Summary of Engagement and Quality Control Standards

Introduction

- In 1955, the Council set up the Research Committee.
- In 1964, the Council published the "Statement on Auditing Practices" as prepared by the Research Committee.
  1) Statements on Qualifications in Auditor's Report
  2) Statement on MAOCARO
  3) Statement on Responsibilities of Joint Auditors
  4) Statement on Payments to Auditors for Other Services
- IFAC set up in 1977 to bring harmony in profession of accountancy.
- IFAC established the IAASB.
- ICAI is member of IFAC
- ICAI constituted the APC in 1982.
- In July, 2002, the APC has been converted into an AASB by the Council of the Institute.
- AASB of ICAI develops Statements on AAS & Guidance Notes. They are issued under authority of Council of ICAI.
- In 2007, the AAS are renamed it to **Engagement Standards**, viz.,
  a) SAs - Audit of historical financial information
  b) SREs - Review of historical financial information
  c) SAEs - Audit of assurance engagements other than historical financial information
  d) SRSs - Engagements to apply agreed upon procedures & other related services engagements such as compilation engagements.

Bifurcation of Numbers of Engagement and Quality Control Standards:

1 – 99	Standards on Quality Control (SQC)
100 – 899	Standards on Auditing
2000 – 2699	Standards on Review Engagements
3000 – 3699	Standards on Assurance Engagements
4000 – 4699	Standards on Related Services

Bifurcation of Numbers of Standards on Auditing:

100-199 Introductory Matters

200-299 General Principles and Responsibilities

300 – 499 Risk Assessment and Response to Assessed Risks

500 – 599 Audit Evidence

600 – 699 Using Work of Others

700 – 799 Audit Conclusions and Reporting

800 – 899 Specialized Areas

Various Things issued by ICAI

- **Statements** - Issued with a view to securing compliance by members on matters which in the opinion of the council of the institute are critical for the proper discharge of their functions. They are mandatory. With the introduction of standards, statements are no longer valid for that topic.
- **General Clarifications** – Issued by the Board under the authority of the council of institute with a view to clarify any issues arising from standards. They are mandatory.
- **Guidance Notes** – Issued to assist professional accountants in implementing the Engagement Standards & the Standards on Quality Control issued by the AASB under the authority of the Council. They are for guidance not compulsory.
- **Technical Guides** are ordinarily aimed at imparting broad knowledge about a particular aspect or of an industry to the professional accountants.
- **Practice Manuals** are aimed at providing additional guidance to professional accountants in performing audit & other related assignments.
- **Studies & other papers** are aimed at promoting discussion or debate or creating awareness on issues relating to quality control, auditing, assurance & related service, affecting the profession.
- Technical Guides, Practice Manuals and Other Papers are issued by AASB directly.

Procedure for Issuing SAs

- AASB determines the broad areas in which the SAs need to be formulated.
- AASB is assisted by Study Groups
- Study Groups prepares an exposure draft of the proposed SA and issued for comments by members of the Institute.
- Based on comments received, the SA is finalised by the AASB and submitted to the Council of the Institute.
- SA is then issued under authority of Council.

SA 200 - Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with SAs

Introduction & Objective

An audit is the 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.

Objectives of the Auditor:

- **a)** To obtain **reasonable assurance** about whether the FS 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 FS are prepared in accordance with an **AFRF**; and
- **b)** To report on the FS, and communicate as required by the SAs, in accordance with the auditor's findings.

Responsibility of FS, Scope of Audit and Auditor's Req.

Responsibility for preparation of FS is of Mgmt.

The **scope of an audit will be determined** by:

- **a)** The terms of the engagement,
- **b)** The requirements of relevant legislation,
- **c)** The pronouncements of the Institute and
- **d)** The legal judgements given by various courts of law.

The terms of engagement cannot restrict the scope prescribed by legislation or by pronouncements of the Institute.

Auditor's Requirements:

1) Ethical Requirements Relating to an Audit of Financial Statements
2) Professional Skepticism
3) Professional Judgment
4) Sufficient Appropriate Audit Evidence and Audit Risk.

Ethical Requirements & Professional Skepticism

Ethical requirements comprise of **Code of Ethics** issued by ICAI.

- **a)** Integrity;
- **b)** Objectivity;
- **c)** Professional competence and due care;
- **d)** Confidentiality; and
- **e)** Professional behavior
- **f)** Independence.

Professional skepticism is an attitude of auditor where is **alert to**:

- **a)** Contradictory audit evidence.
- **b)** Information - question reliability of document
- **c)** Possible fraud.

It reduces risk of:

- **a)** Overlooking unusual circumstances.
- **b)** Over generalising.
- **c)** Using inappropriate assumptions in determining NTE and evaluating results.

It is necessary to critical assessment of evidence.

A belief that management are honest – does not relieve from being Skeptical.

Professional Judgement

An auditor is required to make professional judgment for decisions about:

- **a)** Materiality and audit risk.
- **b)** The NTE of audit procedures required.
- **c)** Evaluating whether sufficient appropriate audit evidence has been obtained
- **d)** Drawing conclusions based on evidence.

SA 200 - Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with SAs

Sufficient Appropriate Audit Evidence and Audit Risk

- To obtain reasonable assurance, the auditor shall obtain **sufficient appropriate** audit evidence to reduce audit risk to an acceptably low level.
- "Audit risk" is the risk that auditor gives inappropriate audit opinion when FS are materially misstated.
  - **a)** Inherent risk
  - **b)** Control risk
  - **c)** Detection risk
- An **auditor cannot obtain absolute assurance** because of inherent limitations of an audit. These are:
  - **a)** The Nature of Financial Reporting – involves judgment,
  - **b)** The Nature of Audit Procedures – NOT designed to catch carefully designed frauds,
  - **c)** Timeliness of Financial Reporting and the Balance between Benefit and Cost and
  - **d)** Other Matters – non-compliance of laws and regulations, existence and completeness of related party transactions difficult to understand.
- **The auditor should obtain sufficient appropriate audit evidence through the performance of compliance and substantive procedures**.

  Compliance procedures are tests designed to obtain reasonable assurance that those internal controls on which audit reliance is to be placed are in effect.

  Substantive procedures are designed to obtain evidence as to the completeness, accuracy and validity of the data produced by the accounting system.

  They are of two types:
  - **a)** Tests of details of transactions and balances;
  - **b)** Analytical Procedures

Conduct of an Audit in Accordance with SAs

Complying with SAs Relevant to the Audit

The auditor shall comply with all SAs relevant to the audit.

Objectives Stated in Individual SAs

To achieve the overall objectives of the auditor, the auditor shall use the objectives stated in relevant SAs in planning and performing the audit

Complying with Relevant Requirements

The auditor shall comply with each requirement of an SA unless, in the circumstances of the audit:

- **a)** The entire SA is not relevant; or
- **b)** The requirement is not relevant because it is conditional and the condition does not exist.

In exceptional circumstances, the auditor may judge it necessary to depart from a relevant requirement in an SA. In such circumstances, the auditor shall perform alternative audit procedures to achieve the aim of that requirement.

Failure to Achieve an Objective

Modify the auditor’s opinion or withdraw from the engagement.

SA 210 - Agreeing the Terms of Audit Engagement

Introduction

The auditor and the client should agree on the terms of the engagement.

The agreed terms would need to be recorded in an audit engagement letter.

Preconditions for an Audit

1) Use by management of an AFRF in the preparation of the FS; and
2) Agreement of management and, where appropriate, TCWG to the premise (basis) on which an audit is conducted.

Limitation on Scope Prior to Audit Engagement Acceptance:

Auditor believes the limitation will result in the auditor disclaiming an opinion, then he shall not accept such an engagement

Audit Engagement Letter

Letter written by the auditor to his client.

Principal Contents:

a) The objective and scope of the audit;
b) The responsibilities of the auditor;
c) The responsibilities of management;
d) Identification of AFRF for the preparation of FS; and
e) Reference to the expected form and content of any reports to be issued by the auditor.

Additional Matters can be added.

If law or regulation prescribes in sufficient detail the terms of the audit engagement, the auditor need not record them in a written agreement, except for the fact that such law or regulation applies

Management Request for Change in Engagement

- If providing lower level of assurance, then consider the appropriateness of reason.
- Where the terms of the engagement are changed, the auditor and the client should agree on the new terms.
- Before agreeing to change, an auditor would consider any legal or contractual implications of the change.
- The report would **not** include reference to the original engagement.
- If the auditor is unable to agree to a change of the engagement and is not permitted to continue the original engagement, the auditor shall **withdraw from the audit engagement.**

SA 220 - Quality Control for Audit Work

Introduction

Quality control systems, policies and procedures are the responsibility of the audit firm.

Objective:

To provide the auditor with reasonable assurance that:

a) **The audit complies with professional standards and regulatory and legal requirements; and**
b) **The auditor's report issued is appropriate in the circumstances.**

Definitions

a) **Engagement partner**: the partner or other person in the firm who is a member of ICAI and is in full time practice and is responsible for the engagement and its performance, and for the report that is issued on behalf of the firm.
b) **Engagement quality control review (EQCR)**: a process designed to provide an objective evaluation, before the report is issued, of the significant judgments the engagement team made and the conclusions they reached in formulating the report.

Requirements

Leadership Responsibilities for Quality on Audits

Relevant Ethical Requirements

Independence

Acceptance and Continuance of Client Relationships and Audit Engagements

Assignment of Engagement Teams

Engagement Performance

1) Direction, Supervision and Performance
2) Reviews
3) Consultation
4) Engagement Quality Control Review

Monitoring

Engagement Quality Control Review

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

a) Determine that an EQCRer has been appointed;
b) Discuss significant matters arising during the audit engagement with the EQCRer; and
c) Not date the auditor's report until the completion of the EQCR.

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

For listed entities EQCRer shall also evaluate:

Independence

Consultation

Documentation proves the conclusion

SA 230 - Documentation

Nature and Purposes

Documentation means the record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached.

Audit documentation provides:

a) Evidence of the auditor's basis for a conclusion about the achievement of the overall objectives of the auditor; and

b) Evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements.

Additional purposes:

- Assisting the engagement team to plan and perform the audit.
- Enabling the engagement team to be accountable for its work.
- Retaining a record of matters of continuing significance to future audits.
- Enabling the conduct of external inspections.

Documentation of the Audit Procedures Performed and Audit Evidence Obtained

Form, Content and Extent of Audit Documentation

- Such that an experienced auditor, having no connection with audit, is able to understand:
  - **a)** The NTE of the audit procedures performed;
  - **b)** The results of the audit procedures performed, and the audit evidence obtained; and
  - **c)** Significant matters arising during the audit, the conclusions reached thereon.
- The **form and content of working papers are affected by**:
  - **a)** The nature of engagement.
  - **b)** The form of auditor's report.
  - **c)** The nature and complexity of the client's business.
  - **d)** The nature and condition of the client's records and degree of reliance on internal controls.
  - **e)** The needs in particular circumstances for direction, supervision and review of work performed by assistants.
- Also record:
  - **a)** Who **performed** the audit work and it's date; and
  - **b)** Who **reviewed** the audit work and it's the date.
  - **c)** Departure from Requirements from SA.

Other Points

Working papers are prepared at each and every stage of audit.

Classification of Working Papers

1) Permanent audit file
2) Current audit file

Assembly of the Final Audit File:

Within 60 days (SQC-1) after the date of the auditor's report.

Auditor should preserve these working papers for seven years from the date of Auditors Report (SQC-1)

Ownership & Custody:

Ownership and Custody of working papers rests with the auditor. However, auditor should not disclose the confidential information of client to any other person unless it is Permitted by client; or Required by law or statute.

Working papers are the property of the auditor. The auditor may, at his discretion, make portions of or extracts from his working papers available to his client.

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

Fraud & Error and it's Responsibility

Error refers to an unintentional misstatement in FS.

Fraud refers to an intentional act by one or more individuals among management, TCWG, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage.

The distinguishing factor between fraud and error is whether the underlying action is intentional or unintentional.

Responsibility for detection of Frauds & Errors:

- The primary responsibility for the prevention & detection of frauds & errors rests with
  - **a)** Those charged with governance; and
  - **b)** The management of an entity.
- The responsibility of the management includes implementing & ensuring the continued operation of accounting and internal control systems, which are designed to prevent and detect frauds and errors.

Objectives & Responsibility of Auditor

a) To identify and assess the risks of material misstatement in FS due to fraud;

b) To obtain sufficient appropriate audit evidence about the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and

c) To respond appropriately to identified or suspected fraud.

Responsibility of Auditor

- To obtaining reasonable assurance that FS taken as a whole are free from material misstatement, whether caused by fraud or error.
- Due to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of FS may not be detected.
- Risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting one resulting from error.
- The auditor is responsible for maintaining professional skepticism throughout the audit.

Requirements

1) Professional Skepticism

2) Discussion Among the Engagement Team

3) Risk Assessment Procedures and Related Activities
- **a)** Inquiry with Management and Others within the Entity
- **b)** Inquiry with TCWG
- **c)** Unusual or Unexpected Relationships Identified
- **d)** Other Information
- **e)** Evaluation of Fraud Risk Factors

4) Identification and Assessment of the Risks of Material Misstatement Due to Fraud.

5) Responses to the Assessed Risks of Material Misstatement:
- **a)** Overall Responses
- **b)** Audit Procedures Responsive to Risk at the Assertion Level
- **c)** Audit Procedures Responsive to Risks of Management Override of Controls

6) Evaluation of Audit Evidence

7) Auditor Unable to Continue the Engagement

8) Management Representations

9) Communications to Management and with TCWG

10) Communications to Regulatory and Enforcement Authorities

11) Documentation

SA 250 - Consideration of Laws and Regulations in an Audit of Financial Statements

Introduction

The management is required to consider the requirements of various laws and regulations in preparation and presentation of FS. For example, Companies Act, Income Tax Act, Excise Act, Customs Act, Banking Act etc.

An audit cannot be expected to detect non-compliance with **<u>all</u>** laws and regulations.

Indications that Non-compliance may have Occurred:

- Investigation by government departments or payment of fines or penalties.
- Payments for unspecified services to consultants, related parties or government employees.
- Purchases at prices significantly above or below market price.
- Unusual payments in cash and other unusual transactions.
- Unusual transactions with companies registered in tax havens (tax free countries like Dubai, Singapore, Mauritius etc.).
- Unauthorised transactions or improperly recorded transactions.

Responsibility of Management

- The responsibility for the prevention and detection of non-compliance rests with management.
- The following policies and procedures may help the management in prevention and detection of non compliance with laws and regulations:
  a) Monitoring legal requirements.
  b) Proper training and understanding of laws and regulations to employees
  c) Taking timely and appropriate action with defaulting employees.
  d) Establishing appropriate systems of internal controls.
  e) Establishing a legal department.

Responsibility of the Auditor

The auditor is responsible for obtaining reasonable assurance.

In conducting an audit of FS, the auditor takes into account the applicable legal and regulatory framework.

Under this SA, auditor shall:

a) obtain **sufficient appropriate audit evidence regarding compliance** with the provisions of those laws and regulations which has **direct effect** on the determination of amounts and disclosures in FS;

b) Perform **specified audit procedures** to help identify instances of non-compliance with **other laws and regulations** that may have material effect on FS. Specified Audit Procedures include Inquiries with Management and Inspecting correspondence with regulatory authorities.

Procedures when Non-compliance is Discovered:

Obtain an understanding of the nature of the act and the circumstances in which it has occurred, and sufficient other information to evaluate the possible effect on FS.

Withdrawal from the Engagement:

May withdraw, when the entity does not take the remedial action that the auditor considers necessary, **even when the non-compliance is not material to FS.**

SA 260 (Revised) - Communication of Audit Matters with those Charged with Governance

Introduction & Objective

The auditor should communicate audit matters of governance interest arising from the audit of FS with TCWG of an entity.

Those charged with governance: The person with responsibility for overseeing the strategic direction of the entity (generally, top level management).

Management – The person(s) with executive responsibility for the conduct of the entity's operations (generally, middle & lower level management).

Objective

a) 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) Obtain from TCWG information relevant to the audit;

c) Provide TCWG with timely observations arising from the audit that are significant; and

d) Promote effective two-way communication between the auditor and TCWG.

Relevant Persons and Matters

The auditor shall determine the appropriate person(s) within the entity's governance structure with whom to communicate.

a) Communication with a Subgroup of TCWG

b) When All of TCWG are Involved in Managing the Entity (no need to communicate again if already communicated to them as management)

Audit Matters of Governance Interest to be Communicated:

a) The Auditor's Responsibilities in Relation to the Financial Statement Audit

b) Planned Scope and Timing of the Audit

c) Significant Findings from the Audit

d) Auditor Independence

Forms of Communication

- The auditor shall communicate in writing with TCWG regarding:
  - **a)** significant findings from the audit
  - **b)** auditor independence
- Where matters are communicated orally, the auditor shall document them. Where matters have been communicated in writing, the auditor shall retain a copy.
- The auditor should communicate to TCWG **on a timely basis.** This enables TCWG to take appropriate action.
- To avoid misunderstandings, an audit engagement letter may:
  - **a)** Describe the form;
  - **b)** Identify the relevant persons with whom such communications will be made;
  - **c)** Identify any specific audit matters of governance interest which is to be communicated.
- Communication between the auditor and TCWG **cannot be regarded as a substitute for such qualified, adverse or disclaimer of opinion.**

SA 265 - Communicating Deficiencies in Internal Control to TCWG and Management

Introduction

The auditor should communicate appropriately to TCWG and management, deficiencies in internal control that the auditor has identified during the audit.

This SA does not impose additional responsibilities on the auditor regarding obtaining an understanding of internal control and designing and performing tests of controls over and above the requirements of SA 315 and SA 330.

Deficiency in internal control:

This exists when:

(i) A control is designed, implemented or operated in such a way that it **is unable** to prevent, or detect and correct, misstatements in the financial statements on a timely basis; or

(ii) A control necessary to prevent, or detect and correct, misstatements in the financial statements on a timely basis **is missing**.

Significant deficiency in internal control

Significant deficiency is a deficiency or combination of deficiencies in internal control that, in the auditor's professional judgment, is **of sufficient importance to merit the attention of TCWG.**

Indicators of Significant Deficiencies:

1) Evidence of ineffective aspects of the control environment, such as management interested transactions are not being appropriately scrutinised.

2) Absence of a risk assessment process within the entity.

3) Evidence of an ineffective response to identified significant risks (e.g., absence of controls over such a risk).

4) Misstatements detected by the auditor's procedures that were not prevented, or detected and corrected, by the entity's internal control.

5) Disclosure of a material misstatement due to error or fraud as prior period items.

Requirements

- If the auditor has identified one or more deficiencies in internal control, the auditor shall determine, whether, individually or in combination, they constitute significant deficiencies.
- The auditor shall communicate **in writing significant deficiencies** in internal control identified during the audit to TCWG on a timely basis.
- 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 those charged with governance and management to understand the context of the communication.
  - **c)** In explaining the potential effects of the significant deficiencies, **the auditor need not quantify those effects.** He may include suggestions for remedial action.

SA 299 (Revised) - Responsibility of Joint Auditors

Introduction

Joint audit refers to audit of financial statements of business by more than one auditor.

This SA does not deal with the Branch Auditors.

Audit Planning, Risk Assessment and Allocation of Work

- The engagement partner and other key members of the engagement team from each of the joint auditors shall be involved in planning the audit.
- The joint auditors shall jointly establish an overall audit strategy
- The joint auditors shall obtain common engagement letter and common management representation letter.
- The work allocation document shall be signed by all the joint auditors and the same shall be communicated to TCWG of the entity.

Relationship among Joint Auditors

For audit work divided among the joint auditors, each joint auditor is responsible only for the work allocated to him.

On the other hand, all the joint auditors are **jointly and severally responsible:**

a) In respect of the audit work which is not divided;

b) In respect of decisions taken by all the joint auditors concerning the nature, timing or extent of the audit procedures to be performed by the joint auditors.

c) In respect of matters which are brought to the notice of the joint auditors by any one of them and on which there is an agreement among the joint auditors;

d) examining that the financial statements of the entity comply with the requirements of the relevant statutes;

e) For examining that the FS comply with the disclosure requirements of the relevant statute; and

f) For ensuring that the audit report complies with the requirements of the relevant statute.

When within the area of one joint auditor, if someone is appointed as branch auditor or expert, then it will be his own responsibility, other joint auditor will not be held responsible.

Reporting Responsibilities

Normally, the joint auditors are able to arrive at an agreed report. However, where the joint auditors are in disagreement with regard to any matters to be covered by the report, each one of them should express his own opinion through a separate report.

Separate audit report shall also make reference to the audit report issued by other joint auditors in other matter paragraph.

A joint auditor is not bound by the views of the majority.

SA 300 - Audit Planning

Objective

The Objective of the Auditor is to plan the audit so that **it will be performed in an Effective and Timely Manner.**

Planning ensures that:

- **a)** Appropriate attention is devoted to important areas of the audit;
- **b)** Potential problems are promptly identified;
- **c)** Work is completed properly and in time;
- **d)** Assistants are utilised properly; and
- **e)** Work done by other auditors and experts is co-ordinated.

Preliminary Engagement Activities

The auditor shall undertake the following activities at the **Beginning of the Current Audit Engagement:**

- **a)** Performing procedures required by SA 220, regarding continuance of the client relationship;
- **b)** Evaluating compliance with ethical requirements, including independence, as required by SA 220; and
- **c)** Understanding of the terms of engagement, as required by SA 210.

Audit Planning includes:

- **a)** **Developing an overall audit strategy** for the expected scope and conduct of the audit; and
- **b)** **Developing an audit plan / programme** showing the nature, timing and extent of audit procedures.

Overall Audit Strategy

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

- **a)** Identify the characteristics of the engagement that define its scope;
- **b)** Ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required;
- **c)** Consider the important areas that would require more efforts of the engagement team;
- **d)** Consider the results of preliminary engagement activities; and
- **e)** Ascertain the nature, timing and extent of **resources necessary** for the engagement.

Audit Plan

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

- **a)** The NTE of **planned risk assessment procedures**, as per SA 315.
- **b)** The NTE of planned **further audit procedures at the assertion level**, as per SA 330.
- **c)** Other planned audit procedures that are required to be carried out so that the engagement complies with SAs.
- **d)** The NTE of direction and supervision of engagement team members and the review of their work.

Revision of Audit Plan:

Planning should be continuous throughout the engagement. Also **plans should be revised as and when necessary** during the course of audit.

SA 315 - Identifying & Assessing the Risk of Material Misstatement by Understanding the Entity & its Environment

Objective and Definitions

Objective of Auditor:

- Is to identify and assess the risks of material misstatement, whether due to fraud or error, **at the financial statement and assertion levels**, through understanding the entity and its environment, including the entity's internal control.
- It would provide a basis for designing and implementing responses to the assessed risks of material misstatement. This will help the auditor to reduce the risk of material misstatement to an acceptably low level.

Definitions:

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

b) **Significant risk:** An identified and assessed risk of material misstatement that, in the auditor's judgment, requires special audit consideration.

Requirements

Steps:

1) Risk Assessment Procedures and Related Activities

2) Discussion among the Engagement Team

3) The Required Understanding of the Entity and Its Environment, Including the Entity's Internal Control

After the above steps, the auditor is able to identify the 4th and 5th Step.

4) Identifying and Assessing the Risks of Material Misstatement at the financial statement and assertion levels.

5) Risks that Require Special Audit Consideration.
Here, auditor considers:
- **a)** Whether the risk is a risk of fraud;
- **b)** Whether the risk is related to recent significant economic, accounting, or other developments;
- **c)** The complexity of transactions;
- **d)** Whether the risk involves significant transactions with related parties;
- **e)** The degree of subjectivity in the measurement of financial information; and
- **f)** Whether the risk involves significant unusual transactions.

6) Revision of Risk Assessment

Understanding of the Entity and Its Environment, Including the Entity's Internal Control

The Entity and Its Environment

- Relevant industry, regulatory, and other external factors including the AFRF.
- The nature of the entity, including:
  - **a)** Its operations;
  - **b)** Its ownership and governance structures;
  - **c)** The types of investments; and
  - **d)** The way that the entity is structured and how it is financed;
- The entity's selection and application of accounting policies.
- The entity's objectives and strategies.
- The measurement and review of the entity's financial performance.

Components of Internal Control

1) Control environment

2) The Entity's Risk Assessment Process

3) The information system, relevant to financial reporting, and communication.

4) Other Control activities relevant to the audit

5) Monitoring of controls

SA 320 - Materiality in Planning and Performing an Audit

Introduction and Objective

- Information is material if its misstatement (i.e., omission or erroneous statement) could influence the economic decisions of users of financial information.
- Materiality should be considered by the auditor when:
  a) Determining the nature, timing and extent of audit procedures;
  b) Evaluating the effect of misstatements.
- Whether the **particular information/item is material can be judged from**:-
  a) Its size/amount.
  b) Its nature (Eg. abnormal, non-recurring, extraordinary etc.).
  c) Its legal requirements (Eg. Securities premium used for payment of dividend).
  d) Its qualitative materiality (Eg. Fraud committed by managing director of small amount).
  e) The auditor needs to consider the possibility of misstatements of relatively small amounts that, cumulatively, could have a material effect on the financial information. (Eg. An error of Rs. 10 in calculation of monthly interest in each savings account by Bank).
- The auditor's determination of materiality is a matter of professional judgment.
- There is inverse relationship between materiality and audit risk. It is because if the transaction is material then surely it must have been considered by the auditor during the process of audit and there is very less chance of having frauds and errors contained within such transactions.

Requirements

Determining Materiality and Performance Materiality – for financial statements as a whole as well as assertion level(s).

Performance materiality means the amount or amounts set by the auditor at less than materiality level to reduce the detection risk to an acceptably lower level. It is determined for both financial statements as a whole as well as assertion level(s).

Revision as the Audit Progresses:

The auditor shall revise materiality for the financial statements as a whole (and, if applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures) in the event of becoming aware of information during the audit that would have caused the auditor to have determined a different amount (or amounts) initially.

Audit Benchmark:

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

Factors affecting identification of an appropriate Benchmark:

a) The elements of the Financial Statements (for example, Assets, Liabilities, Equity, Revenue, Expenses)

b) Items on the Financial Statements in which the users focus.

c) The Nature of the Entity, its life cycle and the industry and economic environment in which the Entity operates;

d) The Entity's ownership structure and the way it is financed (for example, if an Entity is financed solely by Debt rather than Equity, users may put more emphasis on Assets; and

e) The relative volatility of the Benchmark.

SA 330 - The Auditor's Responses to Assessed Risks

Introduction and Objective

This SA deals with the auditor's responsibility to design and implement responses to the risks of material misstatement identified and assessed by the auditor in accordance with SA 315.

The objective of the auditor is to obtain sufficient appropriate audit evidence about the assessed risks of material misstatement, through designing and implementing appropriate responses to those risks.

Requirements:

Overall Responses

The auditor shall design and implement overall responses to address the assessed risks of material misstatement at the financial statement level.

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

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

The above reponses are by way of Audit Procedure which is either Compliance Procedures or Substantive Procedures.

Compliance Procedure - Tests of Controls

- The auditor shall design and perform tests of controls when:
  - **a)** The auditor intends to rely on controls in determining the NTE of substantive procedures; or
  - **b)** Substantive procedures alone cannot provide sufficient appropriate audit evidence.

Nature and Extent of Tests of Controls:

- The auditor shall obtain evidence about the operating effectiveness of the controls, including:
  - **(i)** How the controls were applied at relevant times during the period under audit.
  - **(ii)** The consistency with which they were applied.
  - **(iii)** By whom or by what means they were applied.
- **Controls tested at interim period:** Obtain audit evidence about significant changes subsequent to the interim period
- **Controls tested in previous audits:**
  - **a)** If there have been changes - test the controls in the current audit.
  - **b)** No changes - test the controls at least once in every third audit, and somewhat in each audit.
- **Significant risk:** test those controls in the current period.

Substantive Procedures

- **Irrespective** of the assessed risks of material misstatement, the auditor shall design and perform substantive procedures for each material class of transactions, account balance, and disclosure.
- Substantive Procedures Related to the Financial Statement Closing Process:
  - **a)** Agreeing or reconciling the FS with the underlying accounting records; and
  - **b)** Examining material journal entries and other adjustments.
- The auditor shall perform substantive procedures that are specifically responsive to significant risks.
- When substantive procedures are performed at an interim date, the auditor shall cover the remaining period.
- The auditor shall perform audit procedures to evaluate whether the overall presentation of the financial statements, including the related disclosures, is in accordance with the AFRF.
- After the Compliance Procedure and Substantive Procedures are done, the auditor shall decide whether sufficient appropriate audit evidence has been obtained.

SA 402 - Audit Considerations Relating to an Entity using a Service Organisation

Introduction and Objective

Service organization is a third-party organisation that **provides services to user entities that are part of those entities' information systems** relevant to financial reporting.

Objectives:

The objectives of the user auditor, when the user entity uses the services of a service organisation, are:

a) To obtain an understanding of the nature and significance of the services provided by the service organisation and their effect on the user entity's internal control relevant to the audit, sufficient to identify and assess the risks of material misstatement; and

b) To design and perform audit procedures responsive to those risks.

Definitions:

Type A – Report on Description and Design of Controls at a Service Organisation

Type B – Report on Description, Design, **and Operating Effectiveness** of Controls at a Service Organisation

In Type B report service organisation's auditor would additionally report about **operating effectively** of internal controls based on the results his tests of control.

Requirements

Obtaining an Understanding of the Services Provided by a Service Organisation, Including Internal Control:

It includes obtaining understanding about:

a) The nature of the services provided by the service organisation and the significance of those services to the user entity;

b) The nature and materiality of the transactions processed or accounts or financial reporting processes affected by the service organisation;

c) The degree of interaction between the activities of the service organisation and those of the user entity; and

d) The nature of the relationship between the user entity and the service organisation.

- The user auditor shall evaluate the design and implementation of relevant controls at the user entity that relate to the services provided by the service organisation.
- If the user auditor is **unable to obtain a sufficient understanding from the user entity**, the user auditor shall obtain that understanding from one or more of the following procedures:
  - **a)** Contacting the service organisation, through the user entity, to obtain specific information;
  - **b)** Visiting the service organisation and performing procedures;
  - **c)** Obtaining a Type 1 or Type 2 report, if available; or
  - **d)** Using another auditor to perform procedures that will provide the necessary information about the relevant controls at the service organisation.

SA 450 - Evaluation of Misstatements Identified during the Audit

Introduction and Objective

This SA deals with the auditor's responsibility to evaluate the effect of identified misstatements on the audit and of uncorrected misstatements on FS. The auditor's conclusion required by SA 700 takes into account the auditor's evaluation of uncorrected misstatements

Objective:

To evaluate:

a) The effect of identified misstatements on the audit; and
b) The effect of uncorrected misstatements, if any, on the financial statements.

Requirements

- The auditor shall **accumulate misstatements** identified during the audit, other than those that are clearly trivial (not material).
- The auditor shall determine whether the **overall audit strategy and audit plan need to be revised** if:
  a) The nature of identified misstatements and the circumstances of their occurrence indicate that other misstatements may exist that, when aggregated with misstatements accumulated during the audit, could be material; or
  b) The aggregate of misstatements accumulated during the audit approaches materiality determined in accordance with SA 320 on 'Audit Materiality'.
- The auditor shall determine whether **uncorrected misstatements** are material, individually or in aggregate. In making his determination, the auditor shall consider:
  a) The size and nature of the misstatements
  b) The effect of uncorrected misstatements related to prior periods
- The auditor shall **communicate with TCWG** uncorrected misstatements and the effect that they, individually or in aggregate, may have on the opinion in the auditor's report
- 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.

SA 500 - Audit Evidence

Introduction

- The auditor should obtain sufficient appropriate audit evidence by performing compliance and substantive procedures to enable him make an opinion on FS.
- Sufficiency refers to the quantum of audit evidence obtained; appropriateness relates to its relevance and reliability.
- Factors affecting sufficient appropriate audit evidence:
  a) The degree of risk of misstatement;
  b) The materiality of the item;
  c) The experience gained during previous audits;
  d) The results of auditing procedures, including fraud or error which may have been found;
  e) The type of information available;
  f) The trend from ratios and analysis.

Nature of Assertions & Types of Audit Evidence

Compliance procedures:

a) Existence
b) Effectiveness
c) Continuity

Substantive procedures:

a) Existence
b) Rights and Obligations
c) Occurrence
d) Completeness
e) Valuation
f) Measurement
g) Presentation and Disclosure

Types of Audit Evidence:

a) Internal or External
b) Oral or Written.

- **Internal evidence** is one that has been created, used and retained within the client's organization. Eg: Copy of Sales invoice, Payroll Report.
- **External evidence** is one, which originates outside the client's organization. Eg: Purchase Invoice.

Reliability of Audit Evidence

Based on:

a) Source - Internal or External
b) Nature - Visual, Documentary or Oral
c) Circumstances under which it is obtained.
d) Nature of assertion obtained and its materiality.

Generally,

a) **External evidence** (e.g. confirmation received from a third party) **is usually more reliable** than internal evidence.
b) Internal evidence is more reliable when related internal control is satisfactory.
c) **Written evidence is usually more reliable** than oral representations.
d) **Evidence obtained by the auditor himself is more reliable** than that obtained through the entity.
e) **Evidence provided by original documents is more reliable** than audit evidence provided by photocopies.

Reliability and Methods of Audit Evidence

- Work of **management expert**, the auditor shall:
  a) Evaluate his competence, capabilities and objectivity;
  b) Obtain understanding of his work; and
  c) Evaluate the appropriateness of his work.
- If:
  a) Audit evidence obtained from one source is inconsistent with another; or
  b) The auditor has doubts over the reliability of audit evidence.

  He shall do additional audit procedures or shall modify the report.

Methods for obtaining Audit Evidence:

Inspection
Observation
Inquiry
External confirmation
Recomputation
Reperformance
Analytical review

SA 501 - Audit Evidence – Additional Considerations for Specific Items

Part A: Attendance at Physical Inventory Counting

- Physical verification of inventories is the responsibility of the management of the entity.
- The auditor should obtain sufficient appropriate audit evidence regarding its existence and condition by attendance at physical inventory
- If unable to attend the physical inventory count on the date planned, attend on alternative date and perform alternative audit procedures to assess the changes.
- Where attendance at the physical inventory counting is impracticable, the auditor should consider whether alternative procedures sufficient appropriate audit evidence of existence and condition of inventory.
- Review management's instructions
- Consider cut-off procedures
- When inventory is under the custody and control of a third party, the auditor would ordinarily obtain direct confirmation from the third party as to the quantities and condition of inventory held on behalf of the entity.
- Obtain a written representation from management concerning the completeness of information provided regarding the inventory; and adherence to laid down procedures

Part B: Inquiry Regarding Litigation and Claims

- Claims and Litigation, if results to:
  a) Probable obligation - Create 'Provision'
  b) Possible obligation - Disclosure as 'Contingent Liability'.
- Audit Procedure **to be become aware of litigations and claims:**
  a) Make appropriate inquiries of management.
  b) Review BoD minutes and correspondence with the entity's lawyers.
  c) Examine legal and other relevant expense accounts.
  d) Use any other information obtained including discussions with in-house legal department.
- When **litigation or claims have been identified** by the management or when the auditor believes they may exist, and are likely to be material, the auditor may seek direct communication with entity's lawyers.
- Such letter should be prepared by management. The letter should request the entity's lawyers to communicate directly with the auditor.
- Obtain a written representation from management concerning the completeness and adequacy of information provided

Part C: Segment Information

- As per AS-17 on 'Segmental Reporting', the Company is required to disclose segmental information in notes to accounts of financial information.
- The auditor should perform audit procedures designed to obtain sufficient appropriate audit evidence for appropriate disclosure of segment information
- The auditor is not required to apply auditing procedures that would be necessary to express an opinion on the segment information. Audit procedures regarding segment information ordinarily consist of analytical procedures and other audit tests appropriate.
- The auditor would discuss with management the methods used in determining segment information, and consider whether such methods are likely to result in disclosure in accordance with the applicable financial reporting framework and test the application of such methods.
- Obtain a written representation from management concerning completeness of information; and appropriateness of the selected segments

SA 505 – External Confirmation

Definition

a) **External confirmation:** Audit evidence obtained as a direct written response to the auditor from a third party in paper form, or by electronic or other medium.

b) **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.

c) **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.

Scope of / Assertions Addressed by / Process of External Confirmations

Scope

Frequently used in relation to account balances, but need not be restricted to these items. For eg, the auditor may request external confirmation of the terms of agreements.

Assertions

Provides different types of assertions under different situations. For eg, external confirmation of an account receivable provides strong evidence regarding the existence, but does not indicate whether debtor is good or bad.

Process

- Determining information to be confirmed;
- Selecting the appropriate confirming party;
- Designing the confirmation requests; and
- Sending the requests, including follow-up with the confirming party.

Timing & Design of External Confirmation

Timing: at date of FS or reasonably close.

Design and Form

- Design should meet the specific audit objective.
- He may use positive or negative external confirmation requests or a combination.
- The auditor shall **not use negative confirmation as sole substantive procedure unless <u>ALL</u>** of the following are present:
  - **a)** The risk of material misstatement is low;
  - **b)** The auditor has assessed operating effectiveness of relevant controls;
  - **c)** The population comprises of a large number of small, homogeneous, account balances or transactions;
  - **d)** A very low exception rate is expected; and
  - **e)** Recipients would not disregard such requests.

Reliability of External Confirmation & Management Request

Reliability of External Confirmation depends on:

a) The control which the auditor exercises over confirmation requests and responses

b) The characteristic of the respondents

c) Any restrictions included in the response or imposed by management.

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

a) Inquire as to management's reasons for the refusal;

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

c) Perform alternative audit procedures.

SA 510 – Initial Engagement – Opening Balances

Introduction

Initial Engagement is an engagement where:

a) FS are audited for first time; or
b) FS for P.Y. were audited by another auditor

'Opening balances' means those account balances which exist at the beginning of the period. They reflect the effect of:

a) Transactions and other events of the preceding periods; and

b) Accounting policies applied in the preceding period.

Objective

Auditor should obtain sufficient appropriate Audit Evidence that:

a) Closing Balance of P.Y. has been correctly brought forward;
b) The opening balance does not contain a material mis-statement;
c) Accounting policies are consistently followed

Audit Procedures

1) Opening Balance
- Read most recent FS and the predecessor auditor's report thereon for checking whether they are correctly brought forward.
- Current year's procedure to give evidence about opening balance Eg. Collection from Debtors
- Specific audit procedures for opening balance

2) Consistency of Accounting Policies

3) Relevant information in Previous Auditor's Report:
If the prior period's FS were audited by a predecessor auditor and there was a modification to the opinion, the auditor shall evaluate the effect of the matter giving rise to the modification in assessing the risks of material misstatement in the current period's FS

4) Audit conclusion
If the auditor is **unable to obtain sufficient appropriate audit evidence** - **qualified opinion or a disclaimer**
If the auditor concludes that the opening balances **contain a misstatement - qualified opinion or an adverse opinion**

SA 520 – Analytical Procedure

Introduction

Analytical Procedures means evaluation of Financial Information through analysis of relationships (i.e. Ratios & Trends) amongst both Financial & Non – Financial Data.

It also includes investigation of identified fluctuations or inconsistency in relationships.

Nature & Purpose

1) Includes comparison with:
- **a)** Prior periods
- **b)** Budget
- **c)** Estimates of Auditor
- **d)** Industry Standards

2) While using Analytical Procedures, auditor shall:
- **a)** Determine the Suitability
- **b)** Evaluate Reliability of data
- **c)** Develop an Expectation
- **d)** Determine the difference

3) Useful at all stages

Extent of Reliance

1) Materiality of Item
2) Other Audit Procedures for same objective
3) Accuracy predicted
4) Assessment of Inherent & Control Risk.

Investigating Unusual Items

1) Inquiries with Management
2) Other Audit Procedures

SA 530 – Audit Sampling

Introduction

Auditor always has lack of time, so he carries test audit.

Definitions:

1) Audit Sampling:
Application of Audit Procedure to less than 100% of Population.

2) Anomaly
A misstatement or deviation that is demonstrable not representative of misstatement or deviation in population.

3) **Sampling risk:** Sampling risk arises from the possibility that the auditor's conclusion, based on a sample, may be different from the conclusion that would be reached if the entire population were subjected to the same audit procedure. Sampling risk can lead to two types of erroneous conclusions:

- **i)** In the case of a test of controls, that controls are more effective than they actually are, or in the case of tests of details, that a material misstatement does not exists when in fact it does.
- **ii)** In the case of test of controls, the controls are less effective than they actually are, or in the case of tests of details, that a material misstatements exists when in fact it does not.

4) **Statistical sampling:** An approach to sampling that has the following characteristics:

- **i)** Random selection of the sample items; and
- **ii)** The use of probability theory to evaluate sample results, including measurement of sampling risk.

5) **The tolerable error:** It is the maximum errors in the population that the auditor would be willing to accept and still conclude that the result from the sample has achieved the audit objective.

6) **The expected error:** It is the expectation of an auditor regarding errors in an audit of a FS being conducted.

Requirement

1) Sample Design, Size & Selection
- **a)** **Design:** Depends on Purpose of Audit Procedure & Characteristics of Population. **Eg:** Stratification.
- **b)** **Size:** Depends on Level of Sampling Risk auditor is ready to take.
- **c)** **Selection:** Such that each unit should have chance of selection.

2) Performing audit procedures & finding out deviations & misstatements.

3) Investigating nature & cause of deviations & misstatements. If it's Anomaly, obtain high degree of certainty.

4) Projecting misstatements.

5) Evaluating results of audit sampling.

6) Sampling methods:
- **a)** Random – Simple or Stratified
- **b)** Systematic
- **c)** Haphazard
- **d)** Block
- **e)** Monetary unit.

SA 540 – Audit of Accounting Estimates

Introduction

1) Risk of material misstatement is higher when accounting estimates are involved.

2) Management may use the authority to make or change accounting estimate as a tool for manipulating the books.

3) Definitions:

(a) Accounting Estimate:
It is an approximation of the amount in absence of precise means of measurement.

(b) Estimation Uncertainty:
Possibility that an estimate could be wrong.

Objective

1) Accounting Estimates including Fair Value Estimates are Reasonable; &

2) Disclosures in FS are adequate.

Auditors Requirements

- Risk Assessment Procedures and Related Activities
- Responses to Assessed Risks
- Further Substantive Procedures to Respond to Significant Risks - Estimation Uncertainty
- Evaluating the Reasonableness & Disclosure of the Accounting Estimates
- Indicators of Possible Management Bias
- Written Representations
- Documentation

Risk Assessment Procedures and Related Activities

Auditor shall obtain **understanding of:**

- The requirements of the **AFRF**.
- **How mgmt. identifies** those transactions, events that need accounting estimates
- **How mgmt. makes the accounting estimates** i.e. the method, relevant controls; whether expert used; the assumptions; change in the methods etc.

Requirements

Responses to Assessed Risks

The auditor shall determine:

- Whether management has appropriately applied the requirements of AFRF; and
- Whether the methods are appropriate.

The auditor shall undertake the following:

- Whether events occurring up to date of auditor's report provide audit evidence.
- Test how Mgmt. made accounting estimate.
- Test the operating effectiveness of it.
- Develop a point estimate or a range.

Estimation Uncertainty

For Estimation Uncertainty, the auditor shall evaluate the following:

- How management has considered alternative assumptions, and why it has rejected them.
- Whether the significant assumptions used by management are reasonable.

SA 550 - Related Parties

Introduction and Objective

Accounting Standard (AS) 18, 'Related Party Disclosure', requires the disclosure of the Related Parties and also the transactions with them in notes to accounts.

Objectives:

- The objectives of the auditor are:
  - **a) Irrespective of requirements of AFRF, to obtain an understanding of related party relationships** and transactions sufficient to be able:
    - **i)** To **recognise fraud risk factors**, if any, arising from related party relationships and transactions; and
    - **ii)** To conclude whether the financial statements, insofar as they are affected by those relationships & transactions:
      - **Achieve a true and fair presentation; or**
      - **Are not misleading;** and
  - **b) Where the AFRF establishes related party requirements**, to obtain sufficient appropriate audit evidence about whether related party relationships and transactions have been **appropriately identified, accounted for and disclosed**.

Auditor's Requirements

- Management is responsible for the identification and disclosure of related parties and it's transactions.
- The auditor needs to have a level of knowledge of the entity's business and industry that will enable him to identify the related parties.

Auditor's Requirements

1) Risk Assessment Procedures and Related Activities
   - **a)** Understanding the Entity's Related Party Relationships and Transactions
   - **b)** Maintaining Alertness for Related Party Information When Reviewing Records or Documents
   - **c)** Sharing Related Party Information with Engagement Team.
2) Identification and Assessment of the Risks of Material Misstatement Associated with Related Party Relationships and Transactions
3) Responses to the Risks of Material Misstatement Associated with Related Party Relationships and Transactions
   - **a)** Identification of Previously Unidentified or Undisclosed Related Parties or Significant Related Party Transactions
   - **b)** Identified Significant Related Party Transactions outside the Entity's Normal Course of

Examining Identified Related Party Transactions

Understanding the Entity's Related Party Relationships and Transactions

Inquire of management regarding:

- **a)** The identity of the entity's related parties;
- **b)** The nature of the relationships; and
- **c)** Transactions with related parties.

Obtain understanding of controls, that management has established to:

- **a)** Identify, account, & disclose related party relationships and transactions in accordance with AFRF;
- **b)** Authorise and approve significant transactions with related parties; and
- **c)** Authorise and approve significant transactions outside the normal course of business.

Identification of Previously Unidentified or Undisclosed Related Parties or Significant Related Party Transactions

- **a)** Promptly communicate to the other members of the engagement team;
- **b)** Request management to identify all transactions with the newly identified related parties; and
- **c)** Inquire why management failed to identify or disclosure;
- **d)** Perform appropriate substantive audit procedures relating to such newly identified related parties or

	Business **c)** Assertions That Related Party Transactions Were Conducted on Terms Equivalent to those Prevailing in an Arm's Length Transaction **4)** Evaluation of the Accounting for and Disclosure of Identified Related Party Relationships and Transactions **5)** Written Representations **6)** Communication with Those Charged with Governance **7)** Documentation	significant related party transactions; **e)** Reconsider the risk and perform additional audit procedures as necessary; and **f)** If the non-disclosure by management appears intentional evaluate the implications for the audit.

SA 560 – Subsequent Events

Introduction	Objectives	Audit Procedures	Facts Known After the Date of Auditor's Report but Before the FS are Issued	Facts Known After the FS have been Issued
Subsequent events means, significant events which occurs after the BS date but before the date of the auditor's report. **As per AS 4, there are** two types: **a) Adjusting Events:** Provides additional evidence as to conditions that existed at the BS date. They are adjusted in books. **b) Non-adjusting Events:** Do not provide additional evidence as to conditions that existed at the BS date. If material, they are disclosed in BOD Report. Non-adjusting Events which affects the going concern will be treated as an Adjusting event.	**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.**	The procedures to identify subsequent: **a)** Reviewing Mgmt. procedures to identify the subsequent events. **b)** Reading minutes of the meetings of SHs & BoD. **c)** Read entity's latest available interim FS, budgets, cash flow forecasts and other related management reports. **d)** Inquiring with entity's lawyers regarding the status of litigation and claims. **e)** Inquiring of Mgmt. as to whether any subsequent events have occurred after the BS date.	**a)** Discuss with Mgmt. or TCWG. **b)** Determine whether FS need amendment; **c)** Inquire how Mgmt. intends to address the issue. **If Mgmt. amends** FS: **a)** Check the amendments; and **b)** Provide a new auditor's report on the amended FS. • **Mgmt. does not amend,** then: **a)** If Report has not yet provided to entity, **modify the opinion**; or **b)** If report already provided, tell Mgmt. not to issue FS to third parties. If Mgmt. issues, take appropriate action, to prevent reliance on auditor's report.	**a)** Discuss with management or TCWG. **b)** Determine whether the FS need amendment; **c)** Inquire how management intends to address the issue. **If management amends** FS: **a)** Extend the audit procedures for amendments; **b)** Review the steps taken by mgmt. to inform others about amendment; and **c)** Provide a new auditor's report on the amended FS. • **Management does not amend the FS** then, take appropriate action, to prevent reliance on the auditor's report.

SA 570 (Revised) – Going Concern

Introduction

1) Going Concern is one of the fundamental accounting assumptions (AS 1).

2) Going Concern means entity has neither the need nor the intention to liquidate the business.

3) Objectives:

- **a)** To obtain sufficient appropriate audit evidence regarding appropriateness of going concern assumption.
- **b)** To conclude, whether material uncertainty exists.
- **c)** To determine implications on Auditor's Report.

Audit Procedures

Indicators that question going concern:

a) Financial indicators:

- Adverse key financial ratios.
- Substantial operating losses.
- Substantial negative cash flows from operations.
- Discontinuance of dividends.
- Inability to pay creditors on time.
- Difficulty in complying with the terms of loan agreements.

b) Operating indicators:

- Loss of KMP.
- Loss of a major market, franchise, licence, or supplier.
- Labour difficulties.

c) Other indicators:

- Non-compliance with statutory requirements.
- Pending legal cases that may result in huge liability.
- Changes in legislation or government policy.

The significance of such indications can be mitigated (lowered) by other factors.

Additional Audit Procedures When Events or Conditions Are Identified:

a) Reviewing subsequent events;
b) Review compliance with debts;
c) Budgeted cash-flow;
d) Minutes of meeting;
e) Feasibility of clients' recovery plan.

Audit Conclusion

1) Going concern assumption appropriate but material uncertainty exists:

- **a)** If adequate disclosure in FS, unmodified opinion but **draw attention** to note in FS that discloses the matter & state that material uncertainty exists;
  (by way of separate paragraph in audit report under heading material uncertainty related to going concern)
- **b)** If adequate disclosure NOT in FS, qualified or adverse opinion.

2) Going concern assumption NOT appropriate - **Adverse Opinion**.

3) Communication with TCWG.

4) Significant delay in approval of FS.

SA 580 – Representation by Management

Introduction

- Written representations are written statement by management to the auditor to confirm certain matters or to support other audit evidence.
- Written representations are audit evidence, but they are not sufficient appropriate audit evidence in itself.
- The fact that management has provided reliable written representations does not affect the nature or extent of other audit evidence.
- Written representations cannot be a substitute for other audit evidence.
- They are the last way of getting audit evidences when no other evidences are available in the circumstance.

Basic elements of Management Representation Letter

- **Address of the Auditor** - The letter should be addressed to the auditor.
- **Date** - as near as practicable to, but not after, the date of the auditor's report.
- **Areas/Points on which representation is to be sought**. This would cover representation about:
  - **a)** Management's Responsibilities for Preparation of FS and completeness of the information provided.
  - **b)** Representation to support other audit evidence, if necessary or required by other SAs
- **Signature of the competent official** - The letter should be signed by responsible officials of the management like Managing Director.

Representations on Material Matter

a) Seek corroborative evidence;

b) Evaluate consistency of such a representation with other audit evidence; and

c) Consider whether person making representation is well informed.

Doubt as to the Reliability of Written Representations

- If the auditor has concerns about the competence or integrity of management, the auditor shall determine the effect that may have on the reliability of representations.
- If written representations are inconsistent with other audit evidence, perform audit procedures to resolve the matter.
- If auditor concludes that representations are not reliable - take appropriate actions, including determining the possible effect on the opinion.

Refusal by Management to provide Representation

If management does not provide one or more of the requested written representations, the auditor shall:

a) Discuss the matter with management;

b) Re-evaluate the integrity of management and evaluate the effect that this may have on the reliability of representations (oral or written) and audit evidence in general; and

c) Take appropriate actions, including determining the possible effect on the opinion in the auditor's report.

SA 600 – Using the work of Another Auditor

Principal Auditor's Duties

Another Auditor means Branch Auditor or Subsidiary Auditor

Principal Auditor's Duties:

1) Communicate with other auditor about use of his work to be made.
2) Communicate significant accounting, auditing & other reporting requirement & obtain compliance about the same.
3) Communicate time table.
4) Ascertain any limitation on scope on his work.
5) Consider his professional competence (if not member of ICAI).

Principal Auditor's Rights

1) Guide branch auditor.
2) Demand any information.
3) Visit branch & do supplementary or test audit.

Co-ordination

1) Sufficient liaison (efficient two way communication).
2) In writing.
3) Other auditor should co-operate & bring to notice of principal auditor the significant findings at branch immediately.

Division of Responsibility & Reporting

1) Principal auditor is NOT responsible for work entrusted to other auditor except in circumstances which aroused suspicion about his work.
2) Clearly state the responsibility in report: Number of branches audited by other auditor's and that he has relied on the report submitted by them.

SA 610 (Revised) – Relying upon the Work of Internal Auditor

Objective

a) To determine whether the work of the internal audit function or direct assistance from them can be used;

and having made that determination:

b) If using their the work of the internal audit function, to determine whether that work is adequate for purposes and

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

The external auditor has **sole responsibility** for the opinion expressed.

Determining Whether, in Which Areas, & to What Extent the Work can be Used

- 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 internal auditors**;
  - **b)** The **level of competence**; and
  - **c)** Whether they apply a **systematic and disciplined approach**.
- The external auditor shall **consider the nature and scope of the work** that has been performed **by the internal audit function.**

Using the Work of the Internal of the Internal Audit Function

If using the work of the internal audit function, **the external auditor shall**

- **discuss the planned use** of its work with internal auditor.
- **read the reports** of the internal audit function.
- **perform sufficient audit procedures to determine its adequacy** for purposes of audit, including evaluating whether:
  - **a)** The work had been properly planned, performed, supervised, reviewed and documented;
  - **b)** Sufficient appropriate evidence had been obtained; and
  - **c)** Conclusions reached are appropriate.
- The NTE of the external auditor's audit procedures shall be responsive to the external auditor's evaluation of:
  - **a)** judgment involved;
  - **b)** risk of material misstatement;
  - **c)** internal audit function's organizational status and the objectivity of internal auditors;
  - **d)** The level of competence.

Determining Whether, in Which Areas, and to What Extent Internal Auditors Can Be Used to Provide Direct Assistance

For determining whether, we should consider whether he will be able to work objectively and does he have level of competence.

The external auditor shall **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;

c) Relate to work with which the internal auditors have been involved; or

d) Relate to decisions the external auditor makes in accordance with this SA.

Using Internal Auditors to Provide Direct Assistance

- Obtain **written agreement from management** that the entity will not intervene; and
- Obtain **written agreement from the internal auditors** that they will maintain confidentiality.
- The external auditor shall **direct, supervise and review the work** performed by internal auditors.

SA 620 – Using the work of an Expert

Introduction

There can be:

1) Management Expert
2) Auditor's Expert

This SA applies for Auditor's Expert.

Objective:

1) To determine whether to use work of expert or not.
2) If using work of expert, whether his work is adequate.

Requirements

1) Determining the Need to Use the Work of an Expert
2) Nature, Timing and Extent of Audit Procedures
3) The Competence, Capabilities and Objectivity of the Auditor's Expert
4) Obtaining an Understanding of the Field of Expertise of the Auditor's Expert
5) Agreement with the Auditor's Expert
6) Evaluating the Adequacy of the Auditor's Expert's Work
7) Reference to an Expert in the Auditor's Report

Determining Need of Expert / Agreement with Expert

For determining whether to use the work of an expert, auditor should consider:

1) The **materiality of the item**,
2) The **nature and complexity of item**, and
3) The **other audit evidence available** with respect to the item.

Agreement with Expert:

The auditor shall agree, in writing, on following matters with auditor's expert:

a) **Nature, scope and objectives** of that Expert's work,
b) Respective **roles and responsibilities** of the Auditor and that Expert,
c) NTE of **communication** between the Auditor and that Expert, including the **form of any report** to be provided by that Expert, and
d) Need for the Auditor's Expert to observe **confidentiality** requirements.

Evaluating the Adequacy of the Auditor's Expert's Work & Reference

Evaluating Expert's Work:

a) The reasonableness of expert's conclusions, and their consistency with other audit evidence;
b) The relevance and reasonableness of assumptions & methods used by expert; and
c) The relevance, completeness, and accuracy of source data used by expert.

Responsibility:

1) Auditor continues to be responsible for expert's opinion, responsibility is NOT shifted.
2) If auditor feels that, Expert's work:
   a) Is inconsistent; or
   b) Does not give Sufficient Appropriate Audit Evidence;

   Auditor should express modified opinion.

Reference:

1) Clean Report – NO
2) Modified Report – YES With prior approval of Expert.

SA 700 (Revised) - The Auditor's Report on Financial Statements

Introduction & Objective

This SA deals with the **form and content** of the auditor's report (only clean report).

Objectives

The objectives of the auditor are to:

a) **Form an opinion** on FS based on an evaluation of the conclusions drawn from the audit evidence obtained; and

b) **Express clearly** that opinion through a written report and also describes the basis for the opinion.

This report is on general purpose financial statements which are prepared in accordance with a general purpose framework. It may **be a fair presentation framework or a compliance framework.**

Under fair presentation framework, the word true and fair is used.

Compliance framework just states that FS are prepared as per Laws & Regulations.

Forming an Opinion on FS

The auditor shall form an opinion on whether FS are prepared in accordance with AFRF.

For forming an opinion, auditor considers:

a) Whether **sufficient appropriate audit evidence** has been obtained;

b) Whether **uncorrected misstatements are material**, individually or in aggregate; and

c) The **auditor shall evaluate** whether:

- The FS **adequately disclose the significant accounting policies** selected and applied;
- The accounting policies **selected and applied are consistent** with AFRF;
- The **accounting estimates made by management are reasonable**;
- The information **presented** in the FS is relevant, reliable, comparable and understandable;
- The FS provide **adequate disclosures**; and
- The **terminology** used in FS, including the title of each financial statement, is appropriate.

d) In **fair presentation framework**, the auditor's evaluation as to whether FS achieve fair presentation.

Auditor's Report (Clean Report)

Title: Independent Auditor's Report

Addressee: Appropriate. For Companies, it is Shareholders.

Auditor's Opinion:

1st Para: Identify the entity; State that FS are audited; Identify the title of each FS; Specify the date or period covered by each FS; and Refer to the summary of significant accounting policies;

2nd Para: Opinion

Basis for Opinion: Audit as per SA, Auditor is independent & Sufficient Appropriate Evidence obtained

Going Concern

Key Audit Matters: As per SA 701

Management's Responsibility:

Preparation of FS & for internal controls;

Assessing ability to continue as Going Concern,

Overseeing the FS Reporting Process

Auditor's Responsibility:

1st Para: Objective to obtain reasonable assurance & issue audit report, reasonable assurance is high assurance, mis-statements arises from F&E.

2nd Para: Auditors responsibility is:

to identify and assess risk of material misstatements and perform procedures and obtain sufficient appropriate audit evidence

to obtain understanding of internal controls

		appropriateness of accounting policies and reasonableness of accounting estimates appropriateness of mgmt's use of going concern assumption to evaluate overall presentation **3rd Para:** Communicate to TCWG: Planned scope and timings and significant findings of audit including significant deficiencies in internal control. auditor has complied with relevant ethical requirements regarding independence **Location:** **a)** Within the body of the auditor's report; **b)** As an appendix to the auditor's report; or **c)** Specific reference within the auditor's report to the location of such a description on a website of an appropriate authority. **Other Reporting Responsibilities:** **Signature of the Auditor:** **Date of the Auditor's Report:** **Place of Signature:** **Auditor's Report Prescribed by Law or Regulation:** Report is as per SA if it contains all the above elements **Auditor's Report as per Indian SA and International SA:** One Report if there is no conflict **Supplementary Info Presented with FS:** If not audited it should be differentiated from FS. If mgmt. refuses write in Other Matter Para

SA 701 (New) – Communicating Key Audit Matters in Independent Auditor's Report

Introduction

- The purpose of communicating key audit matters is to enhance the communicative value of the auditor's report.
- Communicating key audit matters may also assist intended users in understanding the entity and areas of significant management judgment in the audited financial statements.
- It will provide intended users a basis to further engage with management and TCWG about certain matters relating to the entity.
- Communicating key audit matters is NOT:
  a) substitute for disclosures in the financial statements
  b) substitute for the auditor expressing a modified opinion
  c) substitute for reporting in accordance with SA 570
  d) separate opinion on individual matters
- SA 705 (Revised) prohibits the auditor from communicating key audit matters when the auditor disclaims an opinion on the financial statements, unless such reporting is required by law or regulation.

Objectives & Definition

Objectives

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.

Definition

Key audit matters: Those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance.

Requirements

Determining Key Audit Matters

In making this determination, the auditor shall consider following:

a) Areas of higher assessed risk of material misstatement, or significant risks identified (SA 315).

b) Significant auditor judgments relating to areas in the FS that involved significant judgment, including estimates identified as having high estimation uncertainty.

c) Significant events or transactions that occurred during the period.

Communicating Key Audit Matters

Under separate heading 'Key Audit Matters' in Audit Report. Give definition and then communicate Individual Key Audit Matters.

Key Audit Matters Not a Substitute for Expressing a Modified Opinion

Circumstances in which Key Audit Matter Is Not Communicated:

a) Law or regulation precludes public disclosure about the matter; or

b) In extremely rare circumstances, the auditor determines that the matter should not be communicated because the adverse consequences of doing so would outweigh the public interest benefits

Communication with TCWG

Documentation

SA 705 (Revised) – Modifications to the Opinion in Independent Auditor's Report

Introduction and Type of Opinion

This SA establishes three types of modified opinions, namely, a qualified opinion, an adverse opinion, and a disclaimer of opinion.

Objective

To express clearly an appropriately modified opinion on FS that is necessary **when**:

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

b) The auditor is **unable to obtain sufficient appropriate audit evidence**.

Type of Opinion to be Expressed:

Nature of Matter Giving Rise to the Modification	**Auditor's Judgment about the Pervasiveness of the Effects or Possible Effects on FS**	
	Material but Not Pervasive	**Material and Pervasive**
FS are materially misstated	Qualified opinion	Adverse opinion
Inability to obtain sufficient appropriate audit evidence	Qualified opinion	Disclaimer of opinion

Pervasive effects on FS are those that, in auditor's judgment:

a) Are not confined to specific elements, accounts or items of FS;

b) If so confined, represent or could represent a substantial proportion of FS; or

c) In relation to disclosures, are fundamental to users' understanding of FS.

Reporting

Basis for Modification Paragraph - before the opinion paragraph

Auditor Responsibility - Audit evidence obtained is sufficient and appropriate to provide a basis for the auditor's modified audit opinion. (for qualified and adverse opinion)

Qualified Opinion:

except for the effects (possible effect, if unable to obtain sufficient appropriate audit evidence) of the matter(s) described in the Basis for Qualified Opinion paragraph, the financial statements…….

Adverse Opinion:

For Fair Presentation Framework:

The financial statements **do not present fairly** (or give a true and fair view) in accordance with AFRF.

For Compliance Framework:

The financial statements **have not been prepared**, in all material respects, in accordance with AFRF

Disclaims an Opinion:

Auditor shall amend the description of the auditor's responsibility to include only the following:

a) A statement that the auditor's responsibility is to conduct an audit of the entity's FS in accordance with SA and to issue an auditor's report;

b) A statement that, 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; and

c) The statement about auditor independence and other ethical responsibilities.

SA 706 (Revised) – EoM Para & OM Para in Independent Auditor's Report

Definitions

1) **EoM Para:**
A Para included in auditor's report that refers to matter appropriately presented or disclosed in FS that, in auditor's judgment is of such importance that is fundamental to user's understanding of FS.
Eg. Material Pending Litigation, Early Application of Voluntary Accounting Standards etc

2) **OM Para:**
A Para included in auditor's report that refers to matter NOT in FS that in auditor's judgment is relevant to user's understanding of Audit, Auditor's Responsibilities or Auditor's Report.
Eg. Number of Branches/Subsidiaries Audited by Other Auditors, Supplementary Information is not audited etc.

Emphasis of Matter Paragraph

- The auditor shall include an Emphasis of Matter paragraph in the auditor's report provided:
  - **a)** The auditor would not be required to modify the opinion as a result of the matter; and
  - **b)** The matter has not been determined to be a key audit matter.
- Use the heading "Emphasis of Matter";
- Clear reference to the matter being emphasized
- Indicate that the auditor's opinion is not modified in respect of the matter emphasised.
- Circumstances requiring Emphasis of Matter Paragraph in Audit Report:
  - **a)** Material uncertainty regarding future outcome of exceptional litigation.
  - **b)** To alert the users that financial statements are prepared as per special purpose framework
  - **c)** Significant subsequent event
  - **d)** Early application of voluntary accounting standards

Other Matter Paragraph

- The auditor shall include other matter paragraph in the auditor's report, with the heading "Other Matter" provided:
  - **a)** This is not prohibited by law or regulation; and
  - **b)** When SA 701 applies, the matter has not been determined to be a key audit matter to be communicated in the auditor's report.
- Circumstances requiring Other Matter Paragraph in Audit Report:
  - **a)** Description regarding number of branches audited by other auditors.
  - **b)** Description regarding reliance on audit report submitted by auditors of subsidiary companies, in case of audit of consolidated financial statements.

SA 710 – Comparatives

Introduction

1) This SA deals with Auditor's responsibility regarding Comparative Information in audit of FS.
2) The nature of Comparative Information that is presented depends on AFRF.
3) Two approaches:
   a) **Corresponding Figures:** Comparative Information where amounts or other disclosure for prior period are included as an integral part of current period FS. The Auditor's opinion refers to current period only, which included comparative information.
   b) **Comparative FS:** Comparative Information where amounts and other disclosure for prior period are included for comparison with FS of current period but if audited are referred to in Auditor's opinion.

Audit Procedure

1) The auditor shall determine whether the FS include the comparative information as required by AFRF.
2) The auditor shall evaluate whether:
   a) The comparative information agrees with amounts or disclosure in prior period.
   b) Accounting policies are consistently followed.
3) If auditor becomes aware of possible material misstatement in the comparative information, the auditor shall perform such additional procedure as appropriate.
4) Auditor shall request written representation for all periods.

Reporting

Corresponding Figures:

1) The auditor shall not refer to corresponding figures.
2) If previous audit report modified & matter not resolved:
   a) CY FS Modified for both, if affecting CY's figures.
   b) If NOT affecting CY's figures, then also CY's FS Modified with respect to corresponding figures.
3) Material misstatement in prior period FS on which unmodified opinion is given, auditor shall verify whether the misstatement has been dealt with & if NOT, CY's FS should be modified w.r.t. corresponding figures.

Comparative FS:

1) The auditor's opinion shall refer to each period reported.
2) When **reporting on prior period FS**, **if the auditor's opinion on such prior period FS differs** from the opinion the auditor previously expressed, auditor shall disclose reasons in **Other Matter paragraph**.

Common:

Prior period FS audited by predecessor auditor: State in Other Matter Paragraph that they are audited by other auditor, type of opinion expressed and date of that report.

Prior period FS NOT audited: State the same in Other Matter Paragraph.

SA 720 – Auditor’s Responsibility in relation to Other Information in Document Containing FS

Introduction

1) Document containing Audited FS refers to Annual Report containing Audited FS & Other Information (OI).

2) In absence of any separate requirement of engagement, the auditor’s opinion does not cover other information & he has no responsibility for the same. However, the auditor reads the other information because the credibility of Audited FS may be undermined by material inconsistencies between audited FS & OI.

3) **Objective:**
Respond appropriately when document containing audited FS & the auditor’s report includes OI that could undermine the credibility of FS & Auditor’s Report.

Requirements

1) Reading other information: To identify material inconsistencies.

2) If material inconsistency found: Whether FS or OI need revision.

3) Material inconsistency identified prior to date of auditor’s report:
- **a)** FS needs revision & Mgmt. refuses: Modify Report.
- **b)** OI needs revision & Mgmt. refuses: Include in other matter para.

4) Material inconsistency identified after date of auditor’s report:
- **a)** FS needs revision: Follow requirements of SA 560.
- **b)** OI needs revision:
  - Mgmt. agrees: Carry out procedures necessary.
  - Mgmt. refuses: Notify TCWG & take appropriate action.

5) **Material misstatement of fact:**
Material misstatement is a misstatement in OI that is NOT a part of FS.
Discuss with mgmt., if they don’t agree tell them to consult qualified third party & notify TCWG.

ABOUT THE WRITER:

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From the day he became CA, he is engaged in Coaching and Motivating the Aspiring Chartered Accountants. He did his Articleship from Deloitte Haskins and Sells, one of the big fours, in order to have the Best of the Industry Experience. His Articleship experience is wide covering Audit of many Listed Companies, Government Companies, Consolidation of Foreign Subsidiaries, IPO Work etc. This wide Practical Experience and his thirst to understand the Concept and make Students understand the Subject Conceptually makes him a Distinguished Faculty amongst the Students.

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His Motivational Stories always help the Students to bring the BEST out of them. He always says, “WE BELIEVE, WE CAN”.

About the Auditing Standard Summary

- This Auditing Standard Summary is prepared with a view to help the students to revise the Auditing Standards thoroughly.
- Each standard is given in chart form covering almost everything.
- Students are advised:
  - to read this summary properly and not just going through;
  - to cover the practical questions from Class Material and ICAI Material;
  - to understand the things and not just mug up.

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