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SA 200 (AAS 1)

Basic Principles Governing an Audit

Integrity, Objectivity and Independence

5. The auditor should be straightforward, honest and sincere in his approach to his professional work. He must be fair and must not allow prejudice or bias to override his objectivity. He should maintain an impartial attitude and both be and appear to be free of any interest which might be regarded, whatever its actual effect, as being incompatible with integrity and objectivity.

Confidentiality

6. The auditor should respect the confidentiality of information acquired in the course of his work and should not disclose any such information to a third party without specific authority or unless there is a legal or professional duty to disclose.

Skills and Competence

7. The audit should be performed and the report should be prepared with due professional care by persons who have adequate training, experience and competence in auditing.

8. The auditor requires specialised skills and competence which are acquired through a combination of general education, technical knowledge obtained through study and formal courses concluded by a qualifying examination recognised for this purpose and practical experience under proper supervision. In addition, the auditor requires a continuing awareness of developments including pronouncements of ICAI on accounting and auditing matters, and relevant regulations and statutory requirements.

Work Performed by Others

9. When the auditor delegates work to assistants or uses work performed by other auditors and experts, he will continue to be responsible for forming and expressing his opinion on the financial information. However, he will be entitled to rely on work performed by others, provided he exercises adequate skill and care and is not aware of any reason to believe that he should not have so relied. In the case of any independent statutory appointment to perform the work on which the auditor has to rely in forming his opinion, such as in the case of the work of branch auditors appointed under the Companies Act, 1956, the auditor's report should expressly state the fact of such reliance.

10. The auditor should carefully direct, supervise and review work delegated to assistants. The auditor should obtain reasonable assurance that work performed by other auditors or experts is adequate for his purpose.

Documentation

11. The auditor should document matters which are important in providing evidence that the audit was carried out in accordance with the basic principles.

Planning

12. The auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner. Plans should be based on a knowledge of the client's business.

13. Plans should be made to cover, among other things:

   (a) acquiring knowledge of the client's accounting system, policies and internal control procedures;

   (b) establishing the expected degree of reliance to be placed on internal control;

   (c) determining and programming the nature, timing, and extent of the audit procedures to be performed; and

   (d) coordinating the work to be performed.

14. Plans should be further developed and revised as necessary during the course of the audit.

Audit Evidence

15. The auditor should obtain sufficient appropriate audit evidence through the performance of compliance and substantive procedures to enable him to draw reasonable conclusions therefrom on which to base his opinion on the financial information.

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

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

Accounting System and Internal Control

18. Management is responsible for maintaining an adequate accounting system incorporating various internal controls to the extent appropriate to the size and nature of the business. The auditor should reasonably assure himself that the accounting system is adequate and that all the accounting information which should be recorded has in fact been recorded. Internal controls normally contribute to such assurance.

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

20. Where the auditor concludes that he can rely on certain internal controls, his substantive procedures would normally be less extensive than would otherwise be required and may also differ as to their nature and timing.

Audit Conclusions and Reporting

21. The auditor should review and assess the conclusions drawn from the audit evidence obtained and from his knowledge of business of the entity as the basis for the expression of his opinion on the financial information. This review and assessment involves forming an overall conclusion as to whether:

(a) the financial information has been prepared using acceptable accounting policies, which have been consistently applied;

(b) the financial information complies with relevant regulations and statutory requirements;

(c) there is adequate disclosure of all material matters relevant to the proper presentation of the financial information, subject to statutory requirements, where applicable.

Integrity, Objectivity and Independence :

- Auditor should be interest free. He must possess qualities such as honesty, sincereness, fairness, objectivity, etc.

Skills and Competence : Auditor must have adequate training, competence and experience.

Confidentiality : Auditor must not disclose any confidential information regarding his client to any third party. However, he may disclose, if –

(i) There is a specific permission of client or

(ii) Required by law.

Work performed by others : Auditor may rely on work done by others i.e. other auditors or experts or his assistants provided he exercised due skill and care and there is nothing to doubt.

Planning : For proper conduct of work in efficient and timely manner.

Audit Evidence : Sufficient and appropriate evidence should be obtained by performing compliance and substantive procedures.

Accounting Systems and Internal Controls : Management is responsible for maintaining the same. The auditor has to check their adequacy.

Conclusion and Reporting : Auditor is required to express opinion on financial information on the basis of conclusions drawn from evidences. He is required to conclude whether –

(a) Financial information is prepared using consistent and acceptable accounting policies.

(b) Financial statements comply with relevant regulations.

(c) There is adequate disclosure of all material matters.

There should be clear expression of opinion in report. If the report is other than unqualified, auditor should state the reason for the same.

SA 200A (AAS 2)

OBJECTIVE AND SCOPE OF THE AUDIT OF FINANCIAL STATEMENTS

Objective of an Audit

2. The objective of an audit of financial statements, prepared within a framework of recognised accounting policies and practices and relevant statutory requirements, if any, is to enable an auditor to express an opinion on such financial statements.

3. The auditor's opinion helps determination of the true and fair view of the financial position and operating results of an enterprise. The user, however, should not assume that the auditor's opinion is an assurance as to the future viability of the enterprise or the efficiency or effectiveness with which management has conducted the affairs of the enterprise.

Responsibility for the Financial Statements

4. While the auditor is responsible for forming and expressing his opinion on the financial statements, the responsibility for their preparation is that of the management of the enterprise. Management's responsibilities include the maintenance of adequate accounting records and internal controls, the selection and application of accounting policies and the safeguarding of the assets of the enterprise. The audit of the financial statements does not relieve management of its responsibilities.

Scope of an Audit

5. The scope of an audit of financial statements will be determined by the auditor having regard to the terms of the engagement, the requirements of relevant legislation and the pronouncements of the Institute. The terms of engagement cannot, however, restrict the scope of an audit in relation to matters which are prescribed by legislation or by the pronouncements of the Institute.

6. The audit should be organised to cover adequately all aspects of the enterprise as far as they are relevant to the financial statements being audited. To form an opinion on the financial statements, the auditor should be reasonably satisfied as to whether the information contained in the underlying accounting records and other source data is reliable and sufficient as the basis for the preparation of the financial statements. In forming his opinion, the auditor should also decide whether the relevant information is properly disclosed in the financial statements subject to statutory requirements, where applicable.

7. The auditor assesses the reliability and sufficiency of the information contained in the underlying accounting records and other source data by:

(a) making a study and evaluation of accounting systems and internal controls on which he wishes to rely and testing those internal controls to determine the nature, extent and timing of other auditing procedures; and

(b) carrying out such other tests, enquiries and other verification procedures of accounting transactions and account balances as he considers appropriate in the particular circumstances.

8. The auditor determines whether the relevant information is properly disclosed in the financial statements by:

(a) comparing the financial statements with the underlying accounting records and other source data to see whether they properly summarise the transactions and events recorded therein; and

(b) considering the judgements that management has made in preparing the financial statements; accordingly, the auditor assesses the selection and consistent application of accounting policies, the manner in which the information has been classified, and the adequacy of disclosure.

9. The auditor's work involves exercise of judgement, for example, in deciding the extent of audit procedures and in assessing the reasonableness of the judgements and estimates made by management in preparing the financial statements. Furthermore, much of the evidence available to the auditor can enable him to draw only reasonable conclusions therefrom. Because of these factors, absolute certainty in auditing is rarely attainable.

10. In forming his opinion on the financial statements, the auditor follows procedures designed to satisfy himself that the financial statements reflect a true and fair view of the financial position and operating results of the enterprise. The auditor recognises that because of the test nature and other inherent limitations of an audit, together with the inherent limitations of any system of internal control, there is an unavoidable risk that some material misstatement may remain undiscovered. While in many situations the discovery of a material misstatement by management may often arise during the conduct of the audit, such discovery is not the main objective of audit nor is the auditor's programme of work specifically designed for such discovery. The audit cannot, therefore, be relied upon to ensure the discovery of all frauds or errors but where the auditor has any indication that some fraud or error may have occurred which could result in material misstatement, the auditor should extend his procedures to confirm or dispel his suspicions.

11. The auditor is primarily concerned with items which either individually or as a group are material in relation to the affairs of an enterprise. However, it is difficult to lay down any definite standard by which materiality can be judged. Material items are those which might influence the decisions of the user of the financial statements[5]. It is a matter in which a decision is arrived at on the basis of the auditor's professional experience and judgement.

12. The auditor is not expected to perform duties which fall outside the scope of his competence. For example, the professional skill required of an auditor does not include that of a technical expert for determining physical condition of certain assets.

SA 210 (AAS 26)

TERMS OF AUDIT ENGAGEMENT

(Effective for all audits relating to accounting periods beginning on or after April 1, 2003)

Audit Engagement Letters

5. **In the interest of both client and auditor, the auditor should send an engagement letter, preferably before the commencement of the engagement, to help avoid any misunderstandings with respect to the engagement.** The engagement letter documents and confirms the auditor's acceptance of the appointment, the objective and scope of the audit and the extent of the auditor's responsibilities to the client.

Principal Contents

6. The form and content of audit engagement letter may vary for each client, but it would generally include reference to:

- The objective of the audit of financial statements.
- Management's responsibility for the financial statements.
- Management's responsibility for selection and consistent application of appropriate accounting policies, including implementation of the applicable accounting standards alongwith proper explanation relating to material departures from those accounting standards.
- Management's responsibility for preparation of the financial statements on a going concern basis.
- Management's responsibility for making judgements and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the entity at the end of the financial year and of the profit or loss of the entity for that period.
- Management's responsibility for the maintenance of adequate accounting records and internal controls for safeguarding the assets of the company and for preventing and detecting fraud or other irregularities.
- The scope of the audit, including reference to the applicable legislation, regulations, and the pronouncements of the Institute of Chartered Accountants of India.
- The fact that having regard to the test nature of an audit, persuasive rather than conclusive nature of audit evidence together with inherent limitations of any accounting and internal control system, there is an unavoidable risk that even some material misstatements, resulting from fraud, and to a lesser extent error, if either exists, may remain undetected.
- Unrestricted access to whatever records, documentation and other information requested in connection with the audit.

The auditor may also include

- Arrangements regarding the planning of the audit.
- Expectation of receiving from management written confirmation concerning representations made in connection with the audit.
- Request for the client to confirm the terms of the engagement by acknowledging receipt of the engagement letter.
- Description of any other letters or reports the auditor expects to issue to the client.
- Basis on which fees are computed and any billing arrangements.
- Arrangements concerning the involvement of other auditors and experts in some aspects of the audit.
- Arrangements concerning the involvement of internal auditors and other staff of the client.
- Arrangements to be made with the predecessor auditor, if any, in the case of an initial audit, i.e., when the financial statements for the preceding period were audited by another auditor.
- Any restriction of the auditor's liability when such possibility exists.
- A reference to any further agreements between the auditor and the client.

Audit of Components

9. When the auditor of a parent entity is also the auditor of its subsidiary, branch or division (component), the factors that influence the decision whether to send a separate engagement letter to the component include:

- Who appoints the auditor of the component?
- Whether a separate audit report is to be issued on the component.
- Legal requirements.
- The extent of any work performed by other auditors.
- Degree of ownership by parent.
- Degree of independence of the management of the component.

Recurring Audits

On recurring audits, the auditor should consider whether circumstances require the terms of the engagement to be revised and whether there is a need to remind the client of the existing terms of the engagement.

However, the following factors may make it appropriate to send a new letter:

- Any indication that the client misunderstands the objective and scope of the audit.
- Any revised or special terms of the engagement.
- A recent change of senior management, board of directors or ownership.
- A significant change in nature or size of the client's business.
- Legal requirements or pronouncements of the Institute of Chartered Accountants of India, or changes in the existing ones.

Acceptance of a Change in Engagement

12. **An auditor who, before the completion of the engagement, is requested to change the engagement to one which provides a lower level of assurance, should consider the appropriateness of doing so.**

13. A request from the client for the auditor to change the engagement may result from a change in circumstances affecting the need for the service, a misunderstanding as to the nature of an audit or related service originally requested or a restriction on the scope of the engagement, whether imposed by management or caused by circumstances. The auditor would consider carefully the reason given for the request, particularly the implications of a restriction on the scope of the engagement.

14. A change in circumstances that affects the entity's requirements or a misunderstanding concerning the nature of service originally requested would ordinarily be considered a reasonable basis for requesting a change in the engagement. In contrast, a change would not be considered reasonable if it appears that the change relates to information that is incorrect, incomplete or otherwise unsatisfactory.

15. Before agreeing to change an audit engagement to a related service, an auditor who was engaged to perform an audit in accordance with SAs would consider, in addition to the above matters, any legal or contractual implications of the change.

16. If the auditor concludes that there is reasonable justification to change the engagement and if the audit work performed complies with the SAs applicable to the changed engagement, the report issued would be that appropriate for the revised terms of engagement. In order to avoid confusion, the report would not include reference to:

(a) the original engagement; or

(b) any procedures that may have been performed in the original engagement, except where the engagement is changed to an engagement to undertake agreed-upon procedures and thus reference to the procedures performed is a normal part of the report.

17. **Where the terms of the engagement are changed, the auditor and the client should agree on the new terms.**

18. **The auditor should not agree to a change of engagement where there is no reasonable justification for doing so.** An example might be an audit engagement where the auditor is unable to obtain sufficient appropriate audit evidence regarding receivables and the client asks for the engagement to be changed to a review engagement to avoid a qualified, adverse or a disclaimer of opinion.

19. **If the auditor is unable to agree to a change of the engagement and is not permitted to continue the original engagement, the auditor should withdraw and consider whether there is any obligation, either contractual or otherwise, to report the circumstances necessitating the withdrawal to other parties, such as the board of directors or shareholders.**

SA 220 (AAS 17)

QUALITY CONTROL FOR AUDIT WORK

The purpose of this Standard on Auditing

1. The purpose of this Standard on Auditing (SA) is to establish standards on the quality control:

(a) policies and procedures of an audit firm regarding audit work generally; and

(b) procedures regarding the work delegated to assistants on an individual audit.

2. Quality control policies and procedures should be implemented at both the level of the audit firm and on individual audits.

Audit Firm

4. **The audit firm should implement quality control policies and procedures designed to ensure that all audits are conducted in accordance with Standards on Auditing (SAs).**

5. Compliance with Standards on Auditing (SAs) is essential whenever an audit is carried out and requires the application of auditing procedures and reporting practices appropriate to the particular circumstances. An audit firm needs to implement appropriate quality control policies and procedures to ensure that all audits are carried out in accordance with Standards on Auditing (SAs).

6. The objectives of the quality control policies to be adopted by an audit firm will ordinarily incorporate the following:

(a) ***Professional Requirements:*** Personnel in the firm are to adhere to the principles of Independence, Integrity, Objectivity, Confidentiality and Professional Behavior.

(b) ***Skills and Competence[2]:*** The firm is to be staffed by personnel who have attained and maintain the Technical Standards and Professional Competence required to enable them to fulfil their responsibilities with Due Care.

(c) ***Assignment:*** Audit work is to be assigned to personnel who have the degree of technical training and proficiency required in the circumstances.

(d) ***Delegation:*** There is to be sufficient direction, supervision and review of work at all levels to provide reasonable assurance that the work performed meets appropriate standards of quality.

(e) ***Consultation:*** Whenever necessary, consultation within or outside the firm is to occur with those who have appropriate expertise.

(f) ***Acceptance and Retention of Clients:*** An evaluation of prospective clients and a review, on an ongoing basis, of existing clients is to be conducted. In making a decision to accept or retain a client, the firm's independence and ability to serve the client properly are to be considered.

Individual Audits

8. **The auditor should implement those quality control procedures which are, in the context of the policies and procedures of the firm, appropriate to the individual audit.**

9. The auditor, and assistants with supervisory responsibilities, will consider the professional competence of assistants performing work delegated to them when deciding the extent of direction, supervision and review appropriate for each assistant.

Supervision

13. Supervision is closely related to both direction and review and may involve elements of both.

14. Personnel carrying out supervisory responsibilities perform the following functions during the audit:

(a) monitor the progress of the audit to consider whether:

   (i) assistants have the necessary skills and competence to carry out their assigned tasks;

   (ii) assistants understand the audit directions; and

   (iii) the work is being carried out in accordance with the overall audit plan and the audit programme;

(b) become informed of and address significant accounting and auditing questions raised during the audit, by assessing their significance and modifying the overall audit plan and the audit programme as appropriate; and

(c) resolve any differences of professional judgement between personnel and consider the level of consultation that is appropriate.

Standard on Auditing (SA) 230[1] (Revised) Audit Documentation

This Standard on Auditing (SA) deals with the auditor's responsibility to prepare audit documentation for an audit of financial statements.

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

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

Form, Content and Extent of Audit Documentation

- 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.

- Audit programmes.
- Analyses.
- Issues memoranda.
- Summaries of significant matters.
- Letters of confirmation and representation.
- Checklists.
- Correspondence (including e-mail) concerning significant matters.

A6. In principle, compliance with the requirements of this SA will result in the audit documentation being sufficient and appropriate in the circumstances.

A7. Audit documentation provides evidence that the audit complies with SAs.

A8. Judging the significance of a matter requires an objective analysis of the facts and circumstances. Examples of significant matters include:

- Matters that give rise to significant risks (as defined in SA 315)[5].
- 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.

A10. Some examples of circumstances in which, in accordance with paragraph 8, it is appropriate to prepare audit documentation relating to the use of professional judgment include, where the matters and judgments are significant:

- 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 judgments (for example, the reasonableness of significant accounting estimates).
- The basis for the auditor's conclusions about the authenticity of a document when further investigation (such as making appropriate use of an expert or of confirmation procedures) is undertaken in response to conditions identified during the audit that caused the auditor to believe that the document may not be authentic.

Identification of Specific Items or Matters Tested, and of the Preparer and Reviewer (Ref: Para. 9)

A12. Recording the identifying characteristics serves a number of purposes. For example, it enables the engagement team to be accountable for its work and facilitates the investigation of exceptions or inconsistencies. Identifying characteristics will vary with the nature of the audit procedure and the item or matter tested. For example:

- For a detailed test of entity-generated purchase orders, the auditor may identify the documents selected for testing by their dates and unique purchase order numbers.
- For a procedure requiring selection or review of all items over a specific amount from a given population, the auditor may record the scope of the procedure and identify the population (for example, all journal entries over a specified amount from the journal register).

- For a procedure requiring systematic sampling from a population of documents, the auditor may identify the documents selected by recording their source, the starting point and the sampling interval (for example, a systematic sample of shipping reports selected from the shipping log for the period April 1 to September 30, starting with report number 12345 and selecting every 125th report).
- For a procedure requiring inquiries of specific entity personnel, the auditor may record the dates of the inquiries and the names and job designations of the entity personnel.
- For an observation procedure, the auditor may record the process or matter being observed, the relevant individuals, their respective responsibilities, and where and when the observation was carried out.

SA 240 (AAS 4)

The Auditor's Responsibility to Consider Fraud and Error in an Audit of Financial Statements

Standard on Auditing (SA) 240 deals with auditor's responsibilities relating to fraud in an audit of financial statements. It elucidates how principles enunciated in SA 315 and SA 330 are to be applied in relation to risks of material misstatement due to fraud.

SA 240 covers:

- Professional Skepticism
- Discussion among the engagement team
- Risk assessment procedures and related activities
- Identification and assessment of the risks of material misstatement due to fraud
- Responses to assessed risks of material misstatement due to fraud
- Evaluation of audit evidence
- Auditor unable to continue the engagement
- Management representations
- Communications to management and with those charged with governance
- Communications to regulatory and enforcement authorities
- Documentation

SA 240 contains two distinct sections – Requirements section and Application Guidance

1. The purpose of this Standard on Auditing (SA) is to establish standards on the auditor's responsibility to consider fraud and error in an audit of financial statements. While this SA focuses on the auditor's responsibilities with respect to fraud and error, the primary responsibility for the prevention and detection of fraud and error rests with both those charged with governance and the management of an entity. In this Standard, the term 'financial information' encompasses 'financial statements'. In some circumstances, specific legislations and regulations may require the auditor to undertake procedures additional to those set out in this SA.

Fraud and Error and Their Characteristics

3. Misstatements in the financial statements can arise from fraud or error. The term "error" refers to an unintentional misstatement in the financial statements, including the omission of an amount or a disclosure, such as:

- A mistake in gathering or processing data from which financial statements are prepared.
- An incorrect accounting estimate arising from oversight or misinterpretation of facts.
- A mistake in the application of accounting principles relating to measurement, recognition, classification, presentation, or disclosure.

4. The term "fraud" refers to an intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage. Although fraud is a broad legal concept, the auditor is concerned with fraudulent acts that cause a material misstatement in the financial statements. Misstatement of the financial statements may not be the objective of some frauds. Auditors do not make legal determinations of whether fraud has actually occurred. Fraud involving one or more members of management or those charged with governance is referred to as "management fraud"; fraud involving only employees of the entity is referred to as "employee fraud". In either case, there may be collusion with third parties outside the entity.

5. Two types of intentional misstatements are relevant to the auditor's consideration of fraud-misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets.

6. Fraudulent financial reporting involves intentional misstatements or omissions of amounts or disclosures in financial statements to deceive financial statement users. Fraudulent financial reporting may involve:

- Deception such as manipulation, falsification, or alteration of accounting records or supporting documents from which the financial statements are prepared.
- Misrepresentation in, or intentional omission from, the financial statements of events, transactions or other significant information.
- Intentional misapplication of accounting principles relating to measurement, recognition, classification, presentation, or disclosure.

7. Misappropriation of assets involves the theft of an entity's assets. Misappropriation of assets can be accomplished in a variety of ways (including embezzling receipts, stealing physical or intangible assets, or causing an entity to pay for goods and services not received); it is often accompanied by false or misleading records or documents in order to conceal the fact that the assets are missing.

Responsibility of Those Charged With Governance and of Management

10. The primary responsibility for the prevention and detection of fraud and error rests with both those charged with the governance and the management of an entity. The respective responsibilities of those charged with governance and management may vary from entity to entity. Management, with the oversight of those charged with governance, needs to set the proper tone, create and maintain a culture of honesty and high ethics, and establish appropriate controls to prevent and detect fraud and error within the entity.

11. It is the responsibility of those charged with governance of an entity to ensure, through oversight of management, the integrity of an entity's accounting and financial reporting systems and that appropriate controls are in place, including those for monitoring risk, financial control and compliance with the laws and regulations.

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12. It is the responsibility of the management of an entity to establish a control environment and maintain policies and procedures to assist in achieving the objective of ensuring, as far as possible, the orderly and efficient conduct of the entity's business. This responsibility includes implementing and ensuring the continued operation of accounting and internal control systems, which are designed to prevent and detect fraud and error. Such systems reduce but do not eliminate the risk of misstatements, whether caused by fraud or error. Accordingly, management assumes responsibility for any remaining risk.

Professional Skepticism

18. The auditor plans and performs an audit with an attitude of professional skepticism. Such an attitude is necessary for the auditor to identify and properly evaluate, for example:

- Matters that increase the risk of a material misstatement in the financial statements resulting from fraud or error (for instance, management's characteristics and influence over the control environment, industry conditions, and operating characteristics and financial stability).
- Circumstances that make the auditor suspect that the financial statements are materially misstated.
- Evidence obtained (including the auditor's knowledge from previous audits) that brings into question the reliability of management representations.

Inquiries of Management

22. When planning the audit, the auditor should make inquiries of management:

(a) to obtain an understanding of:

    (i) management's assessment of the risk that the financial statements may be materially misstated as a result of fraud; and

    (ii) the accounting and internal control systems management has put in place to address such risk;

(b) to obtain knowledge of management's understanding regarding the accounting and internal control systems in place to prevent and detect error;

(c) to determine whether management is aware of any known fraud that has affected the entity or suspected fraud that the entity is investigating; and

(d) to determine whether management has discovered any material errors.

Inherent Risk and Control Risk

32. When assessing inherent risk and control risk in accordance with SA 400 (Revised), "Risk Assessments and Internal Control", the auditor should consider how the financial statements might be materially misstated as a result of fraud or error. In considering the risk of material misstatement resulting from fraud, the auditor should consider whether fraud risk factors are present that indicate the possibility of either fraudulent financial reporting or misappropriation of assets.

Detection Risk

39. Based on the auditor's assessment of inherent and control risks (including the results of any tests of controls), the auditor should design substantive procedures to reduce to an acceptably low level the risk that misstatements resulting from fraud and error that are material to the financial statements taken as a whole will not be detected. In designing the substantive procedures, the auditor should address the fraud risk factors that the auditor has identified as being present.

Procedures when Circumstances Indicate a Possible Misstatement

42. **When the auditor encounters circumstances that may indicate that there is a material misstatement in the financial statements resulting from fraud or error, the auditor should perform procedures to determine whether the financial statements are materially misstated.**

43. During the course of the audit, the auditor may encounter circumstances that indicate that the financial statements may contain a material misstatement resulting from fraud or error. Examples of such circumstances that, individually or in combination, may make the auditor suspect that such a misstatement exists are set out in **Appendix 3** to this SA.

44. When the auditor encounters such circumstances, the nature, timing and extent of the procedures to be performed depends on the auditor's judgment as to the type of fraud or error indicated, the likelihood of its occurrence, and the likelihood that a particular type of fraud or error could have a material effect on the financial statements. Ordinarily, the auditor is able to perform sufficient procedures to confirm or dispel a suspicion that the financial statements are materially misstated resulting from fraud or error. If not, the auditor considers the effect on the auditor's report, as discussed in paragraph 48.

Considering Whether an Identified Misstatement may be Indicative of Fraud

46. When the auditor identifies a misstatement, the auditor should consider whether such a misstatement may be indicative of fraud and if there is such an indication, the auditor should consider the implications of the misstatement in relation to other aspects of the audit, particularly the reliability of management representations.

Evaluation and Disposition of Misstatements, and the Effect on the Auditor's Report

48. **When the auditor confirms that, or is unable to conclude whether, the financial statements are materially misstated as a result of fraud or error, the auditor should consider the implications for the audit.** SA

320, "Audit Materiality," paragraphs 12-16, and SA 700, "The Auditor's Report on Financial Statements", paragraphs 37-47, provide guidance on the evaluation and disposition of misstatements and the effect on the auditor's report. Where a significant fraud has occurred or the fraud is committed by those charged with governance, the auditor should consider the necessity for a disclosure of the fraud in the financial statements. If adequate disclosure is not made the auditor should consider the necessity for a suitable disclosure in his report.

Management Representations

51. The auditor should obtain written representations from management that:

(a) it acknowledges its responsibility for the implementation and operation of accounting and internal control systems that are designed to prevent and detect fraud and error;

(b) it believes the effects of those uncorrected financial statement misstatements aggregated by the auditor during the audit are immaterial, both individually and in the aggregate, to the financial statements taken as a whole. A summary of such items should be included in or attached to the written representation;

(c) it has disclosed to the auditor all significant facts relating to any frauds or suspected frauds known to management that may have affected the entity; and

(d) it has disclosed to the auditor the results of its assessment of the risk that the financial statements may be materially misstated as a result of fraud.

Communication

56. When the auditor identifies a misstatement resulting from fraud, or a suspected fraud, or error, the auditor should consider the auditor's responsibility to communicate that information to management, those charged with governance and, in some circumstances, when so required by the laws and regulations, to regulatory and enforcement authorities also.

Communication of Misstatements Resulting From Error to Management and to Those Charged With Governance

59. If the auditor has identified a material misstatement resulting from error, the auditor should communicate the misstatement to the appropriate level of management on a timely basis, and consider the need to report it to those charged with governance.

60. The auditor should inform those charged with governance of those uncorrected misstatements aggregated by the auditor during the audit that were determined by management to be immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

Communication of Misstatements Resulting From Fraud to Management and to Those Charged with Governance

62. If the auditor has:

(a) identified a fraud, whether or not it results in a material misstatement in the financial statements; or

(b) obtained evidence that indicates that fraud may exist (even if the potential effect on the financial statements would not be material);

the auditor should communicate these matters to the appropriate level of management on a timely basis, and consider the need to report such matters to those charged with governance.

Communication of Material Weaknesses in Internal Control

65. The auditor should communicate to management any material weaknesses in internal control related to the prevention or detection of fraud and error, which have come to the auditor's attention as a result of the performance of the audit. The auditor should also be satisfied that those charged with governance have been informed of any material weaknesses in internal control related to the prevention and detection of fraud that either have been brought to the auditor's attention by management or have been identified by the auditor during the audit.

66. When the auditor has identified any material weaknesses in internal control related to the prevention or detection of fraud or error, the auditor communicates these material weaknesses in internal control to management. Because of the serious implications of material weaknesses in internal control related to the prevention and detection of fraud, it is also important that such deficiencies be brought to the attention of those charged with governance.

67. If the integrity or honesty of management or those charged with governance are doubted, the auditor ordinarily considers seeking legal advice to assist in the determination of the appropriate course of action.

Auditor Unable to Complete the Engagement

69. If the auditor concludes that it is not possible to continue performing the audit as a result of a misstatement resulting from fraud or suspected fraud, the auditor should:

(a) consider the professional and legal responsibilities applicable in the circumstances, including whether there is a requirement for the auditor to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities;

(b) consider the possibility of withdrawing from the engagement; and

(c) if the auditor withdraws:

  (i) discuss with the appropriate level of management and those charged with governance, the auditor's withdrawal from the engagement and the reasons for the withdrawal; and

  (ii) consider whether there is a professional or legal requirement to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities, the auditor's withdrawal from the engagement and the reasons for the withdrawal.

SA 299 (AAS 12)

RESPONSIBILITY OF JOINT AUDITORS

Division of Work

2. Where joint auditors are appointed, they should, by mutual discussion, divide the audit work among themselves. The division of work would usually be in terms of audit of identifiable units or specified areas. In some cases, due to the nature of the business of the entity under audit, such a division of work may not be possible. In such situations, the division of work may be with reference to items of assets or liabilities or income or expenditure or with reference to periods of time. Certain areas of work, owing to their importance or owing to the nature of the work involved, would often not be divided and would be covered by all the joint auditors.

Coordination

4. Where, in the course of his work, a joint auditor comes across matters which are relevant to the areas of responsibility of other joint auditors and which deserve their attention, or which require disclosure or require discussion with, or application of judgement by, other joint auditors, he should communicate the same to all the other joint auditors in writing. This should be done by the submission of a report or note prior to the finalisation of the audit.

Relationship Among Joint Auditors

5. In respect of audit work divided among the joint auditors, each joint auditor is responsible only for the work allocated to him, whether or not he has prepared a separate report on the work performed by 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 among the joint auditors and is carried out by all of them;

(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 any of the joint auditors. It may, however, be clarified that all the joint auditors are responsible only in respect of the appropriateness of the decisions concerning the nature, timing or extent of the audit procedures agreed upon among them; proper execution of these audit procedures is the separate and specific responsibility of the joint auditor concerned;

(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;

Reporting Responsibilities

12. 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. A joint auditor is not bound by the views of the majority of the joint auditors regarding matters to be covered in the report and should express his opinion in a separate report in case of a disagreement.

SA 300(REVISED)[1]

PLANNING AN AUDIT OF FINANCIAL STATEMENTS

(Effective for audits of financial statements for periods beginning on or after 1st April 2008)

Preliminary Engagement Activities

5. The auditor shall undertake the following activities at the beginning of the current audit engagement:

(a) Performing procedures required by SA 220[3], "Quality Control for Audit Work" regarding the continuance of the client relationship and the specific audit engagement;

(b) Evaluating compliance with ethical requirements, including independence, as required by SA 220; and

(c) Establishing an understanding of the terms of the engagement, as required by SA 210[4], "Terms of Audit Engagements". (Ref: Para. A6-A8)

Planning Activities

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

7. 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 factors that, in the auditor's professional judgment, are significant in directing the engagement team's efforts;

(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; and

(e) Ascertain the nature, timing and extent of resources necessary to perform the engagement. (Ref: Para. A9-A12)

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

(a) The nature, timing and extent of planned risk assessment procedures, as determined under SA 315 "Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment".

(b) The nature, timing and extent of planned further audit procedures at the assertion level, as determined under SA 330 "The Auditor's Responses to Assessed Risks".

(c) Other planned audit procedures that are required to be carried out so that the engagement complies with SAs. (Ref: Para. A13)

A3. Planning is not a discrete phase of an audit, but rather a continual and iterative process that often begins shortly after (or in connection with) the completion of the previous audit and continues until the completion of the current audit engagement. Planning, however, includes consideration of the timing of certain activities and audit procedures that need to be completed prior to the performance of further audit procedures. For example, planning includes the need to consider, prior to the auditor's identification and assessment of the risks of material misstatement, such matters as:

- 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.

Preliminary Engagement Activities (Ref: Para. 5)

A6. Performing the preliminary engagement activities specified in paragraph 5 at the beginning of the current audit engagement assists the auditor in identifying and evaluating events or circumstances that may adversely affect the auditor's ability to plan and perform the audit engagement.

A7. Performing these preliminary engagement activities enables the auditor to plan an audit engagement for which, for example:

- The auditor maintains the necessary independence and ability to perform the engagement.
- There are no issues with management integrity that may affect the auditor's willingness to continue the engagement.
- There is no misunderstanding with the client as to the terms of the engagement.

A9. The process of establishing the overall audit strategy assists the auditor to determine, subject to the completion of the auditor's risk assessment procedures, such matters as:

- The resources to deploy for specific audit areas, such as the use of appropriately experienced team members for high risk areas or the involvement of experts on complex matters;
- The amount of resources to allocate to specific audit areas, such as the number of team members assigned to observe the inventory count at material locations, the extent of review of other auditors' work in the case of group audits, or the audit budget in hours to allocate to high risk areas;
- When these resources are to be deployed, such as whether at an interim audit stage or at key cut-off dates; and
- How such resources are managed, directed and supervised, such as when team briefing and debriefing meetings are expected to be held, how engagement partner and manager reviews are expected to take place (for example, on-site or off-site), and whether to complete engagement quality control reviews.

Direction, Supervision and Review (Ref: Para. 10)

A15. The nature, timing and extent of the direction and supervision of engagement team members and review of their work vary depending on many factors, including:

- The size and complexity of the entity.
- The area of the audit.
- The assessed risks of material misstatement (for example, an increase in the assessed risk of material misstatement for a given area of the audit ordinarily requires a corresponding increase in the extent and timeliness of direction and supervision of engagement team members, and a more detailed review of their work).
- The capabilities and competence of the individual team members performing the audit work.

SA 220 contains further guidance on the direction, supervision and review of audit work.

Considerations in Establishing the Overall Audit Strategy

Characteristics of the Engagement

Reporting Objectives, Timing of the Audit, and Nature of Communications

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

Nature, Timing and Extent of Resources

Characteristics of the Engagement

- The financial reporting framework on which the financial information to be audited has been prepared, including any need for reconciliations to another financial reporting framework.
- Industry-specific reporting requirements such as reports mandated by industry regulators.
- The expected audit coverage, including the number and locations of components to be included.
- The nature of the control relationships between a parent and its components that determine how the group is to be consolidated.
- The extent to which components are audited by other auditors.
- The nature of the business segments to be audited, including the need for specialized knowledge.
- The reporting currency to be used, including any need for currency translation for the financial information audited.
- The need for a statutory audit of standalone financial statements in addition to an audit for consolidation purposes.
- The availability of the work of internal auditors and the extent of the auditor's potential reliance on such work.
- The entity's use of service organizations and how the auditor may obtain evidence concerning the design or operation of controls performed by them.
- The expected use of audit evidence obtained in previous audits, for example, audit evidence related to risk assessment procedures and tests of controls.
- The effect of information technology on the audit procedures, including the availability of data and the expected use of computer-assisted audit techniques.

Reporting Objectives, Timing of the Audit, and Nature of Communications

- The entity's timetable for reporting, such as at interim and final stages.
- The organization of meetings with management and those charged with governance to discuss the nature, timing and extent of the audit work.
- The discussion with management and those charged with governance regarding the expected type and timing of reports to be issued and other communications, both written and oral, including the auditor's report, management letters and communications to those charged with governance.
- The discussion with management regarding the expected communications on the status of audit work throughout the engagement.
- Communication with auditors of components regarding the expected types and timing of reports to be issued and other communications in connection with the audit of components.
- The expected nature and timing of communications among engagement team members, including the nature and timing of team meetings and timing of the review of work performed.
- Whether there are any other expected communications with third parties, including any statutory or contractual reporting responsibilities arising from the audit.

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

- The determination of appropriate materiality levels, including:
  - Setting materiality for planning purposes.
  - Setting and communicating materiality for auditors of components.
  - Reconsidering materiality as audit procedures are performed during the course of the audit.
  - Preliminary identification of material components and account balances.

- Preliminary identification of areas where there may be a higher risk of material misstatement.
- The impact of the assessed risk of material misstatement at the overall financial statement level on direction, supervision and review.
- The manner in which the auditor emphasizes to engagement team members the need to maintain a questioning mind and to exercise professional skepticism in gathering and evaluating audit evidence.
- Results of previous audits that involved evaluating the operating effectiveness of internal control, including the nature of identified weaknesses and action taken to address them.
- The discussion of matters that may affect the audit with firm personnel responsible for performing other services to the entity.
- Evidence of management's commitment to the design, implementation and maintenance of sound internal control, including evidence of appropriate documentation of such internal control.
- Volume of transactions, which may determine whether it is more efficient for the auditor to rely on internal control.

- Importance attached to internal control throughout the entity to the successful operation of the business.
- Significant business developments affecting the entity, including changes in information technology and business processes, changes in key management, and acquisitions, mergers and divestments.
- Significant industry developments such as changes in industry regulations and new reporting requirements.
- Significant changes in the financial reporting framework, such as changes in accounting standards.
- Other significant relevant developments, such as changes in the legal environment affecting the entity.

Nature, Timing and Extent of Resources

- The selection of the engagement team (including, where necessary, the engagement quality control reviewer) and the assignment of audit work to the team members, including the assignment of appropriately experienced team members to areas where there may be higher risks of material misstatement.
- Engagement budgeting, including considering the appropriate amount of time to set aside for areas where there may be higher risks of material misstatement.

SA 320 (AAS 13)

AUDIT MATERIALITY

Materiality

3. Information is material if its misstatement (i.e., omission or erroneous statement) could influence the economic decisions of users taken on the basis of the financial information.

4 The objective of an audit of financial information prepared within a framework of recognised accounting policies and practices and relevant statutory requirements, if any, is to enable the auditor to express an opinion on such financial information. The assessment of what is material is a matter of professional judgement.

5. The concept of materiality recognises that some matters, either individually or in the aggregate, are relatively important for true and fair presentation of financial information in conformity with recognised accounting policies and practices. The auditor considers materiality at both the overall financial information level and in relation to individual account balances and classes of transactions. Materiality may also be influenced by other considerations, such as the legal and regulatory requirements, non-compliance with which may have a significant bearing on the financial information, and considerations relating to individual account balances and relationships. This process may result in different levels of materiality depending on the matter being audited.

6. Although the auditor ordinarily establishes an acceptable materiality level to detect quantitatively material misstatements, both the amount (quantity) and nature (quality) of misstatements need to be considered. An example of a qualitative misstatement would be the inadequate or improper description of an accounting policy when it is likely that a user of the financial statements would be misled by the description.

7. The auditor needs to consider the possibility of misstatements of relatively small amounts that, cumulatively, could have a material effect on the financial information. For example, an error in a month-end (or other periodic) procedure could be an indication of a potential material misstatement if that error is repeated each month or each period, as the case may be.

8. Materiality should be considered by the auditor when –

(a) determining the nature, timing and extent of audit procedures;

(b) evaluating the effect of misstatements.

The Relationship between Materiality and Audit Risk

9. When planning the audit, the auditor considers what would make the financial information materially misstated. The auditor's preliminary assessment of materiality, related to specific account balances and classes of transactions, helps the auditor decide such questions as what items to examine and whether to use sampling and analytical procedures. This enables the auditor to select audit procedures that, in combination, can be expected to support the audit opinion at an acceptably low degree of audit risk.

10. There is an inverse relationship between materiality and the degree of audit risk, that is, the higher the materiality level, the lower the audit risk and vice versa. For example, the risk that a particular account balance or class of transactions could be misstated by an extremely large amount might be very low, but the risk that it could be misstated by an extremely small amount might be very high. The auditor takes the inverse relationship between materiality and audit risk into account when determining the nature, timing and extent of audit procedures. For example, if, after planning for specific audit procedures, the auditor determines that the acceptable materiality level is lower, audit risk is increased. The auditor would compensate for this by either:

(a) reducing the assessed degree of control risk, where this is possible, and supporting the reduced degree by carrying out extended or additional tests of control; or

(b) reducing detection risk by modifying the nature, timing and extent of planned substantive procedures.

Materiality and Audit Risk in Evaluating Audit Evidence

11. The auditor's assessment of materiality and audit risk may be different at the time of initially planning the engagement from that at the time of evaluating the results of his audit procedures. This could be because of a change in circumstances or a change in the auditor's knowledge as a result of the audit. For example, if the audit is planned prior to period end, the auditor will anticipate the results of operations and the financial position. If actual results of operations and financial position are substantially different, the assessment of materiality and audit risk may also change. Additionally, the auditor may, in planning the audit work, intentionally set the acceptable cut off level for verifying individual transactions at a lower level than is intended to be used to evaluate the results of the audit. This may be done to cover a larger number of items and thereby reduce the likelihood of undiscovered misstatements and to provide the auditor with the margin of safety when evaluating the effect of misstatements discovered during the audit.

12. In forming his opinion on the financial information, the auditor should consider whether the effect of aggregate uncorrected misstatements on the financial information is material. Qualitative considerations also influence an auditor in reaching a conclusion as to whether the misstatements are material.

13. The aggregate of uncorrected misstatements comprises:

(a) specific misstatements identified by the auditor, including the net effect of uncorrected misstatements identified during the audit of previous periods; and

(b) the auditor's best estimate of other misstatements which cannot be specifically identified (that is, projected errors).

14. When the auditor tests an account balance or class of transactions by an analytical procedure, he ordinarily would not specifically identify misstatements but would only obtain an indication of whether misstatements might exist in the balance or class and possibly its approximate magnitude. If the analytical procedure indicates that misstatements might exist, but not its approximate amount, the auditor ordinarily would have to employ other procedures to enable him to estimate the aggregate misstatement in the balance or class.

15. When an auditor uses audit sampling to test an account balance or class of transactions, he projects the amount of known misstatements identified by him in his sample to the items in the balance or class from which his sample was selected. That projected misstatement, along with the results of other substantive tests, contributes to the auditor's assessment of aggregate misstatement in the balance or class.

16. If the aggregate of the uncorrected misstatements that the auditor has identified approaches the materiality level, or if auditor determines that the aggregate of uncorrected misstatements causes the financial information to be materially misstated, he should consider requesting the management to adjust the financial information or extending his audit procedures. In any event, the management may want to adjust the financial information for known misstatements. The adjustment of financial information may involve, for example, application of appropriate accounting principles, other adjustments in amounts, or the addition of appropriate disclosure of inadequately disclosed matters. If the management refuses to adjust the financial information and the results of extended audit procedures do not enable the auditor to conclude that the aggregate of uncorrected misstatements is not material, the auditor should express a qualified or adverse opinion, as appropriate.

SA 500 (AAS 5)

Audit Evidence

"The auditor should obtain sufficient appropriate audit evidence through the performance of compliance and substantive procedures to enable him to draw reasonable conclusions therefrom on which to base his opinion on the financial information.

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:

(i) tests of details of transactions and balances;

(ii) analysis of significant ratios and trends, including the resulting enquiry of unusual fluctuations and items."

Sufficient Appropriate Audit Evidence

2. Sufficiency and appropriateness are interrelated and apply to evidence obtained from both compliance and substantive procedures. Sufficiency refers to the quantum of audit evidence obtained; appropriateness relates to its relevance and reliability. Normally, the auditor finds it necessary to rely on evidence that is persuasive rather than conclusive. He may often seek evidence from different sources or of different nature to support the same assertion (see paragraphs 5 and 6).

4. The auditor's judgement as to what is sufficient appropriate audit evidence is influenced by such factors as:

(a) The degree of risk of misstatement which may be affected by factors such as:

   (i) the nature of the item;

   (ii) the adequacy of internal control;

   (iii) the nature or size of the business carried on by the entity;

   (iv) situations which may exert an unusual influence on management;

   (v) the financial position of the entity.

(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 indicated by accounting ratios and analysis.

6. Obtaining audit evidence from substantive procedures is intended to reasonably assure the auditor in respect of the following assertions:

Existence	–	that an asset or a liability exists at a given date.
Rights and Obligations	–	that an asset is a right of the entity and a liability is an obligation of the entity at a given date.
Occurrence	–	that a transaction or event took place which pertains to the entity during the relevant period.
Completeness	–	that there are no unrecorded assets, liabilities or transactions.
Valuation	–	that an asset or liability is recorded at an appropriate carrying value.
Measurement	–	that a transaction is recorded in the proper amount and revenue or expense is allocated to the proper period.
Presentation and Disclosure	–	an item is disclosed, classified, and described in accordance with recognised accounting policies and practices and relevant statutory requirements, if any.

The reliability of audit evidence

7. The reliability of audit evidence depends on its source - internal or external, and on its nature - visual, documentary or oral. While the reliability of audit evidence is dependent on the circumstances under which it is obtained, the following generalisations may be useful in assessing the reliability of audit evidence:

- External evidence (e.g. confirmation received from a third party) is usually more reliable than internal evidence.
- Internal evidence is more reliable when related internal control is satisfactory.
- Evidence in the form of documents and written representations is usually more reliable than oral representations.
- Evidence obtained by the auditor himself is more reliable than that obtained through the entity.

Obtaining Audit Evidence

11. The auditor obtains evidence in performing compliance and substantive procedures by one or more of the following methods:

- Inspection
- Observation
- Inquiry and confirmation
- Computation
- Analytical review

The timing of such procedures will be dependent, in part, upon the periods of time during which the audit evidence sought is available.

SA 510 (AAS 22)

INITIAL ENGAGEMENTS - OPENING BALANCES

Audit Procedures

5. For the purpose of this Statement, the sufficiency and appropriateness of the audit evidence, the auditor will need to obtain regarding opening balances, would depend on the following matters:

- The accounting policies followed by the entity.
- Whether the auditor's report contained an unqualified opinion, a qualified opinion, adverse opinion or disclaimer of opinion where the financial statements for the preceding period were audited.
- The nature of the opening balances, including the risk of their misstatement in the financial statements for the current period.
- The materiality of the opening balances relative to the financial statements for the current period.

6. The auditor will need to consider whether the accounting policies followed in the preceding period, as per which the opening balances have been arrived at, were appropriate and that those policies are consistently applied in the financial statements for the current period and where such accounting policies are inappropriate, the same have been changed in the current period and adequately disclosed.

7. When the financial statements for the preceding period were audited by another auditor, the current auditor may be able to obtain sufficient appropriate audit evidence regarding opening balances by perusing the copies of the audited financial statements. Ordinarily, the current auditor can place reliance on the closing balances contained in the financial statements 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.

8. When the financial statements of the preceding period were not audited or the auditor is not satisfied by using the procedures described in paragraph 7, the auditor will need to perform other procedures such as those discussed in paragraphs 9 and 10.

9. For current assets and liabilities, some audit evidence can ordinarily be obtained as part of the audit procedures performed during the current period. For example, the collection/payment of opening accounts receivable/ accounts payable during the current period will provide some audit evidence as to their existence, rights and obligations, completeness and valuation at the beginning of the period.

10. For other assets and liabilities, such as fixed assets, investments and long-term debt, the auditor will ordinarily examine the records underlying the opening balances. In certain cases, the auditor may be able to obtain confirmation of opening balances from third parties, for example, for long-term debt and investments.

Audit Conclusions and Reporting

11. If, after performing procedures including those set out above, the auditor is unable to obtain sufficient appropriate audit evidence concerning opening balances, the auditor should, as appropriate, express:

(a) a qualified opinion, or

(b) a disclaimer of opinion.

The auditor may also express an opinion which is qualified or disclaimed regarding the profit or loss and unqualified regarding state of affairs, as appropriate.

12. If the opening balances contain misstatements which materially affect the financial statements for the current period and the effect of the same is not properly accounted for and adequately disclosed, the auditor should express a qualified opinion or an adverse opinion, as appropriate.

SA 520 (AAS 14)

ANALYTICAL PROCEDURES

Nature and Purpose of Analytical Procedures

4. Analytical procedures include the consideration of comparisons of the entity's financial information with, for example:

- Comparable information for prior periods.
- Anticipated results of the entity, such as budgets or forecasts.
- Predictive estimates prepared by the auditor, such as an estimation of depreciation charge for the year.
- Similar industry information, such as a comparison of the entity's ratio of sales to trade debtors with industry averages, or with other entities of comparable size in the same industry.

5. Analytical procedures also include consideration of relationships:

- Among elements of financial information that would be expected to conform to a predictable pattern based on the entity's experience, such as gross margin percentages.
- Between financial information and relevant non-financial information, such as payroll costs to number of employees.

Analytical procedures are used for the following purposes:

7. Analytical procedures are used for the following purposes:

(a) to assist the auditor in planning the nature, timing and extent of other audit procedures;

(b) as substantive procedures when their use can be more effective or efficient than tests of details in reducing detection risk for specific financial statement assertions; and

(c) as an overall review of the financial statements in the final review stage of the audit.

Analytical Procedures in Planning the Audit

8. **The auditor should apply analytical procedures at the planning stage to assist in understanding the business and in identifying areas of potential risk.** Application of analytical procedures may indicate aspects of the business of which the auditor was unaware and will assist in determining the nature, timing and extent of other audit procedures.

9. Analytical procedures in planning the audit use both financial and non-financial information, for example, the relationship between sales and square footage of selling space or volume of goods sold.

Analytical Procedures as Substantive Procedures

10. The auditor's reliance on substantive procedures to reduce detection risk relating to specific financial statement assertions may be derived from tests of details, from analytical procedures, or from a combination of both. The decision about which procedures to use to achieve a particular audit objective is based on the auditor's judgement about the expected effectiveness and efficiency of the available procedures in reducing detection risk for specific financial statement assertions.

11. The auditor will ordinarily inquire of management as to the availability and reliability of information needed to apply analytical procedures and the results of any such procedures performed by the entity. It may be efficient to use analytical data prepared by the entity, provided the auditor is satisfied that such data is properly prepared.

12. When intending to perform analytical procedures as substantive procedures, the auditor will need to consider a number of factors such as the:

- Objectives of the analytical procedures and the extent to which their results can be relied upon (paragraphs 14-16).
- Nature of the entity and the degree to which information can be disaggregated, for example, analytical procedures may be more effective when applied to financial information on individual sections of an operation or to financial statements of components of a diversified entity, than when applied to the financial statements of the entity as a whole.

- Availability of information, both financial, such as budgets or forecasts, and non-financial, such as the number of units produced or sold.
- Reliability of the information available, for example, whether budgets are prepared with sufficient care.
- Relevance of the information available, for example, whether budgets have been established as results to be expected rather than as goals to be achieved.
- Source of the information available, for example, sources independent of the entity are ordinarily more reliable than internal sources.
- Comparability of the information available, for example, broad industry data may need to be supplemented to be comparable to that of an entity that produces and sells specialised products.
- Knowledge gained during previous audits, together with the auditor's understanding of the effectiveness of the accounting and internal control systems and the types of problems that in prior periods have given rise to accounting adjustments.

Extent of Reliance on Analytical Procedures

15. The extent of reliance that the auditor places on the results of analytical procedures depends on the following factors:

(a) materiality of the items involved, for example, when inventory balances are material, the auditor does not rely only on analytical procedures in forming conclusions. However, the auditor may rely solely on analytical procedures for certain income and expense items when they are not individually material;

(b) other audit procedures directed toward the same audit objectives, for example, other procedures performed by the auditor in reviewing the collectibility of accounts receivable, such as the review of subsequent cash receipts, might confirm or dispel questions raised from the application of analytical procedures to an ageing schedule of customers' accounts;

(c) accuracy with which the expected results of analytical procedures can be predicted. For example, the auditor will ordinarily expect greater consistency in comparing gross profit margins from one period to another than in comparing discretionary expenses, such as research or advertising; and

(d) assessments of inherent and control risks, for example, if internal control over sales order processing is weak and, therefore, control risk is high, more reliance on tests of details of transactions and balances than on analytical procedures in drawing conclusions on receivables may be required.

Investigating Unusual Items

17. **When analytical procedures identify significant fluctuations or relationships that are inconsistent with other relevant information or that deviate from predicted amounts, the auditor should investigate and obtain adequate explanations and appropriate corroborative evidence.**

18. The investigation of unusual fluctuations and relationships ordinarily begins with inquiries of management, followed by:

(a) corroboration of management's responses, for example, by comparing them with the auditor's knowledge of the business and other evidence obtained during the course of the audit; and

(b) consideration of the need to apply other audit procedures based on the results of such inquiries, if management is unable to provide an explanation or if the explanation is not considered adequate.

SA 530 (AAS 15)

AUDIT SAMPLING

Selection of the Sample

18. The auditor should select sample items in such a way that the sample can be expected to be representative of the population. This requires that all items in the population have an opportunity of being selected.

19. While there are a number of selection methods, three methods commonly used are:

- *Random selection*, which ensures that all items in the population have an equal chance of selection, for example, by use of random number tables.

- *Systematic selection*, which involves selecting items using a constant interval between selections, the first interval having a random start. The interval might be based on a certain number of items (for example, every 20th voucher number) or on monetary totals (for example, every Rs 1,000 increase in the cumulative value of the population). When using systematic selection, the auditor would need to determine that the population is not structured in such a manner that the sampling interval corresponds with a particular pattern in the population. For example, if in a population of branch sales, a particular branch's sales occur only as every 100th item and the sampling interval selected is 50, the result would be that the auditor would have selected all, or none, of the sales of that particular branch.

- *Haphazard selection*, which may be an acceptable alternative to random selection, provided the auditor attempts to draw a representative sample from the entire population with no intention to either include or exclude specific units. When the auditor uses this method, care needs to be taken to guard against making a selection that is biased, for example, towards items which are easily located, as they may not be representative.

Evaluation of Sample Results

20. Having carried out, on each sample item, those audit procedures that are appropriate to the particular audit objective, the auditor should:

(a) analyse any errors detected in the sample;

(b) project the errors found in the sample to the population; and

(c) reassess the sampling risk.

Analysis of Errors in the Sample

21. In analysing the errors detected in the sample, the auditor will first need to determine that an item in question is in fact an error. In designing the sample, the auditor will have defined those conditions that constitute an error by reference to the audit objectives. For example, in a substantive procedure relating to the recording of accounts receivable, a mis-posting between customer accounts does not affect the total accounts receivable. Therefore, it may be inappropriate to consider this an error in evaluating the sample results of this particular procedure, even though it may have an effect on other areas of the audit such as the assessment of doubtful accounts.

22. When the expected audit evidence regarding a specific sample item cannot be obtained, the auditor may be able to obtain sufficient appropriate audit evidence through performing alternative procedures. For example, if a positive account receivable confirmation has been requested and no reply was received, the auditor may be able to obtain sufficient appropriate audit evidence that the receivable is valid by reviewing subsequent payments from the customer. If the auditor does not, or is unable to, perform satisfactory alternative procedures, or if the procedures performed do not enable the auditor to obtain sufficient appropriate audit evidence, the item would be treated as an error.

Projection of Errors

25. The auditor projects the error results of the sample to the population from which the sample was selected. There are several acceptable methods of projecting error results. However, in all the cases, the method of projection will need to be consistent with the method used to select the sampling unit. When projecting error results, the auditor needs to keep in mind the qualitative aspects of the errors found. When the population has been divided into sub-population, the projection of errors is done separately for each sub-population and the results are combined.

Reassessing Sampling Risk

26. The auditor needs to consider whether errors in the population might exceed the tolerable error. To accomplish this, the auditor compares the projected population error to the tolerable error taking into account the results of other audit procedures relevant to the specific control or financial statement assertion. The projected population error used for this comparison in the case of substantive procedures is net of adjustments made by the entity. When the projected error exceeds tolerable error, the auditor reassesses the sampling risk and if that risk is unacceptable, would consider extending the audit procedure or performing alternative audit procedures.

SA 540 (AAS 18)

AUDIT OF ACCOUNTING ESTIMATES

2. The auditor should obtain sufficient appropriate audit evidence regarding accounting estimates.

3. "Accounting estimate" means an approximation of the amount of an item in the absence of a precise means of measurement. Examples are:

- Allowances to reduce inventory and accounts receivable to their estimated realisable value.
- Provisions to allocate the cost of fixed assets over their estimated useful lives.
- Accrued revenue.
- Provision for taxation.
- Provision for a loss from a lawsuit.
- Insurer's liability for outstanding claims.
- Losses on construction contracts in progress.

Nature of Accounting Estimates

5. The determination of an accounting estimate may be simple or complex, depending upon the nature of the item. For example, accruing a charge for rent may be a simple calculation, whereas estimating a provision for slow-moving or surplus inventory may involve considerable analysis of current data and a forecast of future sales. In complex estimates, a high degree of special knowledge and judgment may be required.

6. Accounting estimates may be determined as part of the routine accounting system operating on a continuing basis, or may be non-routine, operating only at the end of the period. In many cases, accounting estimates are made by using a formula based on experience, such as the use of standard rates for depreciating each category of fixed assets or a standard percentage of sales revenue for computing a warranty provision. In such cases, the formula needs to be reviewed regularly by management, for example, by reassessing the remaining useful lives of assets or by comparing actual results with the estimate and adjusting the formula when necessary.

Audit Procedures

8. **The auditor should obtain sufficient appropriate audit evidence as to whether an accounting estimate is reasonable in the circumstances and, when required, is appropriately disclosed in the financial statements**. The evidence available to support an accounting estimate will often be more difficult to obtain and less conclusive than evidence available to support other items in the financial statements.

9. An understanding of the procedures and methods, including the accounting and internal control systems, used by management in making the accounting estimates is often important for the auditor to plan the nature, timing and extent of the audit procedures.

10. The auditor should adopt one or a combination of the following approaches in the audit of an accounting estimate:

(a) review and test the process used by management to develop the estimate;

(b) use an independent estimate for comparison with that prepared by management; or

(c) review subsequent events which confirm the estimate made.

Reviewing and Testing the Process Used by Management

11. The steps ordinarily involved in reviewing and testing of the process used by management are:

(a) evaluation of the data and consideration of assumptions on which the estimate is based;

(b) testing of the calculations involved in the estimate;

(c) comparison, when possible, of estimates made for prior periods with actual results of those periods; and

(d) consideration of management's approval procedures.

Evaluation of Data and Consideration of Assumptions

12. The auditor would evaluate whether the data on which the estimate is based is accurate, complete and relevant. When accounting data is used, it will need to be consistent with the data processed through the accounting system. For example, in substantiating a warranty provision, the auditor would obtain audit evidence that the data relating to products still within the warranty period, at period end, agree with the sales information within the accounting system.

13. External evidence is, usually, more reliable for the purpose of an audit than internal evidence. Accordingly, obtaining external evidence may be warranted in certain circumstances. For example, where there may be uncertainties with regard to the anticipated future sales of products requiring provision for obsolescence of inventories, the auditor, in addition to examining internal data such as past levels of sales, orders on hand etc., may seek external evidence to corroborate the requirement for inventory obsolescence provision. Similarly, in respect of claims against the entity arising out of litigation, internal evidence may be required to be corroborated by making a reference to entity's lawyers, if so required. Internal evidence relating to provision for gratuity, pension or other terminal benefits for the staff, where funded by external agencies, may sought to be corroborated by external evidence.

14. The auditor would evaluate whether the data collected is appropriately analysed to form a reasonable basis for determining the accounting estimate. For example, the analysis of the age of accounts receivable to estimate the provision for doubtful debts and advances.

15. The assumptions used in the accounting estimate will be specific to the entity and would be based on internally generated data, while in other cases, the assumptions may be based on industry or government statistics. The auditor would evaluate whether the entity has an appropriate base for the principal assumptions used in the accounting estimate.

16. In evaluating the assumptions on which the estimate is based, the auditor would consider, among other things, whether they are:

- Reasonable in light of actual results in prior periods.
- Consistent with those used for other accounting estimates.
- Consistent with management's plans which appear appropriate.

The auditor would need to pay particular attention to assumptions which are sensitive to variation, subjective or susceptible to material misstatement.

17. In the case of complex estimating processes involving specialised techniques, it may be necessary for the auditor to use the work of an expert, for example, engineers for estimating quantities in stock piles of mineral ores. Requirements as to how to use the work of an expert are prescribed in SA 620, "Using the Work of an Expert."

18. The auditor would review the continuing appropriateness of formulae used by management in the preparation of accounting estimates. For this purpose, the auditor's knowledge of the financial results of the entity in prior periods, practices used by other entities in the industry and the future plans of management as disclosed to the auditor would be useful.

Comparison of Previous Estimates with Actual Results

20. When possible, the auditor would compare accounting estimates made for prior periods with actual results of those periods to assist in:

(a) obtaining evidence about the general reliability of the entity's estimating procedures;

(b) considering whether adjustments to estimating formulae may be required; and

(c) evaluating whether differences between actual results and previous estimates have been quantified and that, where necessary, appropriate adjustments or disclosures have been made.

Consideration of Management's Approval Procedures

21. Material accounting estimates are ordinarily reviewed and approved by management. The auditor would consider whether such review and approval is performed by the appropriate level of management and that it is evidenced in the documentation supporting the determination of the accounting estimate.

Use of an Independent Estimate

22. The auditor may make or obtain an independent estimate and compare it with the accounting estimate, prepared by management. When using an independent estimate, the auditor would ordinarily evaluate the data, consider the assumptions and test the calculation procedures used in its development. It may also be appropriate to compare accounting estimates so made for prior periods with actual results of those periods.

Review of Subsequent Events

23. Transactions and events which occur after period end, but prior to completion of the audit, may provide audit evidence regarding an accounting estimate made by management. The auditor's review of such transactions and events may reduce, or even remove, the need for the auditor to review and test the process used by management to develop the accounting estimate or to use an independent estimate in assessing the reasonableness of the accounting estimate.

SA 550 (AAS 23)

RELATED PARTIES

2. The auditor should perform audit procedures designed to obtain sufficient appropriate audit evidence regarding the identification and disclosure by management of related parties and the related party transactions that are material to the financial statements. However, an audit cannot be expected to detect all related party transactions.

3. In certain circumstances there are limitations that may affect the persuasiveness of evidence available to the auditor to draw conclusions on particular financial statement assertions. Because of the degree of uncertainty associated with the financial statement assertions regarding the completeness of information of related parties, the procedures identified in this SA will provide sufficient appropriate audit evidence regarding those assertions in the absence of any circumstance identified by the auditor that:

(a) increases the risk of misstatement beyond that which would ordinarily be expected; or

(b) indicates that a material misstatement regarding related parties has occurred.

Where there is any indication that such circumstances exist, the auditor should perform modified, extended or additional procedures as are appropriate in the circumstances.

Existence and Disclosure of Related Parties

7. The auditor should review information provided by the management of the entity, identifying the names of all known related parties and should perform the following procedures in respect of the completeness of this information:

(a) review his working papers for the prior years for names of known related parties;

(b) review the entity's procedures for identification of related parties;

(c) inquire as to the affiliation of directors and key management personnel[3], officers with other entities;

(d) review shareholder records to determine the names of principal shareholders or, if appropriate, obtain a list of principal shareholders from the share register;

(e) review memorandum and articles of association, minutes of the meetings of shareholders and the board of directors and its committees and other relevant statutory records such as the register of directors' interests;

(f) inquire of other auditors[4] of the entity as to their knowledge of additional related parties and review the report of the predecessor auditors;

(g) review the entity's income tax returns and other information supplied to regulatory agencies; and

(h) review the joint venture and other relevant agreements entered into by the entity.

needs to be alert for

11. During the course of the audit, the auditor needs to be alert for transactions which appear unusual in the circumstances and may indicate the existence of previously unidentified related parties. Examples include:

- Transactions which have abnormal terms of trade, such as, unusual prices, interest rates, guarantees, and repayment terms.
- Transactions which lack an apparent logical business reason for their occurrence.
- Transactions in which substance differs from form.
- Transactions processed in an unusual manner.
- High volume or significant transactions with certain customers or suppliers as compared with others.
- Rendition of services without receipt or provision of management services at no charge.

carries out procedures \

12. During the course of the audit, the auditor carries out procedures which may identify the existence of transactions with related parties. Examples include:

- Performing detailed tests of transactions and balances.
- Reviewing minutes of meetings of shareholders and directors.
- Reviewing accounting records for large or unusual transactions or balances, paying particular attention to transactions recognised at or near the end of the reporting period.
- Reviewing the entity's income tax returns and other information supplied to regulatory agencies.
- Reviewing confirmations of loans receivable and payable and confirmations from banks. Such a review may indicate guarantor relationship and other related party transactions.
- Reviewing investment transactions, for example, purchase or sale of an equity interest in a joint venture or other entity.

Examining Identified Related Party Transactions

auditor would consider performing procedures such as:

- Confirming the terms and amount of the transaction with the related party.
- Obtaining confirmation from persons associated with the transaction, such as, banks, lawyers, guarantors and agents.

Management Representations

15. The auditor should obtain a written representation from management concerning:

(a) the completeness of information provided regarding the identification of related parties; and

(b) the adequacy of related party disclosures in the financial statements.

Management Representation Letter

Dear Sir,

This representation letter is provided in connection with your audit of the financial statements of ____________ for the year ended _______. We acknowledge our responsibility for preparation of financial statements in accordance with the requirements of the Companies Act, 1956 and recognised accounting policies and practices, including the Accounting Standards issued by the Institute of Chartered Accountants of India.

We confirm the following representation in respect of related parties:

1. We have identified all the related parties and transactions with all such parties. The information provided to you is complete in all respects.

2. The disclosures made in the financial statements are adequate having regard to the framework under which the financial statements have been drawn.

3. The financial statements are free from material misstatements, including omissions with regard to related parties and transactions with related parties.

{Signature of the Authorised Person(s) of the Entity}

SA 560 (AAS 19)

Subsequent Events

2. The auditor should consider the effect of subsequent events on the financial statements and on the auditor's report.

3. Accounting Standard (AS) 4, "Contingencies and Events Occurring After the Balance Sheet Date", issued by the Institute of Chartered Accountants of India, deals with the treatment in financial statements of events, both favourable and unfavourable, occurring between the balance sheet date and the date on which the financial statements are approved by the Board of Directors in the case of a company, and, by the corresponding approving authority in the case of any other entity. AS 4 identifies two types of events:

(a) those which provide further evidence of conditions that existed at the balance sheet date; and

(b) those which are indicative of conditions that arose subsequent to the balance sheet date.

Audit Procedures

4. The auditor should perform procedures designed to obtain sufficient appropriate audit evidence that all events up to the date of the auditor's report that may require adjustment of, or disclosure in, the financial statements have been identified.

Audit Procedures

5. The procedures to identify events that may require adjustment of, or disclosure in, the financial statements would be performed as near as practicable to the date of the auditor's report and ordinarily include the following:

   - Reviewing procedures that the management has established to ensure that subsequent events are identified.
   - Reading minutes of the meetings of shareholders, the board of directors and audit and executive committees held after the balance sheet date and inquiring about matters discussed at meetings for which minutes are not yet recorded.
   - Reading the entity's latest available interim financial statements and, as considered necessary and appropriate, budgets, cash flow forecasts and other related management reports.
   - Inquiring, or extending previous oral or written inquiries, of the entity's lawyers concerning litigation and claims.
   - Inquiring of management as to whether any subsequent events have occurred after the balance sheet date which might affect the financial statements. Examples of inquiries of management on specific matters are:

- The current status of items that were accounted for on the basis of preliminary or inconclusive data.
- Whether there have been any developments regarding risk areas and contingencies.
- Whether any unusual accounting adjustments have been made or are contemplated.
- Whether any events have occurred or are likely to occur which will bring into question the appropriateness of accounting policies used in the financial statements as would be the case, for example, if such events call into question the validity of the going concern assumption.

Examples of inquiries of management

7. When the auditor becomes aware of events which materially affect the financial statements, the auditor should consider whether such events are properly accounted for in the financial statements. When the management does not account for such events that the auditor believes should be accounted for, the auditor should express a qualified opinion or an adverse opinion, as appropriate.

the auditor should express a qualified opinion

SA 570 (AAS 16)

GOING CONCERN

2. When planning and performing audit procedures and in evaluating the results thereof, the auditor should consider the appropriateness of the going concern assumption underlying the preparation of the financial statements.

Appropriateness of the Going Concern Assumption

5. **The auditor should consider the risk that the going concern assumption may no longer be appropriate.**

6. Indications of risk that continuance as a going concern may be questionable could come from the financial statements or from other sources. Examples of such indications that would be considered by the auditor are listed below. This listing is not all-inclusive nor does the existence of one or more always signify that the going concern assumption needs to be questioned.

Examples of such indications

Financial Indications

- Negative net worth or negative working capital.
- Fixed-term borrowings approaching maturity without realistic prospects of renewal or repayment, or excessive reliance on short-term borrowings to finance long-term assets.
- Adverse key financial ratios.

- Substantial operating losses.
- Substantial negative cash flows from operations.
- Arrears or discontinuance of dividends.
- Inability to pay creditors on due dates.
- Difficulty in complying with the terms of loan agreements.
- Change from credit to cash-on-delivery transactions with suppliers.
- Inability to obtain financing for essential new product development or other essential investments.
- Entering into a scheme of arrangement with creditors for reduction of liability.

Operating Indications

- Loss of key management without replacement.
- Loss of a major market, franchise, licence, or principal supplier.
- Labour difficulties or shortages of important supplies.

Other Indications

- Non-compliance with capital or other statutory requirements.
- Pending legal proceedings against the entity that may, if successful, result in judgments that could not be met.
- Changes in legislation or government policy.
- Sickness of the entity under any statutory definition.

Audit Evidence

8. When a question arises regarding the appropriateness of the going concern assumption, the auditor should gather sufficient appropriate audit evidence to attempt to resolve, to the auditor's satisfaction, the question regarding the entity's ability to continue in operation for the foreseeable future.

9. During the course of the audit, the auditor carries out audit procedures designed to obtain audit evidence as the basis for the expression of an opinion on the financial statements. When a question arises regarding the going concern assumption, certain of these procedures may take on additional significance or it may be necessary to perform additional procedures or to update information obtained earlier. Procedures that are relevant in this connection may include:

- Analyse and discuss cash flow, profit and other relevant forecasts with management.
- Review events after the balance sheet date for items affecting the entity's ability to continue as a going concern.
- Analyse and discuss the entity's latest available interim financial statements.
- Review the terms of debentures and loan agreements and determine whether any have been breached.
- Read minutes of the meetings of shareholders, the board of directors and important committees for reference to financing difficulties.

a qualified or adverse opinion, ...

14. If, in the auditor's judgement, the going concern assumption is appropriate because of mitigating factors, in particular management's plans for future action, the auditor should consider whether such plans or other factors need to be disclosed in the financial statements. Where the auditor concludes that such plans or other factors need to be disclosed, but have not been adequately disclosed, the auditor should express a qualified or adverse opinion, as appropriate.

Going Concern Question not Resolved

15. If, in the auditor's judgement, the going concern question is not satisfactorily resolved, the auditor would consider whether the financial statements:

(a) adequately describe the principal conditions that raise substantial doubt about the entity's ability to continue in operation for the foreseeable future;

(b) state that there is significant uncertainty that the entity will be able to continue as a going concern and, therefore, may be unable to realise its assets and discharge its liabilities in the normal course of business; and

(c) state that the financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts, or to amounts and classification of liabilities that may be necessary if the entity is unable to continue as a going concern.

Provided the disclosure is considered adequate, the auditor would not express a qualified or adverse opinion.

16. If adequate disclosure is made in the financial statements, the auditor should ordinarily express an unqualified opinion. However, he should, in his report, add a paragraph that highlights the going concern problem by drawing attention to the note in the financial statements that discloses the matters set out in paragraph 15. The following is an example of such a paragraph:

> "We draw attention to Note X in the financial statements. The Company incurred a net loss of Rs. XXX during the year ended March 31, 19X1 and, as of that date, the Company's current liabilities exceeded its current assets by Rs. XXX and its total liabilities exceeded its total assets by Rs. XXX. These factors, along with other matters as set forth in Note X, raise substantial doubt that the Company will be able to continue as a going concern."

The auditor is not precluded from expressing a disclaimer of opinion for a going concern uncertainty.

example of the explanation and opinion

The following is an example of the explanation and opinion paragraphs when a qualified opinion is to be expressed:

> "The Company has been unable to renegotiate its borrowings from its bankers. Without such financial support there is substantial doubt that it will be able to continue as a going concern. Consequently, adjustments may be required to the recorded asset amounts and classification of liabilities. The financial statements (and notes thereto) do not disclose this fact.
>
> In our opinion, subject to the omission of the information dealt with in the preceding paragraph, the financial statements give a true and fair view of the financial position of the Company at March 31, 19X1 and the results of its operations for the year then ended."

Going Concern Assumption Considered Inappropriate

18. If, on the basis of the additional procedures carried out and the information obtained, including the effect of mitigating circumstances, the auditor's judgment is that the entity will not be able to continue in operation for the foreseeable future, the auditor would conclude that the going concern assumption used in the preparation of the financial statements is inappropriate. **If the result of the inappropriate assumption used in the preparation of the financial statements is so material and pervasive as to make the financial statements misleading, the auditor should express an adverse opinion.**

SA 580 (AAS 11)

REPRESENTATIONS BY MANAGEMENT

representations from management

2. The auditor should obtain representations from management, where considered appropriate.

Acknowledgement by Management of its Responsibility for the Financial Information

3. The auditor should obtain evidence that management acknowledges its responsibility for the appropriate preparation and presentation of financial information and that management has approved the financial information.

Representations by Management as Audit Evidence

4. The auditor should exercise his professional judgement in determining the matters on which he wishes to obtain representations from management. Similarly, the matters on which the auditor wishes to obtain such representations in writing should also be determined by the auditor using his professional judgement. However, representations should be obtained from management invariably in writing on matters material to financial information, either individually or collectively, when other sufficient appropriate audit evidence cannot reasonably be expected to exist. Matters which might be included in a representation letter from management in an audit of financial statements are contained in the example of a management representation letter in the **Appendix**.

5. During the course of an audit, management makes many representations to the auditor, either unsolicited or in response to specific enquiries. When such representations relate to matters which are material to the financial information, the auditor should:

(a) seek corroborative audit evidence from sources inside or outside the entity;

(b) evaluate whether the representations made by management appear reasonable and consistent with other audit evidence obtained, including other representations; and

(c) consider whether the individuals making the representations can be expected to be well-informed on the matter.

6. Representations by management cannot be a substitute for other audit evidence that the auditor could reasonably expect to be available. For example, a representation by management as to the quantity, existence and cost of inventories is no substitute for adopting normal audit procedures regarding verification and valuation of inventories. If the auditor is unable to obtain sufficient appropriate audit evidence that he believes would be available regarding a matter which has or may have a material effect on the financial information, this will constitute a limitation on the scope of his examination even if he has obtained a representation from management on the matter.

Documentation of Representations by Management

9. The auditor should document in his working papers evidence of management's representations.

10. A written representation is better audit evidence than an oral representation and can take the form of:

(a) a representation letter from management;

(b) a letter from the auditor outlining the auditor's understanding of management's representations, duly acknowledged and confirmed by management;

(c) a duly authenticated copy of relevant minutes of meetings of the board of directors or similar body.

Basic Elements of a Management Representation Letter

11. A management representation letter should be addressed to the auditor, containing the relevant information and be appropriately dated and signed.

12. A management representation letter would normally be dated the same date as the auditor's report on the financial information or a date prior thereto. However, in certain circumstances, in respect to specific transactions or events, separate representation letters may also be obtained during the course of audit.

13. A management representation letter should ordinarily be signed by the members of management who have primary responsibility for the entity and its financial aspects, e.g., managing director, finance director.

14. If management refuses to provide representations on any matter that the auditor considers necessary, this will constitute a limitation on the scope of his examination. In such circumstances, the auditor should evaluate any reliance he has placed on other representations made by management during the course of his examination and consider if the refusal may have any additional effect on his report.

Example of a Management Representation Letter
in an Audit of Financial Statements

We confirm, to the best of our knowledge and belief, the following representations:

Accounting Policies

1. The accounting policies which are material or critical in determining the results of operations for the year or financial position are set out in the financial statements and are consistent with those adopted in the financial statements for the previous year. The financial statements are prepared on accrual basis.

Investments

5. The current investments as appearing in the Balance Sheet consist of only such investments as are by their nature readily realisable and intended to be held for not more than one year from the respective dates on which they were made. All other investments have been shown in the Balance Sheet as 'long-term investments'.

6. Current investments have been valued at the lower of cost and fair value. Long-term investments have been valued at cost, except that any permanent diminution in their value has been provided for in ascertaining their carrying amount.

7. In respect of offers of right issues received during the year, the rights have been either been subscribed to, or renunciated, or allowed to lapse. In no case have they been renunciated in favour of third parties without consideration which has been properly accounted for in the books of account.

Profit and Loss Account

26. Except as disclosed in the financial statements, the results for the year were not materially affected by:

(a) transactions of a nature not usually undertaken by the company;

(b) circumstances of an exceptional or non-recurring nature;

(c) charges or credits relating to prior years;

(d) changes in accounting policies.

General

27. The following have been properly recorded and, when appropriate, adequately disclosed in the financial statements:

(a) Losses arising from sale and purchase commitments.

(b) Agreements and options to buy back assets previously sold.

(c) Assets pledged as collateral.

28. There have been no irregularities involving management or employees

SA 600 (AAS 10)

USING THE WORK OF ANOTHER AUDITOR

“When the auditor delegates work to assistants or uses work performed by other auditors and experts, he will continue to be responsible for forming and expressing his opinion on the financial information. However, he will be entitled to rely on work performed by others, provided he exercises adequate skill and care and is not aware of any reason to believe that he should not have so relied. In the case of any independent statutory appointment to perform the work on which the auditor has to rely in forming his opinion, such as in the case of the work of branch auditors appointed under the Companies Act, 1956 the auditor’s report should expressly state the fact of such reliance.”

Auditing (SA) 200, ‘Basic Principles Governing Audit”

5. **When the principal auditor uses the work of another auditor, the principal auditor should determine how the work of the other auditor will affect the audit.**

6. "Principal auditor" means the auditor with responsibility for reporting on the financial information of an entity when that financial information includes the financial information of one or more components audited by another auditor.

7. "Other auditor" means an auditor, other than the principal auditor, with responsibility for reporting on the financial information of a component which is included in the financial information audited by the principal auditor.

8. "Component" means a division, branch, subsidiary, joint venture, associated enterprises or other entity whose financial information is included in the financial information audited by the principal auditor.

Acceptance as Principal Auditor

9. **The auditor should consider whether the auditor's own participation is sufficient to be able to act as the principal auditor.** For this purpose the auditor would consider:

(a) the materiality of the portion of the financial information which the principal auditor audits;

(b) the principal auditor's degree of knowledge regarding the business of the components;

(c) the risk of material misstatements in the financial information of the components audited by the other auditor; and

(d) the performance of additional procedures as set out in this SA regarding the components audited by other auditor resulting in the principal auditor having significant participation in such audit.

The Principal Auditor's Procedures

10. In certain situations, the statute governing the entity may confer a right on the principal auditor to visit a component and examine the books of account and other records of the said component, if he thinks it necessary to do so. Where another auditor has been appointed for the component, the principal auditor would normally be entitled to rely upon the work of such auditor unless there are special circumstances to make it essential for him to

records of the said component.

11. **When planning to use the work of another auditor, the principal auditor should consider the professional competence of the other auditor in the context of specific assignment if the other auditor is not a member of the Institute of Chartered Accountants of India.**

12. **The principal auditor should perform procedures to obtain sufficient appropriate audit evidence, that the work of the other auditor is adequate for the principal auditor's purposes, in the context of the specific assignment.**

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. The principal auditor would inform the other auditor of matters such as areas requiring special consideration, procedures for the identification of inter-component transactions that may require disclosure and the time-table for completion of audit; and

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

13. 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 other auditor.

14. The principal auditor may conclude that it is not necessary to apply procedures such as those described in paragraph 13 because sufficient appropriate audit evidence previously obtained that acceptable quality control policies and procedures are complied with in the conduct of other auditor's practice.

15. **The principal auditor should consider the significant findings of the other auditor.**

Co-ordination Between Auditors

19. **There should be sufficient liaison between the principal auditor and the other auditor.** For this purpose, the principal auditor may find it necessary to issue written communication(s) to the other auditor.

20. **The other auditor, knowing the context in which his work is to be used by the principal auditor, should co-ordinate with the principal auditor.** For example, by bringing to the principal auditor's immediate attention any significant findings requiring to be dealt with at entity level, adhering to the time-table for audit of the component, etc. He should ensure compliance with the relevant statutory requirements. Similarly, the principal auditor should advise the other auditor of any matters that come to his attention that he thinks may have an important bearing on the other auditor's work.

21. When considered necessary by him, the principal auditor may require the other auditor to answer a detailed questionnaire regarding matters on which the principal auditor requires information for discharging his duties. The other auditor should respond to such questionnaire on a timely basis.

Reporting Considerations

22. **When the principal auditor concludes, based on his procedures, that the work of the other auditor cannot be used and the principal auditor has not been able to perform sufficient additional procedures regarding the financial information of the component audited by the other auditor, the principal auditor should express a qualified opinion or disclaimer of opinion because there is a limitation on the scope of audit.**

23. In all circumstances, if the other auditor issues, or intends to issue, a modified auditor's report, the principal auditor should consider whether the subject of the modification is of such nature and significance, in relation to the financial information of the entity on which the principal auditor is reporting, that it requires a modification of the principal auditor's report.

25. When the principal auditor has to base his opinion on the financial information of the entity as a whole relying upon the statements and reports of the other auditors, his report should state clearly the division of responsibility for the financial information of the entity by indicating the extent to which the financial information of components audited by the other auditors have been included in the financial information of the entity, e.g., the number of divisions/branches/subsidiaries or other components audited by other auditors.

SA 610 (AAS 7)

Relying Upon the Work of an Internal Auditor

1. Standard on Auditing (SA) 400**, "Study and Evaluation of the Accounting System and Related Internal Controls in Connection with an Audit", states (paragraph 8):

> "Internal Control System means all the policies and procedures (internal controls) adopted by the management of an entity to assist in achieving management's objective of ensuring, as far as practicable, the orderly and efficient conduct of its business, including adherence to management policies, the safeguarding of assets, the prevention and detection of fraud and error, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information. The internal audit function constitutes a separate component of internal control with the objective of determining whether other internal controls are well designed and properly operated."

Scope and Objectives of the Internal Audit Function

Normally, however, internal audit operates in one or more of the following areas:

(a) ***Review of accounting system and related internal controls:*** The establishment of an adequate accounting system and the related controls is the responsibility of management which demands proper attention on a continuous basis. The internal audit function is often assigned specific responsibility by management for reviewing the accounting system and related internal controls, monitoring their operation and recommending improvements thereto.

(b) ***Examination for management of financial and operating information:*** This may include review of the means used to identify, measure, classify and report such information and specific inquiry into individual items including detailed testing of transactions, balances and procedures.

(c) ***Examination of the economy, efficiency and effectiveness of operations including non-financial controls of an organisation:*** Generally, the external auditor is interested in the results of such audit work only when it has an important bearing on the reliability of the financial records.

(d) ***Physical examination and verification:*** This would generally include examination and verification of physical existence and condition of the tangible assets of the entity.

Evaluation of Internal Audit Function

(a) ***Organisational Status:*** Whether internal audit is undertaken by an outside agency or by an internal audit department within the entity itself, the internal auditor reports to the management. In an ideal situation, he reports to the highest level of management and is free of any other operating responsibility. Any constraints or restrictions placed upon his work by management should be carefully evaluated. In particular, the internal auditor should be free to communicate fully with the external auditor.

(b) ***Scope of Function:*** The external auditor should ascertain the nature and depth of coverage of the assignment which the internal auditor discharges for management. He should also ascertain to what extent the management considers, and where appropriate, acts upon internal audit recommendations.

(c) ***Technical Competence:*** The external auditor should ascertain that internal audit work is performed by persons having adequate technical training and proficiency. This may be accomplished by reviewing the experience and professional qualifications of the persons undertaking the internal audit work.

(d) ***Due Professional Care:*** The external auditor should ascertain whether internal audit work appears to be properly planned, supervised, reviewed and documented. An example of the exercise of due professional care by the internal auditor is the existence of adequate audit manuals, audit programmes, and working papers.

Coordination

11. Having decided in principle that he intends to rely upon the work of the internal auditor, it is desirable that the external auditor ascertains the internal auditor's tentative plan for the year and discusses it with him at as early a stage as possible to determine areas where he considers that he could rely upon the internal auditor's work. Where internal audit work is to be a factor in determining the nature, timing and extent of the external auditor's procedures, it is desirable to plan in advance the timing of such work, the extent of audit coverage, test levels and proposed methods of sample selection, documentation of the work performed, and review and reporting procedures.

12. Coordination with the internal auditor is usually more effective when meetings are held at appropriate intervals during the year. It is desirable that the external auditor is advised of, and has access to, relevant internal audit reports and in addition is kept informed, along with management, of any significant matter that comes to the internal auditor's attention and which he believes may affect the work of the external auditor. Similarly, the external auditor should ordinarily inform the internal auditor of any significant matters which may affect his work.

Evaluating Specific Internal Audit Work

taking into account the following factors:

(a) The scope of work and related audit programmes are adequate for the external auditor's purpose.

(b) The work was properly planned and the work of assistants was properly supervised, reviewed, and documented.

(c) Sufficient appropriate evidence was obtained to afford a reasonable basis for the conclusions reached.

(d) Conclusions reached are appropriate in the circumstances and any reports prepared are consistent with the results of the work performed.

(e) Any exceptions or unusual matters disclosed by the internal auditor's procedures have been properly resolved.

SA 620 (AAS 9)

USING THE WORK OF AN EXPERT

1. Standard on Auditing (SA) 200, "Basic Principles Governing an Audit", states (paragraphs 9-10):

> "When the auditor delegates work to assistants, or uses work performed by other auditors and experts, he will continue to be responsible for forming and expressing his opinion on the financial information. However, he will be entitled to rely on work performed by others, provided he exercises adequate skill and care and is not aware of any reason to believe that he should not have so relied. In the case of any independent statutory appointment to perform the work on which the auditor has to rely in forming his opinion, such as in the case of the work of branch auditors appointed under the Companies Act, 1956, the auditor's report should expressly state the fact of such reliance."
>
> "The auditor should carefully direct, supervise and review work delegated to assistants. The auditor should obtain reasonable assurance that work performed by other auditors or experts is adequate for his purpose."

An expert (or a specialist),

3. An expert (or a specialist), for the purpose of this Statement, is a person, firm or other association of persons possessing special skill, knowledge and experience in a particular field other than accounting and auditing. An 'expert' may be:

- engaged by the client,
- engaged by the auditor,
- employed by the client, or
- employed by the auditor.

Determining the Need to Use the Work of an Expert

5. During the audit, the auditor may seek to obtain, in conjunction with the client or independently, audit evidence in the form of reports, opinions, valuations and statements of an expert. Examples are:

- Valuations of certain types of assets, for example, land and buildings, plant and machinery, works of art, and precious stones.
- Determination of quantities or physical condition of assets, for example, minerals stored in stockpiles, mineral and petroleum reserves, and the remaining useful life of plant and machinery.
- Determination of amounts using specialised techniques or methods, for example, an actuarial valuation.
- The measurement of work completed and to be completed on contracts in progress for the purpose of revenue recognition.
- Legal opinions concerning interpretations of agreements, statutes, regulations, notifications, circulars, etc.

6. When determining whether to use the work of an expert or not, the auditor should consider:

- the materiality of the item being examined in relation to the financial information as a whole,
- the nature and complexity of the item including the risk of error therein, and
- the other audit evidence available with respect to the item.

Evaluating the Work of an Expert

9. When the auditor intends to use the work of an expert, he shoul examine evidence to gain knowledge regarding the terms of the expert' engagement and such other matters as :

- the objectives and scope of the expert's work,
- a general outline as to the specific items in the expert's report,
- confidentiality of the expert's work, including the possibility of it communication to third parties,
- the expert's relationship with the client, if any,
- confidentiality of the client's information used by the expert.

10. The auditor should seek reasonable assurance that the expert's work constitutes appropriate audit evidence in support of the financial information, by considering:-

- the source data used,
- the assumptions and methods used and, if appropriate, their consistency with the prior period, and
- the results of the expert's work in the light of the auditor's overall knowledge of the business and of the results of his audit procedures.

The auditor should also satisfy himself that the substance of the expert's findings is properly reflected in the financial information.

11. The auditor should consider whether the expert has used source data which are appropriate in the circumstances. The procedures to be applied by the auditor should include:

- making inquiries of the expert to determine how he has satisfied himself that the source data are sufficient, relevant and reliable, and
- conducting audit procedures on the data provided by the client to the expert to obtain reasonable assurance that the data are appropriate.

14. If, after performing these procedures, the auditor concludes that:

- the work of the expert is inconsistent with the information in the financial statements, or that
- the work of the expert does not constitute sufficient appropriate audit evidence (e.g., where the work of the expert involves highly technical matters or where, on grounds of confidentiality, the expert refuses to make available to the auditor the source data used by him),

he should express a qualified opinion, a disclaimer of opinion or an adverse opinion, as may be appropriate.

Reference to an Expert in the Auditor's Report

15. When expressing an unqualified opinion, the auditor should not refer to the work of an expert in his report. If, as a result of the work of an expert, the auditor decides to express other than an unqualified opinion, it may in some circumstances benefit the reader of his report if the auditor, in explaining the nature of his reservation, refers to or describes the work of the expert. Where, in doing so, the auditor considers it appropriate to disclose the identity of the expert, he should obtain prior consent of the expert for such disclosure if such consent has not already been obtained.

SA 700 (AAS 28)

THE AUDITOR'S REPORT ON FINANCIAL STATEMENTS

2. The auditor should review and assess the conclusions drawn from the audit evidence obtained as the basis for the expression of an opinion on the financial statements.

Basic Elements of the Auditor's Report

(a) Title;

(b) Addressee;

(c) Opening or introductory paragraph

  (i) identification of the financial statements audited;

  (ii) a statement of the responsibility of the entity's management and the responsibility of the auditor;

(d) Scope paragraph (describing the nature of an audit)

  (i) a reference to the auditing standards generally accepted in India;

  (ii) a description of the work performed by the auditor;

(e) Opinion paragraph containing

  (i) a reference to the financial reporting framework used to prepare the financial statements; and

  (ii) an expression of opinion on the financial statements;

(f) Date of the report;

(g) Place of signature; and

(h) Auditor's signature.

16. The report should include a statement that the audit was planned and performed to obtain reasonable assurance whether the financial statements are free of material misstatement.

17. The auditor's report should describe the audit as including:

   (a) examining, on a test basis, evidence to support the amounts and disclosures in financial statements;

   (b) assessing the accounting principles used in the preparation of the financial statements;

   (c) assessing the significant estimates made by management in the preparation of the financial statements; and

   (d) evaluating the overall financial statement presentation.

18. The report should include a statement by the auditor that the audit provides a reasonable basis for his opinion.

Opinion Paragraph

20. The opinion paragraph of the auditor's report should clearly indicate the financial reporting framework used to prepare the financial statements and state the auditor's opinion as to whether the financial statements give a true and fair view in accordance with that financial reporting framework and, where appropriate, whether the financial statements comply with the statutory requirements.

The Auditor's Report

29. **An *unqualified opinion* should be expressed when the auditor concludes that the financial statements give a true and fair view in accordance with the financial reporting framework used for the preparation and presentation of the financial statements.** An unqualified opinion indicates, implicitly, that any changes in the accounting principles or in the method of their application, and the effects thereof, have been properly determined and disclosed in the financial statements. An unqualified opinion also indicates that:

(a) the financial statements have been prepared using the generally accepted accounting principles, which have been consistently applied;

(b) the financial statements comply with relevant statutory requirements and regulations; and

(c) there is adequate disclosure of all material matters relevant to the proper presentation of the financial information, subject to statutory requirements, where applicable.

Modified Reports[7]

31. An auditor's report is considered to be modified when it includes:

(a) Matters That Do Not Affect the Auditor's Opinion

- emphasis of matter

(b) Matters That Do Affect the Auditor's Opinion

- qualified opinion
- disclaimer of opinion
- adverse opinion

Uniformity in the form and content of each type of modified report will enhance the user's understanding of such reports. Accordingly, this SA includes suggested wordings to express an unqualified opinion as well as examples of modifying phrases for use when issuing modified reports.

Matters That Do Not Affect the Auditor's Opinion

32. In certain circumstances, an auditor's report may be modified by adding an emphasis of matter paragraph to highlight a matter affecting the financial statements which is included in a note to the financial statements that more extensively discusses the matter. The addition of such an emphasis of matter paragraph does not affect the auditor's opinion. The paragraph would preferably be included preceding the opinion paragraph and would ordinarily refer to the fact that the auditor's opinion is not qualified in this respect.

33. **The auditor should modify the auditor's report by adding a paragraph to highlight a material matter regarding a going concern problem where the going concern question is not resolved and adequate disclosures have been made in the financial statements.**

34. **The auditor should consider modifying the auditor's report by adding a paragraph if there is a significant uncertainty (other than going concern problem), the resolution of which is dependent upon future events and which may affect the financial statements.** An uncertainty is a matter whose outcome depends on future actions or events not under the direct control of the entity but that may affect the financial statements

Matters that Do Affect the Auditor's Opinion

37. An auditor may not be able to express an unqualified opinion when either of the following circumstances exists and, in the auditor's judgment, the effect of the matter is or may be material to the financial statements:

(a) there is a limitation on the scope of the auditor's work; or

(b) there is a disagreement with management regarding the acceptability of the accounting policies selected, the method of their application or the adequacy of financial statement disclosures.

The circumstances described in (a) could lead to a qualified opinion or a disclaimer of opinion. The circumstances described in (b) could lead to a qualified opinion or an adverse opinion. These circumstances are discussed in paragraphs 42 - 47.

38. A *qualified opinion* should be expressed when the auditor concludes that an unqualified opinion cannot be expressed but that the effect of any disagreement with management is not so material and pervasive as to require an adverse opinion, or limitation on scope is not so material and pervasive as to require a disclaimer of opinion. A qualified opinion should be expressed as being 'subject to' or 'except for' the effects of the matter to which the qualification relates.

39. A *disclaimer of opinion* should be expressed when the possible effect of a limitation on scope is so material and pervasive that the auditor has not been able to obtain sufficient appropriate audit evidence and is, accordingly, unable to express an opinion on the financial statements.

40. An *adverse opinion* should be expressed when the effect of a disagreement is so material and pervasive to the financial statements that the auditor concludes that a qualification of the report is not adequate to disclose the misleading or incomplete nature of the financial statements.

41. **Whenever the auditor expresses an opinion that is other than unqualified, a clear description of all the substantive reasons should be included in the report and, unless impracticable, a quantification of the possible effect(s), individually and in aggregate, on the financial statements should be mentioned in the auditor's report.** In circumstances where it is not practicable to quantify the effect of modifications made in the audit report accurately, the auditor may do so on the basis of estimates made by the management after carrying out such audit tests as are possible and clearly indicate the fact that the figures are based on management estimates. Ordinarily, this information would be set out in a separate paragraph preceding the opinion or disclaimer of opinion and may include a reference to a more extensive discussion, if any, in a note to the financial statements.

Circumstances That May Result in Other Than an Unqualified Opinion

Limitation on Scope

42. A limitation on the scope of the auditor's work may sometimes be imposed by the entity, for example, when the terms of the engagement specify that the auditor will not carry out an audit procedure that the auditor believes is necessary. However, when the limitation in the terms of a proposed engagement is such that the auditor believes the need to express a disclaimer of opinion exists; the auditor should ordinarily not accept such a limited engagement as an audit engagement, unless required by statute. Also, a statutory auditor should not accept such an audit engagement when the limitation infringes on the auditor's statutory duties.

43. A scope limitation may be imposed by circumstances, for example, when the timing of the auditor's appointment is such that the auditor is unable to observe the counting of physical inventories. It may also arise when, in the opinion of the auditor, the entity's accounting records are inadequate or when the auditor is unable to carry out an audit procedure believed to be desirable. In these circumstances, the auditor would attempt to carry out reasonable alternative procedures to obtain sufficient appropriate audit evidence to support an unqualified opinion.

44. **When there is a limitation on the scope of the auditor's work that requires expression of a qualified opinion or a disclaimer of opinion, the auditor's report should describe the limitation and indicate the possible adjustments to the financial statements that might have been determined to be necessary had the limitation not existed.**

Illustrations of these matters are set out below :

Limitation on Scope — Qualified Opinion

"We have audited .... *(remaining words are the same as illustrated in the introductory paragraph —paragraph 30 above).*

Except as discussed in the following paragraph, we conducted our audit in accordance with .... *(remaining words are the same as illustrated in the scope paragraph — paragraph 30 above).*

We did not observe the counting of the physical inventories as at 31st March 2XXX since that date was prior to the time we were appointed as auditors of ....*(Name of the entity).* Owing to the nature of the entity's records, we were unable to satisfy ourselves as to inventory quantities by other audit procedures.

Limitation on Scope — Disclaimer of Opinion

"We were engaged to audit the attached Balance Sheet of ....(Name of the entity) as at 31st March 2XXX and also the Profit and Loss Account for the year ended on that date annexed thereto. These financial statements are the responsibility of the entity's management. (Omit the sentence stating the responsibility of the auditor).

Disagreement with Management

46. The auditor may disagree with management about matters such as the acceptability of accounting policies selected, the method of their application, or the adequacy of disclosures in the financial statements. **If such disagreements are material to the financial statements, the auditor should express a qualified or an adverse opinion.**

47. Illustrations of these matters are set out below:

> ***Disagreement on Accounting Policies-Inappropriate Accounting Method—Qualified Opinion***
>
> "We have audited .... *(remaining words are the same as illustrated in the introductory paragraph — paragraph 30 above).*
>
> We conducted our audit in accordance with .... *(remaining words are the same as illustrated in the scope paragraph—paragraph 30 above).*

Disagreement on Accounting Policies - Inadequate Disclosure - Adverse Opinion

In our opinion and to the best of our information and according to the explanations given to us, because of the effects of the matters discussed in the preceding paragraph(s), the financial statements do not give a true and fair view in conformity with the accounting principles generally accepted in India[9]:

(a) in the case of the Balance Sheet, of the state of affairs of the company as at 31st March 2XXX; and

(b) in the case of the Profit and Loss Account, of the profit/loss for the year ended on that date.

CHANGES IN NOS.OF AAS		
OLD NO.	NEW NO.	NAME OF AAS
AAS-1	SA 200	BASIC PRINCIPLES GOVERNING AN AUDIT
AAS-2	SA 200A	OBJECTIVES & SCOPE OF AN AUDIT
AAS-3	SA 230	DOCUMENTATION
AAS-4	SA 240	AUDITORS RESPONSIBILITY TO CONSIDIDER
		FRAUDS & ERRORS IN AN AUDIT OF F.S
AAS-5	SA 500	AUDIT EVIDENCES
AAS-6	SA 400	RISK ASSESSMENT & INT.CONTROL
AAS-7	SA 610	RELYING UPON THE WORK OF AN INT.AUD
AAS-8	SA 300	AUDIT PLANNING
AAS-9	SA 620	USING THE WORK OF AN EXPERT
AAS-10	SA 600	USING THE WORK OF ANOTHER AUDITOR
AAS-11	SA 580	MANAGEMENT RESPONSIBILITY
AAS-12	SA 299	JOINT AUDITORS
AAS-13	SA 320	AUDIT MATERIALITY
AAS-14	SA 520	ANALYTICAL PROCEDURE
AAS-15	SA 530	AUDIT SAMPLING
AAS-16	SA 570	GOING CONCERN
AAS-17	SA 220	QUALITY CONTROL OF AN AUDIT WORK
AAS-18	SA 540	AUDIT OF ACCOUNTING ESTIMATES
AAS-19	SA 560	SUBSEQUENT EVENT
AAS-20	SA 310	KNOWLEDGE OF BUSINESS

CHANGES IN NOS.OF AAS		
OLD NO.	NEW NO.	NAME OF AAS
AAS-21	SA 250	CONSIDERATION OF LAWS & REGULATION
		IN AUDIT OF FINANCIAL STATEMENT
AAS-22	SA 510	INITIAL ENGAGEMENT OPENING BALANCES
AAS-23	SA 550	RELATED PARTY
AAS-24	SA 402	CONSIDERATION FOR AUDIT MATTER FOR
		ENTITY USING SERVICE ORGANISATION
AAS-25	SA 710	COMPARITIVES
AAS-26	SA 210	TERMS OF ENGAGEMENT
AAS-27	SA 260	COMMUNICATION OF AUDIT MATTER TO
		THOSE CHARGE WITH AUDIT GOVERNANCE
AAS-28	SA 700	AUDIT REPORT
AAS-29	SA 401	AUDIT IN COMPUTER INFO.ENVI.SYSTEM
AAS-30	SA 505	EXTERNAL CONFIRMATION
AAS-31	SRS 4410	ENGAGEMENT TO COMPILE FINANCIAL INFO.
AAS-32	SRS 4400	ENGAGEMENT TO PERFORM REGARDING
		FINANCIAL INFORMATION
AAS-33	SRE 2400	ENGAGEMENT TO REMOVE FINANCIAL ST.
AAS-34	SA 501	AUDIT EVIDENCE FOR ADDITIONAL
		CONSIDERATION OF SPECIFIC ITEM
AAS-35	SAE 3400	THE EXAMINATION OF PROSPECTIVE
		FINANCIAL INFORMATION