- It helps to understand the **significant features of the business** carried on by the concern

**(B) 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

This is again an **on-the-job requirement** and instructions are framed having regard to the **desirable elements** of control.

**(D) Internal Control Questionnaire**

This is a **comprehensive series of questions concerning internal control** usually issued to the client and the client is requested to get it filled by the concerned executives and employees

**ADVANTAGE -**

- **Oversight or omission of significant internal control review procedures** is less likely to occur with this method.
- **All internal control evaluation can be completed** at one time or in sections.
- Provides an **orderly means of disclosing control defects**.

- **Inspection of documents supporting transactions** and other events
- **Inquiries about, and observation of, internal controls** which leave no audit trail [ most efficient, least effective]
- **Re-performance** involves the auditor's **independent execution of procedures or controls** that were originally performed as part of the entity's internal control [ most effective, least efficient]
- **Testing of internal control operating on specific computerised applications** or over the overall

## AUTOMATED ENVIRONMENT

### MEANING

An automated environment 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

### RISKS

- **Inaccurate processing** of data, processing inaccurate data, or both.
- **Unauthorized access** to data.
- **Direct data changes** (backend changes).
- **Excessive access** / Privileged access (super users).

### IMPACT OF IT RISKS

- **Impact on substantive checking**  
It could lead to increased substantive checking
- **Impact on controls**  
It may result in additional audit work.
- **Impact on reporting**  
It may lead to modification of auditor's report

## CONTROLS IN AUTOMATED ENVIRONMENT

### GENERAL IT CONTROLS

Policies and procedures that **relate to many applications** and support the effective functioning of application controls. Also, known as **"pervasive" controls** or **"indirect" controls**

Data centre and network operations

Program change

Access security

Application system acquisition, development, and maintenance

### APPLICATION CONTROLS

Application controls include both **automated or manual controls** that operate at a **business process level**. Automated Application controls are **embedded into IT applications**

### IT DEPENDENT CONTROLS

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

### General IT Controls vs. Application Controls

These two categories of control over IT systems are interrelated. General IT Controls are needed to support the functioning of application controls, and both are needed to ensure complete and accurate information processing through IT systems.

## TESTING OF AUTOMATED ENVIRONMENT

### METHODS

#### Method

Inquiry ---→ Most efficient, least effective

Observation

Inspection

Reperformance ---→ Least efficient, most effective

### PROCESS

1. Obtain an understanding of how an automated transaction is processed by doing a walkthrough
2. Observe how a user processes transactions under different scenarios.
3. Inspect the configuration defined in an application

## AUDIT APPROACH IN AUTOMATED ENVIRONMENT

Risk  
assessment

Understand and  
evaluate

Test for  
operating  
effectiveness

Reporting

## MANUAL CONTROLS

Controls in a **manual system** may include such procedures as **approvals and reviews of transactions, and reconciliations and follow-up of reconciling items.**

### SUITABILITY

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

### NON- SUITABILITY

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



## DATA ANALYTICS

### MEANING

The combination of processes, tools and techniques that are used to tap vast amounts of electronic data to obtain meaningful information is called data analytics. The tools and techniques that auditors use in applying the principles of data analytics are known as **Computer Assisted Auditing Techniques** or **CAATs** in short.

### APPLICATION

- Check completeness of data and population
- Selection of audit samples
- Re-computation of balances -
- Reperformance of mathematical calculations
- Analysis of journal entries

## 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 and of each of the internal control components
- (c) The identified and assessed risks of material misstatement at the financial statement level and at the assertion level and
- (d) The risks identified, and related controls about which the auditor has obtained an understanding.

## INTERNAL FINANCIAL CONTROLS AS PER REGULATORY REQUIREMENTS

### Meaning -

Refers to the policies and procedures put in place by companies for ensuring:

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

### Reporting Responsibilities

Section 134 (5)(e) of Companies Act, 2013 - Director's responsibility under **Directors' responsibility statement**

Section 143(3)(i) of Companies Act, 2013 - Auditor's responsibility under **auditor's report**. [Exception - Private company with Turnover < 50 cr and borrowing < 25 cr, One person company, small company]

Section 177(4)(vii) of Companies Act, 2013 - **audit Committee's responsibility**

Section 149(8) of Companies Act, 2013 - **Independent directors' responsibility under Schedule IV**



## THE AUDITOR'S RESPONSES TO ASSESSED RISKS

- (a) The auditor shall design and implement **overall responses** to address the assessed ROMM at the financial statement 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 ROMM at the assertion level.

### FURTHER AUDIT PROCEDURES

#### TEST OF CONTROL (TOC)

#### SUBSTANTIVE PROCEDURE

##### What is TOC?

(a) Perform other audit procedures in combination with inquiry to obtain audit evidence about the operating effectiveness of the controls, including:

1. How the controls were applied at relevant times during the period under audit.
2. The consistency with which they were applied.
3. By whom or by what means they were applied.

(b) Determine whether the controls to be tested depend upon other controls

##### When is TOC needed?

(a) The auditor's assessment of ROMM at the assertion level includes an expectation that the controls are operating effectively or

(b) Substantive procedures alone cannot provide sufficient appropriate audit evidence

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

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

##### Timing of Test of Controls

- The auditor shall test controls for the particular time, or throughout the period, for which the auditor intends to rely on those controls
- Audit evidence pertaining only to a point in time may be sufficient for the auditor's purpose
- 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

#### TEST OF DETAILS

#### ANALYTICAL PROCEDURE

Further classified into **tests of transactions** i.e., vouching and **tests of balances** i.e., verification.

Evaluations of financial information through analysis of plausible relationships among both **financial and non-financial data**

**Using Audit Evidence Obtained in Previous Audits**

- (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
- (f) The **risks of material misstatement** and the extent of reliance on the control

**The best way to predict your future is to create it**

## SA 500 - AUDIT EVIDENCE

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

Information contained in the **accounting records underlying the FS**

Example - Journal, Ledger, TB, Invoices, contracts, work sheet, spreadsheet

**Other information that authenticates the accounting records** and also supports the auditor's rationale behind the T & F view of FS

Example - minutes, written confirmation, manual contain internal control

### TYPES OF AUDIT EVIDENCE

Depending upon nature

**Visual**

[Example - observing PV of inventory]

**Documentary**

[Example - FD certificate]

**Oral**

[Example - Discussion with management]

Depending upon source

**Internal**

[Example - Sales invoice, GRN, debit and credit note]

**External**

[Example - Purchase invoice, supplier's challan,]

### SUFFICIENT AND APPROPRIATE EVIDENCE

#### SUFFICIENT

It is the measure of the **quantity of audit evidence**.

The quantity of audit evidence needed is affected by-

- **Materiality** (Materiality  $\propto$  Audit evidence)
- **ROMM** (ROMM  $\propto$  Audit evidence)
- **Size & characteristics of a population** (Less evidence would be required  $\rightarrow$  Smaller, more homogeneous population and vice versa)
- **Quality** (the higher the quality, the less may be required)

#### APPROPRIATE

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

**Relevance of audit evidence**  $\rightarrow$  affected by purpose of the audit procedure and direction of testing

**Reliability of audit evidence**  $\rightarrow$  its **source** and its **nature**, and the **circumstances** under which it is obtained, including the **controls over its preparation** and **maintenance** where relevant

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

- The reliability of audit evidence is **increased** when it is obtained from independent sources outside the entity.
- 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.
- Audit evidence obtained **directly** by the auditor is more reliable than audit evidence obtained **indirectly** or by inference
- Audit evidence in **documentary form**, whether paper, electronic, or other medium, is more reliable than evidence obtained orally
- Audit evidence obtained as **original documents** is more reliable than audit evidence obtained as photocopies.

### AUDIT PROCEDURES TO OBTAIN AUDIT EVIDENCE

Inspection	Inspection involves examining records or documents, whether internal or external, in paper form, electronic form, or other media, or a physical examination of an asset
Observation	Observation consists of looking at a process or procedure being performed by others. Limitation - It is limited to the point in time at which the observation takes place
External Confirmation	An external confirmation represents audit evidence obtained by the auditor as a direct written response to the auditor from a third party, in paper form, or by electronic or other medium
Recalculation	Recalculation consists of checking the mathematical accuracy of documents or records. It may be performed manually or electronically
Reperformance	Reperformance 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.
Inquiry	<ul style="list-style-type: none"> <li>• Inquiry consists of seeking information of knowledgeable persons, both financial and non-financial, within the entity or outside the entity.</li> <li>• Evaluating responses to inquiries is an integral part of the inquiry process. Responses to inquiry may provide auditor with - <ul style="list-style-type: none"> <li>- information not previously possessed</li> <li>- corroborative audit evidence.</li> <li>- information that differs significantly from other information</li> </ul> </li> <li>• Inquiry alone ordinarily does not provide sufficient audit evidence of the absence of a material misstatement</li> </ul>

## AUDIT TRAIL

### Meaning –

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 financial statement of an entity.

### Advantages –

- They help to **reduce fraud, material errors, and unauthorized use**.
- They also help to **enhance internal controls and data security**.
- Audit trails can help in **fixing responsibility, rebuilding events and in thorough analysis of problem areas**.
- It can also help in **ensuring operation of system as intended**.
- Systems which have a feature of audit trail **inspires confidence in auditors**.
- It aids in verification **whether a transaction was indeed performed by a person authorised to do it**.

### Disadvantages–

Audit trails **involve costs**. The cost is not only in terms of **system expenditure** but also in terms of time involved in **analysing data** made available by audit trails.

## SELECTING ITEMS FOR TESTING TO OBTAIN AUDIT EVIDENCE

Selecting all items	<ul style="list-style-type: none"> <li>• 100% examination is unlikely in the case of tests of controls; however, it is more common for tests of details.</li> <li>• 100% examination may be appropriate when, <ul style="list-style-type: none"> <li>— The population constitutes a <b>small number of large value items</b>;</li> <li>— There is a significant risk and other means do not provide <b>sufficient appropriate audit evidence</b>; or</li> <li>— The <b>repetitive nature of a calculation</b> or other process performed automatically by an information system makes a 100% examination cost effective</li> </ul> </li> </ul>
Selecting Specific Items	<p>The auditor may decide to <b>select specific items from a population</b>. In making this decision, factors that may be relevant include the</p> <ul style="list-style-type: none"> <li>• auditor's <b>understanding of the entity</b>,</li> <li>• the <b>assessed risks of material misstatement</b>, and the</li> <li>• <b>characteristics of the population</b> being tested.</li> </ul> <p><b>Specific items selected may include:</b> High value or key items, all items over a certain amount, Items to obtain information.</p>
Audit Sampling	<p>Audit sampling is designed to <b>enable conclusions to be drawn about an entire population on the basis of testing a sample</b> drawn from it.</p>

## EVALUATION OF AUDIT EVIDENCE

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

**MANAGEMENTS EXPERT**

**Who is managements expert?**

An individual or organisation **possessing expertise in a field other than accounting or auditing**, whose work in that field is used by the entity to assist the entity in preparing the financial statements

**The nature, timing and extent of audit procedures may be affected by such matters**

- The **nature and complexity** of the matter to which the management's expert relates.
- The **risks of material misstatement** in the matter.
- The **availability of alternative sources** of audit evidence.
- The **nature, scope and objectives of the management's expert's work**.
- Whether the **management's expert is employed by the entity**, or is a party engaged by it to provide relevant services.
- The **extent to which management can exercise control or influence** over the work of the management's expert.
- Whether the **management's expert is subject to technical performance standards**
- The **nature and extent of any controls within the entity** over the management's expert's work.

**Relying on the work of a 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**; and
- (c) Evaluate the **appropriateness of that expert's work** as audit evidence for the relevant assertion.

**Slow progress is better than no progress**



## SA 505 – EXTERNAL CONFIRMATION

External confirmation may be defined as audit evidence obtained as a direct **written response** to the **auditor from a third party** (the confirming party), in **paper form**, or by **electronic or other medium**.

### EXTERNAL CONFIRMATION PROCEDURES ADOPTED BY THE AUDITOR TO OBTAIN AUDIT EVIDENCE

#### 1. 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.
- terms of agreements, contracts, or transactions between an entity and other parties, or
- the absence of certain conditions, such as a “side agreement”

#### 2. Selecting the Appropriate Confirming Party

Responses to confirmation requests provide more relevant and reliable audit evidence when the confirming party is someone who is **knowledgeable about the information to be confirmed**.

#### 3. Design of a confirmation request

The design of a confirmation request may directly **affect the confirmation response rate, and the reliability and the nature of the audit evidence obtained from responses**.

- **Factors to be considered by auditor when designing confirmation requests**

Factors to consider when designing confirmation requests include:

- The **assertions** being addressed.
- 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 **method of communication**
- **Management's authorisation or encouragement** to the confirming parties to respond to the auditor.
- The **ability of the intended confirming party to confirm or provide the requested information**

#### 4. Determination of properly addressed requests

Determining that requests are properly addressed includes testing the **validity of some or all of the addresses on confirmation requests** before they are sent out.

#### 5. 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 or the auditor may, having re-verified the accuracy of the original address, **send a follow-up request**.

### EVALUATING THE EVIDENCE OBTAINED

A response **deemed unreliable**

A response providing requested **information without exception**

A **non-response**

A response indicating an **exception**

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

**STEP 1:** Inquire as to management's reasons for the refusal

REASONABLE

**STEP 2:** Seek audit evidence as to the validity and reasonableness of the reasons

UNREASONABLE

**STEP 2:** 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**

**STEP 3:** Perform alternative audit procedures designed to obtain relevant and reliable audit evidence

**STEP 4:** 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
- determine the **implications for the audit and the auditor's opinion** in accordance with SA 705 [MODIFIED OPINION]

## TYPES OF CONFIRMATION

### 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**.

**Useful when** – When alternative evidence is available

### 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.

**Useful when**

- The auditor has assessed the **risk of material misstatement as low**
- The population comprises a **large number of small, homogeneous, account balances, transactions;**
- A **very low exception rate** is expected; and
- The auditor is not aware of circumstances or conditions that would cause **recipients of negative confirmation requests to disregard such requests**

### Blank confirmation request

A request that **does not state the amount (or other information) on the request**, and ask the confirming party to fill in the amount or furnish other information

**Useful when** – When the response rate is not expected to be low

Wake up determined, go to bed satisfied

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



### OBJECTIVE -

Obtain **sufficient appropriate audit evidence** regarding the:

- (A) **Existence and condition of inventory;**
- (B) **Completeness of litigation and claims** involving the entity; and
- (C) **Presentation and disclosure of segment information** in accordance with the applicable FRF.

### INVENTORY

The auditor shall obtain **sufficient appropriate audit evidence regarding the existence and condition** of inventory by:

(1) **Attendance at physical inventory counting**, unless impracticable, to:

- (i) **Evaluate management's instructions** and procedures for recording and controlling the results of the entity's physical inventory counting;
- (ii) **Observe the performance** of management's count procedures;
- (iii) **Inspect** the inventory; and
- (iv) **Perform test counts.**

(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



#### It involves -

- (a) **Inspecting the inventory** to ascertain its existence and evaluate its condition,
- (b) **Observing compliance with management's instructions** and the performance of procedures and
- (c) **Obtaining audit evidence** as to the reliability of management's count procedures

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

- (a) **Nature** of inventory.
- (b) **Stages of completion** of work in progress.
- (c) The **risks of material misstatement** related to inventory.
- (d) The **nature of the internal control** related to inventory.
- (e) Whether **adequate procedures** are expected to be established
- (f) The **timing** of physical inventory counting

#### If Physical Inventory Counting is conducted other than at the Date of the Financial Statements

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 -

- Whether the **perpetual inventory records** are properly adjusted.

- Reliability of the entity's **perpetual inventory records**.
- Reasons for **significant differences between the information obtained during the physical count and the perpetual inventory records**.

**Attendance at Physical Inventory Counting becomes impractical**

- If attendance at physical inventory counting is impracticable, the auditor shall perform **alternative audit procedures** to obtain sufficient appropriate audit evidence
- It may be due to **location or nature of inventory**, however, the matter of general inconvenience to the auditor, is **not sufficient to support a decision** by the auditor that attendance is impracticable (as stated in SA 200).
- If it is not possible to do so, the auditor shall **modify the opinion** in the auditor's report in accordance with **SA 705**

**INVENTORY WITH THIRD PARTY**

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 such as 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

**SEGMENT REPORTING**

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

- (a) **Obtaining an understanding of the methods** used by management in determining segment information, and:
  - (i) Evaluating whether such **methods are likely to result in disclosure in accordance with the applicable financial reporting framework**; and
  - (ii) Where appropriate, **testing the application of such methods**; and
- (b) **Performing analytical procedures** or other audit procedures appropriate in the circumstances.

**Example of matters that may be relevant when obtaining an understanding of the methods used by management in determining segment information -**

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

## LITIGATION AND CLAIMS

The auditor shall **design and perform audit procedures** in order to identify litigation and claims involving the entity: -

- (a) **Inquiry of management** and, where applicable, others within the entity, including in-house legal counsel;
- (b) **Reviewing minutes of meetings** of TCWG and correspondence between the entity and its external legal counsel; and
- (c) **Reviewing legal expense** accounts.

### IF ROMM OF LITIGATIONS AND CLAIMS IS HIGH

**STEP 1:** Seek direct communication with the entity's external legal counsel

If letter of inquiry is not responded

**STEP 2:** 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**

**STEP 2:** If it is considered unlikely that the entity's external legal counsel will **respond** appropriately to a letter of general inquiry, the auditor may seek direct communication through a **letter of specific inquiry**.

A letter of specific inquiry includes:

- (a) A list of **litigation and claims**;
- (b) Where available, **management's assessment of the outcome of each of the identified litigation and claims** and its estimate of the financial implications, including costs involved; and
- (c) A request that the **entity's external legal counsel confirm the reasonableness of management's assessments and provide the auditor with further information** if the list is considered by the entity's external legal counsel to be incomplete or incorrect

**STEP 2:** 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 - the auditor determines that the **matter is a significant risk**, the **matter is complex**, there is **disagreement between management and the entity's external legal counsel**.

**STEP 3:** 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**,

The auditor shall **modify the opinion** in the auditor's report in accordance with **SA 705**.



## SA 510 – INITIAL AUDIT ENGAGEMENTS – OPENING BALANCES



### OBJECTIVE –

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; and
- (b) **Appropriate accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, or changes thereto are properly accounted for and adequately presented and disclosed** in accordance with the applicable FRF

### OBTAINING SUFFICIENT APPROPRIATE AUDIT EVIDENCE ABOUT OPENING BALANCES

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

- (a) Determining whether the **prior period's closing balances have been correctly brought forward to the current period**;
- (b) Determining whether the opening balances **reflect the application of appropriate accounting policies**;

### AUDIT PROCEDURE

#### Nature and extent of Audit Procedures

The nature and extent of audit procedures 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**.
- The **significance of the opening balances** relative to the current period's FS.
- Whether the **prior period's FS were audited** and, if so, whether the predecessor auditor's opinion was modified.

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

The auditor may be able to obtain sufficient appropriate audit evidence regarding the opening balances

- **Perusing the copies of the audited FS** including the other relevant documents relating to the prior period FS such as supporting schedules to the **audited FS**.
- Ordinarily, the current auditor can place **reliance on the closing balances contained in the FS** 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**.

#### Audit procedures –

- For current assets and liabilities, some audit evidence about **opening balances may be obtained as part of the current period's audit procedures**
- For non-current assets and liabilities, some audit evidence may be obtained by **examining the accounting records and other information underlying the opening balances**.
- In certain cases, the auditor may be able to obtain **some audit evidence regarding opening balances through confirmation with third parties**

**AUDITOR CONCLUSION**

If opening balances contain misstatements

perform such **additional audit procedures** as are appropriate in the circumstances to determine the effect on the current period's FS

the auditor shall communicate the misstatements with the **appropriate level of management and TCWG**

The auditor shall express a **qualified opinion or an adverse opinion** as appropriate in accordance with SA 705

- Current period's accounting policies are **not consistently applied in relation to opening balances** in accordance with the applicable FRF
- A **change in accounting policies** is **not properly accounted for** or not adequately presented or disclosed in accordance with the applicable FRF

If the auditor concludes that the **opening balances** contain a misstatement that **materially affects the current period's financial statements**, and the effect of the misstatement is not properly accounted for or not adequately presented or disclosed

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

**Push harder than yesterday,  
If you want a different tomorrow**

## SA 550 – RELATED PARTY

### OBJECTIVE –

- It deals with the auditor's responsibilities regarding **related party relationships and transactions when performing an audit of FS**
- Specifically, it applies in relation to **risks of material misstatement associated with related party relationships and transactions**

### RELATED PARTY

A party that is either

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

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

- (i) **Direct or indirect equity holdings** or other financial interests in the entity.
- (ii) **The entity's holdings of direct or indirect equity** or other financial interests in other entities.
- (iii) **Being part of those charged with governance or key management**
- (iv) **Being a close family member** of TCWG
- (v) **Having a significant business relationship** with TCWG

### NATURE OF RELATED PARTY RELATIONSHIPS

The nature of related party relationships and transactions may, in some circumstances, give **rise to higher risks of material misstatement** of the FS

For example,

- (A) Related parties may operate through an **extensive and complex range of relationships and structures**
- (B) **Information systems may be ineffective** at identifying or summarising transactions and outstanding balances between an entity and its related parties.
- (C) Related party transactions **may not be conducted under normal market terms and conditions**;

## UNDERSTANDING RELATED PARTY RELATIONSHIPS

The auditor shall inquire of management regarding:

- (a) The **identity of the entity's related parties**, including changes from the prior period;
- (b) The **nature of the relationships** between the entity and these related parties;
- (c) Whether the **entity entered into any transactions with these related parties during the period** and, if so, the **type and purpose** of the transactions.

The auditor shall inquire of management and others within the entity, and perform other risk assessment procedures considered appropriate, to obtain an understanding of the controls, if any, that management has established to -

- **Identify, account for, and disclose** related party relationships and transactions in accordance with the applicable financial reporting framework;
- **Authorise and approve** significant transactions and arrangements with **related parties**; and
- **Authorise and approve** significant transactions and arrangements **outside the normal course of business**

### How can an auditor verify the existence of related party relationships and transactions?

1. Entity income tax returns.
2. Information supplied by the entity to regulatory authorities.
3. Shareholder registers to identify the entity's principal shareholders.
4. Statements of conflicts of interest from management and TCWG.
5. Records of the entity's investments and those of its pension plans.
6. Contracts and agreements with key management or TCWG.
7. Significant contracts and agreements not in the entity's ordinary course of business.
8. Specific invoices and correspondence from the entity's professional advisors.
9. Life insurance policies acquired by the entity.
10. Significant contracts re-negotiated by the entity during the period.
11. Internal auditors' reports.

## CONSIDERATIONS SPECIFIC TO SMALLER ENTITIES

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.

An owner-manager may mitigate some of the risks arising from related party transactions, or potentially increase those risks, **through active involvement in all the main aspects of the transactions**

## SA 520 - ANALYTICAL PROCEDURE

### OBJECTIVE -

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

### MEANING

Evaluations of **financial information** through analysis of **plausible relationships among both financial and non-financial data**. They, also encompass such **investigation as is necessary of identified fluctuations or relationships that are inconsistent** with other relevant information or that differ from expected values by a significant amount.

### What are the major types of analytical procedures? -

- Comparison of client and **industry data**
- Comparison of client data with **similar prior period data**
- Comparison of client data with **client-determined expected results**
- Comparison of client data with **auditor-determined expected results** and
- Comparison of client data with **expected results, using non-financial data**.

### PURPOSE OF ANALYTICAL PROCEDURE

- They use comparisons and relationships to assess whether account balances or other **data appear reasonable**
- 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**. Also, it helps in identifying risks of material misstatement

### TIMING OF ANALYTICAL PROCEDURE

**Planning Phase** - understanding the **client's business**, identifying areas of **potential risk** of which he was **previously unaware**, determining the **nature, timing and extent** of his other audit procedures.

**Testing Phase** - Substantive Analytical Procedure

**Conclusion Phase** - **corroborate conclusions formed** during the audit of the financial statements, **assists the auditor to draw reasonable conclusions on, identify a previously unrecognised risk of material misstatement**



## TECHNIQUES OF ANALYTICAL PROCEDURE

Technique	Meaning
Trend analysis	<u>Trend analysis implies analysing account fluctuations</u> by comparing current year to prior year information and, also, to information derived over several years.
Ratio analysis	Ratio analysis is useful for <u>analysing asset and liability accounts as well as revenue and expense accounts</u> . Further, ratios can also be <u>compared over time</u> or to the ratios of separate <u>entities within the group</u> , or with the ratios of <u>other companies in the same industry</u>
Reasonableness tests	This procedure relies upon <u>non-financial data for the audit period under consideration</u> . These tests are generally more applicable to <u>income statement accounts</u> and certain accrual or prepayment accounts. In other words, these tests are made by <u>reviewing the relationship of certain account balances to other balances</u> for reasonableness of amounts.
Structural modelling	A modelling tool constructs a <u>statistical model</u> from financial and/or non-financial data of prior accounting periods <u>to predict current account balances</u>

## SUBSTANTIVE ANALYTICAL PROCEDURE

### WHEN IS ANALYTICAL PROCEDURE UNDERTAKEN?

The decision about which audit procedures to perform, including whether to use substantive analytical procedures, is based on the auditor's judgment about the expected effectiveness and efficiency of the available audit procedures to reduce audit risk at an acceptably low level.

### FACTORS TO BE CONSIDERED FOR SUBSTANTIVE AUDIT PROCEDURES

- Availability of Data** - The availability of **reliable and relevant data** will facilitate effective analytical procedures.
- Disaggregation** - The **degree of disaggregation** in available data can directly affect the **degree of its usefulness** in detecting misstatements.
- Account Type** - Substantive analytical procedures are more useful for certain types of accounts than for others. Income statement accounts are more predictable because they reflect accumulated transactions over a period than balance sheet accounts]
- Source** - Some classes of transactions tend to be more predictable because they consist of **numerous, similar transactions**, whereas the transactions recorded by **non-routine and estimation SCOTs** are often subject to management judgment and therefore more difficult to predict.
- Predictability** - Substantive analytical procedures are more appropriate **when an account balance or relationships between items of data are predictable**. A predictable relationship is one that may reasonably be expected to **exist and continue over time**.
- Nature of Assertion** - Substantive analytical procedures may be more effective in providing evidence for some assertions [Completeness - effective, Rights or obligation - ineffective]
- Inherent Risk or "What Can Go Wrong"** -When inherent risk is **higher**, we may design tests of details to address the higher inherent risk. When significant risks have been identified, audit evidence obtained solely from substantive analytical procedures is unlikely to be sufficient.

## PROCESS OF ANALYTICAL PROCEDURES AS SUBSTANTIVE TESTS



Determine suitability of analytical procedure	<ol style="list-style-type: none"> <li>1. Substantive analytical procedures are generally more applicable to <b>large volumes of transactions that tend to be predictable over time.</b></li> <li>2. The application of planned analytical procedures is based on the <b>expectation that relationships among data exist and continue in the absence of known conditions to the contrary.</b></li> <li>3. Different types of analytical procedures provide <b>different levels of assurance.</b></li> <li>4. The determination of the suitability of particular substantive analytical procedure is influenced by the nature of the assertion and the <b>auditor's assessment of the risk of material misstatement.</b></li> <li>5. Particular substantive analytical procedures may also be considered suitable <b>when tests of details are performed on the same assertion</b></li> <li>6. In some cases, even an <b>unsophisticated predictive model may be effective as an analytical procedure.</b></li> </ol>
Evaluate reliability of data	<ul style="list-style-type: none"> <li>• <b>Source</b> of the information available</li> <li>• <b>Comparability</b> of the information available</li> <li>• <b>Nature and relevance</b> of the information available</li> <li>• <b>Controls over the preparation of the information</b> that are designed to ensure its completeness, accuracy and validity.</li> </ul>
Develop an expectation	<p>Matters relevant to the auditor's evaluation of whether the expectation <b>can be developed sufficiently precisely to identify a misstatement that</b>, may cause the financial statements to be materially misstated, include:</p> <ul style="list-style-type: none"> <li>• The <b>accuracy</b> with which the expected results of substantive analytical procedures can be predicted.</li> <li>• The <b>degree to which information</b> can be disaggregated.</li> <li>• The <b>availability</b> of the information, both financial and non-financial.</li> </ul>
Determine acceptable difference	<p>The auditor's determination of the amount of difference from the expectation that can be accepted without further investigation is influenced by</p> <ul style="list-style-type: none"> <li>• <b>materiality</b> and</li> <li>• <b>the consistency with the desired level of assurance</b></li> </ul>

## INVESTING 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:

- Inquiring of management and obtaining appropriate audit evidence relevant to management's responses:
- Performing other audit procedures as necessary in the circumstances

## SA 530 - AUDIT SAMPLING

### MEANING -

Application of audit procedures to less than 100% of items within a population, such that all sampling units have an equal chance of selection which enables the auditor to draw conclusions and express his opinion based on a pre-determined objective

### POPULATION

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

Characteristics of population -

1. Appropriateness --→ It means population from which the samples are drawn shall be **relevant for the specific objective under audit**.
2. Completeness --→ It means that the **population needs to include all relevant items w.r.t objective**, throughout the entire period.
3. Reliable --→ It means to ensure that the information upon which the audit sampling is performed is sufficiently **complete and accurate**.

### APPROACHES TO SAMPLING

Statistical sampling	Nonstatistical sampling
<p>Approach to sampling that has the</p> <ul style="list-style-type: none"> <li>• <b>random selection</b> of the sample units; and</li> <li>• the <b>use of probability theory</b> to evaluate sample results, including measurement of sampling risk characteristics.</li> </ul>	<p>Approach to sampling under which</p> <ul style="list-style-type: none"> <li>• the sample size and its composition are determined on the basis of the <b>personal experience and knowledge</b> of the auditor</li> </ul>
<ul style="list-style-type: none"> <li>• Audit testing done through this approach is <b>more scientific</b> because it involves <b>use of mathematical laws of probability</b></li> <li>• Statistical sampling has <b>reasonably wide application</b> where a population to be tested consists of a large number of similar items</li> <li>• There is <b>no personal bias of the auditor in case of statistical sampling</b>.</li> </ul>	<ul style="list-style-type: none"> <li>• The non-statistical sampling is criticized on the grounds that it is <b>neither objective nor scientific</b>.</li> <li>• The expected degree of objectivity cannot be assured in nonstatistical sampling <b>because the risk of personal bias in selection of sample items cannot be eliminated</b>.</li> </ul>

Whatever may be the approach the sample **must be representative**. This means that it must be closely similar to the whole population although not necessarily exactly the same

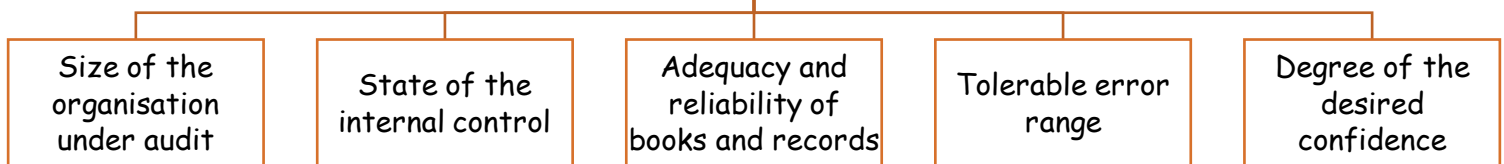
### Where is sampling process performed?

- **Tests of controls** to identify deviations from expected internal controls
- **Tests of details** to identify misstatements of account balances and class of transactions

### ADVANTAGES OF STATISTICAL SAMPLING -

- (1) The amount of testing (sample size) **does not increase** in proportion to the increase in the size of the **area** (universe) tested.
- (2) The sample selection is **more objective** and thereby more defensible.
- (3) The method provides a means of **estimating the minimum sample size** associated with a specified **risk and precision**.
- (4) It provides a means for deriving a "calculated risk" and corresponding precision (sampling error)
- (5) It may provide a **better description** of a large mass of data than a complete examination of **all the data**, since non-sampling errors such as processing and clerical mistakes are not as large.
- (6) 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.

### Factors affecting sampling approach



### SAMPLING PROCESS

#### 1. Sampling Design

When designing an audit sample, the auditor's consideration includes

- the **specific purpose to be achieved** and
- the **combination of audit procedures** that is likely to best achieve that purpose.

#### **Specific purpose to be achieved**

The auditor's consideration of the purpose of the audit procedure includes a **clear understanding of what constitutes a deviation or misstatement**

#### **Characteristics of population**

In considering the characteristics of a population, for tests of controls, the auditor makes an assessment of the **expected rate of deviation based on the auditor's understanding of the relevant controls**

In considering the characteristics of the population from which the sample will be drawn, the auditor may determine that stratification or value-weighted selection is appropriate.

#### • **Stratification**

Dividing a **population into discrete sub population** which have identifying characteristics is called as Stratification. 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.

#### • **Value-Weighted Selection**

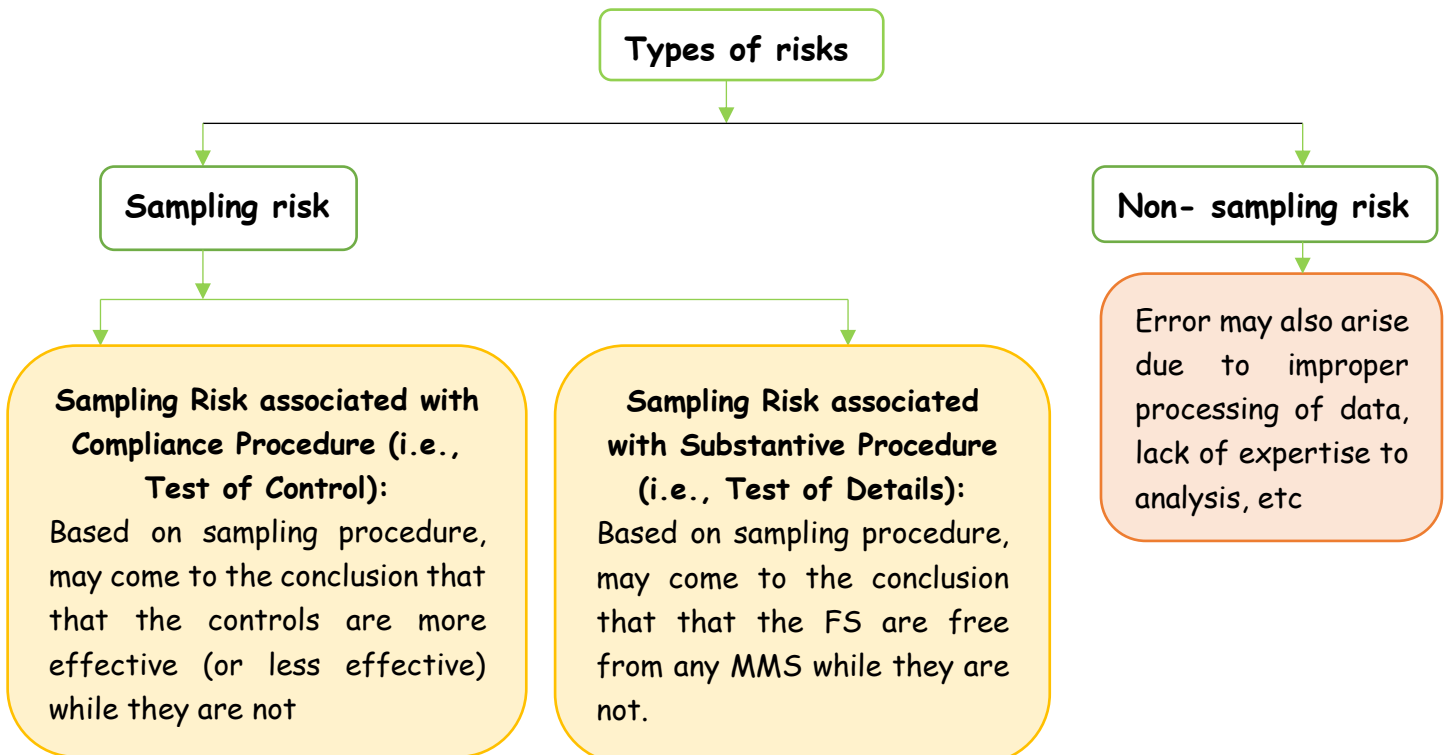
Dividing a population in such a way thereby making it efficient to identify the **sampling unit as the individual monetary units that make up the population**

<b>2. Sampling Size</b>	<p>Factors affecting sample size -</p> <table border="1"> <thead> <tr> <th>Situation</th><th>Increase/Decrease</th></tr> </thead> <tbody> <tr> <td>Increase in the extent to which the auditor's risk assessment takes into account relevant controls</td><td>Increase</td></tr> <tr> <td>Increase in the tolerable rate of deviation/misstatement</td><td>Decrease</td></tr> <tr> <td>Increase in the expected rate of deviation/misstatement of the population</td><td>Increase</td></tr> <tr> <td>Increase in the auditor's desired level of assurance that the tolerable rate of deviation/misstatement is not exceeded by the actual rate of deviation/misstatement in the population</td><td>Increase</td></tr> <tr> <td>Stratification of the population is appropriate</td><td>Decrease</td></tr> <tr> <td>Increase in auditor's assessment of the risk of material misstatement</td><td>Increase</td></tr> <tr> <td>Increase in reliance on other substantive procedures</td><td>Decrease</td></tr> <tr> <td>Increase in the number of sampling units in the population</td><td>Negligible Effect</td></tr> </tbody> </table>	Situation	Increase/Decrease	Increase in the extent to which the auditor's risk assessment takes into account relevant controls	Increase	Increase in the tolerable rate of deviation/misstatement	Decrease	Increase in the expected rate of deviation/misstatement of the population	Increase	Increase in the auditor's desired level of assurance that the tolerable rate of deviation/misstatement is not exceeded by the actual rate of deviation/misstatement in the population	Increase	Stratification of the population is appropriate	Decrease	Increase in auditor's assessment of the risk of material misstatement	Increase	Increase in reliance on other substantive procedures	Decrease	Increase in the number of sampling units in the population	Negligible Effect
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<b>3. Sample Selection</b>	<p><b>Random Sampling</b> - It ensures that all items in the population or within each stratum have a known chance of selection. [Involves use of random number tables.]</p> <p><b>Monetary Unit Sampling</b> - It is a type of value-weighted selection in which sample size, selection and evaluation results in a conclusion in monetary amounts.</p> <p><b>Simple Random Sampling</b> - 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</p> <p><b>Stratified Sampling</b> - 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.</p> <p><b>Block Sampling</b> - This method involves selection of a block(s) of contiguous items from within the population.</p> <p><b>Haphazard Sampling</b> - It is a technique 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</p> <p><b>Interval Sampling or Systematic Sampling</b> - It 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</p>																		
<b>4. Performing Audit Procedures</b>	<p>(i) The auditor shall perform audit procedures, appropriate to the purpose, on each item selected.</p> <p>(ii) If the audit procedure is not applicable to the selected item, the auditor shall perform the procedure on a replacement item.</p> <p>(iii) If the auditor is unable to apply the designed audit procedures, or suitable alternative procedures, to a selected item, the auditor shall treat that item as a deviation from the prescribed control, in the case of tests of controls, or a misstatement, in the case of tests of details.</p>																		
<b>5. Nature and cause of mis - statement</b>	<p>(i) In analysing the deviations and misstatements identified, the auditor may observe that many have a common feature</p> <p>(ii) 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 fraud.</p>																		



	<p>(iii) 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.</p> <p>(iv) In the extremely rare circumstances when the auditor considers a misstatement or deviation discovered in a sample to be an anomaly [something that is not representative of the population], the auditor shall obtain a high degree of certainty that such misstatement or deviation is not representative of the population by performing additional audit procedures to obtain sufficient appropriate audit evidence.</p>
6. Projecting misstatement	<p>(i) 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.</p> <p>(ii) 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.</p> <p>(iii) For tests of details, the auditor shall project misstatements found in the sample to the population whereas for tests of controls, no explicit projection of deviations is necessary since the sample deviation rate is also the projected deviation rate for the population as a whole.</p>
7. Evaluating Results of Audit Sampling	<p>The auditor shall evaluate-</p> <p>(a) The results of the sample; and</p> <p>(b) Whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested.</p>

## RISK ASSOCIATED WITH SAMPLING



If its important to you, you'll find a way. If not, you will find an excuse

## SA 610 - USING THE WORK OF INTERNAL AUDITORS

### OBJECTIVE -

It 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.

### INTERNAL AUDIT FUNCTION

A function of an entity that performs **assurance and consulting** activities designed to evaluate and improve the effectiveness of the **entity's governance, risk management and internal control processes**.

#### Activities Relating to Governance

Check accomplishment of objectives on

- **ethics** and values,
- **performance** management and accountability,
- **communicating** risk and control information
- **effectiveness** of communication among TCWG, external and internal auditors, and management

#### Activities Relating to Risk Management

Assist the entity in

- identifying and evaluating significant **exposures to risk**
- contributing to the improvement of risk management and internal control
- **detection of fraud**.

#### Activities Relating to Internal Control

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

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

- to obtain information that is relevant to the external auditor's **assessments of the risks of material misstatement due to error or fraud**.
- Unless prohibited, or restricted by law or regulation, the external auditor, after appropriate evaluation, may decide to use work **partial substitution for audit evidence to be obtained directly by the external auditor**.
- Unless prohibited, or restricted 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**

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

- (a) 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;
- (b) If using the work of the internal audit function, to determine whether that work is adequate for purposes of the audit; and
- (c) If using internal auditors to provide direct assistance, to appropriately direct, supervise and review their work.

## EVALUATING THE INTERNAL AUDIT FUNCTION

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

### Objectivity and its evaluation

Objectivity refers to the ability to perform those tasks without allowing bias, conflict of interest or undue influence

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

- Whether the organizational status of the IAF, supports the ability of the function to be free from bias, conflict of interest or undue influence
- Whether TCWG oversee employment decisions related to the IAF
- Whether there are any constraints or restrictions placed on the IAF by management or TCWG
- Whether the IAF is free of any conflicting responsibilities

### Competency and its evaluation

Competence of the internal audit function refers to the attainment and maintenance of knowledge and skills to enable assigned tasks to be performed diligently and in accordance with applicable professional standards.

Factors that may affect the external auditor's determination in relation to competence:

- Whether the internal audit function is adequately and appropriately resourced relative to the size of the entity and the nature of its operations.
- Whether there are established policies for hiring, training and assigning internal auditors to internal audit engagements.
- Whether the internal auditors have adequate technical training and proficiency in auditing.
- Whether the internal auditors possess the required knowledge relating to the entity's FS and the applicable FRF

### Application of a Systematic and Disciplined Approach

The application of a systematic and disciplined approach to planning, performing, supervising, reviewing and documenting its activities

Factors affecting external auditor's determination in relation to systematic and disciplined approach:

- The existence, adequacy and use of documented internal audit procedures or guidance covering such areas as risk assessments, work programs, documentation and reporting.
- Whether the internal audit function has appropriate quality control policies and procedures

If any of the above is not satisfied i.e. IAF do not adequately support the objectivity of internal auditors, lacks sufficient competence, or does not apply a systematic and disciplined approach, then the external auditor shall not use the work of the internal audit function

### WHERE WORK OF INTERNAL AUDIT FUNCTION SHOULD BE USED?

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

### Circumstances in which the external auditor shall plan to use less of the work of the IAF /direct assistance of IAF and perform more of the work directly

(a) The more judgment is involved in:

- Planning and performing relevant audit procedures; and
- 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.

(e) 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 by the internal audit function; or

(f) Relate to decisions the external auditor makes in accordance with this SA regarding the internal audit function and the use of its work or direct assistance.

### USING THE WORK OF THE INTERNAL AUDIT FUNCTION

(A) Discuss the planned use of its work with the function as a basis for coordinating their respective activities.

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:

- The **timing** of such work.
- The **nature** of the work performed.
- The **extent of audit coverage**.
- **Materiality** for the financial statements as a whole and performance materiality.
- **Proposed methods** of item selection and sample sizes.
- **Documentation of the work** performed.
- **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 when such matters may affect the work of the external auditor
- (B) Read the reports of the internal audit function relating to the work of the function that the external auditor plans to use to obtain an understanding of the nature and extent of audit procedures it performed and the related findings.
- (C) 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.

### USING THE WORK OF THE INTERNAL AUDIT FUNCTION AS DIRECT ASSISTANCE

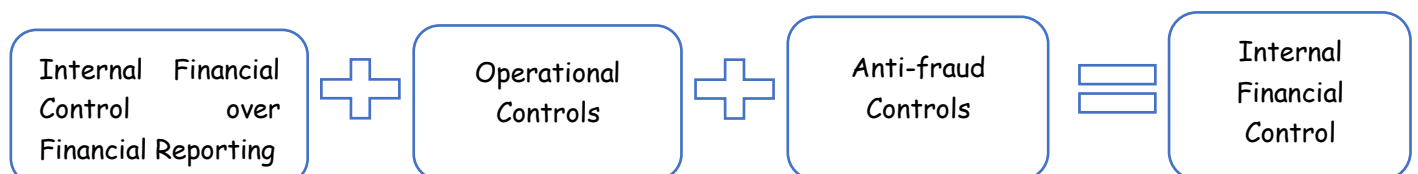
Additional procedures using internal auditors to provide direct assistance for purposes of the audit, the external auditor shall

- (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.

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 by the internal audit function; or
- (d) Relate to **decisions the external auditor makes in accordance with this SA regarding the internal audit function** and the use of its work or direct assistance.

### DISTINCTION BETWEEN INTERNAL FINANCIAL CONTROL AND INTERNAL CONTROL OVER FINANCIAL REPORTING





## AUDIT DOCUMENTATION

### MEANING

Record of

- **audit procedures** performed,
- relevant **audit evidence** obtained, and
- **conclusions** the auditor reached

### OBJECTIVE

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

### What is the purpose of audit documentation?

**Ans.** The following are the purpose of Audit documentation:

1. Assisting the engagement team to **plan and perform the audit.**
2. Assisting members of the engagement team to **direct and supervise the audit work**, and to **discharge their review responsibilities.**
3. Enabling the engagement team to be **accountable** for its work.
4. Retaining a **record of matters of continuing significance** to future audits.
5. Enabling the conduct of **quality control reviews and inspections in accordance with SQC 1.**
6. Enabling the conduct of **external inspections in accordance with applicable legal, regulatory or other requirements.**

### On what does form, content and extent of audit documentation depend on?

- The **size and complexity** of the entity.
- The **nature of the audit procedures** to be performed.
- The **identified risks of material misstatement.**
- The **significance of the audit evidence** obtained.
- The **nature and extent of exceptions** identified.
- The **need to document a conclusion or the basis for a conclusion not readily determinable** from the documentation of the work performed or audit evidence obtained.
- The **audit methodology and tools** used.

### What is not to be included in audit documentation?

Audit documentation is **not a substitute for the entity's accounting records.** The auditor need **not include** in audit documentation **superseded drafts of working papers and financial statements, notes that reflect incomplete or preliminary thinking, previous copies of documents** corrected for typographical or other errors, and duplicates of documents.

### EXAMPLE OF AUDIT DOCUMENTATION -

Audit programmes, Analyses, Issues memoranda, Checklist

### What is to be included in audit documentation?

- The auditor shall prepare audit documentation that is **sufficient to enable an experienced auditor**, having no previous connection with the audit, to understand:
  - The **nature, timing and extent** of the audit procedures performed.
  - The **results of the audit procedures** performed and the **audit evidence obtained** and
  - **Significant matters arising during the audit** and the **conclusions reached thereon** and **significant professional judgements** made in reaching those conclusions.
- Further in documenting the **nature, timing and extent** of audit procedures performed, the auditor shall record:
  - (a) The **identifying characteristics** of the specific items or matters tested.
  - (b) **Who performed the audit work** and the **date such work was completed**; and
  - (c) **Who reviewed the audit work** performed and the **date and extent** of such review.
- The auditor shall **document discussions of significant matters with management**, those **charged with governance**, and **others**, including the **nature of the significant matters** discussed and when and with whom the discussions took place.
- If the auditor identified information that is **inconsistent with the auditor's final conclusion regarding a significant matter**, the auditor shall document how the auditor addressed the inconsistency

#### Examples of significant matters include: -

Matters that give rise to significant risks.

- **Results of audit procedures** indicating (a) that the **financial statements could be materially misstated**, or (b) a need to **revise the auditor's previous assessment of the risks of material misstatement** and the auditor's responses to those risks.
- Circumstances that cause the auditor **significant difficulty in applying necessary audit procedures**.
- 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.

### AREAS OF USE OF PROFESSIONAL JUDGEMENT IN AUDIT DOCUMENTATION

- The rationale for the auditor's conclusion when a requirement provides that **the auditor 'shall consider' certain information or factors**, and that consideration is significant in the context of the particular engagement.
- The basis for the auditor's conclusion on the **reasonableness of areas of subjective judgements**
- The basis for the auditor's conclusions about the **authenticity of a document when further investigation** is undertaken in response to conditions identified during the audit that caused the auditor to believe that the document may not be authentic.

- SQC 1 provides that, unless otherwise specified by law or regulation, **audit documentation is the property of the auditor**.
- 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.

### 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.

### COMPLETION MEMORANDUM

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

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

USEFUL FOR LARGE AND COMPLEX AUDITS

### PREPARATION OF AUDIT DOCUMENTATION

The auditor shall prepare audit documentation on a timely basis. Preparing sufficient and appropriate audit documentation on a timely basis helps to **enhance the quality of the audit and facilitates the effective review and evaluation of the audit evidence obtained and conclusions reached before the auditor's report is finalised**. Documentation prepared after the audit work has been performed is likely to be **less accurate than documentation prepared at the time such work is performed**.

### ASSEMBLY OF AUDIT FILE

- An appropriate time limit within which to complete the assembly of the final **audit file is ordinarily not more than 60 days after the date of the auditor's report**. The completion of the assembly of the final audit file after the date of the auditor's report is an administrative process that **does not involve the performance of new audit procedures or the drawing of new conclusions**.
- **Changes** may, however, be made to the audit documentation **during the final assembly process, if they are administrative in nature**.
- Examples of such changes include:
  - **Deleting or discarding superseded** documentation.
  - **Sorting, collating and cross-referencing** working papers.
  - **Signing off on completion checklists** relating to the file assembly process.
  - **Documenting audit evidence** that the auditor has obtained, discussed and agreed with the relevant members of the engagement team before the date of the auditor's report.
- After the assembly of the final audit file has been completed, the **auditor shall not delete or discard audit documentation of any nature** before the end of its retention period.
- The retention period for audit engagements ordinarily is **no shorter than seven years from the date of the auditor's report**, or, if later, the date of the group auditor's report.

## SA 560 - SUBSEQUENT EVENTS

### OBJECTIVE -

- (a) Obtain **sufficient appropriate audit evidence** about whether **events occurring between the date of the FS and the date of the auditor's report** that require adjustment of, or disclosure in, the FS are **appropriately reflected in those FS** 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.

### SUBSEQUENT EVENTS

#### Meaning of subsequent events as per FRF [ AS 4 / IndAS 10]

FS may be affected by certain events that occur after the date of the FS. Many financial reporting frameworks specifically refer to such events. Such financial reporting frameworks ordinarily identify two types of events: -

- (a) Those that **provide evidence of conditions that existed at the date of the FS** and [ ADJUSTING EVENTS]
- (b) Those that **provide evidence of conditions that arose after the date of the FS**. [NON - ADJUSTING EVENTS]

#### Meaning of subsequent events as per SA 560

- (a) Events occurring **between the date of the FS and the date of the auditor's report**
- (b) Facts which become known to the auditor **after the date of the auditor's report but before the date the FS are issued**
- (c) Facts which become known to the auditor **after the FS have been issued**

The date that the **auditor's report and audited FS are made available to third parties** is considered as the date the FS are issued.

### AUDIT PROCEDURES RELATING TO EVENTS OCCURRING BETWEEN THE DATE OF THE FINANCIAL STATEMENTS AND THE DATE OF THE AUDITOR'S REPORT

Perform audit procedures to obtain **audit evidence** that **all events occurring between** require **adjustment of, or disclosure** have been identified -

- **Obtaining an understanding of any procedures** management has established to ensure that subsequent events are identified.
- **Inquiring of management** whether any subsequent events have occurred
- **Reading minutes held after the date of the FS** and **inquiring matters** discussed at any such meetings
- Reading latest **subsequent interim FS**
- **Accounting records** pertaining to period **after date of FS**
- Obtain **written representation from management** that all events occurring subsequent to the date of the FS and for which the applicable financial reporting framework requires adjustment or disclosure have been adjusted or disclose

**FACTS WHICH BECOME KNOWN TO THE AUDITOR AFTER THE DATE OF AUDITORS REPORT  
BUT BEFORE THE FS HAVE BEEN ISSUED**

**STEP 1:**

- Discuss the matter with management
- Determine whether the financial statements need amendment
- Inquire how management intends to address the matter

IF MANAGEMENT AMENDS THE FS WHERE THE AUDITOR BELIEVES THEY NEED TO BE AMENDED

YES

**STEP 2:**

- Carry out the audit procedures necessary on the amendment
- Provide new auditor's report
- Extend the audit procedures to the date of the new auditor's report
- Include in the new or amended auditor's report a statement in an EMP or OMP the reason for the amendment of the previously issued FS and audit report.

NO

**STEP 2:**

Auditor's report has not yet been provided - Modify the opinion  
Auditor's report has already been provided - Notify management not to issue the financials to third parties  
**If financials are issued -**  
Take appropriate action, to seek to prevent reliance on the auditor's report

DATE THE NEW AUDITOR'S REPORT- NO EARLIER THAN THE DATE OF APPROVAL OF THE AMENDED FS

**FACTS WHICH BECOME KNOWN TO THE AUDITOR AFTER THE FS HAVE BEEN ISSUED**

**STEP 1:**

- Discuss the matter with management
- Determine whether the financial statements need amendment
- Inquire how management intends to address the matter

IF MANAGEMENT AMENDS THE FS WHERE THE AUDITOR BELIEVES THEY NEED TO BE AMENDED

YES

**STEP 2:**

- Carry out the audit procedures necessary on the amendment
- Review the steps taken by management to ensure that anyone in receipt of the issued FS is informed of the situation.
- Provide new auditor's report
- Extend the audit procedures to the date of the new auditor's report and include in the new or amended auditor's report a statement in an EMP or OMP the reason for the amendment of the previously issued FS and audit report.

NO

- Notify management that the auditor will seek to prevent future reliance on the auditor's report.  
- If management still does not take necessary steps → Take appropriate action, to seek to prevent reliance on the auditor's report



## SA 570 - GOING CONCERN

### OBJECTIVE -

- (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 financial statements;
- (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**.

A material uncertainty exists when the **magnitude of its potential impact and likelihood of occurrence** is such that, in the auditor's judgment, **appropriate disclosure of the nature and implications of the uncertainty is necessary**

### EXAMPLES OF EVENTS OR CONDITIONS THAT MAY CAST SIGNIFICANT DOUBT ON THE ENTITY'S ABILITY TO CONTINUE AS A GOING CONCERN

#### Financial events or conditions

- Net liability or net current liability position
- Fixed-term borrowings approaching maturity without realistic prospects of renewal or repayment;
- Indications of withdrawal of financial support by creditors
- Negative operating cash flows
- Adverse key financial ratios

#### Operating events or conditions

- Management intentions to liquidate the entity or to cease operations
- Loss of key management without replacement
- Loss of a major market, key customer(s), franchise, license, or principal supplier(s)
- Labour difficulties
- Shortages of important supplies

#### Other events or conditions

- Non-compliance with capital or other statutory or regulatory requirements
- Pending legal or regulatory proceedings against the entity
- Changes in law or regulation or government policy expected to adversely affect the entity
- Uninsured or underinsured catastrophes when they occur

### RESPONSIBILITY FOR ASSESSMENT OF THE ENTITY'S ABILITY TO CONTINUE AS A GOING CONCERN

The preparation of the FS requires management to assess the entity's ability to continue as a going concern even if the FRF does not include an explicit requirement to do so. **Management's assessment of the entity's ability to continue as a going concern involves making a judgment about inherently uncertain future outcomes of events or conditions.** The following factors are relevant to that judgment: -

- The **degree of uncertainty** associated with the outcome of an event or condition **increases significantly the further into the future an event or condition or the outcome occurs.**
- 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 affect the judgment
- Any judgment about the **future is based on information available at the time at which the judgment is made.** Subsequent events may result in outcomes that are inconsistent with judgments that were reasonable at the time they were made

## RISK ASSESSMENT PROCEDURES AND RELATED ACTIVITIES

### If such an assessment has been performed

- 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

### If such an assessment has not been performed

- 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.

## EVALUATING MANAGEMENT'S ASSESSMENT

- The auditor shall evaluate management's assessment of the entity's ability to continue as a going concern.
- Evaluating management's assessment of the entity's ability to continue as a going concern, may include an
  - evaluation of the process management followed to make its assessment,
  - the assumptions on which the assessment is based and
  - management's plans for future action and
  - whether management's plans are feasible in the circumstances
- In some cases, the auditor's evaluation of the appropriateness of management's assessment may be made without performing detailed evaluation procedures if the auditor's other audit procedures are sufficient.
- In evaluating management's assessment of the entity's ability to continue as a going concern, the auditor shall cover the same period as that used by management to make its assessment.

[If management's assessment of the entity's ability to continue as a going concern covers less than 12 months from the date of the FS, the auditor shall request management to extend its assessment period to at least twelve months from that date.]

## IF EVENTS OR CONDITIONS HAVE BEEN IDENTIFIED THAT MAY CAST SIGNIFICANT DOUBT ON THE ENTITY'S ABILITY TO CONTINUE AS A GOING CONCERN

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

- Analysing and discussing cash flow, profit and other relevant forecasts with management
- Analysing and discussing the entity's latest available interim financial statements
- Reading the terms of debentures and loan agreements and determining whether any have been breached
- Reading minutes of the meetings of shareholders, those charged with governance and relevant committees for reference to financing difficulties
- Inquiring of the entity's legal counsel regarding the existence of litigation and claims and the reasonableness of management's assessments of their outcome and the estimate of their financial implications

The auditor shall obtain **audit evidence** to determine whether or not 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. These procedures shall include: -

- 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**.
- 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** and whether **management's plans are feasible** in the circumstances.
- 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:
  - Evaluating the **reliability of the underlying data** generated to prepare the forecast; and determining whether there is **adequate support for the assumptions underlying the forecast**.
- Considering whether any **additional facts or information** have become available **since the date on which management made its assessment**
- Requesting **written representations from management** and, where appropriate, those charged with governance, regarding their **plans for future actions and the feasibility of these plans**

### DISCLOSURE REQUIREMENTS

When events or conditions have been identified and a material uncertainty exists

When events or conditions have been identified but no material uncertainty exists

Adequately disclose the principal events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and management's plans to deal with these events or conditions and disclose clearly that there is a material uncertainty related to events or conditions exists

Whether, in view of the requirements of the applicable financial reporting framework, the financial statements provide adequate disclosures about these events or conditions

### IMPLICATION ON THE AUDITORS REPORT

**UNMODIFIED OPINION** + Include a separate section in auditors report under the heading **Material Uncertainty Related to Going Concern**

Use of going concern basis of accounting is appropriate but material uncertainty exists and adequate disclosure of material uncertainty is made

**ADVERSE OPINION**

Use of going concern basis of accounting is inappropriate

**QUALIFIED/ADVERSE OPINION** + In the Basis for Qualified (Adverse) Opinion section of the auditor's report, state that a material uncertainty exists and appropriate disclosure is not made

Use of going concern basis of accounting is appropriate but material uncertainty exists and adequate disclosure of material uncertainty is not made

## SA 580 - WRITTEN REPRESENTATION (WR)

### OBJECTIVE -

- (a) To obtain **written representations** from management and, where appropriate, TCWG that they believe that they have **fulfilled their responsibility for the preparation of the FS and for the completeness of the information** provided to the auditor;
- (b) To **support other audit evidence** relevant to the FS or specific assertions in the FS by means of written representations, if determined necessary by the auditor or required by other SAs; and
- (c) To **respond appropriately to written representations** provided by management and, where appropriate, TCWG, or if management or, where appropriate, TCWG **do not provide the written representations requested by the auditor**.

### MEANING

A written representation is a **written statement** by management provided to the **auditor to confirm** certain matters or to **support other audit evidence**.

### IMPORTANT QUESTIONS

Question	Answer
From whom Written representations are requested by auditor?	The auditor shall request written representations from <b>management with appropriate responsibilities for the FS and knowledge of the matters concerned</b>
Is written representation an sufficient appropriate audit evidence?	<ul style="list-style-type: none"> <li>• If <b>management modifies or does not provide the requested written representations</b>, it may alert the auditor to the possibility that <b>one or more significant issues</b> may exist. Further, a request for written, rather than oral, representations in many cases <b>may prompt management to consider such matters more rigorously</b>, thereby enhancing the quality of the representations.</li> <li>• Although written representations provide necessary audit evidence, <b>they do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal</b>.</li> </ul>
What shall be the date of written representations?	<p>The date of the written representations shall be as <b>near as practicable to, but not after, the date of the auditor's report on the FS</b> because</p> <ul style="list-style-type: none"> <li>- <b>written representations are necessary audit evidence</b>, the auditor's opinion cannot be expressed, and the <b>auditor's report cannot be dated, before the date of the written representations</b>.</li> <li>- Furthermore, because the <b>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</b></li> </ul>
What shall be the period covered by written representations?	The written representations are for all periods referred to in the auditor's report because management needs to <b>reaffirm that the written representations it previously made with respect to the prior periods remain appropriate</b> .



## WRITTEN REPRESENTATIONS ABOUT MANAGEMENT'S RESPONSIBILITIES

### (A) WHAT IS TO BE CONFIRMED IN WRITTEN REPRESENTATIONS

#### (I) Preparation of the FS

The auditor shall request management to provide a written representation that it has fulfilled its responsibility for the preparation of the FS in accordance with the applicable financial reporting framework, including, where relevant, their fair presentation.

In some cases, however, management may decide to make inquiries of others who participate in preparing and presenting the FS and assertions therein, including individuals who have specialized knowledge relating to the matters about which written representations are requested.

To reinforce the need for management to make informed representations, the auditor may request that management include in the written representations, confirmation that it has made such inquiries as it considered appropriate to be able to make the requested written representations.

#### (II) 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.
- (c) Management has communicated to the auditor all deficiencies in internal control of which management is aware

### (B) WHY THESE WRITTEN REPRESENTATIONS ARE NECESSARY?

Audit evidence obtained during the audit that management has fulfilled its responsibilities regarding preparation of financial statements and about information provided and completeness of transactions is not sufficient because the auditor is not able to judge solely on other audit evidence whether management has prepared and presented the financial statements and provided information to the auditor on the basis of the agreed acknowledgement and understanding of its responsibilities.

### THE AUDITOR MAY ALSO ASK MANAGEMENT TO RECONFIRM ITS ACKNOWLEDGEMENT AND UNDERSTANDING OF THOSE RESPONSIBILITIES IN WRITTEN REPRESENTATIONS. [IMP]

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;
- Changes in circumstances make it appropriate to do so

### WRITTEN REPRESENTATIONS ABOUT SPECIFIC ASSERTIONS

When obtaining evidence about, or evaluating, judgments and intentions, the auditor may consider the following:

- The entity's past history in carrying out its stated intentions.
- The entity's reasons for choosing a particular course of action.
- The entity's ability to pursue a specific course of action.
- The existence or lack of any other information that might have been obtained during the course of the audit that may be inconsistent with management's judgment or intent.

In addition, the auditor may consider it necessary to request management to provide written representations about specific assertions in the FS, to support an understanding that the auditor has obtained from other audit evidence of management's judgment or intent in relation to specific assertion.



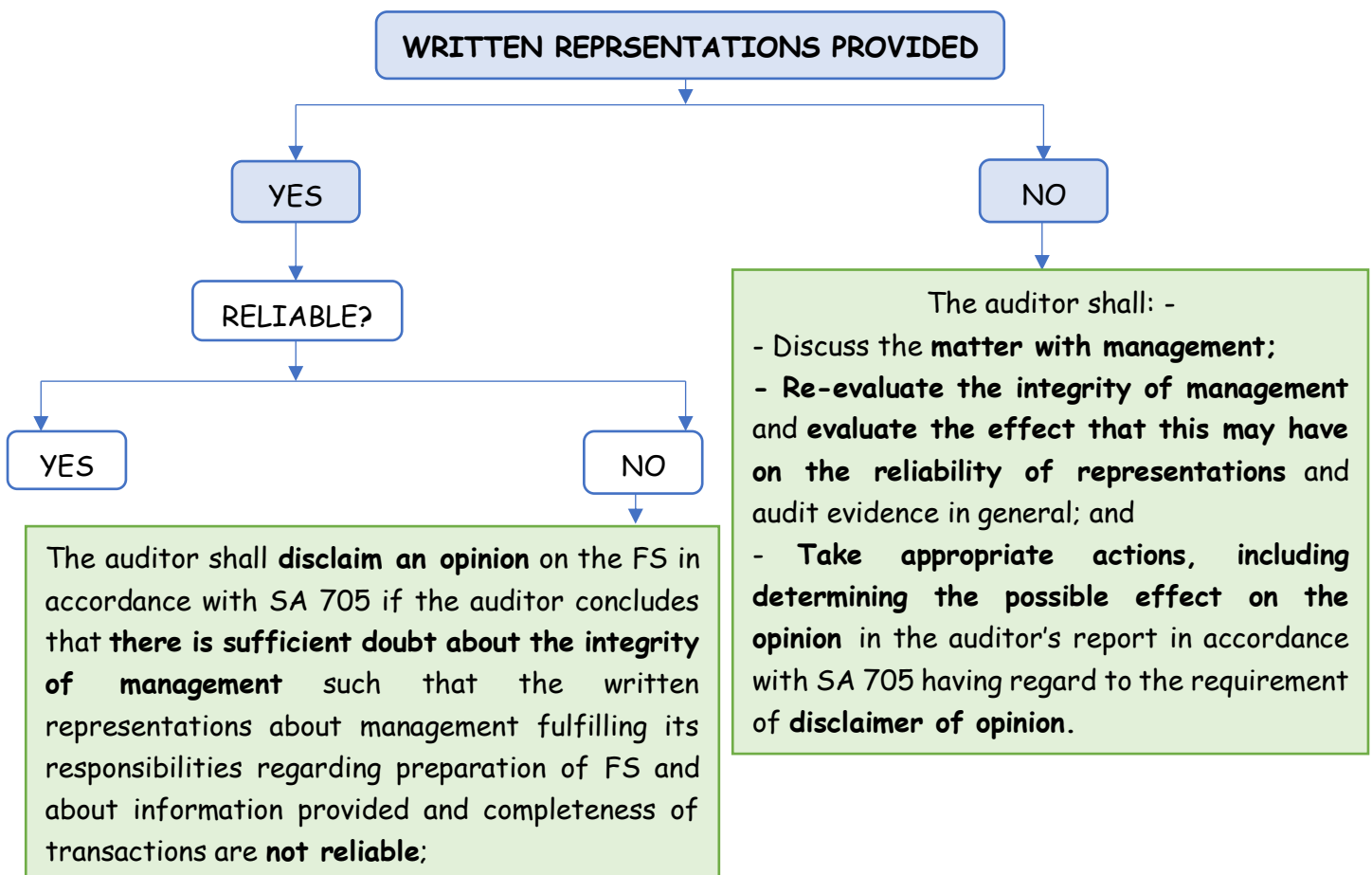
## OTHER WRITTEN REPRESENTATIONS

The auditor may consider it **necessary to request other written representations about the FS**. They may include representations about the following: -

- Whether the **selection and application of accounting policies** are appropriate; and
- Whether matters such as the following, where relevant under the **applicable financial reporting framework, have been recognized, measured, presented or disclosed** in accordance with that framework: -
  - Plans or intentions that may affect the **carrying value or classification of assets and liabilities**;
  - **Liabilities**, both actual and contingent;
  - **Title to, or control over, assets, the liens or encumbrances** on assets, and assets pledged as collateral; and
  - **Aspects of laws, regulations and contractual agreements** that may affect the FS, including non-compliance.

Further, **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, **the auditor shall request such other written representations**

## AUDITOR'S CONCLUSION



## SA 450 - EVALUATION OF MISSTATEMENTS IDENTIFIED DURING THE AUDIT



### OBJECTIVE -

To evaluate

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

### STEP 1: Accumulation of misstatements identified during the audit

The auditor shall accumulate misstatements identified during the audit, **other than those that are clearly trivial**. A misstatement may arise from a variety of factors such as inaccuracy in gathering or processing data from which FS or an omission of an amount or disclosure

### STEP 2: Consideration of identified misstatements as the audit progresses

The auditor shall determine **whether the overall audit strategy and audit plan need to be revised** if: -  
(a) The nature of identified misstatements **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**.

### STEP 3: Communication and correction of misstatements

- **Timely communication of misstatements** by auditor 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 auditor shall **request management to correct those misstatements**.
- If, 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**.
- 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** and shall take that understanding into account when evaluating **whether the FS as a whole are free from material misstatement**.

### STEP 4: Evaluating the effect of uncorrected misstatements

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 as a whole, and the **particular circumstances of their occurrence** and  
(b) The **effect of uncorrected misstatements related to prior periods** on the relevant classes of transactions, account balances or disclosures, and the FS as a whole.

### STEP 5: Communication with those charged with governance

The auditor shall communicate with those charged with governance 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,**

- material uncorrected misstatements individually and request that uncorrected misstatements be corrected, and
- the effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the FS as a whole.

**STEP 6: Written Representation from management regarding effects of uncorrected statements**

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

**STEP 7: Documentation regarding misstatements identified during audit**

The audit documentation shall include: -

- (a) The amount below which misstatements would be regarded as clearly trivial;
- (b) All misstatements accumulated during the audit and whether they have been corrected; and
- (c) The auditor's conclusion as to whether uncorrected misstatements are material, individually or in aggregate, and the basis for that conclusion.

**The harder you work, the more luck you seem to have**

## SA 260 – COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE



### OBJECTIVE -

- (a) To **communicate clearly with TCWG the responsibilities of the auditor** in relation to the financial statement audit, and an overview of the **planned scope and timing of the audit**;
- (b) To obtain from TCWG **information relevant to the audit**;
- (c) 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
- (d) To promote **effective two-way communication** between the auditor and TCWG

### THOSE CHARGED WITH GOVERNANCE



The person(s) or organization(s) (e.g., a corporate trustee) with responsibility for

- overseeing the **strategic direction** of the entity,
- obligations related to the **accountability of the entity** and
- overseeing the **financial reporting** process.

### WHY IS COMMUNICATION REQUIRED?



An effective two-way communication is important in assisting: -

- (a) The auditor and TCWG in **understanding matters related to the audit in context, and in developing a constructive working relationship**. This relationship is developed while maintaining the auditor's independence and objectivity.
- (b) The auditor in **obtaining from TCWG information relevant to the audit**. For example, TCWG may assist the auditor in understanding the entity and its environment, in identifying appropriate sources of audit evidence; and
- (c) TCWG in **fulfilling their responsibility to oversee the financial reporting process, thereby reducing the risks of material misstatement of the FS**

### COMMUNICATION PROCESS



- The auditor shall communicate with TCWG on a **timely basis**.
- The auditor shall communicate with TCWG the **form, timing and expected general content** of communications.
- Written communications need not include all matters that arose during the course of the audit.
  - The auditor shall **communicate in writing** with TCWG regarding **significant findings from the audit** if, in the auditor's professional judgment, **oral communication would not be adequate**.
  - The auditor shall communicate in writing with TCWG regarding auditor **independence when required in case of listed entities**.

## MATTERS TO BE COMMUNICATED BY AUDITOR

### (a) The auditor's responsibilities in relation to the FS audit

The auditor shall communicate with TCWG that:

- The auditor is responsible for forming and expressing an opinion on the FSs that have been prepared by management with the oversight of TCWG and
- The audit of the FSs does not relieve management or TCWG of their responsibilities.

### (b) 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.

### (c) Significant findings from the audit

The auditor shall communicate with TCWG: -

- The auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and FS disclosures. When applicable, the auditor shall explain to TCWG why the auditor considers a significant accounting practice, that is acceptable under the applicable financial reporting framework, not to be most appropriate to the particular circumstances of the entity
  - Significant difficulties, if any, encountered during the audit;
  - Unless all of TCWG are involved in managing the entity: -
    - Significant matters arising during the audit that were discussed, or subject to correspondence, with management;
    - Written representations the auditor is requesting
  - Circumstances that affect the form and content of the auditor's report, if any and
- Any other significant matters arising during the audit that, in the auditor's professional judgment, are relevant to the oversight of the financial reporting process.

## ADDITIONAL COMMUNICATION OF AUDITOR'S INDEPENDENCE IN CASE OF LISTED ENTITIES

In the case of listed entities, the auditor shall communicate with those charged with governance: -

- (a) A statement that the engagement team and others in the firm as appropriate, the firm and, when applicable, network firms have complied with relevant ethical requirements regarding independence
- (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 financial statements 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.

## DOCUMENTATION

Where matters required by SA 260 to be communicated are communicated orally, -

- the auditor shall include them in the audit documentation,
- and when and to whom they were communicated.

Where matters have been communicated in writing, the auditor shall retain a copy of the communication.



**SA 265 - COMMUNICATING DEFICIENCIES IN INTERNAL CONTROL TO THOSE CHARGED WITH GOVERNANCE AND MANAGEMENT**

**OBJECTIVE -**

To **communicate appropriately** to those charged with governance 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**

DEFICIENCY IN INTERNAL CONTROL	SIGNIFICANT DEFICIENCY IN INTERNAL CONTROL
<p>This exists when: -</p> <p>(i) A control is <b>designed, implemented or operated</b> in such a way that it is <b>unable to prevent, or detect and correct</b>, misstatements in the financial statements on a timely basis or</p> <p>(ii) A control necessary to <b>prevent, or detect and correct</b>, misstatements in the financial statements on a timely basis is <b>missing</b>.</p>	<p>A deficiency or combination of deficiencies in internal control that, in the auditor's professional judgment, is of <b>sufficient importance to merit the attention of TCWG</b>.</p> <p>The <b>significance of a deficiency</b> or a combination of deficiencies in internal control <b>depends - not only on whether a misstatement has actually occurred,</b></p> <ul style="list-style-type: none"> <li>- but also, on the <b>likelihood that a misstatement could occur and</b></li> <li>- the <b>potential magnitude of the misstatement</b>.</li> </ul>

**COMMUNICATION OF SIGNIFICANT DEFICIENCIES IN INTERNAL CONTROL TO THOSE CHARGED WITH GOVERNANCE**

The auditor shall also communicate to management at an appropriate level on a timely basis: -

- (a) **In writing, significant deficiencies in internal control** that the auditor has communicated or intends to communicate to TCWG, unless it would be inappropriate to communicate directly to management in the circumstances; and
- (b) **Other deficiencies in internal control** identified during the audit that **have not been communicated to management by other parties** and that, in the auditor's professional judgment, are of sufficient importance to merit management's attention.

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.

In particular, the auditor shall explain that: -

- (i) The purpose of the audit was for the auditor to express an opinion on the FS;
- (ii) The audit included consideration of internal control relevant to the preparation of the FS in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control; and
- (iii) The matters being reported are limited to those deficiencies that the auditor has identified during the audit and that the auditor has concluded are of sufficient importance to merit being reported to TCWG.

### **EXAMPLES OF MATTERS THAT THE AUDITOR MAY CONSIDER IN DETERMINING WHETHER A DEFICIENCY OR COMBINATION OF DEFICIENCIES IN INTERNAL CONTROL CONSTITUTES A SIGNIFICANT DEFICIENCY**

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

### **EXAMPLES OF INDICATORS OF SIGNIFICANT DEFICIENCIES IN INTERNAL CONTROL**

- Indications that significant transactions in which management is financially interested are not being appropriately scrutinised by TCWG.
- Identification of management fraud, whether or not material, that was not prevented by the entity's internal control.
- Management's failure to implement appropriate remedial action on significant deficiencies previously communicated.
- Absence of a risk assessment process within the entity where such a process would ordinarily be expected to have been established.
- Evidence of an ineffective entity risk assessment process, such as management's failure to identify a risk of material misstatement that the auditor would expect the entity's risk assessment process to have identified.
- Evidence of an ineffective response to identified significant risks

**Setting goals is the first step of turning the invisible into the visible**

## SA 700 – FORMING AN OPINION AND REPORTING ON FINANCIAL STATEMENTS

### OBJECTIVE –

1. To form an **opinion on the financial statements** based on an evaluation of the conclusions drawn from the audit evidence obtained; and
2. To **express clearly that opinion** through a written report.

### HOW TO FULFILL THE OBJECTIVE?

In order to form that opinion, the auditor shall **conclude as to whether the auditor has obtained reasonable assurance about whether the financial statements as a whole are free from material misstatement**, whether due to fraud or error.

Whether **sufficient appropriate audit evidence** has been obtained (SA 500)

Whether **uncorrected misstatements are material**, individually or in aggregate (SA 265)

The **evaluations**

### EVALUATIONS BY AUDITOR

Qualitative Aspects of the Entity's Accounting Practices	Specific Evaluations by the Auditor
<ul style="list-style-type: none"> <li>• Management makes a <b>number of judgements</b> about the amounts and disclosures in the FS.</li> <li>• In considering the qualitative aspects of the entity's accounting practices, <b>the auditor may become aware of possible bias in management's judgements.</b></li> <li>• The auditor may conclude that the cumulative effect of <b>lack of neutrality, together with the effect of uncorrected misstatements</b>, causes the FSs as a whole to be materially misstated.</li> <li>• <b>Indicators of a lack of neutrality ---→</b> <ul style="list-style-type: none"> <li>- The <b>selective correction of misstatements</b> brought to management's attention during the audit.</li> <li>- <b>Possible management bias</b> in the making of accounting estimates</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• The FS adequately disclose the <b>significant accounting policies</b> selected and applied;</li> <li>• The accounting policies <b>selected and applied are consistent with the applicable financial reporting framework</b> and are appropriate;</li> <li>• The <b>accounting estimates</b> made by management are reasonable;</li> <li>• The information presented in the FS is <b>relevant, reliable, comparable, and understandable</b>;</li> <li>• The FS provide adequate disclosures to <b>enable the intended users to understand the effect of material transactions and events</b> on the information conveyed in the FS; and</li> <li>• The <b>terminology used in the FS</b>, including the title of each FS, is appropriate.</li> </ul>

**AUDITOR'S REPORT FOR AUDITS CONDUCTED IN ACCORDANCE WITH SA 700**

ELEMENTS OF AUDIT REPORT	EXPLANATION IF ANY TO BE GIVEN FURTHER FOR THE SAME
Title (HEADING)	The auditor's report shall have a title that clearly indicates that it is the report of an independent auditor. <b>Example - Independent auditors report</b>
Addressee (KISKE LIYE AUDIT REPORT BANAYA)	The auditor's report shall be addressed, as appropriate, based on the circumstances of the engagement. The auditor's report is normally addressed to those for whom the report is prepared, often either to the shareholders or to those charged with governance of the entity whose financial statements are being audited.
Auditor's Opinion (KYA LAGTA HAI FS KE BAARE MEIN)	This includes the auditor's opinion, and shall have the heading "Opinion". Along with that the following shall also be stated- <ul style="list-style-type: none"> <li>Identify the entity whose FS have been audited;</li> <li>State that the FS have been audited;</li> <li>Identify the title of each statement comprising the FS;</li> <li>Refer to the notes, including the summary of significant accounting policies;</li> <li>Specify the date of, or period covered by, each FS</li> </ul>
Basis for Opinion (OPINION KE SUPPORTINGS)	This section shall explain the basis for holding such opinion. Accordingly, it shall <ul style="list-style-type: none"> <li>(i) State that the audit has been conducted with applicable SA</li> <li>(ii) Refer to the section that describes auditor's responsibilities under the SA.</li> <li>(iii) Include a statement that the auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit</li> <li>(iv) State whether the auditor believes that the audit evidences obtained by him is sufficient and appropriate to provide a basis for the auditor's opinion</li> </ul>
Report on Going Concern Assumption (COMPANY CHALEGI?)	Where applicable, the auditor shall report in accordance with SA 570 (Revised) on Going Concern assumption. Based on the audit evidence obtained, the auditor shall conclude whether, in the auditor's judgement, a material uncertainty exists related to events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern.
Key Audit Matters (KUCH CHIZON PE ZYADA DHYAN LAGEGA)	In case of audit of complete set of general-purpose financial statements of a listed entity, the auditor needs to communicate the key audit matters in accordance with SA 701. These are matters that, in the auditor's professional judgement, were of most significance in the audit of the financial statements of the current period or matters for those who are of significant public interest.
Other Information	Where applicable, the auditor shall report in accordance with SA 720 (Revised)
Responsibilities for the FS (FS BANAYEGA KON?)	The report of an auditor should also include a section with heading 'Management's Responsibilities for the FSs'. Accordingly, this section of the audit report shall describe management's responsibility for:

	<p>(i) the preparation of the FS as per applicable financial reporting framework and for the <b>design, implementation and maintenance of an appropriate internal control</b> relevant to the preparation of the FS that are free from material misstatement, whether due to fraud or error.</p> <p>(ii) assessing the <b>entity's ability to continue as a going concern</b> and whether the going concern basis of accounting is appropriate.</p> <p>This section of the auditor's report shall also <b>identify those responsible for the oversight of the financial reporting process</b>, when those responsible for such oversight <b>are different from Management</b></p>
<p>Auditor's Responsibilities for the Audit of the Financial Statement</p> <p>(AB MAIN CHARACTER KI RESPONSIBILITIES KA WAQT AAGYA HAI)</p>	<p>This section of the auditor's report shall state that:</p> <ul style="list-style-type: none"> <li>The objectives of the auditor are to: <ul style="list-style-type: none"> <li>Obtain <b>reasonable assurance about whether the financial statements as a whole are free</b> from material misstatement, whether due to fraud or error; and</li> <li>Issue an <b>auditor's report</b> that includes the auditor's opinion.</li> </ul> </li> <li>State that <b>reasonable assurance is a high level of assurance</b>, but is not a guarantee;</li> <li>State that <b>misstatements can arise from fraud or error</b>, and either: <ul style="list-style-type: none"> <li>Describe that they are considered material if, individually or in the aggregate, they could reasonably be expected to <b>influence the economic decisions of users taken on the basis of these financial statements</b>; or</li> <li>Provide a definition or description of materiality in accordance with the <b>applicable FRF</b>.</li> </ul> </li> </ul> <p>Further,</p> <ul style="list-style-type: none"> <li>State that, as a part of an audit in accordance with SAs, the <b>auditor has exercised professional judgement and maintained professional skepticism</b> throughout the audit.</li> <li>State that the auditor's responsibilities are: <ul style="list-style-type: none"> <li>to <b>identify and assess the risk</b> of material misstatements, to <b>design and perform audit procedures</b> responsive to those risks; and to <b>obtain audit evidence that is sufficient and appropriate</b> to provide a basis for the auditor's opinion.</li> <li>to obtain an understanding of <b>internal control</b>.</li> <li>to evaluate the <b>appropriateness of accounting practices</b> followed and reasonableness of accounting estimates.</li> <li>to conclude on the appropriateness of <b>management's use of going concern concept</b> and whether there is any uncertainty that may cast significant doubt on the entity's ability to continue as a going concern.</li> <li>When the <b>FS are prepared in accordance with a FRF</b>, to evaluate the overall presentation, structure and content of the FS, including the disclosures, and whether the <b>FS represent the underlying transactions and events</b> in a manner that achieves fair presentation</li> </ul> </li> <li>When SA 600 applies, the <b>division of responsibility for the financial information of the entity</b> by indicating the <b>extent to which the financial</b></li> </ul>



	<p>information of components is audited by the other auditors have been included in the financial information of the entity</p> <ul style="list-style-type: none"> <li>State that the <b>auditor communicates with TCWG regarding, among other matters, the planned scope and timing of the audit and significant audit findings</b>, including any significant deficiencies in internal control that the auditor identifies during the audit;</li> <li>For audits of <b>FS of listed entities</b>, state that the auditor provides TCWG with a statement that the <b>auditor has complied with relevant ethical requirements regarding independence and communicate with them all relationships and other matters</b> that may reasonably be thought to bear on the auditor's independence, and where applicable, related safeguards; and</li> <li>For audits for which key audit matters are communicated in accordance with SA 701, state that, from the matters communicated with TCWG, <b>the auditor determines those matters that were of most significance in the audit of the FS</b> of the current period and are therefore the key audit matters.</li> </ul>
Location of the description of the auditor's responsibilities for the audit of the FS	<p>The description of the auditor's responsibilities for the audit of the FS shall be included:</p> <ul style="list-style-type: none"> <li><b>Within the body of the auditor's report</b></li> <li><b>Within an appendix to the auditor's report</b>, in which case the auditor's report shall include a reference to the location of the appendix or</li> <li><b>By a specific reference within the auditor's report</b> to the location of such a description on a website of an appropriate authority</li> </ul>
Other Reporting Responsibilities (AUDITOR KI ZIMMEDERIYA BHAD RHI HAI)	<p>These other reporting responsibilities shall be addressed in a separate heading titled <b>"Report on Other Legal and Regulatory Requirements"</b>.</p> <p>In case these other reporting responsibilities address the same topics as required by the SAs, these may be presented in the same section as the related report elements required by the SAs.</p>
Signature of the Auditor (AUDITOR KA AUTOGRAPH)	<ul style="list-style-type: none"> <li>Signed by <b>auditor [Engagement Partner]</b></li> <li>In case of firm, sign of engagement partner and name of <b>audit firm</b></li> <li><b>Membership no.</b> of engagement partner to be stated</li> <li><b>Registration number</b> of firm</li> </ul>
Place of Signature (KAHA SIGN KIYA?)	<p><b>Place and city</b> where audit report is signed</p>
Date of the Auditor's Report (KAB SIGN KIYA?)	<p>The auditor's report shall be <b>dated no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence</b> on which to base the auditor's opinion on the FS, including evidence that:</p> <ul style="list-style-type: none"> <li><b>All the statements that comprise the FS</b>, including the related notes, have been prepared; and those with the <b>recognized authority have asserted that they have taken responsibility for those FS</b></li> </ul> <p>The date of the auditor's report informs the <b>user of the auditor's report that the auditor has considered the effect of events and transactions of which the auditor became aware and that occurred up to that date</b>. The auditor's responsibility for events and transactions after the date of the auditor's report is addressed in SA 560</p>

## UDIN - Unique Document Identification Number

Chartered Accountants having full-time Certificate of Practice can register on UDIN Portal and generate UDIN by registering the certificates attested/certified by them. Accordingly, an auditor is required to mention the UDIN with respect to each audit report being signed by him, along with his membership number. Basically, UDIN is to be stated in every document attested by the

### AUDITOR'S REPORT PRESCRIBED BY LAW OR REGULATION

- SA 200 explains that the auditor may be required to comply with legal or regulatory requirements in addition to SAs. When the differences between the legal or regulatory requirements and SAs relate only to the layout and wording of the auditor's report, the requirements stated below in points (a)-(m) set out the minimum elements to be included in the auditor's report to enable a reference to the Standards on Auditing.
- If the auditor is required by law or regulation to use a specific layout, or wording of the auditor's report, the auditor's report shall refer to SA only if the auditor's report includes, at a minimum, each of the following elements:

- |   |
|---|
| (a) A title.  |
| (b) An addressee, as required by the circumstances of the engagement.   |
| (c) An Opinion section containing an expression of opinion on the FS and a reference to the applicable financial reporting framework used to prepare the FS   |
| (d) An identification of the entity's FS that have been audited.  |
| (e) A statement that the auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit, and has fulfilled the auditor's other ethical responsibilities in accordance with these requirements. The statement shall refer to the Code of Ethics issued by ICAI. |
| (f) Where applicable, a section that addresses, and is not inconsistent with, the reporting requirements relating to going concern as per SA 570 (Revised).   |
| (g) Where applicable, a Basis for Qualified (or Adverse) Opinion section that addresses, and is not inconsistent with, the reporting requirements relating to going concern as per SA 570(Revised).   |
| (h) Where applicable, a section that includes the information required by SA 701, or additional information about the audit that is prescribed by law or regulation and that addresses, and is not inconsistent with, the reporting requirements in that SA.  |
| (i) A description of management's responsibilities for the preparation of the FS and an identification of those responsible for the oversight of the financial reporting process that addresses, and is not inconsistent with, the requirements as contained in this SA 700                                     |
| (j) A reference to Standards on Auditing and the law or regulation, and a description of the auditor's responsibilities for an audit of the FS that addresses, and is not inconsistent with, the requirements as contained in this SA 700.  |
| (k) The auditor's signature.  |
| (l) The Place of signature.   |
| (m) The date of the auditor's report.   |

## SA 705 – MODIFICATIONS TO THE OPINION IN THE INDEPENDENT AUDITOR'S REPORT

### OBJECTIVE -

To express clearly an **appropriately modified opinion** on the financial statements that is necessary when:

- (a) The auditor concludes, based on the audit evidence obtained, that the financial statements as a **whole are not free from material misstatement**; or
- (b) The auditor is **unable to obtain sufficient appropriate audit evidence** to conclude that the financial statements as a whole are free from material misstatement.

### TYPES OF OPINION

Opinion	Meaning
<b>UNMODIFIED OPINION</b>	The auditor shall express an unmodified opinion when the auditor concludes that the <b>FS are prepared, in all material respects, in accordance with the applicable FRF.</b>
<b>QUALIFIED OPINION</b>	<p>(a) The auditor, <b>having obtained sufficient appropriate audit evidence</b>, concludes that misstatements, either individually or in aggregate, are <b>MATERIAL BUT NOT PERVASIVE</b> to the FS (i.e., not highly significant);</p> <p>(b) The auditor is <b>unable to obtain sufficient appropriate audit evidence</b> on which to base his opinion, but concludes that the possible effects of undetected misstatements on the FSs could be <b>MATERIAL BUT NOT PERVASIVE.</b></p> <p><b>Basis for Qualified Opinion section</b> -----&gt;</p> <p>When the modification arises from an inability to obtain sufficient appropriate audit evidence, the auditor shall use the corresponding phrase <b>"except for the possible effects of the matter(s) ..."</b> for the modified opinion.</p>
<b>ADVERSE OPINION</b>	<p>The auditor, <b>having obtained sufficient appropriate audit evidence</b>, concludes that misstatements, either individually or in aggregate, are both <b>MATERIAL AND PERVASIVE</b> to the FS.</p> <p><b>Basis for Adverse Opinion section</b> -----&gt;</p> <p>(a) When reporting in accordance with a <b>fair presentation framework</b>, the accompanying FSs <b>do not present fairly (or give a true and fair view of)</b> [...] in accordance with [the applicable FRF]; or</p> <p>(b) When reporting in accordance with a <b>compliance framework</b>, the accompanying FSs <b>have not been prepared, in all material respects</b>, in accordance with [the applicable FRF].</p>
<b>DISCLAIMER OF OPINION</b>	<p>The auditor shall disclaim an opinion when the auditor is <b>unable to obtain sufficient appropriate audit evidence on which to base the opinion</b>, and the auditor concludes that the possible effects on the FS of undetected misstatements, if any, could be <b>BOTH MATERIAL AND PERVASIVE.</b></p> <p><b>Amend the description of auditor's responsibility</b> ----&gt;</p> <p>(a) A statement that the auditor's responsibility is to conduct an <b>audit of the entity's FS in accordance with SA and to issue an auditor's report</b>;</p>

- (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; and
- (c) The statement about auditor independence and other ethical responsibilities required by SA 700 (Revised).

When the auditor disclaims an opinion due to an 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 sufficient appropriate audit evidence to provide a basis for an audit opinion on the FS; and
- (c) **Amend the statement required by SA 700 (Revised), which indicates that the FS have been audited**, to state that the auditor was engaged to audit the FS.

### BASIS FOR OPINION

When the auditor modifies the opinion on the financial statements, the auditor shall - **Amend the heading "Basis for Opinion" required by SA 700 (Revised) to "Basis for Qualified Opinion," "Basis for Adverse Opinion," or "Basis for Disclaimer of Opinion,"**

#### If material misstatement of the FS that relates to specific amounts ---->

A description and quantification of the financial effects of the misstatement, unless impracticable  
If it is not practicable to quantify the financial effects, the auditor shall so state in this section

#### If material misstatement relates to narrative disclosures ---->

Explanation of how the disclosures are misstated

#### If material misstatement of the FS relates to the non-disclosure of information required to be disclosed ----->

- (a) Discuss the **non-disclosure** with TCWG
- (b) Describe in the Basis for Opinion section **the nature of the omitted information**; and
- (c) Unless prohibited by law or regulation, **include the omitted disclosures**, provided it is practicable to do so and if auditor has obtained sufficient appropriate audit evidence about the same.

#### If the modification results from an inability to obtain sufficient appropriate audit evidence --> Reasons for that inability.

### CONSEQUENCE OF AN INABILITY TO OBTAIN SUFFICIENT APPROPRIATE AUDIT EVIDENCE DUE TO A MANAGEMENT IMPOSED LIMITATION AFTER THE AUDITOR HAS ACCEPTED THE ENGAGEMENT

Request the management to remove the limitation

**Management removes the limitation**  
----> Proceed with audit procedures

**Management refuses to remove the limitation ---->**  
Communicate with TCWG and perform alternative audit procedures

#### Still unable to obtain sufficient and appropriate audit evidence ---->

Possible effects (Material but not pervasive) ---- Qualified opinion

Possible effects (Material and pervasive) ---- Disclaimer of opinion or withdraw from engagement

## SA 706 – EMPHASIS OF MATTER PARAGRAPHS AND OTHER MATTER PARAGRAPHS IN THE INDEPENDENT AUDITOR'S REPORT

### EMPHASIS OF MATTER PARAGRAPH

<b>Meaning</b>	Emphasis of Matter paragraph is a paragraph included in the auditor's report that refers to a <b>matter appropriately presented or disclosed in the FS</b> that, in the auditor's judgement, is of such importance that it is <b>fundamental to users' understanding of the FS</b>
<b>Conditions to satisfy before giving EMP</b>	<ul style="list-style-type: none"> <li>- The auditor would <b>not be required to modify the opinion</b> in accordance with SA 705 (Revised) as a result of the matter; and</li> <li>- When SA 701 applies, the matter <b>has not been determined to be a key audit matter</b> to be communicated in the auditor's report</li> </ul>
<b>Examples</b>	<ul style="list-style-type: none"> <li>➤ An uncertainty relating to the future outcome of exceptional litigation or regulatory action.</li> <li>➤ A significant subsequent event that occurs between the date of the FS and the date of the auditor's report.</li> <li>➤ Early application (where permitted) of a new accounting standard that has a material effect on the FS.</li> </ul>
<b>Separate section for Emphasis of Matter paragraph</b>	<p>When the auditor includes an Emphasis of Matter paragraph in the auditor's report, the auditor shall:</p> <ul style="list-style-type: none"> <li>- Include the <b>paragraph within a separate section of the auditor's report</b> with an appropriate heading that includes the term "Emphasis of Matter";</li> <li>- Include in the <b>paragraph a clear reference to the matter being emphasized and to where relevant disclosures that fully describe the matter</b> can be found in the FS. The paragraph shall refer only to information presented or disclosed in the FS; and</li> <li>- Indicate that the <b>auditor's opinion is not modified</b> in respect of the matter emphasized.</li> </ul>
<b>An Emphasis of Matter paragraph is not a substitute for:</b>	<ul style="list-style-type: none"> <li>- A <b>modified opinion in accordance with SA 705 (Revised)</b> when required by the circumstances of a specific audit engagement;</li> <li>- <b>Disclosures in the FS that the applicable FRF requires management to make,</b></li> <li>- <b>Reporting in accordance with SA 570 (Revised) when a material uncertainty exists</b> relating to events or conditions that may cast significant doubt on an entity's ability to continue as a going concern.</li> </ul>

### OTHER MATTER PARAGRAPH

<b>Meaning</b>	Other Matter paragraph is a paragraph included in the auditor's report that refers to a <b>matter other than those presented or disclosed in the FS</b> that, in the auditor's judgement, is relevant to <b>users' understanding of the audit, the auditor's responsibilities or the auditor's report.</b>
<b>Conditions to satisfy before giving OMP</b>	This is <b>not prohibited by law or regulation</b> ; and the matter <b>has not been determined to be a key audit matter</b> to be communicated in the auditor's report.



SA 701 - KEY AUDIT MATTERS

**OBJECTIVE -**

the objectives of the auditor are to **determine key audit matters** and, having formed an opinion on the financial statements, **communicate those matters by describing them in the auditor's report**.

<b>Meaning</b>	<ul style="list-style-type: none"> <li>- Key Audit Matters are those matters that, in the <b>auditor's professional judgement were of most significance in the audit of the FS</b> of the current period. KAM are <b>selected from matters communicated with TCWG</b>.</li> </ul>
<b>Purpose of Communicating Key Audit Matters</b>	<ul style="list-style-type: none"> <li>- To enhance the <b>communicative value of the auditor's report</b> by providing greater transparency about the audit that was performed.</li> <li>- Communicating key audit matters provides <b>additional information to intended users of the FS</b> to assist them in understanding those matters that, were of most significance in the audit of the FS of the current period.</li> <li>- Also, <b>assist intended users in understanding the entity and areas of significant management judgement</b> in the audited FS.</li> </ul>
<b>Determining Key Audit Matters</b>	<p>In making this determination, the auditor shall take into account the following -</p> <ul style="list-style-type: none"> <li>- Areas of <b>higher assessed risk of material misstatement</b>, or significant risks identified in accordance with SA 315.</li> <li>- <b>Significant auditor judgements relating to areas in the FS that involved significant management judgement</b>, including accounting estimates that have been identified as having high estimation uncertainty.</li> <li>- The effect on the <b>audit of significant events or transactions that occurred</b>.</li> </ul>
<b>How are they presented in FS?</b>	<ul style="list-style-type: none"> <li>- Key audit matters are those matters that, in the auditor's professional judgement, <b>were of most significance in the audit of the FS</b>; and</li> <li>- These matters <b>were addressed in the context of the audit of the FS</b> as a whole, and in forming the auditor's opinion thereon, and the auditor does not provide a separate opinion on these matters.</li> </ul>
<b>Communicating Key Audit Matters- not a substitute [IMPORTANT]</b>	<p>Communicating key audit matters in the auditor's report is not:</p> <ul style="list-style-type: none"> <li>- A <b>substitute for disclosures in the FS that the applicable FRF</b> requires management to make, or that are necessary to achieve fair presentation;</li> <li>- A <b>substitute for the auditor expressing a modified opinion</b> when required by the circumstances of a specific audit engagement in accordance with SA 705;</li> <li>- A <b>substitute for reporting in accordance with SA 570</b> 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</li> <li>- A <b>separate opinion on individual matters</b>.</li> </ul>
<b>Communication with TCWG</b>	<p>The auditor shall communicate with those charged with governance:</p> <ul style="list-style-type: none"> <li>- Those matters the auditor has determined to be <b>the key audit matters</b>; or</li> <li>- If applicable, depending on the facts and circumstances of the entity and the audit, <b>the auditor's determination that there are no key audit matters to communicate in the auditor's report</b>.</li> </ul>

Hard work beats talent when talent doesn't work hard

## SA 710 - COMPARATIVE INFORMATION, CORRESPONDING FIGURES AND COMPARATIVE FS

### OBJECTIVE -

- (a) To obtain sufficient appropriate audit evidence about whether the comparative information included in the financial statements 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**

The nature of the comparative information that is presented in an entity's FS depends on the requirements of the applicable financial reporting framework.

There are two different broad approaches to the auditor's reporting responsibilities in respect of such comparative information:

- corresponding figures and
- comparative FS.

The essential audit reporting differences between the approaches are:

- (a) For **corresponding figures**, -----→ the auditor's opinion on the FS refers to the current period only; whereas
- (b) For **comparative FS**, -----→ the auditor's opinion refers to each period for which FS are presented.

### AUDIT REPORTING REGARDING CORRESPONDING FIGURES

Meaning	<p>Comparative information where,</p> <ul style="list-style-type: none"> <li>- <b>amounts and other disclosures for the prior period</b> are included as an integral part of the current period FS and</li> <li>- are intended to be <b>read only in relation to the amounts and other disclosures relating to the current period</b></li> </ul> <p>The level of detail presented in the corresponding amounts and disclosures is dictated <b>primarily by its relevance to the current period figures</b>.</p>
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**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. In the Basis for Modification paragraph in the auditor's report, the auditor shall either:
  - **Refer to both the current period's figures and the corresponding figures in the description of the matter** giving rise to the modification when the effects or possible effects of the matter on the current period's figures are material; or

- In other cases, explain that the **audit opinion has been modified because of the effects or possible effects of the unresolved matter** on the comparability of the current period's figures and the corresponding figures.
- 2. If the auditor obtains audit evidence that a **material misstatement exists in the prior period FS 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 financial reporting framework 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, modified with respect to the corresponding figures included therein.**
- 3. If the **prior period FS were not audited**, the auditor shall state in an **Other Matter paragraph** in the auditor's report that the corresponding figures 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.**

#### Prior Period Financial Statements Audited by a Predecessor Auditor

If the FS 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 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 INFORMATION

Meaning	The amounts and disclosures included in the FS in respect of one or more prior periods in accordance with the applicable FRF.
Audit Procedures	<ul style="list-style-type: none"> <li>• The auditor shall determine whether the <b>FS include the comparative information required by the applicable FRF</b> and whether such information is appropriately classified. For this purpose, the auditor shall evaluate whether <ul style="list-style-type: none"> <li>➤ The <b>comparative information agrees with the amounts</b> and other disclosures presented in the prior period; and</li> <li>➤ The <b>accounting policies reflected in the comparative information are consistent</b> with those applied in the current period or, if there have been <b>changes</b> in accounting policies, whether those changes have been properly accounted for and adequately <b>presented and disclosed</b>.</li> </ul> </li> <li>• If the auditor becomes <b>aware of a possible material misstatement</b> in the comparative information while performing the current period audit, the auditor shall <b>perform such additional audit procedures as are necessary in the circumstances to obtain sufficient appropriate audit evidence</b>. If the auditor had audited the prior period's FS, the auditor shall also follow the relevant requirements of <b>SA 560</b>.</li> </ul>

- As required by SA 580, the auditor shall request written representations for all periods referred to in the auditor's opinion. The auditor shall also obtain a specific written representation regarding any prior period item that is separately disclosed in the current year's statement of profit and loss

### AUDIT REPORTING REGARDING COMPARATIVE FS

Meaning	<p>Comparative information where amounts and other disclosures for the prior period are included for comparison with the FS of the current period but, if audited, are referred to in the auditor's opinion.</p> <p>The level of information included in those comparative FS is comparable with that of the FS of the current period.</p>
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#### Auditor's opinion- to refer each period

When comparative FS are presented, the auditor's opinion shall refer to each period for which FS are presented and on which an audit opinion is expressed.

When reporting on prior period FS in connection with the current period's audit, if the auditor's opinion on such prior period FS 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 FS Audited by a Predecessor Auditor -

- State the fact in OMP along with details
- If the auditor concludes that a material misstatement exists that affects the prior period FS on which the predecessor auditor had previously reported without modification, the auditor shall
  - communicate the misstatement with the appropriate level of management and TCWG and request that the predecessor auditor be informed.
  - If the prior period FS are amended, and the predecessor auditor agrees to issue a new auditor's report on the amended FS of the prior period, the auditor shall report only on the current period.

#### Prior Period FS Not Audited -

If the prior period FS were not audited, the auditor shall state in an Other Matter paragraph that the comparative FS 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.

What comes easy won't last  
What lasts won't come easy

**REPORTING REQUIREMENTS UNDER THE COMPANIES ACT, 2013**

Reporting requirement relating to matters stated in section 143(1)	<p>(a) whether <b>loans and advances made by the company</b> 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</p> <p>(b) whether <b>transactions of the company which are represented merely by book entries</b> are prejudicial to the interests of the company;</p> <p>(c) where the <b>company</b> not being an investment company or a banking company, whether investments have been sold at a <b>price less than that at which they were purchased by the company</b>;</p> <p>(d) whether <b>loans and advances</b> made by the company have been shown as <b>deposits</b>;</p> <p>(e) whether <b>personal expenses have been charged to revenue account</b>;</p> <p>(f) where it is stated in the books and documents of the company that any <b>shares have been allotted for cash</b>, whether cash has actually been received in respect of such allotment, and if <b>no cash has actually been so received</b>, whether the position as stated in the account books and the <b>balance sheet is correct, regular and not misleading</b></p>
Reporting on accounts examined - Sec 143(2)	Report shall after taking into account the <b>provisions of this Act, the accounting and auditing standards and matters which are required to be included in the audit report under the provisions of this Act.</b>
Reporting on accounts examined - Sec 143(3)	<ul style="list-style-type: none"> <li>• <b>Obtained all information and explanation</b> to the best of his knowledge</li> <li>• <b>Maintenance of proper books of accounts</b> as per law</li> <li>• <b>Report</b> of the branch auditor + <b>Returns</b> filed by branch has been received</li> <li>• Company's <b>Balance Sheet and P&amp;L</b> are in agreement with books of accounts</li> <li>• Compliance of <b>FS with accounting standards</b></li> <li>• <b>Observations or comments</b> on matters having adverse effect on functioning of the company</li> <li>• <b>Disqualification of director</b> as per Sec 164(2)</li> <li>• <b>Qualification, reservation or adverse remark</b> relating to accounts and other matters</li> <li>• Report on <b>Internal Financial Control</b> over Financial Reporting</li> </ul> <p>However, it may be noted that the reporting requirement on adequacy of <b>internal financial controls (IFCs) with reference to financial statements</b> shall not be applicable to a <b>private company</b> which is a-</p> <p>(i) <b>One person company</b>; or</p> <p>(ii) <b>Small company</b>; or</p> <p>(iii) Company having <b>turnover &lt; 50 crore</b> as per latest audited financial statement and <b>aggregate borrowings from Banks/FI or any body corporate</b> at any point of time during the financial year <b>&lt; 25 crore</b>.</p> <ul style="list-style-type: none"> <li>• Such other matters as are prescribed in Rule 11 of the Companies (Audit and Auditors) Rules, 2014</li> </ul>



	<ul style="list-style-type: none"> <li>- Impact of <b>pending litigations</b></li> <li>- Provision for <b>material foreseeable losses</b></li> <li>- <b>Delay in depositing</b> the amount in IEPF</li> <li>- <b>Dividend paid or declared</b> is in accordance with Sec 123</li> <li>- Existence of <b>Audit Trail</b></li> </ul>
Reporting on any other matter specified by CG - <b>Sec 143(11)</b>	The <b>CG</b> may, in consultation with the <b>NFRA</b> , 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 - <b>Sec 143(12)</b>	<p>If an auditor of a company in the course of the performance of his duties as auditor, has reason to believe that</p> <ul style="list-style-type: none"> <li>- <b>an offence of fraud, which involves or is expected to involve individually an amount of Rs. 1 crore or above</b></li> <li>- <b>is being or has been committed in the company by its officers or employees,</b></li> <li>- the auditor shall report the matter to the <b>Central Government</b> within such time and in such manner as prescribed.</li> </ul> <p>In case of a</p> <ul style="list-style-type: none"> <li>- <b>fraud involving lesser than the specified amount</b> [i.e. less than Rs. 1 crore], the auditor shall report the matter to the <b>audit committee constituted under section 177</b> or to the <b>Board</b> in other cases within such time and in such manner as prescribed</li> </ul>

**You don't have to be great to start but you have to start to be great**

## REPORTING REQUIREMENTS UNDER THE CARO, 2020

### APPLICABILITY -

**CARO, 2020 applies to every company except;**

- Pvt Co (Not a holding a holding or subsidiary of Public Co.)-  
**PUSC + R&S  $\leq$  1cr on BS date AND**  
**Borrowings from any Bank or FI  $\leq$  1cr at any point during FY AND**  
**Revenue (including revenue from discontinued operations)  $\leq$  10 cr during the FY**
- Banking Company
- Section 8 Co.
- Insurance Company
- OPC & Small Company

### PARA 3 (I) - PROPERTY, PLANT AND EQUIPMENT

Maintenance of **Proper records** showing full particulars including quantitative details and situation (For both PPE and intangible assets)

**Title deeds of all immovable properties** shown in FS are held in the name of company

**If the title deeds are not held in the name of company, the following shall be disclosed -**

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

Proceedings initiated or pending for holding any **benami Property** and disclosures for the same

**Physical verification at reasonable intervals** and proper dealing of discrepancies

**Revaluation of PPE**, if any during the year is based on valuation of Registered Valuer and disclosure of Change if change is 10% or more in the aggregate of the net carrying value of each class of PPE or intangible Asset is made

### PARA 3 (II) - INVENTORY

**Physical verification of inventory** at regular intervals, method of which is appropriate and in case of discrepancies of 10% or more in the aggregate for each class of inventory were properly dealt with.

Whether the company has been sanctioned a **working capital loan in excess of 5 crs** during any point of time and whether quarterly statements or returns filed with the bank are in agreement with the books of accounts

**PARA 3 (III) - LOANS, GUARANTEE, SECURITY, INVESTMENT**

Aggregate amount and balance outstanding at the balance sheet date of the LGSI whether provided to subsidiary, JV, associate or others

Stipulation of the **schedule of repayment of principal and payment of interest** and regularity of the repayments or receipts

Any amount **overdue for more than 90 days** and the steps taken to recover the due

Aggregate amount of Loans or advances **repayable on demand or without specifying any terms** or period of repayment and its percentage to the total loans, aggregate amount of Loans to RPT, Promoters

Aggregate amount of Loans **extended or renewed or fresh loans granted to the same party** whose loan has fallen due during the year and its percentage to the total amount of Loans

**Terms and condition** of the LGSI are not prejudicial to company's interest

**PARA 3 (IV) - COMPLIANCES IN CASE OF LOANS, GUARANTEE, SECURITY, INVESTMENT**

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

**PARA 3 (V) - DEPOSITS**

Whether **RBI directives** are followed

Compliance of **Sec 73 to 76** and if not, nature of contravention

Order passed by Company Law Tribunal or NCLT and the same has been complied with

**PARA 3 (VI) - COST RECORDS**

Whether maintenance of cost records has been specified by the Central Government under sub-section (1) of **section 148 of the Companies Act** and whether such accounts and records have been **so made and maintained** (Refer Chapter Company Audit further for this clause)

**PARA 3 (VII) - STATUTORY DUES**

**Disputed** - State the amount and forum

**Undisputed** - Whether the company is regular in depositing the dues

If not, state the amount overdue for **more than 6 months** as on the last day of the financial year.

**PARA 3 (VIII) - UNRECORDED INCOME**

Whether any transactions not recorded in the books of account have been surrendered or disclosed as income during the year in the tax assessments under the Income Tax Act, 1961 (43 of 1961), if so, whether the **previously unrecorded income has been properly recorded** in the books of account.

**PARA 3 (IX) - LOANS AND BORROWINGS**

If any funds have been taken to meet the obligations of its subsidiaries, associates or joint venture, state the nature and amount

**Application of term loans** for the purpose they were obtained. In case of diversion, state the amount and purpose

**Default** in repayment of deposits or payment of interest, make adequate disclosures

Nature of borrowing, including debt securities	Name of lender	Amount not paid on due date	Whether principal or interest	No. of days delay or unpaid	Remarks, if any

If funds raised for short term purpose have been used for long term purpose, state the nature and amount

**Declared wilful defaulter** by Bank or Financial Institution

If any funds have been raised on the pledge of securities of Subsidiaries, JV or associate, give the details and also report where the company has defaulted in repayment of loans

**PARA 3 (X) - UTILIZATION OF PUBLIC PROCEEDS**

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;

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

**PARA 3 (XI) - FRAUD**

Whether any report has been filed under Sec 143(12) in Form ADT-4 with the Central Government

**Nature and amount of fraud** by the company or fraud on the company during the year

Whether all whistle blower complaints received have been considered

**PARA 3 (XII) - NIDHI COMPANY**

**Net owned fund: Deposit** = 1:20 to meet out liability

Maintenance of 10 % unencumbered term deposits as per rules

**Default in payment of interest** or repayment of deposit

**PARA 3 (XIII) - RELATED PARTY TRANSACTION**

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;

**PARA 3 (XIV) - INTERNAL AUDIT SYSTEM**

Whether the company has an internal audit system commensurate with the **size and nature of its business**;

Whether the **reports of the Internal Auditors** for the period under audit were considered by the statutory auditor;

**PARA 3 (XV) - NON-CASH TRANSACTION**

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.

**PARA 3 (XVI) - NBFC**

Company is required to be registered under **45 IA of the Act**? If so, whether Registration obtained?

Whether the company has conducted any **non-banking activities without a valid COR**

If the **company is a CIC**? Whether the company is a exempted or unregistered CIC?

How many **CIC** are the part of the group?

**PARA 3 (XVII) - CASH LOSSES**

Whether the company has incurred cash losses in the **financial year** and in the immediately **preceding financial year**, if so, state the **amount of cash losses**.

**PARA 3 (XVIII) - RESIGNATION OF STATUTORY AUDITOR**

Whether there has been any resignation of the statutory auditors during the year, if so, **whether the auditor has taken into consideration the issues, objections or concerns** raised by the outgoing auditors;

**PARA 3 (XIX) - GOING CONCERN**

On the basis of the -

- financial ratios,
- ageing and expected dates of realization 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.



**PARA 3 (XX) - CSR**

**In respect of other than ongoing projects-**

Deposit unspent amount within 6 months to Fund specified in Schedule VII

**In respect of ongoing projects-**

Deposit unspent amount to a special (escrow account)

**PARA 3 (XXI) - QUALIFICATIONS IN CFS**

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.

**AUDIT OF BRANCH OFFICE ACCOUNTS**

**Provisions relating to branch audit**

Where a company has a branch office the accounts shall be audited either by the **statutory auditor of the company** or any other **person qualified for appointment**

Where a company has a branch office outside India the accounts shall be audited either by the **statutory auditor of the company** or any other **person qualified for appointment as per laws of that country**

The branch auditor shall submit his **report to the company's auditor**

**Duty regarding reporting of fraud** by the auditor shall also extend to the branch auditor to the extent it relates to the concerned branch.

The **duties and powers** of statutory auditor in respect of branch or branch auditor if appointed separately shall remain the same as stated in **143(1) to 143(4)**

**SA 600 - USING THE WORK OF ANOTHER AUDITOR**

**Principal auditor** ----> responsibility for reporting on the financial information of an entity

**Other auditor** -----> responsibility for reporting on the financial information of a component

**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) advise the other auditor of the **significant accounting, auditing and reporting requirements and obtain representation** as to compliance with them.

- 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.
- 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.
- This knowledge **may have been enhanced from the review of the previous audit work** of the auditor.

**JOINT AUDIT**

<b>Meaning</b>	Joint audit basically implies <b>pooling together the resources and expertise of more than one firm of auditors</b> to render an expert job in a given time period which may be difficult to accomplish acting individually.
<b>Joint Audit Plan</b>	<p>(i) the joint auditors should <b>jointly establish an overall audit strategy which sets the scope, timing and direction</b> of the audit, and also guides the development of the audit plan.</p> <p>(ii) before the commencement of the audit, the joint auditors should discuss and develop a joint audit plan. In developing the joint audit plan, the joint auditors should:</p> <ul style="list-style-type: none"> <li>- <b>identify division of audit areas and common audit areas;</b></li> <li>- ascertain the <b>reporting objectives</b> of the engagement;</li> <li>- consider and communicate among all joint auditors the factors that are <b>significant in directing the engagement team's efforts;</b></li> <li>- consider the <b>results of preliminary engagement activities</b>, or similar engagements performed earlier.</li> <li>- ascertain the <b>nature, timing and extent of resources</b> necessary to accomplish the engagement.</li> </ul> <p>(iii) each of the joint auditors should <b>consider and assess the risks of material misstatement</b> and communicate to other joint auditors.</p> <p>(iv) the joint auditors should discuss and <b>document the nature, timing, and the extent of the audit procedures</b> for (I) common and (II) specific allotted areas of audit to be performed.</p> <p>(v) the joint auditors should <b>obtain common engagement letter and common management representation letter.</b></p> <p>(vi) the <b>work allocation document</b> should be signed by all the joint auditors and communicated to those charged with governance</p>
<b>Joint Responsibility</b>	<p>(i) the audit work <b>which is not divided</b> among the joint auditors and is carried out by all joint auditors;</p> <p>(ii) <b>decisions taken by all the joint auditors</b> under audit planning in respect of common audit areas;</p> <p>(iii) <b>matters which are brought to the notice of the joint auditors</b> by any one of them and there is an agreement among the joint auditors on such matters;</p> <p>(iv) examining that the <b>financial statements of the entity comply with the requirements of the relevant statutes;</b></p> <p>(v) <b>presentation and disclosure of the financial statements</b> as required by the applicable financial reporting framework;</p> <p>(vi) ensuring that the <b>audit report complies with the requirements of the relevant statutes, applicable SA and other relevant pronouncements</b> issued by ICAI</p>
<b>Reporting Responsibilities</b>	It may be noted that the joint auditors are required to <b>issue common audit report</b> . However, where the joint auditors are in disagreement with regard to the opinion or any matters to be covered by the audit report, they shall express their opinion in a separate audit report--→ In such circumstances, the <b>audit report(s) issued by the joint auditor(s) shall make a reference to each other's audit report(s).</b>

## BANK AUDIT

### TYPES OF BANKS

<b>Commercial banks</b>	Two of its main functions are: (a) accepting deposits and (b) granting advances
<b>Regional Rural Banks</b>	They have been set up in rural areas in different states of the country to cater to the basic banking and financial needs of the rural communities.
<b>Co-operative Bank</b>	They are commercial Banks only but are set up on the basis of Cooperative Principles and registered under the Cooperative Societies Act.
<b>Payments Banks</b>	They are allowed to accept restricted deposits but they cannot issue loans and credit cards. However, customers can open Current & Savings accounts.
<b>Development Banks</b>	They had been conceptualized to provide funds for infrastructural facilities important for the economic growth of the country.
<b>Small Finance Banks</b>	They have been set up by RBI to make available basic financial and banking facilities to the unserved and unorganised sectors.

### PECULIARITIES INVOLVED IN BANKS

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

### FORM AND CONTENT OF FINANCIAL STATEMENTS

Form A -----> contains the form of Balance Sheet and

Form B -----> contains the form of Profit and Loss Account

Every banking company needs to comply with the disclosure requirements under the various Accounting Standards, as specified under section 133 of the Companies Act, 2013, in so far as they apply to banking companies or the Accounting Standards issued by the ICAI.

### RESERVE BANK OF INDIA: REGULATING BODY

<b>RBI is responsible for</b>	<b>Important functions of RBI are</b>
Development and supervision of the constituents of the Indian financial system	Issuance of currency and regulation of currency issue
Determining, in conjunction with the Central Government, the monetary and credit policies	Acting as banker to the central and state governments
Regulating the activities of commercial and other banks	Acting as banker to commercial and other types of banks

## BANK AUDIT

<b>Audit of accounts</b>	Banking company should be audited by a person duly qualified under any law for the time being in force to be an auditor of companies.						
<b>Appointment of auditor</b>	As per the provisions of the relevant enactments: - <table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 40%;"><b>Banking company</b></td><td>Appointed at the <b>AGM of the shareholders</b></td></tr> <tr> <td><b>Nationalised bank</b></td><td>Appointed by the bank concerned acting through its <b>BOD with the approval of RBI</b></td></tr> <tr> <td><b>Regional rural banks</b></td><td>Appointed by the bank concerned with the <b>approval of the Central Government.</b></td></tr> </table>	<b>Banking company</b>	Appointed at the <b>AGM of the shareholders</b>	<b>Nationalised bank</b>	Appointed by the bank concerned acting through its <b>BOD with the approval of RBI</b>	<b>Regional rural banks</b>	Appointed by the bank concerned with the <b>approval of the Central Government.</b>
<b>Banking company</b>	Appointed at the <b>AGM of the shareholders</b>						
<b>Nationalised bank</b>	Appointed by the bank concerned acting through its <b>BOD with the approval of RBI</b>						
<b>Regional rural banks</b>	Appointed by the bank concerned with the <b>approval of the Central Government.</b>						
<b>Remuneration of auditor</b>	The remuneration of auditor of a - <b>Banking company</b> ---→ are fixed in accordance with the provisions of <b>Section 142</b> of the Companies Act, 2013 [In the GM] <b>Nationalised banks and State Bank of India</b> ----→ is to be fixed by the RBI in consultation with the <b>Central Government.</b>						

## BANK AUDIT APPROACH

### 1. UNDERSTANDING OF ACCOUNTING SYSTEM IN BANKS

- In the computerized environment, it is imperative that the **auditor is familiar with and satisfied that all the norms/parameters** as per the latest applicable RBI guidelines are incorporated and built into the system.
- The auditor should not go by the **assumption that the system generated information is correct and can be relied upon without evidence**
- He should use **Professional Skepticism and Prudence** wherever he feels that something manually needs to be performed to check the authenticity and consistency of the information obtained from the systems and document the results of such activities performed.

### 2. DRAWING AN AUDIT PLAN

An audit plan should be drawn up based on: -

- the nature and level of **operations**,
- nature of **adverse features**,
- **level of compliance** based on previous reports and
- **audit risks** based on inadequacy in or breach of internal controls and the
- **familiarization exercise** carried out

### 3. ENGAGEMENT TEAM DISCUSSIONS

- The engagement team should hold discussions to **gain better understanding of the bank and its environment, including internal control, and also to assess the potential for material misstatements of the financial statements.**
- All these discussions should **be appropriately documented for future reference.**
- The engagement team discussion ordinarily includes a discussion of the following matters:
  - **Errors that may be more likely to occur;**
  - Errors which have been **identified in prior years;**
  - **Method by which fraud might be perpetrated** by bank personnel or others within particular account balances and/or disclosures;

- **Audit responses** to Engagement Risk, Pervasive Risks, and Specific Risks;
- Need to **maintain professional scepticism** throughout the audit engagement;
- Need to **alert for information or other conditions that indicates that a material misstatement may have occurred**

**Advantages of such a discussion: -**

- Enables the engagement team to consider an **appropriate response to fraud risks**, including those related to engagement risk, pervasive risks, and specific risks.
- It further enables the audit engagement partner to **delegate the work to the experienced engagement team members**, and to determine the procedures to be followed when fraud is identified.
- Further, **audit engagement partner may review the need to involve specialists** to address the issues relating to fraud.

#### 4. CONTROL ENVIRONMENT AT THE BANK

A bank should have appropriate controls to **mitigate its risks**, including **effective segregation of duties** (particularly, between front and back offices), **accurate measurement and reporting of positions**, **verification and approval of transactions**, **reconciliation of positions and results**, **setting up limits**, **reporting and approval of exceptions**, **physical security and contingency planning**.

The following are certain common questions /steps, which have to be kept in mind while undertaking/ performing control activities:

Nature of Questions	Questions to be considered / answered
Who	Who performs the control? Does the above person have knowledge and authority to perform the control?
What	What evidence is available to demonstrate /prove that the control is performed?
When	When and with what frequency is the control performed? Is the frequency enough to prevent, detect and correct ROMM?
Where	Where is the evidence of performance of the control retained? For how long is the evidence retained? Is the evidence accessible/ available for audit?
Why	Why is the control being performed? What type of errors are prevented or detected through the control?
How	How is the control performed? What are the control activities? Can these activities be bypassed? Can the bypass, if any, be detected? How are exceptions / deviations resolved on identification? What is the time frame for resolving the exceptions / deviations?

**Productivity is never an accident. It is always the result of a commitment to excellence, intelligent planning and focused effort**



## CONDUCTING AN AUDIT

### 1. Initial consideration by the statutory auditor

#### Declaration of Indebtedness

The RBI has advised that the banks, before appointing their statutory central/branch auditors, should obtain a declaration of indebtedness.

#### Internal Assignments in Banks by Statutory Auditors

The RBI decided that the audit firms should not undertake statutory audit assignment while they are associated with internal assignments in the bank during the same year, like Concurrent audits

#### Planning

SA 300, "Planning an Audit of FS" requires that the auditor shall undertake the following activities prior to starting an initial audit:

- (a) Performing procedures required by SA 220; and
- (b) Establish understanding of terms of engagement as per SA 210,

#### Communication with Previous Auditor

A Chartered Accountant in practice cannot accept position as auditor previously held by another chartered accountant without first communicating with him in writing.

He should get a **NO Objection Certificate (NOC)** from the previous auditor through this communication as to know whether he has any objections to such an appointment made

#### Terms of Audit Engagements

SA 210 requires that for each period to be audited, the auditor should agree on the terms of the audit engagement with the bank before beginning significant portions of fieldwork.

Terms of the engagement should be documented, in order to prevent any confusion as to the terms that have been agreed in relation to the audit and the respective responsibilities

#### Initial Engagements

The auditor needs to perform the audit procedures as mentioned in SA 510 and if after performing those procedures, the auditor concludes that the opening balances contain misstatements which materially affect the FS for the current period and the effect of the same is not properly accounted for and adequately disclosed, the auditor should express a QO or AO, as appropriate

#### Assessment of Engagement Risk

The assessment of engagement risk is a critical part of the audit process and should be done prior to the acceptance of an audit engagement since it affects the decision of accepting the engagement and also in planning decisions if the audit is accepted.

#### Establish the Engagement Team

The size and composition of the engagement team would depend on the size, nature and complexity of the bank's operations.

### 2. Identifying and Assessing the Risks of Material Misstatements

SA 315 requires the auditor to identify and assess the ROMM at the financial statement level and the assertion level to provide a basis for designing and performing further audit procedures.

### 3. Understanding the Bank and Its Environment including Internal Control

An understanding of the bank and its environment, including its internal control, enables the auditor to identify and assess risk; to develop an audit plan so as to determine the operating effectiveness of the controls and to address the specific risks

#### 4. Understanding the Bank's Accounting Process

The accounting process produces financial and operational information for management's use and it also contributes to the internal control. Thus, understanding of the accounting process is necessary to identify and assess the ROMM and to design and perform further audit procedures.

#### 5. Understanding the Risk Management Process

Management develops controls and uses performance indicators to aid in managing key business and financial risks. An effective risk management system in a bank generally requires the following

<b>Oversight and involvement in the control process by TCWG</b>	TCWG (Board of Directors/Managing Director) should approve written risk management policies. The policies should be consistent with the bank's business objectives and strategies, capital strength, management expertise, regulatory requirements.
<b>Identification, measurement and monitoring of risks:</b>	Risks that could significantly impact the achievement of bank's goals should be identified, measured and monitored against pre-approved limits and criteria.
<b>Control activities</b>	A bank should have appropriate controls to mitigate its risks including effective segregation of duties, accurate measurement and reporting of positions, verification and approval of transactions, reconciliation of positions and results, setting up limits, reporting
<b>Monitoring activities</b>	Risk management models, methodologies and assumptions used to measure and mitigate risk should be regularly assessed and updated.
<b>Reliable information systems</b>	Banks require reliable information systems that provide adequate financial, operational and compliance information on a timely and consistent basis.

#### 6. Engagement Team Discussions

The engagement team should hold discussions to gain better understanding of banks and its environment, including internal control, and also to assess the potential for material misstatements of the FS

#### 7. Establish the Overall Audit Strategy:

SA 300 states that the objective of the auditor is to plan the audit so that it will be performed in an effective manner.

For this purpose, the audit engagement partner should:

- establish the overall audit strategy, prior to the commencement of an audit; and
- involve key engagement team members and other appropriate specialists while establishing the overall audit strategy, which depends on the characteristics of the audit engagement.

#### 8. Develop the Audit Plan:

SA 300 deals with the auditor's responsibility to plan an audit of FS in an effective manner. It requires the involvement of all the key members of the engagement team while planning an audit.

#### 9. Audit Planning Memorandum

The auditor should summarise the audit plan by preparing an audit planning memorandum in order to:

- Describe the expected scope and extent of the audit procedures to be performed by the auditor.
- Highlight all significant issues and risks identified during their planning and risk assessment activities, as well as the decisions concerning reliance on controls.
- Provide evidence that they have planned the audit engagement appropriately and have responded to engagement risk, pervasive risks, specific risks, and other matters

### 10. Determine Audit Materiality

The auditor should consider the **relationship between the audit materiality and audit risk** when conducting an audit. The determination of audit materiality is a matter of **professional judgment and depends upon the knowledge of the bank, assessment of engagement risk and the reporting requirements** for the financial statements.

### 11. Consider Going Concern

The auditor should consider whether there are **events and conditions which may cast significant doubt on the bank's ability to continue as a going concern**.

### 12. Assess the Risk of Fraud including Money Laundering

The **attitude of professional skepticism** should be maintained by the auditor so as to recognise the possibility of misstatements due to fraud. The RBI has framed specific guidelines that deal with prevention of money laundering and "Know Your Customer (KYC)" norms. **RBI has from time to time issued guidelines, requiring banks to establish policies, procedures and controls to deter and to recognise and report money laundering activities.**

### 13. Assess Specific Risks

The auditors should identify and assess the ROMM at the FS level which refers to **risks that relate pervasively to the financial statements as a whole and potentially affect many assertions**

### 14. Risk Associated with Outsourcing of Activities

Outsourcing as a means of both reducing costs as well as making use of services of an expert not available internally. There are, however, a **number of risks associated with outsourcing of activities by banks and therefore, it is quintessential for the banks to effectively manage those risks.**

### 15. Response to the Assessed Risks

SA 330 requires the auditor to **design and implement overall responses to address the assessed risks of material misstatement** at the financial statement level. The auditor should **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

### 16. Stress Testing

Stress testing is a software testing activity that determines the **robustness of software by testing beyond the limits of normal operation**. Stress testing is particularly important for "mission critical" software, but is used for all types of software. RBI has required that all commercial banks **shall put in place a Board approved 'Stress Testing framework' to suit their individual requirements**

### 17. BASEL III framework

Basel norms or accords are the **International Banking regulations issued by the BCBS and the Financial Stability Board (FSB) has undertaken an extensive review of the regulatory framework in the wake of the sub-prime crisis**. The set of agreement by the BCBS, **which mainly focuses on risks to banks and the financial system are called Basel accord.**

### 18. Reliance on / review of other reports

The auditor should take into **account the adverse comments**, if any, on advances in the following

- Previous year's audit reports.
- Latest internal inspection reports of bank officials.
- Reserve Bank's latest inspection report.
- Concurrent / Internal audit report.
- Report on verification of security.
- Any other internal reports specially related to particular accounts.

**ADVANCES**

<b>MEANING</b>	Advances are amount of money or credit, given as a loan from a bank to another party with an agreement that the money will be repaid. All Bank Loans are made at interest which is a compensation for borrowing.
<b>WHAT ADVANCES DO COMPRISE</b>	<b>Advances comprise of funded amounts by way of:</b> <ul style="list-style-type: none"> <li>- Term loans, Cash credits, Overdrafts, Demand Loans</li> <li>- Bills Discounted and Purchased, Participation on Risk Sharing basis, Interest-bearing Staff Loans</li> </ul>
<b>TYPES OF ADVANCES</b>	<ul style="list-style-type: none"> <li>- <b>Funded loans</b> are those loans where there is an actual transfer of funds from the bank to the borrower.</li> <li>- <b>Non-funded facilities</b> are those which do not involve such transfer.</li> </ul>
<b>LEGAL REQUIREMENTS OF DISCLOSURE IN THE BALANCE SHEET</b>	<p>A.</p> <ul style="list-style-type: none"> <li>(i) Bills purchased and discounted</li> <li>(ii) Cash credits, Overdrafts and loans repayable on demand</li> <li>(iii) Term Loans</li> </ul> <p>B.</p> <ul style="list-style-type: none"> <li>(i) Secured by tangible assets</li> <li>(ii) Covered by Bank/Government guarantees</li> <li>(iii) Unsecured</li> </ul>

**Classification of Advances**

**Sector wise**

RBI issues common **guidelines for lending to Priority Sector** which banks are required to follow. These guidelines cover rate of interest; service charges, receipt, sanction, rejection, disbursement Register; issue of Loan Application Acknowledgement. Further, RBI also issues targets for banks for lending to Priority Sector [Examples of Priority Sectors are Agriculture, MSME, Education, Housing, etc.]

**Security wise**

Banks ask **Security or Collateral** while lending to assure that the Borrower will return the money to bank in prescribed time else the Banks have legal authority to sell the collateral

**NATURE OF SECURITY**

**Collateral security** is an additional security. Security can be in any form i.e. tangible or intangible asset, movable or immovable asset.

**Primary security** refers to the security offered by the borrower for bank finance or the one against which credit has been extended by the bank. This security is the **principal security for an advance**.

**EXAMPLE OF SECURITY**

Personal Security of Guarantor, Immovable Property, Third Party Guarantees

MODE OF CREATION OF SECURITY

MORTGAGE	<p>Mortgage are of several kinds but the most important are the <b>Registered Mortgage and the Equitable Mortgage</b>.</p> <ul style="list-style-type: none"> <li>• <b>Registered Mortgage</b> can be affected by a registered instrument called the '<b>Mortgage Deed</b>' signed by the mortgagor. It registers the property to the mortgagee as a security.</li> <li>• <b>Equitable mortgage</b>, on the other hand, is affected by a <b>mere delivery of title deeds or other documents</b> of title with intent to create security.</li> </ul>
PLEDGE	<p>A pledge involves</p> <ul style="list-style-type: none"> <li>• <b>bailment or delivery of goods</b> by the borrower to the lending bank</li> <li>• with the <b>intention of creating a charge</b> thereon as security for the advance.</li> <li>• The <b>legal ownership of the goods remains with the pledger</b> while the lending banker gets certain defined interests in the goods.</li> <li>• The pledge of goods <b>constitutes a specific (or fixed) charge</b>.</li> </ul>
HYPOTHECATION	<ul style="list-style-type: none"> <li>• The hypothecation is the <b>creation of an equitable charge</b>, which is created in favor of the lending bank by execution of hypothecation agreement in respect of the <b>moveable securities belonging to the borrower</b>.</li> <li>• <b>Neither ownership nor possession is transferred</b> to the bank.</li> <li>• However, the <b>borrower holds the physical possession of the goods</b> as an agent/trustee of the bank.</li> <li>• The borrower <b>periodically submits statements regarding quantity and value of hypothecated assets</b> (stocks, debtors, etc.) to the lending banker on the basis of which the drawing power of the borrower is fixed.</li> </ul>
ASSIGNMENT	<ul style="list-style-type: none"> <li>• Assignment represents a <b>transfer of an existing or future debt, right or property</b> belonging to a person in favor of another person.</li> <li>• <b>Only actionable claims</b> (i.e., claim to any debt other than a debt secured by a mortgage of immovable property or by hypothecation or pledge of moveable property) such as book debts and life insurance policies are accepted by banks as security by way of assignment.</li> <li>• An assignment gives the <b>assignee absolute right over the moneys/debts assigned to him</b>.</li> </ul>
SET - OFF	<ul style="list-style-type: none"> <li>• Set-off is a statutory right of a <b>creditor to adjust, wholly or partly, the debit balance in the debtor's account against any credit balance lying in another account of the debtor</b>.</li> <li>• The right of set-off enables a <b>bank to combine two accounts</b> (a deposit account and a loan account) of the same person provided both the accounts are in the <b>same name and same right</b> (i.e., the capacity of the account holder in both the accounts should be the same).</li> <li>• For the purpose of set-off, <b>all the branches of a bank are treated as one single entity</b>. The right of set-off can be exercised in respect of time-barred debts also.</li> </ul>
LIEN	<p>Lien is <b>creation of a legal charge with consent of the owner</b>, which gives lender a legal right to seize and dispose / liquidate the asset under lien.</p>



## PRUDENTIAL NORMS ON INCOME RECOGNITION, ASSET CLASSIFICATION AND PROVISIONING PERTAINING TO ADVANCES [IMPORTANT]

### 1. NON-PERFORMING ASSETS

- An asset becomes NPA when it ceases to generate income for the Bank.
- A non-performing asset (NPA) is a loan or an advance where -:
- interest and/ or instalment of principal remain overdue for a period of more than 90 days in respect of a term loan;
- the account remains 'out of order' in respect of an Overdraft/Cash Credit (OD/ CC);
- the bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted.
- Classification as NPA should be based on the record of recovery. Availability of security or net worth of borrower/guarantor is not to be taken into account for purpose of treating an advance as NPA or otherwise.
- Asset classification would be borrower-wise and not facility-wise. All facilities including investments in securities would be termed as NPA.
- Interest partly/fully realised in NPAs can be taken to income. However, it should be ensured that the credits towards interest in the relevant accounts are not out of fresh/additional credit facilities sanctioned to the borrowers concerned.

Categories of Non-Performing Assets	Provision required
<b>Substandard Assets</b> Which has remained NPA for a period less than or equal to 12 months.	15%
<b>Doubtful Assets</b> Which has remained in the substandard category for a period of 12 months. <b>Sub-categories</b> Doubtful up to 1 Year (D1) Doubtful 1 to 3 Years (D2) Doubtful more than 3 Years (D3)	(Secured + Unsecured) 25% + 100% 40% + 100% 100% + 100%
<b>Loss Assets</b> Where loss has been identified by the bank or internal or external auditors or the RBI inspection but the amount has not been written off wholly	100%

### 2. OUT OF ORDER

An account should be treated as 'out of order' if: -

- the outstanding balance remains continuously in excess of the sanctioned limit/drawing power or
- credits are there but are not enough to cover the interest debited during the same period, these accounts should be treated as 'out of order'.

- In cases where the outstanding balance in the principal operating account is less than the sanctioned limit/drawing power, but there are no credits continuously for 90 days as on the date of Balance Sheet; or

### 3. OVERDUE

Any amount due to the bank under any credit facility is 'overdue' if it is not paid on the due date fixed by the bank.

### 4. ACCOUNTS REGULARIZED NEAR THE BALANCE SHEET DATE

The auditor should check for sample transactions immediately before the closing of the Financial Year and immediately after the closing of the financial year to get a knowledge of the objective behind the transactions if they have any relation to each other in the Borrower accounts or if any/some transactions are being reversed during the first few days after closing which might show an arrangement to prevent the Borrower account(s) from slipping into the NPA category.

### 5. GOVERNMENT GUARANTEED ADVANCES

	ASSET CLASSIFICATION	INCOME RECOGNITION
Central Govt. guaranteed Advances	Until guarantee is not invoked/ repudiated would be classified as Standard Assets [Even if advance is due for more than 90 days]	NPA if advance is overdue for 90 days irrespective of guarantee
State Govt. guaranteed Advances	NPA if advance is overdue for 90 days irrespective of guarantee	NPA if advance is overdue for 90 days irrespective of guarantee

### 6. ADVANCES UNDER CONSORTIUM

- Consortium advances mean advancing loans to a borrower by two or more Banks jointly by forming a Consortium. Usually, a Bank with a higher share will lead.
- Consortium advances should be based on the record of recovery of the respective individual member banks and other aspects having a bearing on the recoverability of the advances.
- Where the remittances by the borrower under consortium lending arrangements are pooled with one bank and/or where the bank receiving remittances is not parting with the share of other member banks, the account should be treated as not serviced in the books of the other member banks and therefore, an NPA.
- The banks participating in the consortium, therefore, need to arrange to get their share of recovery transferred from the lead bank or to get an express consent from the lead bank for the transfer of their share of recovery, to ensure proper asset classification in their respective books.
- The Lead Bank would be responsible for computing the drawing power (DP) of the borrower and allocate the same to member banks.

### 7. ADVANCES AGAINST TERM DEPOSITS, NSCS, KVPS/ IVPS

Advances against Term Deposits, NSCs eligible for surrender, KVP/IVP and life policies need not be treated as NPAs, provided adequate margin is available in the accounts.

## 8. ACCOUNTS WHERE THERE IS EROSION IN THE VALUE OF SECURITY / FRAUDS COMMITTED BY BORROWERS

Erosion means the gradual destruction or diminution of something not prudent to follow stages of asset classification.: -

Erosion is considered when	Effect
The realisable value of the security < 50% of the value assessed by the bank or accepted by RBI at the time of last inspection	Such NPAs may be straight-away classified under doubtful category and provisioning should be made as applicable to doubtful assets.
The realisable value of the security < 10% of the value assessed by the bank or accepted by RBI at the time of last inspection	The existence of security should be ignored and the asset should be straight-away classified as loss asset. It may be either written off or fully provided for by the bank.

## 9. ADVANCES TO STAFF

In the case of housing loan or similar advances granted to staff members where interest is payable after recovery of principal, interest need not be considered as overdue from the first quarter onwards.

Such loans/advances should be classified as NPA only when there is a default in repayment of instalment of principal or payment of interest on the respective due dates. The staff advances by a bank as an employer and not as a banker are required to be included under the sub-head 'Others' under the schedule of Other Assets.

## 10. AGRICULTURAL ADVANCES

As per the guidelines, Agricultural Advances are of two types:

- (1) Agricultural Advances for "long duration" crops; and
- (2) Agricultural Advances for "short duration" crops.

The "long duration" crops would be -- → crops with crop season longer than one year and crops, which are not "long duration" crops would be treated as "short duration" crops.

The following NPA norms would apply to agricultural advances:

Short duration crops	Will be treated as NPA, if the instalment of principal or interest thereon remains overdue for two crop seasons
Long duration crops	Will be treated as NPA, if the instalment of principal or interest thereon remains overdue for one crop seasons

Master Circular issued by the RBI deals elaborately with the classification and income recognition issues due to impairment caused by natural calamities. Banks may decide on their own relief measures, viz.,

- conversion of the short-term production loan into a term loan or
- re-schedulement of the repayment period and
- the sanctioning of fresh short-term loan

In such cases, the NPA classification would be governed by such rescheduled terms.

## COMPUTATION OF DRAWING POWER



<b>MEANING</b>	Drawing power is the <b>limit up to which a firm or company can withdraw from the working capital limit sanctioned.</b>
<b>DIFFERENT FROM SANCTIONED LIMIT</b>	<p>The <b>Sanctioned limit</b> is the <b>total exposure</b> that a bank can take on a particular client for facilities like cash credit, overdraft, export packing credit, non-funded exposures etc.</p> <p>On the other hand, <b>Drawing Power</b> refers to the amount calculated <b>based on primary security less margin</b> as on a particular date.</p>
<b>CONSIDERATIONS</b>	<p>All accounts should be kept <b>within both the drawing power and the sanctioned limit at all times.</b></p> <p>The accounts which <b>exceed the sanctioned limit or drawing power or are against unapproved securities</b> or are otherwise irregular should be brought to the notice of the <b>Management/Head Office</b> regularly.</p>
<b>BANK'S DUTIES</b>	<p>Drawing power is required to be arrived at <b>based on current stock statement.</b> However, considering the difficulties of large borrowers, <b>stock statements</b> relied upon by the banks for determining drawing power should <b>not be older than three months.</b></p> <p>The <b>outstanding</b> in the account based on drawing power calculated from <b>stock statements older than three months is deemed as irregular.</b></p>
<b>AUDITOR'S CONCERN</b>	<p>The <b>stock statements, quarterly returns and other statements</b> submitted by the borrower to the bank should be scrutinized in detail.</p> <p>The <b>Audited Annual Report</b> submitted by the borrower should be <b>scrutinized properly.</b></p> <p>The monthly stock statement of the month for which the audited accounts are <b>prepared and submitted</b> should be compared and the <b>reasons for deviations</b>, if any, should be ascertained.</p>
<b>COMPUTATION OF DP</b>	<p>It needs to be ensured that the <b>drawing power is calculated as per the extant guidelines</b> formulated by the <b>BOD of the respective bank and agreed upon by the concerned statutory auditors.</b></p> <p>Special consideration should be given to <b>proper reporting of sundry creditors</b> for the purposes of calculating drawing power</p>
<b>STOCK AUDIT</b>	<p>The stock audit should be carried out by the bank for all accounts having <b>funded exposure of more than 5 crores.</b></p> <p>Auditors can also advise for stock audit in other cases if <b>the situation warrants the same.</b></p> <p>The <b>report submitted by the stock auditors</b> should be reviewed and special focus should be given to the comments made by the stock auditors on valuation of security and calculation of drawing power.</p>

### DRAWING POWER CALCULATION

<b>Stocks</b> Stocks at realizable value Less: Unpaid stocks: - Sundry creditors - Acceptances/LCs etc. Paid for stocks Margin @ 25%		
<b>Debtors</b> Total Debtors Less: Ineligible debtors Eligible debtors Margin @ 40%		
<b>Total DP</b>		

### AUDIT OF ADVANCES



(a)	Amounts included in balance sheet in respect of advances which are <b>outstanding</b> at the date of the balance sheet.
(b)	Advances <b>represent amount</b> due to the bank.
(c)	Amounts due to the bank are <b>appropriately supported by loan documents and other documents</b> as applicable to the nature of advances.
(d)	There are <b>no unrecorded advances</b> .
(e)	The stated <b>basis of valuation of advances</b> is <b>appropriate</b> and properly applied and the recoverability of advances is recognised in their valuation.
(f)	The advances are <b>disclosed, classified and described in accordance with recognised accounting policies</b> and practices and relevant statutory and regulatory requirements.
(g)	Appropriate provisions towards advances have been made as <b>per the RBI norms, Accounting Standards and generally accepted accounting practices</b> .
(h)	In carrying out his <b>substantive procedures</b> , the auditor should <b>examine all large advances and advances with problem accounts</b> while other advances may be examined on a sampling basis.
(i)	<b>Advances which are sanctioned during the year or which are adversely commented by RBI inspection team, concurrent auditors, bank's internal inspection, etc.</b> should generally be included in the auditor's review

The auditor can obtain **sufficient appropriate audit evidence about advances** by study and evaluation of internal controls relating to advances, and by:

- examining the **validity of the recorded amounts**;
- examining **loan documentation**;
- **reviewing the operation** of the accounts;
- examining the **existence, enforceability and valuation** of the security;
- checking **compliance with RBI norms** including appropriate classification and provisioning; and
- carrying out **appropriate analytical procedures**



## EVALUATION OF INTERNAL CONTROLS OVER ADVANCES

- The bank should make an advance only after satisfying itself as to the **credit worthiness of the borrower** and after obtaining sanction from the appropriate authorities of the bank.
- **All the necessary documents** (e.g., agreements, demand promissory notes, letters of hypothecation, etc.) **should be executed** by the parties before advances are made.
- The compliance with the **terms of sanction and end use of funds** should be ensured.
- **Sufficient margin as specified in the sanction letter should be kept against securities** taken so as to cover for any decline in the value thereof.
- If the **securities are taken**, the **ownership of the same should be transferred in the name of the bank** and the effective control of such securities be retained as a part of documentation.
- All **securities requiring registration should be registered in the name of the bank** or otherwise accompanied by documents sufficient to give title to the bank.
- In the case of goods in the possession of the bank, **contents of the packages should be test checked at the time of receipt.**
- **Drawing Power Register should be updated every month** to record the value of securities hypothecated. These entries should be checked by an officer.
- The accounts **should be kept within both the drawing power and the sanctioned limit.** All the accounts which exceed the sanctioned limit or drawing power or are otherwise irregular and should be brought to the notice of the controlling authority.
- The operation of **each advance account should be reviewed at least once a year** and at more frequent intervals in the case of large advances

## AUDIT OF REVENUE ITEMS - PROFIT AND LOSS ACCOUNT

### INCOME

#### Examples -

Interest Income on Investments, Interest on Balances with RBI and Other Inter-bank Funds, Commission on bills for collection, Commission on letters of credit and guarantees, letter of comforts, Loan processing, arranger and syndication fees, Rent from letting out of lockers, Profit/loss on sale of investments

#### AUDIT APPROACH AND PROCEDURES

<b>Auditor's Concern</b>	<p>The auditor should obtain reasonable assurance that the recorded income arose from transactions,</p> <ul style="list-style-type: none"> <li>- which took place during the relevant period and</li> <li>- pertained to the bank,</li> <li>- there is no unrecorded income and</li> <li>- the income is recorded at appropriate amount</li> </ul>
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<b>RBI's Directions</b>	RBI has advised that in respect of any income which exceeds 1% of the total income of the bank if the income is reckoned on a gross basis or 1% of the net profit before taxes if the income is reckoned net of costs, should be considered on accrual as per AS 9
<b>Materiality</b>	If any item of income is not considered to be material as per the above norms, it may be recognised when received
<b>Revenue Certainty</b>	Banks recognise income (such as interest, fees and commission) on accrual basis, i.e., as it is earned. It is an essential condition for accrual of income that it should not be unreasonable to expect its ultimate collection.
<b>Revenue Uncertainty</b>	In view of the significant uncertainty regarding ultimate collection of income arising in respect of NPA, the guidelines require that banks should not recognize income on nonperforming assets until it is actually realised. When a credit facility is classified as non-performing for the first time, interest accrued and credited to the income account in the corresponding previous year which has not been realized should be reversed or provided for.
<b>Advances against Securities</b>	Interest on advances against Term Deposits, National Savings Certificates (NSCs), Indira Vikas Patras (IVPs), Kisan Vikas Patras (KVPs) and Life policies may be taken to income account on the due date, provided adequate margin is available.
<b>Bills Purchased</b>	In the case of bills purchased outstanding at the close of the year the discount received thereon should be properly apportioned between the two years. [The Unexpired discount/ rebate on bills discounted i.e., where part of receipt comprising discount charges on bills purchased relate to the period beyond the year-end, should be recorded as "Other Liabilities"]. Interest (discount) component paid by Bank/Branch on rediscount of bills from other financial institutions, is not to be netted off from the discount earned on bills discounted.
<b>Bills for Collection</b>	In the case of bills for collection, the auditor should also examine the procedure for crediting the party on whose behalf the bill has been collected. The procedure is usually such that the customer's account is credited only after the bill has actually been collected from the drawee either by the bank itself or through its agents, etc. The commission of the branch becomes due only when the bill has been collected.
<b>Renegotiations</b>	Fees and commissions earned by the banks as a result of re-negotiations or rescheduling of outstanding debts should be recognised on an accrual basis over the period of time covered by extension of credit. Test check the interest earned by the banks for the sample selected. Test check the fees and commissions earned by the banks made for commission on bills for collection, letters of credit and bank guarantees.

- Reversal of Income:**

(a) If any advance, including bills purchased and discounted, becomes NPA as at the close of any year, the entire interest accrued and credited to income account in the past periods, should be reversed or provided for if the same is not realised. This will apply to

Government guaranteed accounts also. Further, **income that have accrued should cease to accrue** in the current period

(c) Further, in case of **banks which have wrongly recognised income in the past should reverse the interest if it was recognised as income** during the current year or make a provision for an equivalent amount if it was recognized as income in the previous year(s).

(d) Furthermore, the auditor should enquire **if there are any large debits in the Interest Income account that have not been explained.**

(e) The **component of finance income** on the leased asset which was accrued and credited to the income account before the asset became non-performing and remaining unrealised, **should be reversed or provided for in the current accounting period**

(f) On an account turning NPA, banks should reverse the interest already charged however, **banks may continue to record such accrued interest in a Memorandum account in their books** for control purposes.

#### • Income from Investments

Interest Income on Investments	This includes all <b>income derived from Government securities, bonds and debentures of corporates and other investments</b> by way of interest and dividend, except income earned by way of dividends, etc., from subsidiaries and JV abroad/in India. Broken period interest paid on securities purchased is net off from the interest income on investments.
Profit on Sale of Investments	The net <b>profit or loss on sale of investments</b> is taken to profit and loss account
Profit/Loss on Revaluation of Investments	RBI, investments are to be valued at periodical intervals and <b>depreciation or appreciation in valuation should be recognised</b> and taken to P&L

#### EXPENSES

**Example** - Interest on Deposits, Payments to and Provisions for Employees, Provisions made in respect of the NPA, Interest on RBI/Inter-Bank Borrowings, Rent, Taxes and Lighting, Printing and Stationery, Provisions for Taxation, Advertisement

<b>Audit interest expense</b>	<b>of</b>	<ul style="list-style-type: none"> <li>- Analysis of <b>various types of deposits outstanding</b> at the end of each quarter and work out a <b>weighted average interest rate</b>. Also, compare this <b>average rate with actual rate</b> and enquire into the difference, if material.</li> <li>- Compare the <b>average rate of interest</b> paid on the relevant deposits with the <b>corresponding figures for the previous years</b> and analyse any material differences.</li> <li>- Obtain <b>general ledger break-up</b> for the interest expense incurred on deposits (savings and term deposits) and borrowing each month/quarter. Also check whether <b>interest expense considered in the cost analysis agrees with the general ledger</b></li> </ul>
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	<ul style="list-style-type: none"> <li>- Analyse month on month (or quarter on quarter) cost analysis and document the reasons for the variances as per the benchmark stated</li> <li>- <b>Interest has been accrued on the entire borrowing portfolio</b> and the same should agree with the general ledgers</li> <li>- Ensure that <b>recomputed amount is tallying</b> with the amount as per books of accounts</li> <li>- <b>On test check basis</b></li> <li>• Interest has been <b>provided on all deposits</b> up to the date of the balance sheet;</li> <li>• Interest rates are in <b>accordance with the bank's internal regulations, the RBI directives and agreements</b> with the respective deposit holder;</li> <li>• Interest on savings accounts are in <b>accordance with the rules framed by the bank/RBI in this behalf.</b></li> <li>• <b>Interest on inter-branch balances</b> has been provided at the rates prescribed by the head office/RBI.</li> </ul>
<b>Audit of operating expenses</b>	<ul style="list-style-type: none"> <li>- study and evaluate the <b>system of internal control</b> relating to expenses</li> <li>- examine any <b>divergent trends</b> in respect of major items of expenses</li> <li>- perform <b>substantive analytical procedures</b> w.r.t expenses</li> <li>- verify expenses with reference to <b>supporting documents</b></li> </ul>
<b>Audit of provisions and contingencies</b>	<ul style="list-style-type: none"> <li>- ensure that the <b>compliances for various regulatory requirements</b> for provisioning have been fulfilled.</li> <li>- obtain an understanding as to how the <b>bank computes provision on standard assets</b> and non-performing assets</li> <li>- obtain the <b>detailed break up</b> of standard loans, non-performing loans and agree the outstanding balances with the general ledger.</li> <li>- obtain the <b>tax provision computation</b> from the bank's management and verify nature of items debited or credited.</li> </ul>

## AUDITORS REPORT

In the case of a nationalised bank, the auditor is required to make a report to the CG in which he has to state the following:

(a) whether, in his opinion, the **FS present a true and fair view of the affairs of the bank** and in case he had called for any **explanation or information**, whether it has been given and whether it is satisfactory;

(b) **whether or not the transactions of the bank**, which have come to his notice, have been **made within the powers of that bank**;

(c) whether or not the **returns received from the offices and branches of the bank have been found adequate** for the purpose of his audit; and

(d) **any other matter which he considers should be brought to the notice of the CG.**

The report of auditors of **State Bank of India** is also to be made to the **CG** and is almost identical to the auditor's report in the case of a nationalised bank.

### FORMAT OF REPORT

- The auditors, central as well as branch, should also ensure that the audit report issued by them **complies with the requirements of SA**
- The auditor should ensure that not only **information relating to number of unaudited branches is given but quantification of advances, deposits, interest income and interest expense for such unaudited branches has also been disclosed in the audit report.**
- In addition to the aforesaid, the auditor of a banking company is also required to state in his report the matters covered by Section 143 of the Companies Act, 2013.

### Long Form Audit Report

- Besides the audit report as per the statutory requirements the auditor is also required to furnish a **long form audit report (LFAR)**. The matters which the banks require their auditors to deal with in the long form audit report have been specified by the **RBI**.
- The Statutory Central Auditors are required to submit the LFAR to the banks latest by **30th June every year**. While the format of LFAR does not require an executive summary to be given, **members may consider providing the same to bring out the key observations from the whole document.**

### Reporting to RBI

- As per the **circular relating to implementation of recommendations of Committee on Legal Aspects of Bank Frauds** applicable to all scheduled commercial banks, the member shall be required to report the kind of matters stated in the circular to RBI.
- Auditor should also consider the provisions of **SA 250, "Consideration of Laws and Regulations in an Audit of FSs"**.
- **SA 240, "The Auditor's Responsibilities Relating to Fraud in an Audit of FS"** states that an auditor conducting an audit in accordance with SAs is responsible for obtaining reasonable assurance that the FS taken as a whole are free from material misstatement, whether caused by fraud or error.

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

- Report on **adequacy and operating effectiveness of Internal Controls over Financial Reporting** in case of banking companies
- **Long Form Audit Report. (LFAR)**
- Report on compliance with **SLR requirements**.
- Report on **whether the treasury operations of the bank have been conducted** in accordance with the instructions issued by the RBI
- Report on whether the **income recognition, asset classification and provisioning** have been made as per the guidelines issued by the RBI from time to time.
- Report on **whether any serious irregularity was noticed** in the working of the bank which requires immediate attention.
- Report on status of the compliance by the bank with regard to the implementation of recommendations of the **Ghosh Committee** relating to frauds and malpractices and of the recommendations of **Jilani Committee** on internal control and inspection/credit system.
- Report on instances of **adverse credit-deposit ratio** in the rural areas.





**CA ISHA AGARWAL**