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Mob. 7737345000

Standard on Auditing (SA) 300 (Revised)
Planning an Audit of Financial Statements

1. Effective Date [Para – 2]

This SA is effective for audits of financial statements for periods beginning **on or after April 1, 2008.**

2. Scope of this SA [Para – 1]

- SA – 300 deals with the Auditor's **responsibilities to plan** an audit of FS's, in the context of Recurring Audit.
- Additional considerations in initial audit engagements are separately identified

Note → Planning an audit involves establishing the overall Audit Strategy for the engagement and developing an Audit Plan. [Para A.1]

3. Overall Objectives of the Auditor [Para – 3]

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

4. The Role and Timing of Audit Planning

Para No.	Aspect	Description
A.1	**Benefits of Planning**	As we know that planning is one very most powerful element and has many benefits in Audit. Some benefits are – 1. Helping the auditor to devote appropriate attention to important areas of the audit. 2. Helping the auditor identify and resolve potential problems on a timely basis. 3. Helping the auditor properly organize and manage the audit engagement so that it is performed in an effective and efficient manner. 4. Assisting in the selection of engagement team members with appropriate levels of capabilities and competence to respond to anticipated risks, and the proper assignment of work to them. 5. Facilitating the direction and supervision of engagement team members and the review of their work. 6. Assisting, where applicable, in coordination of work done by auditors of component and experts
A.2	**Factors affecting Planning**	The nature and extent of planning activities will vary according to – 1. The size and complexity of the entity, 2. The key engagement team members' previous experience with the entity, and 3. Changes in circumstances that occur during the audit engagement.
A.3	**Timing of activities to be performed in Audit**	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).
A.4	**Discussion of Elements Planning**	The auditor may decide to discuss elements of planning with the entity's management to facilitate the conduct and management of the audit engagement (for example, to coordinate some of the planned audit procedures with the work of the entity's personnel).

		Note → When discussing matters included in the overall audit strategy or audit plan, care is required in order not to compromise the effectiveness of the audit. For example, discussing the nature and timing of detailed audit procedures with management may compromise the effectiveness of the audit by making the audit procedures too predictable. [Para A.4]

4. Requirement

Para. No.	Terms	Description
4	**Involvement of Key Engagement Team Members**	☞ The engagement partner and other key members of the engagement team shall be involved in planning the audit, including planning and participating in the discussion among engagement team members. [Para – 4] ☞ Their involvement in planning the audit draws on their experience and insight, thereby enhancing the effectiveness and efficiency of the planning process. [Para A.5]
5	**Preliminary Engagement Activities**	The auditor shall undertake the following activities at the beginning of the current audit engagement – (a) Performing procedures required by SA 220 , "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, "Terms of Audit Engagements".
		<u>Planning Activities</u>
6 & 7	**Development of Overall Audit Strategy**	☞ The auditor shall establish an overall audit strategy that sets the scope, timing and direction of the audit, and that guides the development of the audit plan. [Para – 6] ☞ Establishing the Overall Audit Strategy, the Auditor shall – [Para – 7] (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.
8	**Develop an Audit Plan**	The auditor shall develop an audit plan that shall include a description of – (a) The nature, timing and extent of planned risk assessment procedures, as determined under SA 315 "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.
9	**Updating and Changing Audit Strategy and Audit**	☞ The auditor shall update and change the overall audit strategy and the audit plan as necessary during the course of the audit. [Para 9] ☞ As a result of unexpected events, changes in conditions, or the audit evidence obtained from the results of audit procedures, the auditor may need to modify the overall audit strategy and audit plan and thereby the resulting planned nature, timing and extent of further audit procedures, based on the revised consideration of assessed risks. [Para A.14] ☞ This may be the case when information comes to the auditor's attention that differs significantly from the information available when the auditor planned the audit procedures. For example, audit evidence obtained through the performance of substantive procedures may contradict the audit evidence obtained through tests of controls. [Para A.14]
10	**Direction, Supervision and Review**	☞ The auditor shall plan the nature, timing and extent of direction and supervision of engagement team members and the review of their work. ☞ Factors affecting NTE of the DSR are – (a) The size and complexity of the entity. (b) The area of the audit. (c) 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). (d) The capabilities and competence of the individual team members performing the audit work.
11	**Documentation**	The auditor shall document – (a) The overall audit strategy, (b) The audit plan, and (c) Any significant changes made during the audit engagement to the overall audit strategy or the audit plan, and the reasons for such changes.
12	**Additional Considerations in Initial Audit Engagement**	The auditor shall undertake the following activities prior to starting an initial audit– (a) Performing procedures required by SA 220 regarding the acceptance of the client relationship and the specific audit engagement, and (b) Communicating with the predecessor auditor, where there has been a change of auditors, in compliance with relevant ethical requirements, including review of the Predecessor Auditor's working papers, whenever permissible, (c) The audit procedures necessary to obtain sufficient appropriate audit evidence regarding opening balances as per SA – 510 (d) Other Procedures required by the Firm's system of Quality Control for Initial Audit Engagements.

Some Past Attempts Questions

<table>
<tr><th>S.N.</th><th>Questions</th><th>Marks and Attempt</th><th>Answer</th></tr>
<tr><td>1.</td><td>You have been appointed as the auditor of a Multiplex Cinema House. Draw an audit programme in respect of its Revenue and Expenditure.</td><td>[8 Marks]
[Nov. 2008]</td><td>See Below</td></tr>
<tr><td>Ans.</td><td colspan="3"><u>Audit Programme of Multiplex</u> –
1. Peruse the Memorandum of Association and Articles of Association of the entity.
2. Ensure the object clause permits the entity to engage in this type of business.
3. In the case of income from sale of tickets –
(a) Verify the control system as to how it is ensured that the collections on sale of tickets of various shows are properly accounted.
(b) Verify the system of relating to on line booking of various shows and the system of realization of money.
(c) Check that there is overall system of reconciliation of collections with the number of seats available for different shows on a day.
4. Verify the internal control system and its effectiveness relating to the income from cafes shops, pubs etc., located within the multiplex.
5. Verify the system of control exercised relating to the income receivable from advertisements exhibited within the premises and inside the hall such as hoarding, banners, slides, short films etc.
6. Verify the system of collection from the parking areas in respect of the vehicles parked by the customers.
7. In the case of payment to the distributors verify the system of payment which may be either through out right payment or percentage of collection or a combination of both.
8. Ensure at the time of settlement any payment of advance made to the distributor is also adjusted against the amount due.
9. Verify the system of payment of salaries and other benefits to the employees and ensure that statutory requirements are complied with.
10. Verify the payments effected in respect of the maintenance of the building and ensure the same is in order.</td></tr>
<tr><td>2.</td><td>A & Co. was appointed as auditor of Great Airways Ltd. As the audit partner what factors shall be considered in the development of overall audit plan?</td><td>[8 Marks]
[May 2011]</td><td>Refer Para No. 6 to 8 on Pg. no. 3 to 4 and
Also See Below</td></tr>
<tr><td>Ans.</td><td colspan="3"><u>Development of an overall plan</u> – Overall plan is basically intended to provide direction for audit work programming and includes the determination of timing, manpower development and co-ordination of work with the client, other auditors and other experts. The auditor should consider the following matters in developing his overall plan for the expected scope and conduct of the audit.</td></tr>
</table>

	1. Terms of his engagement and any statutory responsibilities. 2. Nature and timing of reports or other communications. 3. Applicable Legal or Statutory requirements. 4. Accounting policies adopted by the clients and changes, if any, in those policies. 5. The effects of new accounting and auditing pronouncement on the audit. 6. Identification of significant audit areas. 7. Setting of materiality levels for the audit purpose. 8. Conditions requiring special attention such as the possibility of material error or fraud or involvement of parties in whom directors or persons who are substantial owners of the entity are interested and with whom transactions are likely. 9. Degree of reliance to be placed on the accounting system and internal control. 10. Possible rotation of emphasis on specific audit areas. 11. Nature and extent of audit evidence to be obtained. 12. Work of the internal auditors and the extent of reliance on their work, if any in the audit. 13. Involvement of other auditors in the audit of subsidiaries or branches of the client and involvement of experts. 14. Allocation of works to be undertaken between joint auditors and the procedures for its control and review. 15. Establishing and coordinating staffing requirements.		
3.	In the audit planning process of X Ltd., you would like to consider **audit risk at the financial statement level.** What are the **factors can influence** your decision?	**[3 Marks]** **[May 2010]**	**See Below**
Ans.	**<u>Audit risk at financial statement level</u>** The following factors will be considered for determination of audit risk at financial statement level. 1. Integrity of Management. 2. Management experience, knowledge and changes during the period. 3. Unusual pressures on the Management. 4. Nature of entity's business. 5. Factors affecting the Industry in which the entity operates.		

Standard on Auditing (SA) 315 (Revised)

Identifying and Assessing The Risk of Material Misstatement Through Understanding the Entity and Its Environment

1. Effective Date [Para – 2]

This SA is effective for audits of financial statements for periods beginning **on or after April 1, 2008.**

2. Scope of this SA [Para – 1]

This Standard on Auditing (SA) deals with the auditor's responsibility to identify and assess the risks of material misstatement in the financial statements, through understanding the entity and its environment, including the entity's internal control.

3. Objective [Para – 1]

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

4. Definitions [Para – 4]

(a)	**Assertions**	Representations by management, explicit or otherwise, that are embodied in the financial statements, as used by the auditor to consider the different types of potential misstatements that may occur.
(b)	**Business Risk**	A risk resulting from significant conditions, events, circumstances, actions or inactions that could adversely affect an entity's ability to achieve its objectives and execute its strategies, or from the setting of inappropriate objectives and strategies.
(c)	**Internal Control**	The process designed, implemented and maintained by those charged with governance, management and other personnel to provide reasonable assurance about the achievement of an entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, safeguarding of assets, and compliance with applicable laws and regulations. The term "controls" refers to any aspects of one or more of the components of internal control.
(d)	**Risk Assessment Procedure**	The audit procedures performed to obtain an understanding of the entity and its environment, including the entity's internal control, to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels.
(e)	**Significant Risk**	An identified and assessed risk of material misstatement that, in the auditor's judgment, requires special audit consideration.

Note → **<u>Materiality of an item may be judged using many factors, which include</u> –**

1. Value or Amount of transaction in the relative context.
2. Percentage Analysis.
3. Impact on the overall figure of Profit or Loss.
4. Comparison with previous year's figures.
5. Estimation Errors in determinable amounts.
6. Minor Deviations from Statutory Requirements.
7. Substantial effect of small inaccuracies.
8. Cumulative effect of small and insignificant items.

5. Requirements [Para – 4]

A. Perform "Risk Assessment Procedure"		
5	**Auditor's Duties**	The auditor shall perform risk assessment procedures to provide a basis for the identification and assessment of risks of material misstatement at the financial statement and assertion levels. Risk assessment procedures by themselves, however, do not provide sufficient appropriate audit evidence on which to base the audit opinion.
6	**Procedures**	Inquiries of management and of others within the entity who in the auditor's judgment may have information that is likely to assist in identifying risks of material misstatement due to fraud or error. Analytical procedures. Observation and inspection.
7 & 8	**Relevance of Information Obtained**	The auditor shall consider whether information obtained from the auditor's client acceptance or continuance process is relevant to identifying risks of material misstatement. Where the engagement partner has performed other engagements for the entity, the engagement partner shall consider whether information obtained is relevant to identifying risks of material misstatement.
B. Using the Information obtained from previous audits		
9	**Experience from Previous Audits**	When the auditor intends to use information obtained from the auditor's previous experience with the entity and from audit procedures performed in previous audits, the auditor shall determine whether changes have occurred since the previous audit that may affect its relevance to the current audit.
C. Discussions by Engagement Partner & Team Members		
10	**Team Discussion**	☞ The engagement partner and other key engagement team members shall discuss the susceptibility of the entity's financial statements to material misstatement, and the application of the applicable financial reporting framework to the entity's facts and circumstances. ☞ The engagement partner shall determine which matters are to be communicated to engagement team members not involved in the discussion.
D. Obtain Understanding of Entity and its Environment [5 Aspects]		
11	**Aspects**	The auditor shall obtain an understanding of the following – (a) Relevant industry, regulatory, and other external. (b) The nature of the entity, including: 1. Its operations; 2. Its ownership and governance structures; 3. The types of investments that the entity is making and plans to make; and 4. The way that the entity is structured and how it is financed; (c) The entity's selection and application of accounting policies. (d) The entity's objectives and strategies, and those related business risks that may result in risks of material misstatement. (e) The measurement and review of the entity's financial performance.
E. Obtain an Understanding of Entity's Internal Control relevant to audit [4 Sections].		
12	**General Nature and Characteristics of Internal Control**	☞ **Duties –** The auditor shall obtain an understanding of internal control relevant to the audit. ☞ **Limitations of IC [Para A.42 – A.46]** (a) Control provides only Reasonable Assurance about achieving the Entity's Financial Reporting Objectives. (b) Human Judgment – Human Error

		(c) The operation of a control may not be effective, such as where information produced for the purposes of internal control (for example, an exception report) is not effectively used because the individual responsible for reviewing the information does not understand its purpose or fails to take appropriate action. (d) Controls can be circumvented by the collusion of two or more people or inappropriate management override of internal control. (e) In designing and implementing controls, management may make judgments on the nature and extent of the controls it chooses to implement, and the nature and extent of the risks it chooses to assume. (f) Smaller entities often have fewer employees which may limit the extent to which segregation of duties is practicable. ☞ **Manual &n Automated Elements of IC – SEE separate Table at the end of SA**
12	**Controls Relevant to the Audit**	☞ **Relevant Controls –** Although most controls relevant to the audit are likely to relate to financial reporting, but not all controls that relate to financial reporting are relevant to the audit. It is a matter of the **auditor's professional judgment** whether a control, individually or in combination with others, is relevant to the audit. ☞ **Examples –** Controls relating to – (a) Completeness and accuracy of Information, (b) Operations and Compliance of Objectives, and Statute/Regulation compliance, etc. are relevant to the audit. ☞ **Factors –** Factors relevant to the auditor's judgment about whether a control, individually or in combination with others, is relevant to the audit may include such matters as the following: ✓ Materiality. ✓ The significance of the related risk. ✓ The size of the entity. ✓ The nature of the entity's business, including its organisation and ownership characteristics. ✓ The diversity and complexity of the entity's operations. ✓ Applicable legal and regulatory requirements. ✓ The circumstances and the applicable component of internal control. ✓ The nature and complexity of the systems that are part of the entity's internal control, including the use of service organisations. ✓ Whether, and how, a specific control, individually or in combination with others, prevents, or detects and corrects, material misstatement.
13	**Nature, Extent of Understanding of Rel. Control**	When obtaining an understanding of controls that are relevant to the audit, the auditor shall evaluate the design of those controls and determine whether they have been implemented, by performing procedures in addition to inquiry of the entity's personnel.
F. Understanding the Components of Internal Control [5 Items]		
14	**Control Environment**	The auditor shall obtain an understanding of the control environment and shall evaluate whether – (a) Management, with the oversight of those charged with governance, has created and maintained a culture of honesty and ethical behaviour; and (b) The strengths in the control environment elements collectively provide an appropriate foundation for the other components of internal control, and (c) Whether those other components are not undermined by deficiencies in the control environment.

15 To 17	**Entity's Risk Assessment Process (RAP)**	1. **Existence of RAP –** The auditor shall obtain an understanding of the entity's process for: (a) Identifying business risks relevant to financial reporting objectives; (b) Estimating the significance of the risks; (c) Assessing the likelihood of their occurrence; and (d) Deciding about actions to address those risks. 2. **Auditor's Duties when there is RAP –** (a) Where the auditor identifies risks of material misstatement that management failed to identify, the auditor shall evaluate whether there was an underlying risk of a kind that the auditor expects would have been identified by the entity's risk assessment process. (b) If there is such a risk, the auditor shall obtain an understanding of why that process failed to identify it, and evaluate whether the process is appropriate to its circumstances or if there is a material weakness in the entity's risk assessment process. 3. **Auditor's Duties when there is no RAP –** (a) If the entity has no such processes as aforesaid, then the auditor shall discuss with management whether business risks relevant to financial reporting objectives have been identified and how they have been addressed. (b) Evaluate whether the absence of a documented RAP is appropriate in the circumstances or determine if there is a significant deficiency in the IC w.r.t. Entity's RAP.
18 & 19	**Information System, Including related business processes, relevant to Financial Reporting, and Communication**	☞ The auditor shall obtain an understanding of the information system by evaluating– (a) The significant classes of transactions; (b) The procedures, within both information technology (IT) and manual systems; (c) The related accounting records, supporting information and specific accounts in the financial statements; (d) How the information system captures events and conditions, other than transactions, that are significant to the financial statements; (e) The financial reporting process; (f) Controls surrounding journal entries. ☞ The auditor shall obtain an understanding of matters relating to financial reporting, including – (a) Communications between management and those charged with governance; and (b) External communications, such as those with regulatory authorities.
20 & 21	**Control activities relevant to the Audit**	☞ An audit requires an understanding of only those control activities related to significant class of transactions, account balance, and disclosure in the financial statements and the assertions which the auditor finds relevant in his risk assessment process. ☞ In understanding the entity's control activities, the auditor shall obtain an understanding of how the entity has responded to risks arising from IT.
22 To 24	**Monitoring Controls**	☞ The auditor shall obtain an understanding of the major activities that the entity uses to monitor internal control over financial reporting, including those related to those control activities relevant to the audit, and how the entity initiates corrective actions to its controls.

		☞ The auditor shall obtain an understanding of the sources of the information used in the entity's monitoring activities, and the basis upon which management considers the information to be sufficiently reliable for the purpose.
G. Identifying and Assessing the risks of Material Misstatements -		
25	**Levels of Risks**	The FS Level, and The Assertion Level
26	**Auditor's Procedures**	(a) Identify risks, (b) Assess the identified risks, (c) Relate the identified risks to what can go wrong at the assertion level, taking account of relevant controls that the auditor intends to test; and (d) Consider the likelihood of misstatement, including the possibility of multiple misstatements, and whether the potential misstatement is of a magnitude that could result in a material misstatement.
H. Identifying Significant Risks		
27	**Significant Risks**	As part of the risk assessment as described in paragraph 25, the auditor shall determine whether any of the risks identified are, in the auditor's judgment, a significant risk. In exercising this judgment, the auditor shall exclude the effects of identified controls related to the risk.
28	**Factors**	(a) Whether the risk is a risk of fraud; (b) Whether the risk is related to recent significant economic, accounting, or other developments; (c) The complexity of transactions; (d) Whether the risk involves significant transactions with related parties; (e) The degree of subjectivity in the measurement of financial information related to the risk, especially those measurements involving a wide range of measurement uncertainty; and (f) Whether the risk involves significant transactions that are unusual.
29	**Controls**	When the auditor has determined that a significant risk exists, the auditor shall obtain an understanding of the entity's controls, including control activities, relevant to that risk.
I. Identifying Risks for which Substantive Procedures alone do not provides SAAE		
30	**Identification of Risks**	In respect of some risks, the auditor may judge that it is not possible or practicable to obtain sufficient appropriate audit evidence only from substantive procedures. In such cases, the entity's controls over such risks are relevant to the audit and the auditor shall obtain an understanding of them.
J. Revision of Risk Assessment [Para 31]		
The auditor's assessment of the risks of material misstatement at the assertion level may change during the course of the audit as additional audit evidence or information is obtained. In such case, the auditor shall revise the assessment and modify the further planned audit procedures accordingly.		
K. Documentation [Para – 32]		
The auditor shall document – (a) The discussion among the engagement team and the significant decisions reached; (b) Key elements of the understanding obtained regarding each of the aspects of the entity and its environment, internal control components, the sources of information and the risk assessment procedures performed; (c) The identified and assessed risks of material misstatement at the financial statement level and at the assertion level; and (d) Significant risks identified, and related controls.		

Note – Classification of Assertions

A. Assertions about Classes of Transactions and Events for the period under audit.

1.	**Occurrence**	Transactions and events that have been recorded have occurred and pertain to the entity.
2.	**Completeness**	All transactions and events that should have been recorded have been recorded
3.	**Accuracy**	Amounts and other data relating to recorded transactions and events have been recorded appropriately.
4.	**Cut – off**	Transactions and events have been recorded in the correct accounting period.
5.	**Classification**	Transactions and events have been recorded in the proper accounts.

B. Assertions about Account Balances at the period – end.

1.	**Existence**	Assets, liabilities, and equity interests exist.
2.	**Rights and Obligations**	The entity holds or controls the rights to assets, and liabilities are the obligations of the entity.
3.	**Completeness**	All assets, liabilities and equity interests that should have been recorded have been recorded.
4.	**Valuation and Allocation**	Assets, liabilities, and equity interests are included in the financial statements at appropriate amounts and any resulting valuation or allocation adjustments are appropriately recorded.

C. Assertions about Presentation and Disclosure.

1.	**Occurrence and Rights & Obligations**	Disclosed events, transactions, and other matters have occurred and pertain to the entity.
2.	**Completeness**	All disclosures that should have been included in the financial statements have been included.
3.	**Classification and Under – Standability**	Financial information is appropriately presented and described, and disclosures are clearly expressed.
4.	**Accuracy and Valuation**	Financial and other information are disclosed fairly and at appropriate amounts.

Examples of Assertions in particular instances.

1.	**Cash in Hand**	(a) That the Cash exists on the B/S date. (b) That there is no charge on the Cash Balance. (c) That the amount of Cash available is Rs ……… (d) That the Cash Balance is properly disclosed in the FS.\ (e) That there is no unrecorded Cash Balance.
2.	**Secured Loans**	(a) That the liability of Rs………. Lakhs exists on the date of B/S. (b) That the loans are the liability of the Company. (c) That the loans are secured to the extent of Rs……..] (d) That the loans are recorded at the appropriate carrying value. (e) That all transactions relating to loans are recorded & recognized at proper values & expenses is allocated to the proper period.

3.	**Machinery – Cost XXX (-) Dep. (XXX) XXX**	(a) That the Machinery physically exists on the B/S date. (b) That it is recorded at Historical Cost at Rs……… (c) That the M/c is free of charge/lien. (d) That P.Y. figures are properly B/F to the C.Y. (e) That Dep. Is charged at fair rated and on a consistent basis. (f) That the applicable Accounting Standards (AS 10, AS 6 and AS 16) are followed.
4.	**Investments**	1. That Investments are free of any charge/lien, etc. 2. That Investments are shown at lower of Cost or Market Price. 3. That Investments exists on the date of B/S. 4. The Investments are classified according to the purpose of the holding as per AS – 13. 5. That Investments are within the limits prescribed under the Companies Act, 1956 or Companies Act, 2013 6. That all Investments of the Company are disclosed. 7. That all the write – offs, purchase and sale transaction are recorded in the books of accounts, Profit and Loss is properly recognized in the FSs.

Manual & Automated Elements of Internal Controls [See Para 12 – 1]

A.57	**Suitability of Manual Elements in IC**	Manual elements in internal control may be more suitable where judgment and discretion are required such as for the following circumstances – ☞ Large, unusual or non-recurring transactions. ☞ Circumstances where errors are difficult to define, anticipate or predict. ☞ In changing circumstances that require a control response outside the scope of an existing automated control. ☞ In monitoring the effectiveness of automated controls.
A.58	**Disadvantage of Manual Elements in IC**	(a) They may be **less reliable** than automated elements because they can be more easily bypassed, ignored, or overridden and (b) They are also **more prone to simple errors and mistakes.** So, consistency of application of a manual control element cannot therefore be assumed. (c) They are **less suitable** for the following circumstances – ☞ **High volume** or recurring transactions, or in situations where errors that can be anticipated or predicted can be prevented, or detected and corrected, by control parameters that are automated. ☞ **Control activities** where the specific ways to perform the control can be adequately designed and automated.
A.55	**Benefits of IT in IC**	IT benefits an entity's internal control by enabling an entity to – ☞ Consistently apply predefined business rules and perform complex calculations in processing large volumes of transactions or data; ☞ Enhance the timeliness, availability, and accuracy of information; ☞ Facilitate the additional analysis of information; ☞ Enhance the ability to monitor the performance of the entity's activities and its policies and procedures; ☞ Reduce the risk that controls will be circumvented; and ☞ Enhance the ability to achieve effective segregation of duties by implementing security controls in applications, databases, and operating systems.
A.54	**Risks due to use of It in IC**	IT also poses specific risks to an entity's internal control, including, for example – ☞ Reliance on systems or programs that are inaccurately processing data, processing inaccurate data, or both. ☞ Unauthorised access to data that may result in destruction of data or improper changes to data, including the recording of unauthorised or non-existent

		transactions, or inaccurate recording of transactions. Particular risks may arise where multiple users access a common database. ☞ The possibility of IT personnel gaining access privileges beyond those necessary to perform their assigned duties thereby breaking down segregation of duties. ☞ Unauthorised changes to data in master files. ☞ Unauthorised changes to systems or programs. ☞ Failure to make necessary changes to systems or programs. ☞ Inappropriate manual intervention. ☞ Potential loss of data or inability to access data as required.

Some Past Attempts Questions

S.N.	Questions	Marks and Attempt	Answer
1.	**IT system**s also pose (cause/create/pretense) **specific risks** to an **entity's internal control?** What are those risks?	[4 Marks] [May 2010]	**Refer Para No. A.54 on Pg. no. 13**
2.	What are the points to be considered while **evaluating the "Knowledge of the Business" in the conduct of an audit?**	[8 Marks] [June 2009]	**Refer Para No. 11 on Page no. 8 also Refer Below**
Ans.	**In addition** to the importance of knowledge of the client's business in establishing the overall audit plan, such knowledge helps the auditor to **identify areas of special audit consideration,** to evaluate the **reasonableness both of accounting estimates and management representations**, and to make **judgement regarding the appropriateness of accounting policies and disclosures.**		
3.	As auditor of Z Ltd., you would like to limit your **examination of account balance tests.** What are the **control objectives** you would like the **accounting control system to achieve to suit your purpose?**	[4 Marks] [May 2010]	**Refer Note – Classification of Assertions on Page no. 12 also Refer Below**
Ans.	**<u>Basic Accounting Control Objectives</u> –** The basic accounting control objectives which are sought to be achieved by any accounting control system are – 1. Whether all transactions are recorded; 2. Whether recorded transactions are real; 3. Whether all recorded transactions are properly valued; 4. Whether all transactions are recorded timely; 5. Whether all transactions are properly posted; 6. Whether all transactions are properly classified and disclosed; 7. Whether all transactions are properly summarized.		

Mob. 7737345000

Standard on Auditing (SA) 320 (Revised)
Materiality in Planning and Performing Audit

1. Effective Date [Para – 7]

This SA is effective for audits of financial statements for periods beginning **on or after April 1, 2010.**

2. Scope of this SA [Para – 1]

This Standard on Auditing (SA) deals with the auditor's responsibility to apply the concept of materiality in planning and performing an audit of financial statements.

3. Objective [Para – 8]

The Objective of the auditor is to apply the concept of materiality appropriately in planning and performing the audit.

4. Definition [Para – 9]

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

5. Materiality in the Context of an Audit

2	**Materiality Framework**	**Materiality generally explains that –** a) Misstatements, including omissions, could be material if it influences the decisions of the user; b) Judgments are affected by the size or/& nature of a misstatement or combination for both; and c) Judgments which are material to users are based on a consideration of the common financial information needs of users as a group, and not for individual whose needs may vary.
3	**FRF doesn't provide discussion on Materiality**	The applicable financial reporting framework does not include a discussion of the concept of materiality, the characteristics referred to in paragraph 2 provide the auditor with such a frame of reference.
4	**Auditor's Assumption's**	The auditor's determination of materiality is a matter of professional judgment, and it is reasonable for the auditor to assume that users – i. Have a reasonable knowledge of business economic activities and accounting; ii. Understand that financial statements are prepared, presented and audited to levels of materiality; iii. Recognize the uncertainties inherent in the judgments and estimation; iv. Make reasonable economic decision on the basis of the information in the financial statements.
5	**Recognition of Materiality**	The concept of materiality is applied by the auditor – (a) in **planning and performing** the audit, and (b) in **evaluating** the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial statements and (c) in **forming the opinion** in the auditor's report.

<table>
<tr><td>6</td><td>Aspects to be considered in Materiality</td><td><u>Material judgments provide the provide the basis in;</u>
a) Determining the nature, timing and extent of risk assessments procedures;
b) Identifying and assessing the risks of material misstatement;
c) Determining the nature, timing and extent of further audit procedures.
d) Considering not only the size but also the nature of the uncorrected misstatements and particular circumstances of their occurrence while evaluating the financial statements.</td></tr>
<tr><td>A.1</td><td>Materiality and Audit Risk</td><td>(a) Audit risk is the risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated.
(b) Audit risk is a function of the risks of material misstatement and detection risk.
(c) <u>Materiality – Risk Relationship</u> – Where the materiality level is to be set very high, even the largest number will have effect on the decision of users, so the risk that the Auditor will conclude with an inappropriate opinion is low. Where the materiality level is set to be low, individual balance and classes of the balance becomes more critical, and the Auditor's Risk corresponding rises.
(d) Materiality and audit risk are considered throughout the audit, in particular, when –
1. Identifying and assessing the risks of material misstatement;
2. Determining the nature, timing and extent of further audit procedures; and
3. Evaluating the effect of uncorrected misstatements, if any, on the financial statements and in forming the opinion in the auditor's report</td></tr>
</table>

6. Requirements

<table>
<tr><td>10 & 11</td><td>Determining Materiality when planning the Audit</td><td>☞ The auditor shall determine the level of materiality for the FS and also for a particular class of transactions when this class of transaction affects the decision of the user.
☞ The auditor shall determine performance materiality for purposes of assessing the risks of material misstatement and determining the nature, timing and extent of further audit procedures.</td></tr>
<tr><td>A.2 & A.3</td><td>Benchmarking</td><td>☞ <u>Meaning</u> – Benchmarking is one recognised method through which an Auditor determining materiality level. A percentage is often applied to a chosen benchmark as a starting point in determining materiality for the financial statements as a whole.
☞ <u>Factors</u> – Factors that may affect the identification of an appropriate benchmark include the following –
(a) The elements of the financial statements (for example, assets, liabilities, equity, revenue, expenses);
(b) Whether there are items on which the attention of the users of the particular entity's financial statements tends to be focused (for example, for the purpose of evaluating financial performance users may tend to focus on profit, revenue or net assets);
(c) The nature of the entity, where the entity is at in its life cycle, and the industry and economic environment in which the entity operates;
(d) The entity's ownership structure and the way it is financed (for example, if an entity is financed solely by debt rather than equity, users may put more emphasis on assets, and claims on them, than on the entity's earnings); and</td></tr>
</table>

		(e) The relative volatility of the benchmark. ☞ **Examples of benchmarks** that may be appropriate, depending on the circumstances of the entity, include categories of reported income such as profit before tax, total revenue, gross profit and total expenses, total equity or net asset value. Profit before tax from continuing operations is often used for profit-oriented entities. When profit before tax from continuing operations is volatile, other benchmarks may be more appropriate, such as gross profit or total revenues. **[Para A.3]**
12 & 13	**Revision as the Audit Progresses**	☞ The auditor shall revise materiality in the event of becoming aware of information during the audit that would have caused the auditor to determine a different amount initially. ☞ When materiality is revised then auditor should consider that whether performance materiality and further audit procedures are appropriate or not.

7. Documentation [Para – 14]

Auditor shall document –

1. Materiality for the financial statements as a whole.
2. If applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures.
3. Performance materiality and
4. Any revision of (i) – (iii), above as the audit progressed.

Some Past Attempts Question

S.N.	Question	Marks and Attempt	Answer
1.	Mr. X was appointed as the auditor of M/s Easygo Ltd. and intends to apply the concept of materiality for the financial statements as a whole. Please guide him as to the **factors that may affect the identification of an appropriate benchmark for this purpose.**	[4 Marks] [Nov. 2013]	**Refer Para No. A.2 on Page no. 16**

Standard on Auditing (SA) 330

The Auditor's Responses to Assessed Risks

1. Effective Date [Para – 2]

This SA is effective for audits of financial statements for periods beginning **on or after April 1, 2008.**

2. Scope of this SA [Para – 1]

This Standard on Auditing (SA) deals with the auditor's responsibility to design and implement responses to the risks of material misstatement identified and assessed by the auditor in accordance with SA 315, in a financial statement audit.

3. Objective [Para – 3]

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

4. Definitions [Para – 4]

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

5. Requirements

A. Overall Responses at Financial Statement Level		
5	**Requirement**	The auditor shall design and implement overall responses to address the assessed risks of material misstatement at the financial statement level.
A.1	**Overall Responses**	Overall responses to address the assessed risks of material misstatement at the financial statement level may include – (a) Emphasizing to the audit team the need to maintain professional skepticism. (b) Assigning more experienced staff or those with special skills or using experts. (c) Providing more supervision. (d) Incorporating additional elements of unpredictability in the selection of further audit procedures to be performed. (e) Making general changes to the nature, timing or extent of audit procedures, for example – (i) Performing substantive procedures at the period end instead of at an interim date; or (ii) Modifying the nature of audit procedures to obtain more persuasive audit evidence.
A.2	**Control Environment**	The assessment of the risks of material misstatement at the financial statement level, and thereby the auditor's overall responses, is affected by the auditor's understanding of the control environment. An effective control environment may allow the auditor to conduct some audit procedures at an interim date rather than at the period – end.

B. Audit Procedures at Assertion Level		
6	**Requirement**	The auditor shall design and perform further audit procedures whose nature, timing and extent are based on and are responsive to the assessed risks of material misstatement at the assertion level.
7	**Factors**	The auditor shall design and perform audit procedures that are responsive to the assessed risks of material misstatement at the assertion level and in designing such audit procedures, the auditor shall – (a) Consider the reasons for the assessment given to the risk of material misstatement at the assertion level for each class of transactions, account balance, and disclosure, including inherent risks and control risks. (b) Obtain more persuasive audit evidence when the auditor's assessment of risk is high.
C. Performing Tests of Controls, their Nature, Extent & Timing		
8	**Need for Tests of Control**	The auditor shall design and perform tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of relevant controls when – (a) The auditor intends to rely on the operating effectiveness of controls; or (b) Substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level.
9	**Persuasive Evidence**	In designing and performing tests of controls, more persuasive audit evidence should be obtained when greater reliance is placed on the effectiveness of a control.
10	**Nature and Extent of TOCs**	☞ Auditor should perform other audit procedures and inquiries to obtain audit evidence about the operating effectiveness of the controls. ☞ Further, he should determine whether the controls to be tested depends upon indirect controls, and if so, whether it is necessary to obtain audit evidence supporting the effective operation of those indirect controls
11	**Timing of TOCs**	The auditor shall test controls for the particular time, or throughout the period, for which the auditor intends to rely on those controls
D. Using Audit Evidence obtained during Interim Period		
12	**Requirement**	When the auditor obtains audit evidence about the operating effectiveness of controls during an interim period, the auditor shall: (a) Obtain audit evidence about significant changes to those controls subsequent to the interim period; and (b) Determine the additional audit evidence to be obtained for the remaining period.
E. Using Audit Evidence obtained in Previous Audits		
13	**Factors**	If the auditor decides to use audit evidence about the operating effectiveness of controls obtained in previous audits, the auditor shall consider the following – (a) The effectiveness of other elements of internal control; (b) The risks arising from the manual or automated controls; (c) The effectiveness of general IT-controls; (d) The effectiveness of the control and its application by the entity, including the nature and extent of deviations in the application of the control noted in previous audits, and whether there have been personnel changes that significantly affect the application of the control; (e) Whether the lack of a change in a particular control poses a risk due to changing circumstances; and (f) The risks of material misstatement and the extent of reliance on the control.

<table>
<tr><td>14</td><td>Establishing Continuing Relevance of Evidence</td><td>(a) If the auditor plans to use audit evidence from a previous audit about the operating effectiveness of specific controls, the auditor shall establish the continuing relevance of that evidence by obtaining audit evidence about whether significant changes in those controls have occurred subsequent to the previous audit.
(b) The auditor shall obtain this evidence by performing inquiry combined with observation or inspection, to confirm the understanding of those specific controls, and
<table>
<tr><td>In the case of any such change</td><td>The auditor should test the operating effectiveness of such controls in the current audit.</td></tr>
<tr><td>In the case of no such change</td><td>The auditor should test the operating effectiveness of such controls at least once in every third audit, and shall test some controls each audit.
This will avoid the possibility that auditor tests all controls on which he intends to rely in a single audit period with no testing of controls in subsequent Two Audit Periods.</td></tr>
</table></td></tr>
<tr><td colspan="3">F. <u>Control over Significant Risks</u> [Para – 15]</td></tr>
<tr><td colspan="3">When the auditor plans to rely on controls over a risk the auditor has determined to be a significant risk, the auditor shall test those controls in the current period.</td></tr>
<tr><td colspan="3">G. <u>Evaluation the Operating Effectiveness of Controls</u></td></tr>
<tr><td>16</td><td>Effectiveness of Controls</td><td>As per the mistake detected by substantive procedure, the auditor shall evaluate that whether the relevant controls are operating effectively or not. The absence of misstatements detected by substantive procedures, however, does not assert that controls are effective.</td></tr>
<tr><td>17</td><td>Deviation from Controls</td><td>When deviations from controls upon which the auditor intends to rely are detected, the auditor shall make specific inquiries to understand these matters and their potential consequences, and shall determine whether –
(a) The tests of controls that have been performed provide an appropriate basis for reliance on the controls;
(b) Additional tests of controls are necessary; or
(c) The potential risks of misstatement need to be addressed using substantive procedures.</td></tr>
<tr><td colspan="3">H. <u>Performing Substantive Procedures</u></td></tr>
<tr><td>18 & 19</td><td>Substantive Procedures are a must</td><td>Irrespective of the assessed risks of material misstatement, the auditor shall design and perform substantive procedures for each material class of transactions, account balance, and disclosure. [Para – 18]
The Auditor shall consider whether External Confirmation Procedures are to be performed as SAP [Para – 19]
Note → This requirement reflects the facts that – [Para A.42]
(i) The Auditor's assessment of risk is Judgmental and may not identify all risk of Material Misstatement, and
(ii) There are Inherent Limitations to Internal Control, including Management override.</td></tr>
<tr><td>A.43</td><td>Nature and Extent</td><td><u>SPs may be any of the following –</u>
(a) Substantive Analytical Procedures [Note – They are generally more applicable to large volumes of transactions that tend to be predictable over time].</td></tr>
</table>

		(b) Test of Details – The nature of the risk and assertion is relevant to the design of test of details. For examples – test of details related to the existence or occurrence assertion may involve selecting from items contained in a financial statement amount and obtaining the relevant audit evidence. **(c) Combination** of Substantive Analytical Procedures and Test of Details.
A.46 & A.47	**Relationship between Risk, TOC & SPs**	Since the assessment of the risk of material misstatement takes account of internal control, the extent of substantive procedures may need to be increased when the results from tests of controls are unsatisfactory. However, increasing the extent of an audit procedure is appropriate only if the audit procedure itself is relevant to the specific risk. In designing tests of details, the extent of testing is ordinarily thought of in terms of the sample size. However, other matters are also relevant, including whether it is more effective to use other selective means of testing.
20	**SPs of FS Closing Process**	The Auditor's SPs shall include the following APs related to the FS closing process – (a) Agreeing or reconciling the financial statements with the underlying accounting records; and (b) Examining material journal entries and other adjustments made during the course of preparing the financial statements.
21	**SPs for Significant Risks**	When the assessed risk of material misstatement at the assertion level is a significant risk, the auditor shall perform substantive procedures including test of details that are specifically responsive to that risk. When the approach to a Significant Risk consists only of SPs, that procedures shall include TOD.
22 & 23	**SPs at Interim date (Timing of SPs)**	1. **Year – End Additional Procedures [Para – 22] –** When substantive procedures are performed at an interim date, the auditor shall cover the remaining period by performing – (a) Substantive procedures, combined with tests of controls for the intervening period; or (b) If the auditor determines that it is sufficient, further substantive procedures only; that provide a reasonable basis for extending the audit conclusions from the interim date to the period end. 2. **Modifications [Para – 23] –** If misstatements that the auditor did not expect when assessing the risks of material misstatement are detected at an interim date, the auditor shall evaluate whether the related assessment of risk and the planned nature, timing, or extent of substantive procedures covering the remaining period need to be modified.
<u>I.</u> <u>Evaluating adequacy of Presentation and Disclosure</u> [Para – 24]		
The auditor shall perform audit procedures to evaluate whether the overall presentation of the financial statements, including the related disclosures, is in accordance with the applicable financial reporting framework.		
<u>J.</u> <u>Evaluating Sufficiency & Appropriateness of Audit Evidence</u>		
25	**Risk Assessment**	Based on the audit procedures performed and the audit evidence obtained, the auditor shall evaluate before the conclusion of the audit whether the assessments of the risks of material misstatement at the assertion level remain appropriate.
26	**Conclusion as to Audit Evidence**	The auditor shall conclude whether sufficient appropriate audit evidence has been obtained. In forming an opinion, the auditor shall consider all relevant audit evidence, regardless of whether it appears to corroborate or to contradict the assertions in the financial statements.
27	**If SAAE is not obtained**	If the auditor has not obtained sufficient appropriate audit evidence as to a material financial statement assertion, the auditor shall attempt to obtain further audit

		evidence. If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor shall express a qualified opinion or a disclaimer of opinion.

6. Documentation under SA – 330

28	**Matter to be documented**	The Auditor shall document – (a) The overall responses to address the assessed risks of material misstatement at the financial statement level, and the nature, timing and extent of the further audit procedures performed; (b) The linkage of those procedures with the assessed risks at the assertion level; and (c) The results of the audit procedures, including the conclusions where these are not otherwise clear.
29	**Conclusion based on previous audit**	If the auditor plans to use audit evidence about the operating effectiveness of controls obtained in previous audits, the auditor shall document the conclusions reached about relying on such controls that were tested in a previous audit.
30	**Agreement with Books**	The auditors' documentation shall demonstrate that the financial statements agree or reconcile with the underlying accounting records.

Some Past Attempts Questions

S.N.	Questions	Marks and Attempt	Answer
1.	In the course of audit of Z Ltd, its auditor wants to **rely on audit evidence obtained in previous audit** in respect of effectiveness of internal controls instead of retesting the same during the current audit. As an advisor to the auditor kindly caution him about the **factors that may warrant a re-test of controls.**	[4 Marks] [May 2013]	**Refer Para No. 13 & 14 on Page no. 19 & 20**
2.	**As a Statutory Auditor, how would you deal with the following?** While commencing the statutory audit of B Company Limited, the auditor undertook the **risk assessment and found that the detection risk relating to certain class of transactions cannot be reduced to acceptance level.**	[4 Marks] [Nov. 2003]	**See Below**
And.	SA 315 and SA 330 establish standards on the procedures to be followed to obtain an understanding of the accounting and internal control systems and on audit risk and its components – inherent risk, control risk and detection risk. SAs 315 and 330 require that the auditor should **use professional judgement to assess audit risk and to design audit procedures to ensure that it is reduced to an acceptably low level.** "Detection risk" is the risk that an auditor's substantive procedures will not detect a misstatement that exists in an account balance or class of transactions that could be material. **The higher the assessment of inherent and control risks, the more audit evidence the auditor should obtain from the performance of substantive procedures.** When both inherent and control risks are assessed as high, the auditor needs to consider whether substantive procedures can provide s**ufficient appropriate audit evidence to reduce detection risk**, and therefore audit risk, to an acceptably low level. If it cannot be reduced to an acceptable level, the auditor should **express a qualified opinion or a disclaimer of opinion as may be appropriate.**		

Standard on Auditing (SA) 402 (Revised)

Audit Consideration relating to an Entity using a SO

1. Effective Date [Para – 6]

This SA is effective for audits of financial statements for periods beginning **on or after April 1, 2010.**

2. Scope of this SA [Para – 1, 2, 3, 4 & 5]

1. This SA deals with the user auditor's responsibility to obtain sufficient appropriate audit evidence when a user entity uses the services of one or more Service Organizations (SO).
2. Many services are given by the service organizations like information processing, maintenance of safe custody or assets, and initiation or execution of transactions. However not all may be relevant to the audit.
3. A service is relevant to financial reporting and is part of entities information system when they affect;
   a) The classes of transactions are significant.
   b) The transfer and reporting of accounting entries.
   c) The related accounting records and how information is transferred to the general ledger ;
   d) How the user entity's information system captures insignificant events and conditions ;
   e) The reporting process including significant accounting estimates and disclosures ; and
   f) Controls surrounding journal entries, including non-standard journal entries used to record non- recurring, unusual transactions or adjustments.

Note → The nature and extent of work to be performed by the user auditor regarding the services provided by a service organisation depend on the nature and significance of those services to the user entity and the relevance of those services to the audit.

Note → This SA do not cover services of Financial Institutions that are limited to processing, for an entity's account held at the financial institution, transactions that are specifically authorised by the entity (For e.g. Bank or Stock Broker). Also this SA does not cover other entities (For e.g. Partnerships, Corporations and Joint Ventures).

3. Objective [Para – 7]

(a) To **obtain** an understanding of the nature and significant of the services and their effect on the user entity's internal control relevant to the audit, sufficient to identify and assess the risks of material misstatement; and

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

4. Definition [Para – 8]

(a)	**Complementary User entity controls**	Controls that the service organization assumes, in the design of its service, will be implemented by user entities, and which, if necessary to achieve control objectives, are identified in the description of its system.
(b)	**Type 1 Report (Report on the description and design of controls at a service organization)**	A report that comprises – (a) A description, prepared by management of the service organization, of the service organization's system, control objectives and related controls that have been designed and implemented as at a specified date ; and (b) A report by the service auditor with the objective of conveying reasonable assurance that includes the service auditor's opinion on the description of the service organization's system, control objectives and related controls and the suitability of the design of the controls to achieve the specified control objectives.

(c)	**Type 2 Report (Report on the description, design & operating effectiveness of controls at a service organization)**	A report that comprises – 1. A description, prepared by management of the service organisation, of the service organisation's system, control objectives and related controls, their design and implementation as at a specified date or throughout a specified period and, in some cases, their operating effectiveness throughout a specified period; and 2. A report by the service auditor with the objective of conveying reasonable assurance that includes – (a) The service auditor's opinion on the description of the service organisation's system, control objectives and related controls, the suitability of the design of the controls to achieve the specified control objectives, and the operating effectiveness of the controls; and (b) A description of the service auditor's tests of the controls and the results thereof.
(d)	**Service Auditor**	An auditor who, at the request of the service organization, provides an assurance report on the controls of a service organization.
(e)	**Service Organisation**	A third-party organization (or segment of a third party organization) that provides services to user entities that are part of those entities' information systems relevant to financial reporting.
(f)	**Service Organisation's System**	The policies and procedures designed, implemented and maintained by the service organization to provide user entities with the services covered by the service auditor's report.
(g)	**Subservice Organisation**	A service organization used by another service organization to perform some of the services provided to user entities that are part of those user entities' information systems relevant to financial reporting.
(h)	**User Auditor**	An auditor who audits and reports on the financial statement of a user entity.
(i)	**User Entity**	An entity that uses a service organization and whose financial statements are being audited.

5. Requirement

A. Obtaining the Understanding the Services provided by a SO, including IC		
A.1 & A.2	**Sources of Information**	☞ Information on the nature of the services provided by a service organisation may be available from a wide variety of sources, such as: ✓ User manuals, ✓ System overviews, ✓ Technical manuals, ✓ The contract or service level agreement between the user entity and the service organisation, ✓ Reports by service organisations, internal auditors or regulatory authorities on controls at the service organisation, ✓ Reports by the service auditor, including management letters, if available. ☞ Knowledge obtained through the user auditor's experience with the service organisation, (for example through experience with other audit engagements).
9	**How Services are uses**	(a) The nature of service provided by the SO and significance of such services and its effect on internal control of UE; (b) The nature and materiality of the transactions processed or accounts or Financial Reporting processes affected by the SO; (c) The degree of interaction between the activities of SO and those of UE and; (d) The nature of the relationship between the UE and SO.

<table>
<tr><td>10</td><td>Design and Implementation of Controls</td><td>Evaluate the design and implementation of relevant controls at the user entity</td></tr>
<tr><td>11</td><td>Risk Assessment</td><td>The User Auditor shall determine whether a sufficient understanding of the nature and significance of the services provided by the SO and their effect on the UE's IC relevant to the audit has been obtained, to provide a basis for the I&A of Risks of Material Misstatement.</td></tr>
<tr><td>12.</td><td>Additional Procedures</td><td>If the user Auditor is unable to obtain sufficient understanding, following procedure should be done by the Users Auditor –
(a) Obtaining a Type 1 or Type 2 report, if available;
(b) Contacting the service organization, through the user entity, to obtain specific information;
(c) Visiting the service organization and performing procedures that will provide the necessary information about the relevant controls at the service organization; or
(d) Using another auditor to perform procedures that will provide the necessary information about the relevant controls at the service organization.</td></tr>
<tr><td>A.20</td><td>SSO</td><td>A user entity may use a service organisation that in turn uses a subservice organisation to provide some of the services provided to a user entity that are part of the user entity's information system relevant to financial reporting. In such situations, the interaction between the activities of the UE and those of the SO is expanded to include SSO's also, in order to evaluate the controls in the SSO's.</td></tr>
<tr><td colspan="3"><u>B. Using a Type 1 or Type 2 Report to support the Auditor's understanding of the SO</u></td></tr>
<tr><td>13</td><td>Sufficiency of Report</td><td><u>In determining the sufficiency and appropriateness the auditor shall</u> –
1. The service auditor's professional competence (except where the service auditor CA) and independence from the service organization ; and
2. The adequacy of the standards under which the Type 1 or Type 2 report was issued.</td></tr>
<tr><td>14</td><td>Evaluation of Report</td><td><u>If auditor plan to use a Type 1 or 2 Report the auditor shall</u> –
1. Evaluate whether the description and design of controls is at a date or for a period that is appropriate for the user auditor's purposes;
2. Evaluate the sufficiency and appropriateness of the evidence provided by the report.
3. Determine whether complementary user entity controls identified by the service organization are relevant to the user entity and, if so, obtain an understanding of whether the user entity has designed and implemented such controls.</td></tr>
<tr><td colspan="3"><u>C. Responding to Assessed Risk of Material Misstatement</u> – If the evidence is not sufficient conducting additional procedures or using another auditor to obtain the evidence.</td></tr>
<tr><td colspan="3"><u>D. Test of Control</u></td></tr>
<tr><td>16</td><td>Affirmation of Operating Effectively</td><td><u>Operating effectiveness of controls can be affirmed by</u>
(a) Obtaining a Type 2 report, if available;
(b) Performing appropriate tests of controls at the service organization ; or
(c) Using another auditor to perform tests of controls at the service organization on behalf of the user auditor.</td></tr>
<tr><td colspan="3"><u>E. Using Type 2 Report as Audit Evidence for Operating Effectiveness of Controls at the SO</u></td></tr>
<tr><td>17</td><td>Type 2 Report as AE for Operating Effectiveness of Controls</td><td>(a) Evaluating whether the description, design and operating effectiveness of controls at the service organization is at a date or for a period that is appropriate for the user auditor's purposes;
(b) Determining whether complementary user entity controls if any are implemented and tested ;</td></tr>
</table>

		(c) Evaluating the adequacy of the time period covered and the time elapsed since the performance of the tests of controls ; and (d) Evaluating whether the tests of controls are relevant to the assertions and provide sufficient basis to support the user auditor's risk assessment.
F. Evaluation of SO Auditor's Report		
A.37 & A.38	**Evaluation of So Auditor's Report**	☞ If the user auditor believes that the service auditor's report may not provide sufficient appropriate audit evidence, the User Auditor may contact the SO, through the user entity, to request a **discussion with the service auditor** about the scope and results of the service auditor's work. Also, if the user auditor believes it is necessary, the user auditor may contact the service organisation, through the user entity, to request that the service auditor perform procedures at the service organisation. **[Para A.37]** ☞ Exceptions noted by the service auditor or a modified opinion in the service auditor's Type 2 report do not automatically mean that the service auditor's Type 2 report will not be useful for the audit of the user entity's financial statements in assessing the risks of material misstatement. Rather, the exceptions and the matter giving rise to a modified opinion in the service auditor's Type 2 report are considered in the user auditor's assessment of the testing of controls performed by the service auditor. **[Para A.38]**
G. Inclusive or Carve Out Method of Reporting		
A.40	**Inclusive or Carve Out Method**	If a service organisation uses a subservice organisation, the service auditor's report may either include or exclude the subservice organisation's relevant control objectives and related controls in the service organisation's description of its system and in the scope of the service auditor's engagement. These two methods of reporting are known as the inclusive method and the carve-out method, respectively.
18	**Reports Carve Out of services SSO**	User Auditor plans to use a Type 1 & Type 2 Report that excludes the services provided by SSO, and those services are relevant to the audit of the UEs FSs, in this case the auditor shall apply this SA to the services of a subservice used by the user entity.
H. Fraud, Non Compliance with L&R and Uncorrected Misstatements in relation to Activities at the SO		
19	**If the above items are present at SO**	☞ The user auditor shall inquire to management and ☞ Evaluate how such matters affect the nature, timing and extent of the user auditor's further audit procedures, including the effect on the user auditor's conclusions and user auditor's report.
I. Reporting by the User Auditor		
20 To 22	**Reporting**	(a) If the user auditor is unable to obtain sufficient appropriate audit evidence regarding the services the user auditor shall modify his opinion. (b) The user auditor shall not refer a service auditor in case of unmodified opinion unless required by law or regulation, and the user auditor's report shall indicate that the reference does not diminish the user auditor's responsibility for the audit opinion. (c) If reference to the work of a service auditor is relevant to an understanding of a modification to the user auditor's opinion, the user auditor's report shall indicate that such reference does not diminish the user auditor's responsibility for that opinion.

Some Past Attempts Questions

S.N.	Questions	Marks and Attempt	Answer
1.	In the course of the audit of R Ltd., the audit manager of ABC & Co. observed that **R Ltd. has outsourced certain activities to an outsourcing agency.** As the engagement partner guide the audit manager in the **assessment of services provided by the outsourcing agency** in relation to the audit.	[4 Marks] [May 2011]	**Refer Para No. 9, 10 & 11 on Page no. 24 & 25**
2.	G Ltd. is a mobile phone operating company. Barring the **marketing function** it had **outsourced** the entire operations like maintenance of mobile infrastructure, customer billing, payroll, accounting functions, etc. Assist the auditor of G Ltd. as to how he can **obtain an understanding of how G Ltd. uses the services of the outsourced agency in its operations.**	[5 Marks] [Nov. 2013]	**Refer Para No. 9, 10 & 11 on Page no. 24 & 25**

Standard on Auditing (SA) 450

Evaluation of Misstatements identified during the Audit

1. Effective Date [Para – 2]

This SA is effective for audits of financial statements for periods beginning **on or after April 1, 2010.**

2. Scope of this SA [Para – 1]

This Standard on Auditing (SA) deals with the auditor's responsibility to evaluate the effect of identified misstatements on the audit and of uncorrected misstatements, if any, in forming an opinion on the financial statements.

3. Objectives [Para – 3]

The objective of the auditor is to evaluate –

(a) The effect of identified misstatements on the audit; and

(b) The effect of uncorrected misstatements, if any, on the financial statements.

4. Definition [Para – 4]

(a)	**Misstatement**	A difference between the amounts, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework. Misstatements can arise from error or fraud. When the auditor expresses an opinion on whether the financial statements give a true and fair view or are presented fairly, in all material respects, misstatements also include those adjustments of amounts, classifications, presentation, or disclosures that, in the auditor's judgment, are necessary for the financial statements to give a true and fair view or present fairly, in all material respects.
A.1	**Reasons for Misstatement**	**Misstatements may result from –** 1. An inaccuracy in gathering or processing data from which the financial statements are prepared; 2. An Omission of an amount or disclosure; 3. An incorrect accounting estimate arising from overlooking, or clear misinterpretation of, facts; and 4. Judgments of management concerning accounting estimates that the auditor considers unreasonable or 5. The selection and application of accounting policies that the auditor considers inappropriate.
A.3	**Types of Misstatement**	**Misstatements can be Classified into –** 1. Factual misstatements are misstatements about which there is no doubt. 2. Judgmental misstatements are differences arising from the judgments of management concerning accounting estimates that the auditor considers unreasonable, or the selection or application of accounting policies that the auditor considers inappropriate. 3. Projected misstatements are the auditor's best estimate of misstatements in populations, involving the projection of misstatements identified in audit samples to the entire populations from which the samples were drawn.
(b)	**Uncorrected Misstatement**	Misstatements that the auditor has accumulated during the audit and that have not been corrected.

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5. Requirements [Para – 4]

A. Accumulation of Identified Misstatement		
5	**Accumulation of Identified Misstatement**	☞ The auditor shall accumulate misstatements identified during the audit, other than those that are insignificant. [Para – 5] ☞ The auditor may designate an amount below which misstatements would be clearly trivial and would not need to be accumulated because the auditor expects that the accumulation of such amounts clearly would not have a material effect on the financial statements. [Para A.2] ☞ **"Clearly trivial" is not another expression for "not material"** [Para A.2]
B. Consideration of Identified Misstatements as the Audit Progresses		
6 & 7	**Misstatement as Audit Progresses**	The auditor shall identify whether there is need to revise audit plan if the circumstances are such that there may be other misstatements, and the collective effect of such is material.
C. Communication and Correction of Misstatements		
8 & 9	**Communication & Correction**	☞ The auditor shall communicate on a timely basis all misstatements accumulated during the audit with the appropriate level of management, unless prohibited by law. ☞ If management refuses to correct the same then appropriate procedures should be followed.
D. Evaluating the effect of Uncorrected Misstatements		
10 & 11	**Evaluation of Uncorrected Misstatement**	The auditor shall reassess the materiality of misstatements and effect of those on particular classes of transactions, account balances or disclosures in the financial statements, prior period's relevant transactions and financial statements as a whole.
E. Communication with TCWG		
12 & 13	**Communication with TCWG**	**The Auditor shall –** ☞ Uncorrected misstatements and the effect that they, individually or in aggregate, may have on the opinion in the auditor's report, unless prohibited by law or regulation. The auditor's communication shall identify material uncorrected misstatements individually. The auditor shall request that uncorrected misstatements be corrected. ☞ The effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole.
F. Written Representation		
14	**WR**	The auditor shall request a written representation from management and, where appropriate, those charged with governance that whether they believe that the effects of uncorrected misstatements are immaterial, individually and in aggregate, to the financial statements as a whole. A summary of such items shall be included in or attached to the written representation.
G. Documentation		
15	**Documentation**	(a) The amount below which misstatements would be regarded as clearly immaterial (trivial), (b) All misstatements accumulated during the audit and whether they have been corrected and (c) The auditor's conclusion as to whether uncorrected misstatements are material, individually or in aggregate and the basis for that conclusion.

Some Past Attempts Questions

S.N.	Questions	Marks and Attempt	Answer
1.	In the course of audit of T Ltd., the audit team is not sure of the **possible source of misstatements** in the financial statements. As the audit manager identify the sources of misstatements.	[4 Marks] [May 2011] & [May 2013]	**Refer Para No. A.1 on Page no. 28**
2.	The Auditor should consider the aggregate of all uncorrected mis – statements including those involving estimates in his assessment of materiality in audit. Comment. **OR** An assistant of X & Co., CAs, detected an **error of ₹ 5 per interest payment,** which **recurred a number of times.** The General Manager (Finance) of T Ltd advised him not to request for passing any adjustment entry as **individually** the **errors** were of **very small amounts.** The Company had **2000 Deposit Accounts** and interest was paid quarterly. State your views in this issue, with reasons. **OR** While auditing the accounts of a Public Limited Company for the year ended 31st March, an Auditor fount out **error in the valuation of inventory,** which **affects** the **Financial Statement materially.** Comment as per Auditing Standard.	[8 Marks] [May 2002]	**Refer Para No. 5 to 15 on Pg. no. 29**

Standard on Auditing (SA) 500 (Revised)
Audit Evidence

1. Effective Date [Para – 3]

This SA is effective for audits of financial statements for periods beginning **on or after April 1, 2009.**

2. Scope of this SA [Para – 1 & 2]

This SA explains what constitutes audit evidence in an audit of financial statements, and deals with the auditor's responsibility to design and perform audit procedures to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion.

This SA is applicable to all the audit evidence obtained during the course of the audit. Other SAs deal with specific aspects of the audit (for example, SA 315), the audit evidence to be obtained in relation to a particular topic [for example, SA 570(Revised)], specific procedures to obtain audit evidence [for example, Proposed SA 520 (Revised)], and the evaluation of whether sufficient appropriate audit evidence has been obtained {Proposed SA 200 (Revised) and SA 330].

3. Objectives [Para – 4]

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

4. Definition [Para – 5]

(a)	**Accounting Records**	The records of **initial accounting entries and supporting records**, such as checks and records of electronic fund transfers ; invoices; contracts; the general and subsidiary ledgers, journal entries and other **adjustments** to the financial statements that are not reflected in journal entries; and records such as work sheets and spreadsheets supporting cost allocations, computations, reconciliations and disclosures.
(b)	**Appropriateness of AE**	The **measure of the quality** of audit evidence; that is, its **relevance** and its **reliability** in providing support for the conclusions on which the auditor's opinion is based.
(c)	**AE**	Information used by the auditor in arriving at the conclusions on which the auditor's opinion is based. Audit evidence includes both information contained in the accounting records underlying the financial statements and other information.
(d)	**Management Expert**	An individual or organization **possessing expertise in a field other than accounting or auditing**, whose work in that field is used by the entity to assist the entity in preparing the financial statements.
(e)	**Sufficiency of AE**	The **measure of the quantity** of audit evidence. The quantity of the audit evidence needed is **affected by** the **auditor's assessment of the risks of material misstatement** and also **by the quality** of such audit evidence.

5. Requirement

A. SAAE		
6	**SAAE**	The auditor shall design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence.
B. Reliability of Audit Evidence [Para – 7] - – When designing and performing audit procedures, the auditor shall evaluate the relevance and reliability of the information to be used as audit evidence. The following are the principles in this regard –		

I. Relevance [Para A.27 to A.30]		
(a)	**Meaning**	Relevance deals with the logical connection with, or bearing upon, the purpose of the audit procedure and, where appropriate, the assertion under consideration.
(b)	**Relevance to Audit Procedure**	☞ The relevance of information to be used as audit evidence may be affected by the direction of testing. ☞ **For example –** To test for overstatement in the existence or valuation of accounts payable (Creditor), testing the recorded accounts payable may be a relevant audit procedure. On the other hand, when testing for understatement in the existence or valuation of accounts payable, testing the recorded accounts payable would not be relevant, but testing such information as subsequent disbursements, unpaid invoices, suppliers' statements, and unmatched receiving reports may be relevant.
(c)	**Relevance to Assertion**	☞ A given set of audit procedures may provide audit evidence that is relevant to certain assertions, but not others. ☞ **For example –** The existence of inventory, is not a substitute for obtaining audit evidence regarding another assertion, for example, the valuation of that inventory. On the other hand, audit evidence from different sources or of a different nature may often be relevant to the same assertion.
(d)	**Relevance of TOCs**	☞ Tests of controls are designed to evaluate the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements at the assertion level. ☞ Designing tests of controls to obtain relevant audit evidence includes identifying conditions (characteristics or attributes) that indicate performance of a control, and deviation conditions which indicate departures from adequate performance.
(e)	**Relevance of TODs**	☞ Substantive procedures are designed to detect material misstatements at the assertion level. They comprise tests of details and substantive analytical procedures. ☞ Designing substantive procedures includes identifying conditions relevant to the purpose of the test that constitute a misstatement in the relevant assertion.

II. Relevance [Para A.31 to A.33] – Reliability of AE is influenced by its source and its nature, and the circumstances under which it is obtained, including the controls over its preparation and maintenance where relevant. The general rules about the reliability of AE are –	
(a)	Reliability of AE is increased when it is obtained from independent sources outside the Entity. However, such independent external source may not be reliable if the source is not knowledgeable, or a management's expert may lack objectivity.
(b)	The reliability of audit evidence that is generated internally is increased when the related controls, including those over its preparation and maintenance, imposed by the entity are effective.
(c)	Audit evidence obtained directly by the auditor (for example, observation of the application of a control) is more reliable than audit evidence obtained indirectly or by inference (for example, inquiry about the application of a control).
(d)	Audit evidence in documentary form, whether paper, electronic, or other medium, is more reliable than evidence obtained orally
(e)	Audit evidence provided by original documents is more reliable than audit evidence provided by photocopies or facsimiles, or documents that have been filmed, digitised or otherwise transformed into electronic form, the reliability of which may depend on the controls over their preparation and maintenance.

Four major categories of documentary evidence, which provide degree of reliability are –		
Origin	**Held by**	**Example**
Third Parties	**Third Parties**	**Title Deeds to land held by bank towards security.**
Third Parties	**Entity**	**Purchase invoices, Bills for services obtained, Bills for expenses.**
Entity	**Third Parties**	**Sales invoices, Delivery Challans.**
Entity	**Entity**	**Copy of Goods Received Note (GRN), Journal Vouchers (JV).**

C. Information to be used as AE

8	**Using M's E**	When information to be used as audit evidence has been prepared using the work of a management's expert, the auditor shall, to the extent necessary, having regard to the significance of that expert's work for the auditor's purposes – 1. Evaluate the competence, capabilities and objectivity of that expert; 2. Obtain an understanding of the work of that expert; and 3. Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion
9	**Information produced by the Entity**	When using information produced by the entity, the auditor shall evaluate whether the information is sufficiently reliable for the auditor's purposes, including as necessary in the circumstances – 1. Obtaining audit evidence about the accuracy and completeness of the information; and 2. Evaluating whether the information is sufficiently precise and detailed for the auditor's purposes.

D. Selecting Items for Testing to Obtain AE

(a) When designing tests of controls and tests of details, the auditor shall determine means of selecting items for testing that are effective in meeting the purpose of the audit procedure. [Para – 10]

(b) The means available to the Auditor for selecting items for Testing and explained below – [Para A.52]

1. Selecting All Items (100%)
2. Selecting Specific Items
3. Audit Sampling

E. Inconsistency in, or doubts over reliability of AE [Para – 11]

S.N.	Situation	The Auditor Shall
(a)	If audit evidence obtained from one source is inconsistent with that obtained from another, or	☞ Determine what modifications or additions to audit procedures are necessary to resolve the matter, and ☞ Consider the effect of the matter, if any, on other aspects of the audit.
(b)	If the auditor has doubts over the reliability of information to be used as audit evidence.	

Other Matter

Audit Procedures for Collecting AE.

1.	**Inspection**	Inspection involves examining records or documents, whether internal or external, in paper form, electronic form, or other media, or a physical examination of an asset
2.	**Observation**	Observation consists of looking at a process or procedure being performed by others. E.g. The auditor's observation of inventory counting by the entity's personnel, or of the performance of control activities.
3.	**External Confirmation**	An external confirmation represents audit evidence obtained by the auditor as a direct written response to the auditor from a third party (the confirming party), in paper form, or by electronic or other medium.
4.	**Recalculation**	Recalculation consists of checking the mathematical accuracy of documents or records. Recalculation may be performed manually or electronically.
5.	**Re – Performance**	Re – Performance involves the auditor's independent execution of procedures or controls that were originally performed as part of the entity's internal control.
6.	**Analytical Procedures**	Analytical procedures consist of evaluations of financial information made by a study of plausible relationships among both financial and non-financial data. Analytical procedures also encompass the investigation of identified fluctuations and relationships that are inconsistent with other relevant information or deviate significantly from predicted amounts.
7.	**Inquiry**	Inquiry consists of seeking information of knowledgeable persons, both financial and non- financial, within the entity or outside the entity. Inquiry is used extensively throughout the audit in addition to other audit procedures. Inquiries may range from formal written inquiries to informal oral inquiries. Evaluating responses to inquiries is an integral part of the inquiry process.
8.	**Written Representations**	In respect of some matters, the auditor may consider it necessary to obtain written representations from management and, where appropriate, those charged with governance to confirm responses to oral inquiries.

Some Past Attempts Questions

S.N.	Questions	Marks and Attempt	Answer
1.	The MD of a client Company has advised you Audit Manager that **because of the confidentiality of the Director' Salaries,** the appropriate **records** will **only** be made available **to** you as the **Partner in charge** and **not to your audit staff.** Explain the steps you will take to resolve the issue.	-----------	**Refer Para No. A.31 on Page no. 32**
2.	An assistant of X & Co. Chartered Accountants wanted to **verify the cash in hand and investment** of T Ltd. The **General Manager (Finance)** of T Ltd. **suggested** to the assistant of X & Co. that **it was not necessary as his staff has done the same only few days back and no discrepancies were noted.** Comment on the above.	---------	**Refer Para No. 7 to 9 on Page No. 31 to 32**

Standard on Auditing (SA) 501 (Revised)
Specific Considerations for Selected Items

1. Effective Date [Para – 2]

This SA is effective for audits of financial statements for periods beginning **on or after April 1, 2010.**

2. Scope of this SA [Para – 1]

This Standard on Auditing (SA) deals with specific considerations by the auditor in obtaining sufficient appropriate audit evidence in accordance with SA 330, SA 500 (Revised) and other relevant SAs, with respect to certain aspects of inventory, litigation and claims involving the entity, and segment information in an audit of financial statements.

3. Objectives [Para – 3]

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

a. Existence and condition of inventory;
b. Completeness of litigation and claims involving the entity; and
c. Presentation and disclosure of segment information in accordance with the applicable financial reporting framework.

4. Requirement

A. Inventory – The Auditors' Duties are summarized as under –		
4	**Existence and Condition**	When inventory is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by – (a) Attendance at physical inventory counting, unless impracticable, to – 1. Evaluate management's instructions and procedures for recording and controlling the results of the entity's physical inventory counting; 2. Observe the performance of management's count procedures; 3. Inspect the inventory; and 4. Perform test counts; and (b) Performing audit procedures over the entity's final inventory records to determine whether they accurately reflect actual inventory count results.
5	**Different date of Physical Count**	If physical inventory counting is conducted at a date other than the date of the financial statements, the auditor shall, in addition to the procedures mentioned above, perform audit procedures to obtain audit evidence about whether changes in inventory between the count date and the date of the financial statements are properly recorded. Relevant matters for consideration when designing audit procedures to obtain audit evidence about whether changes in inventory amounts between the count date, or dates, and the final inventory records are properly recorded include – [Para A.11] ✓ Whether the perpetual inventory records are properly adjusted. ✓ Reliability of the entity's perpetual inventory records. ✓ Reasons for significant differences between the information obtained during the physical count and the perpetual inventory records.
6 & 7	**Auditor not able to attend Physical**	☞ If the auditor is unable to attend physical inventory counting due to unforeseen circumstances, the auditor shall make or observe some physical counts on an alternative date, and perform audit procedures on intervening transactions.

<table>
<tr><td></td><td>Inventory Counting</td><td>☞ If attendance at physical inventory counting is impracticable, the auditor shall perform alternative audit procedures to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory. If it is not possible to do so, the auditor shall modify the opinion in the auditor's report in accordance with SA 705.</td></tr>
<tr><td>8</td><td>Inventory under custody and control with Third Party</td><td>When inventory under the custody and control of a third party is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of that inventory by performing one or both of the following –
(a) Request confirmation from the third party as to the quantities and condition of inventory held on behalf of the entity.
(b) Perform inspection or other audit procedures appropriate in the circumstances.
Depending on the circumstances, for example where information is obtained that raises doubt about the integrity and objectivity of the third party, the auditor may consider it appropriate to perform other audit procedures instead of, or in addition to, confirmation with the third party. Examples of other audit procedures include – [Para A.16]
✓ Attending, or arranging for another auditor to attend, the third party's physical counting of inventory, if practicable.
✓ Obtaining another auditor's report, or a service auditor's report, on the adequacy of the third party's internal control for ensuring that inventory is properly counted and adequately safeguarded.
✓ Inspecting documentation regarding inventory held by third parties, for example, warehouse receipts.
✓ Requesting confirmation from other parties when inventory has been pledged as collateral.</td></tr>
<tr><td colspan="3" align="center"><u>B.</u> <u>Litigation and Claims</u> –</td></tr>
<tr><td>9</td><td>Identification of L&C</td><td>The auditor shall design and perform audit procedures in order to identify litigation and claims involving the entity which may give rise to a risk of material misstatement, including –
(a) Inquiry of management and, where applicable, others within the entity, including in-house legal counsel;
(b) Reviewing minutes of meetings of those charged with governance and correspondence between the entity and its external legal counsel; and
(c) Reviewing legal expense accounts.</td></tr>
<tr><td>10</td><td>Letter of Inquiry with Entity's External Legal Counsel (ELC)</td><td>☞ If the auditor assesses a risk of material misstatement regarding litigation or claims that have been identified, or when audit procedures performed indicate that other material litigation or claims may exist, the auditor shall, in addition to the procedures required by other SAs, seek direct communication with the entity's external legal counsel.
☞ The auditor shall do so through a letter of inquiry, prepared by management and sent by the auditor, requesting the entity's external legal counsel to communicate directly with the auditor.
☞ If law, regulation or the respective legal professional body prohibits the entity's external legal counsel from communicating directly with the auditor, the auditor shall perform alternative audit procedures.</td></tr>
<tr><td>A.21</td><td>Direct Communication with ELC</td><td>Direct communication with the entity's external legal counsel through a letter of general or specific enquiry assists the auditor in obtaining sufficient appropriate audit evidence as to whether potentially material litigation and claims are known and management's estimates of the financial implications, including costs, are reasonable.</td></tr>
</table>

A.23	**Letter of Inquiry to ELC**	***A letter of specific inquiry includes*** **–** (a) A list of litigation and claims; (b) Where available, management's assessment of the outcome of each of the identified litigation and claims and its estimate of the financial implications, including costs involved; and (c) A request that the entity's external legal counsel confirm the reasonableness of management's assessments and provide the auditor with further information if the list is considered by the entity's external legal counsel to be incomplete or incorrect.
A.24	**Meeting with ELC**	The auditor may also decide to meet the entity's external legal counsel in the case of significant or complex matters or when there is disagreement between management and the entity's external legal counsel.

Note → IF – [Para – 11]

(a) Management refuses to give the auditor permission to communicate or meet with the entity's external legal counsel, or the entity's external legal counsel refuses to respond appropriately to the letter of inquiry, or is prohibited from responding; and

(b) The auditor is unable to obtain sufficient appropriate audit evidence by performing alternative audit procedures; the auditor shall modify the opinion in the auditor's report in accordance with SA 705.

A.25	**Date on Auditor's Report**	The auditor is required to date the auditor's report no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor's opinion on the financial statements.
12	**Written Representation**	The auditor shall request management and, where appropriate, those charged with governance to provide written representations that all known actual or possible litigation and claims whose effects should be considered when preparing the financial statements have been disclosed to the auditor and appropriately accounted for and disclosed in accordance with the applicable financial reporting framework.
	C. Segment Information –	
19	**Obtain SAAE**	The auditor shall obtain sufficient appropriate audit evidence regarding the presentation and disclosure of segment information in accordance with the applicable financial reporting framework by – (a) Obtaining an understanding of the methods used by management in determining segment information, and – 1. Evaluating whether such methods are likely to result in disclosure in accordance with the applicable financial reporting framework; and 2. Where appropriate, testing the application of such methods; and (b) Performing analytical procedures or other audit procedures appropriate in the circumstances.
A.27	**Methods used by Management in Segment Information**	Matters that may be relevant when obtaining an understanding of the methods used by management in determining segment information and whether such methods are likely to result in disclosure in accordance with the applicable financial reporting framework include – 1. Sales, transfers and charges between segments, and elimination of inter-segment amounts. 2. Comparisons with budgets and other expected results, for example, operating profits as a percentage of sales. 3. The allocation of assets and costs among segments. 4. Consistency with prior periods, and the adequacy of the disclosures with respect to inconsistencies.

Some Past Attempts Questions

S.N.	Questions	Marks and Attempt	Answer
1.	You are the auditor of Easy Communications Ltd. for the year 2012–13. The inventory as at the end of the year i.e. 31.3.13 was ₹ 2.25 Crores. **Due to unavoidable circumstances, you could not be present at the time of annual physical verification.** Under the above circumstances how would you ensure that the physical verification conducted by the management was in order?	[5 Marks] [Nov. 2008]	**Refer Para No. 6 & 7 on Page no. 36 & 37**
2.	XYZ Ltd has significant operations in a foreign country. Due to civil and political unrest in that country **physical verification of inventory and fixed assets could not carried out** and you are not in a position to obtain audit evidence through other audit procedures also. The **value of fixed assets and inventory forms part of 80% of the asset value of the company.** As the auditor of XYZ Ltd what **factors** do you **consider** in your **reporting responsibility.** Also draft a suitable report that will be incorporated in the main audit report (Reporting under CARO 03 need not be considered).	[8 Marks] [May 2013]	**See Below**

Ans.

Following factors are to be considered in auditor's reporting responsibility –

(a) Inventories and the Fixed Assets are material to the financial statements.

(b) Auditor is unable to attend physical verification of the inventories and fixed assets. In other words, physical verification becomes impracticable due to civil and political unrest in the foreign country, where the inventory and fixed assets are located, posing threats to the safety of auditor.

(c) Auditor failed to obtain proper and sufficient audit evidence, even by alternative audit procedures.

Draft of the suitable report to be incorporated in the main audit report –

"Our responsibility is to express an opinion on these financial statements based on our audit in accordance with the Standards on Auditing issued by the Institute of Chartered Accountants of India. Because of the matters described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for Disclaimer of Opinion

We were appointed as auditors of the Company and we report that we could not observe the counting of physical inventories and physical verification of fixed assets due to civil and political unrest in foreign country where the company has significant operation. We were also unable to satisfy

	ourselves by alternative means concerning the inventory quantities and fixed assets of the company held at March 31st 20XX, which are stated in the Balance Sheet at ₹ XXX and ₹ XXX, respectively. ***Disclaimer of Opinion*** *Because of the significance of the matters described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on the financial statements.* ***Report on Other Legal and Regulatory Requirements*** As required by section 227(3) of the Companies Act, 1956, we report that – As described in the Basis for Disclaimer of Opinion paragraph, we were unable to obtain all the information and explanations which to the best of our knowledge and belief were necessary for the purpose of our audit.

Standard on Auditing (SA) 505 (Revised)
External Confirmations

1. Effective Date [Para – 4]

This SA is effective for audits of financial statements for periods beginning **on or after April 1, 2010.**

2. Scope of this SA [Para – 1]

- This Standard on Auditing (SA) deals with the auditor's use of external confirmation procedures to obtain audit evidence in accordance with the requirements of SA – 330 and SA – 500.
- It does not address inquiries regarding litigation and claims.

3. Objectives [Para – 5]

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

4. Definitions [Para – 6]

(a)	**External Confirmation**	Audit evidence obtained as a direct written response to the auditor from a third party (the confirming party), in paper form, or by electronic or other medium.
(b)	**Positive Confirmation Request**	A request that the confirming party respond directly to the auditor indicating whether the confirming party agrees or disagrees with the information in the request, or providing the requested information.
(c)	**Negative Confirmation Request**	A request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request.
(d)	**Non Response**	A failure of the confirming party to respond, or fully respond, to a positive confirmation request, or a confirmation request returned undelivered.
(e)	**Exception**	A response that indicates a difference between information requested to be confirmed, or contained in the entity's records, and information provided by the confirming party.

5. External Confirmation Procedures to Obtain Audit Evidence [Para –2 &3]

- Audit evidence in the form of external confirmations received directly by the auditor from confirming parties may be more reliable than evidence generated internally by the entity. This SA is intended to assist the auditor in designing and performing external confirmations procedures to obtain relevant and reliable audit evidence.
- Other SAs recognise the importance of external confirmations as audit evidence,(for example – SA 240/330/500).

6. Requirement

Para No.	Aspects	Descriptions
7	**Procedure / Control**	**When using external confirmation procedures, maintain control over external confirmation requests, including –** (a) Determining the information to be confirmed or requested; (b) Selecting the appropriate confirming party; (c) Designing the confirmation requests and their route such that they are properly

<table>
<tr><td></td><td></td><td>addressed and contain return information for responses to be sent directly to the auditor; and
(d) Sending the requests, including follow – up requests when applicable, to the confirming party.</td></tr>
<tr><td>8
&
9</td><td>Effect of Management 's Refusal</td><td>1. If management refuses to allow the auditor to send a confirmation request, the auditor shall –
(a) Inquire the validity and reasonableness of the reasons for their refusal;
(b) Evaluate its implications on the auditor's assessment of the relevant risks of material misstatement, including the risk of fraud, and on the nature, timing and extent of other audit procedures; and
(c) Perform alternative audit procedures to obtain relevant and reliable audit evidence.
2. Further Duties of Auditor –
<table>
<tr><th>S.N.</th><th>If the Auditor –</th><th>Then the Auditor Shall –</th></tr>
<tr><td>(a)</td><td>Concludes that management's refusal is unreasonable, or</td><td rowspan="2">☞ Communicate with those charged with governance and
☞ Also determine the implications for the audit and the auditor's opinion.</td></tr>
<tr><td>(b)</td><td>Is unable to obtain relevant and reliable audit evidence from alternative audit procedures</td></tr>
</table></td></tr>
<tr><td colspan="3">Results of External Confirmation Procedures [Para – 10 to 14]</td></tr>
<tr><td>10
&
11</td><td>Doubt or Unreliable Response</td><td>☞ If the auditor doubts or concludes that a response to a confirmation request is not reliable, then he shall obtain further audit evidence and
☞ Shall evaluate the implications on the assessment of the relevant risks of material misstatement, including the risk of fraud, and on the related nature, timing and extent of other audit procedures.</td></tr>
<tr><td>12</td><td>Non – Response</td><td>In the case of each non-response, the auditor shall perform alternative audit procedures to obtain relevant and reliable audit evidence.</td></tr>
<tr><td>13</td><td>Necessity of Positive Confirmation</td><td>☞ If the auditor has determined that a response to a positive confirmation request is necessary to obtain sufficient appropriate audit evidence, alternative audit procedures will not provide the audit evidence the auditor requires.
☞ If the auditor does not obtain such confirmation, the auditor shall determine the implications for the audit and the auditor's opinion in accordance with SA 705.</td></tr>
<tr><td>14</td><td>Exceptions</td><td>The auditor shall investigate exceptions to determine whether or not they are indicative of misstatements.</td></tr>
<tr><td>15</td><td>Negative Confirmation</td><td>Negative confirmation requests should not be used as the sole substantive audit procedure to address an assessed risk of material misstatement at the assertion level unless all of the following are present –
(a) The auditor has assessed the risk of material misstatement as low and has obtained sufficient appropriate audit evidence regarding the operating effectiveness of controls relevant to the assertion;
(b) The population of items subject to negative confirmation procedures comprises a large number of small, homogeneous, account balances, transactions or conditions;
(c) A very low exception rate is expected; and
(d) The auditor is not aware of circumstances or conditions that would cause recipients of negative confirmation requests to disregard such requests.</td></tr>
</table>

16	**Evaluating Evidence Obtained**	The auditor shall evaluate whether the results of the external confirmation procedures provide relevant and reliable audit evidence, or whether performing further audit procedures is necessary.
A.48 of SA 330	**External Confirmations may be used in the following situations**	1. Bank Balances and Other Information relevant to Banking Relationships. 2. Accounts Receivables balances and items. 3. Accounts Payable balances and items. 4. Inventories held by Third Parties at Bonded Warehouses for Processing or on Consignment. 5. Property Title Deed held by Lawyers or Financers for safe custody or as security. 6. Investment held for safe – keeping by Third Parties, or Purchased from Stock – Brokers but not delivered at B/S date. 7. Amount due to Lenders, including relevant terms of repayment and restrictive covenants.

Some Past Attempts Questions

S.N.	Questions	Marks and Attempt	Answer
1.	The management of S Ltd. requests you **not to seek confirmation from its debtors.** As the auditor of S Ltd., what can be an appropriate response? **OR** The auditor of H Ltd. wanted to obtain confirmation from its creditors. But the **management made a request to the auditor not to seek confirmation from certain creditors citing disputes.** Can the auditor of H Ltd. Accede to this request?	**[6 Marks] [May 2011] & [4 Marks] [May 2013]**	**Refer Para No. 8 & 9 on Page no. 42**
2.	Moon Limited replaced its statutory auditor for the Financial year 2013 – 14. During the course of audit, the new auditor found a credit item of ₹ 5 Lakhs. On enquiry, the company explained him that it is, a very old credit balance. **The creditor had neither approached for the payment nor is he traceable.** Under the circumstances, **no confirmation of the credit balance is available.** Comment.	**[5 Marks] [Nov. 2009]**	**See Below**
Ans.	This is a case of external confirmation, covered by SA 505 "External Confirmation". The identities of creditors are not traceable to confirm the credit balance as appearing in the financial statement of the company. It is also **not a case of pending litigation.** It might be a case that an **income** of ₹ 5 Lakhs had been **hidden in previous year/s.** The statutory auditor should **examine the validity of the credit balance** as appeared in the company's financial statements. He should **obtain sufficient evidence in support of the balance.** He should **apply alternative audit procedures to get documentary proof** for the transaction/s and should **not rely entirely on the management representation.** Finally, he should include the matter y way of a qualification in his audit report to the members.		

Standard on Auditing (SA) 510 (Revised)
Initial Audit Engagements – Opening Balances

1. Effective Date [Para – 2]

This SA is effective for audits of financial statements for periods beginning **on or after April 1, 2010.**

2. Scope of this SA [Para – 1]

- This Standard on Auditing (SA) deals with the auditor's responsibilities relating to opening balances when conducting an initial audit engagement.
- In addition to financial statement amounts, opening balances include matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments.

3. Objectives [Para – 3]

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

(a) Opening balances contain misstatements that materially affect the current period's financial statements; and

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

4. Definitions [Para – 4]

(a)	**Initial Audit Engagement**	An engagement in which either – (a) The financial statements for the prior period were not audited; or (b) The financial statements for the prior period were audited by a predecessor auditor.
(b)	**Opening Balance**	Those account balances that exist at the beginning of the period. Opening balances are based upon the closing balances of the prior period and reflect the effects of transactions and events of prior periods and accounting policies applied in the prior period. Opening balances also include matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments.
(c)	**Predecessor Auditor**	The auditor from a different audit firm, who audited the financial statements of an entity in the prior period and who has been replaced by the current auditor.

5. Requirements

A. Audit Procedures		
5	**Reading FS**	The auditor shall read the most recent financial statements as well as the predecessor auditor's report
6 & A.2	**Procedures**	Audit shall obtain sufficient appropriate audit evidence that whether the opening balances contain misstatements that materially affect the current period's financial statements by – - Checking prior period's closing balances with current year's opening balances and other adjustments disclosed as prior period items in the current year's Statement of Profit and Loss. - Auditor should determine whether the opening balances reflect the application of appropriate accounting policies and

		☞ Auditor should get the copies of prior period's which he should evaluate and perform specific audit procedures to obtain evidence regarding the opening balances.
7	**Misstatement**	☞ If the auditor obtains audit evidence that the opening balances contain misstatements that could materially affect the current period's financial statements, the auditor shall perform such additional audit procedures as are appropriate in the circumstances to determine the effect on the current period's financial statements. ☞ If the Auditor concludes that such Misstatement exist in the current period's FSs, the Auditor shall communicate the Misstatements as per SA – 450.
B. Special Duties –		
8	**Consistency of Accounting Policies**	**The auditor shall obtain sufficient appropriate audit evidence about –** ☞ Whether the accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, and ☞ Whether changes in the accounting policies have been properly accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.
9	**Modification of Opinion in Predecessor Auditors Report**	If the prior period's financial statements were audited by a predecessor auditor and there was a modification to the opinion, the auditor shall evaluate the effect of the matter giving rise to the modification in assessing the risks of material misstatement in the current periods financial.

C. Audit Conclusions and Forms of Reporting

Para No.	Situation	Nature of Opinion
10	If the auditor is unable to obtain SAAE regarding the Opening Balances.	Qualified Opinion or a Disclaimer of Opinion as per SA – 705
11	**If the auditor concludes that –** (a) The opening balances contain a misstatement that materially affects the current period's financial statements, and (b) The effect of the misstatement is not properly accounted for or not adequately presented or disclosed	Qualified Opinion or a Disclaimer of Opinion as per SA – 705
12	**If the auditor concludes that –** (a) The current period's accounting policies are not consistently applied in relation to opening balances in accordance with the applicable financial reporting framework; or (b) A change in accounting policies is not properly accounted for or not adequately presented or disclosed in accordance with the applicable financial reporting framework.	Qualified Opinion or a Disclaimer of Opinion as per SA – 705
13	If the predecessor auditor's opinion regarding the prior period's financial statements included a modification to the auditor's opinion that remains relevant and material to the current period's financial statements	Qualified Opinion or a Disclaimer of Opinion as per SA – 705 and SA – 710

Some Past Attempts Questions

S.N.	Questions	Marks and Attempt	Answer
1.	In an initial audit engagement the auditor will have to **satisfy about the sufficiency and appropriateness of 'Opening Balances'** to ensure that they are free from misstatements, which may materially affect the current financial statements. Lay down the audit procedure, you will follow in cases – (i) When the financial statements are **audited for the preceding period by another auditor;** and (ii) When financial statements are **audited for the first time.**	[7 Marks] [Nov. 2004]	**Refer Para No. 5 to 9 on Page no. 44 & 45**
2.	If, after performing the procedure, you **are not satisfied about the correctness of 'Opening Balances'**; what approach you will adopt in drafting your audit report in two situations mentioned in (2) above?	[7 Marks] [Nov. 2004]	**Refer Para No. 10 to 13 on Pg. no. 45**

Standard on Auditing (SA) 520 (Revised)
Analytical Procedures

1. Effective Date [Para – 2]

This SA is effective for audits of financial statements for periods beginning **on or after April 1, 2010.**

2. Scope of this SA [Para – 1]

☞ This Standard on Auditing (SA) deals with the auditor's use of analytical procedures as substantive procedures ("substantive analytical procedures"), and as procedures near the end of the audit that assist the auditor when forming an overall conclusion on the financial statements.

☞ The use of analytical procedures as risk assessment procedures is dealt with in SA 315. SA 330 includes requirements and guidance regarding the nature, timing and extent of audit procedures in response to assessed risks; these audit procedures may include substantive analytical procedures.

3. Objectives [Para – 3]

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

(b) To design and perform analytical procedures near the end of the audit that assists the auditor when forming an overall conclusion as to whether the financial statements are consistent with the auditor understanding of the entity.

4. Definitions [Para – 4]

(a)	**Analytical Procedures**	☞ For the purposes of the SAs, the term "Analytical Procedures" means evaluation of financial information through analysis of plausible relationships among both financial and non-financial data. ☞ Analytical procedures also encompass such investigation as is necessary of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount. The auditor's choice of procedures, methods and level of application is a matter of professional judgement. Analytical procedures include the consideration of **comparisons** of the entity's financial information with – **[Para A.1]** ✓ Prior period information; ✓ Budgets, forecasts ; ✓ Similar industry information etc. **Analytical procedures also include consideration of relationships, for example – [Para A.2]** ☞ 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.

5. Requirements

A. Substantive Analytical Procedures [Para – 5] – When designing and performing substantive analytical procedures, the auditor shall –	
(a)	Determine the suitability of particular substantive analytical procedures for given assertions
(b)	Develop an expectation of recorded amounts or ratios and evaluate whether the expectation is sufficiently precise to identify a misstatement.
(c)	Evaluate the reliability of data from which the auditor's expectation of recorded amounts or ratios is developed.
(d)	Determine the amount of any difference of recorded amounts from expected values that is acceptable without further investigation.

B. APs that assist when forming an Overall Conclusion [Para – 6] –

- The auditor shall design and perform analytical procedures near the end of the audit that assist the auditor when forming an overall conclusion as to whether the financial statements are consistent with the auditor's understanding of the entity.
- The results of such analytical procedures may identify a previously unrecognised risk of material misstatement. These analytical procedures may be similar to those that would be used as risk assessment procedures. **[Para A.18]**

C. Investigating Results of APs [Para – 7] –

- If analytical procedures performed in accordance with this SA identify fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, the auditor shall **investigate** such differences by –
  - (a) **Inquiring of management** and obtaining appropriate audit evidence relevant to management's responses; and
  - (b) Performing **other audit procedures** as necessary in the circumstances.
- The need to perform other audit procedures may arise when, for example, management is unable to provide an explanation, or the explanation, together with the audit evidence obtained relevant to management's response, is not considered adequate.**[Para A.21]**

Examples of Analytical Procedures

1	**Trends**	Analysing account fluctuations by comparing current year to prior year information and, also, to information derived over several years.
2	**Reasonableness Tests**	Tests are made by reviewing the relationship of certain account balances to other balances for reasonableness of amounts. Examples of accounts that may be reasonably tested are – (a) Interest expense against interest bearing obligations. (b) Raw Material Consumption to Production (quantity). (c) Wastage & Scrap % against production & raw material consumption (quantity). (d) Work-in-Progress based on issued of materials & Sales (quantity). (e) Sales discounts and commissions against sales volume. (f) Rental revenues based on occupancy of premises

3	**Analysis by Computation of Ratios**	Analysis by computation of ratios includes the study of relationships between financial statement amounts. Commonly used ratios include – (a) Elements of income or loss as a percentage of sales. (b) Gross profit turnover. (c) Accounts receivable turnover. (d) Inventory turnover. (e) Profitability, leverage, and liquidity

Sources of Information for Analytical Procedures

1	**Interim financial information**
2	**Budgets**
3	**Management Accounts**
4	**Non – Financial Information**
5	**Bank and Cash Records**
6	**VAT Returns**
7	**Board Minutes**
8	**Discussion or Correspondence with Client at year – end.**

Some Past Attempts Question

S.N.	Question	Marks and Attempt	Answer
1.	In the audit of Hotel Great Stay Ltd. its auditor wants to **use the analytical procedure as substantive procedure** in respect of room rental income as well as payroll costs. Guide him as to how it can be done.	**[4 Marks]** **[Nov. 2013]**	**See Below**
Ans.	As per **SA 520 on "Analytical Procedures",** in some cases, even an unsophisticated predictive model may be effective as an analytical procedure. ☞ **In case of Payroll cost –** Where an entity has a known number of employees at fixed rates of pay throughout the period, it may be possible for the auditor to use this data to estimate the total payroll costs for the period with a high degree of accuracy, thereby providing audit evidence for a significant item in the financial statements and reducing the need to perform tests of details on the payroll. ☞ **In case of Room Rental Income of Hotel –** Different types of analytical procedures provide different levels of assurance. Analytical procedures involving the prediction of total rental income in case of Hotel taking the room tariff rates, the number of rooms and vacancy rates into consideration, can provide persuasive evidence and may eliminate the need for further verification by means of tests of details, provided the elements are appropriately verified.		

Standard on Auditing (SA) 530 (Revised)

Audit Sampling

1. Effective Date [Para – 3]

This SA is effective for audits of financial statements for periods beginning **on or after April 1, 2009.**

2. Scope of this SA [Para – 1]

- This Standard on Auditing (SA) applies when the auditor has decided to use audit sampling in performing audit procedures.
- It deals with the auditor's use of statistical and non-statistical sampling when designing and selecting the audit sample, performing tests of controls and tests of details, and evaluating the results from the sample.

3. Objectives [Para – 4]

The objective of the auditor when using audit sampling is to provide a reasonable basis for the auditor to draw conclusions about the population from which the sample is selected.

4. Definitions [Para – 5]

<table>
<tr><td>(a)</td><td>Audit Sampling (Sampling)</td><td>The application of audit procedures to less than 100% of items within a population of audit relevance such that all sampling units have a chance of selection in order to provide the auditor with a reasonable basis on which to draw conclusions about the entire population.</td></tr>
<tr><td>(b)</td><td>Population</td><td>The entire set of data from which a sample is selected and about which the auditor wishes to draw conclusion.</td></tr>
<tr><td>(c)</td><td>Sampling Risk</td><td>The risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure. Sampling risk can lead to two types of erroneous conclusion –
<table>
<tr><th>Error Type</th><th>In case of TOCs</th><th>In case of TODs</th><th>Effect of this erroneous conclusion</th></tr>
<tr><td>Type I</td><td>That Controls are more effective than they actually are (i.e. Risk of over reliance)</td><td>That a Material Misstatement doesn't exist, when in fact it does (i.e. Risk of incorrect acceptance)</td><td>This affects audit effectiveness, and is more likely to lead to an inappropriate audit opinion.</td></tr>
<tr><td>Type 2</td><td>That Controls are less effective than they actually are (i.e. Risk of over reliance)</td><td>That a Material Misstatement does exist, when in fact it does not (i.e. Risk of incorrect rejected)</td><td>This affects audit efficiency, as it would usually lead to additional work to establish that initial conclusions were incorrect.</td></tr>
</table></td></tr>
<tr><td>(d)</td><td>Non – Sampling Risk</td><td>The risk that the auditor reaches an erroneous conclusion for any reason not related to sampling risk. (E.g. use of inappropriate audit procedures, mis – interpretation of audit evidence, failure to recognize a mis – statement or deviation, etc.)</td></tr>
<tr><td>(e)</td><td>Anomaly</td><td>A misstatement or deviation that is demonstrably not representative of misstatements or deviations in a population.</td></tr>
</table>

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(f)	**Sampling Unit**	The individual items constituting a population.
(g)	**Statistical sampling**	☞ An approach to sampling that has the following characteristics – (a) Random selection of the sample items; and (b) The use of probability theory to evaluate sample results, including measurement of sampling risk. ☞ A sampling approach that does not have characteristics (i) and (ii) is considered non-statistical sampling.
(h)	**Stratification**	The process of dividing a population into sub-populations, each of which is a group of sampling units which have similar characteristics (often monetary value).
(i)	**Tolerable Mis – statement**	A monetary amount set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that the monetary amount set by the auditor is not exceeded by the actual misstatement in the population.
(j)	**Tolerable Rate of Deviation**	A rate of deviation from prescribed internal control procedures set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that the rate of deviation set by the auditor is not exceeded by the actual rate of deviation in the population.

5. Requirements

A. Design, Size & Selection of Items for Testing [Para – 6 – 8]	
6	When designing an audit sample, the auditor shall consider the purpose of the audit procedure and the characteristics of the population from which the sample will be drawn.
7	☞ The auditor shall determine a sample size sufficient to reduce sampling risk to an acceptably low level. ☞ The level of sampling risk that the auditor is willing to accept affects the sample size required. The lower the risk the auditor is willing to accept, the greater the sample size will need to be. [Para A.10]
8	The auditor shall select items for the sample in such a way that each sampling unit in the population has a chance of selection.
B. Performing Audit Procedures [Para – 9 – 11]	
9	The auditor shall perform audit procedures, appropriate to the purpose, on each item selected.
10	If the audit procedure is not applicable to the selected item, the auditor shall perform the procedure on a replacement item.
11	If the auditor is unable to apply the designed audit procedures, or suitable alternative procedures, to a selected item, the auditor shall treat that item as a deviation from the prescribed control, in the case of tests of controls, or a misstatement, in the case of tests of details.
C. Nature and Cause of Deviations and Mis – statement [Para – 12 & 13]	
12	The auditor shall investigate the nature and cause of any deviations or misstatements identified, and evaluates their possible effect on the purpose of the audit procedure and on other areas of the audit.
13	In the extremely rare circumstances when the auditor considers a misstatement or deviation discovered in a sample to be an anomaly, the auditor shall obtain a high degree of certainty that such misstatement or deviation is not representative of the population. The auditor shall obtain this degree of certainty by performing additional audit procedures to obtain sufficient appropriate audit evidence that the misstatement or deviation does not affect the remainder of the population.
D. Projecting Mis - Statements [Para – 14]	
14	For tests of details, the auditor shall project misstatements found in the sample to the population. Note – If a misstatement / deviation is categorized as an anomaly, it may be excluded from being projected on to the population.

E. Evaluating Results of Audit Sampling [Para – 15] – The Auditor shall evaluate –	
15	(a) The results of the sample; and (b) Whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested.
F. Conclusions on Audit Sampling [Para A.21, A.22] – The Auditor shall evaluate –	
TOCs	A high sample deviation rate may lead to an increase in the assessed risk of material misstatement
TODs	☞ A high Mi – Statement amount in a sample may cause the Auditor to believe that a class of transactions or account balance is materially misstated. ☞ When the auditor's best estimate of misstatement in the population (i.e., projected misstatement plus anomalous misstatement) > tolerable misstatement, the sample does not provide a reasonable basis for conclusions about the population that has been tested. ☞ The closer the projected misstatement plus anomalous misstatement is to tolerable misstatement, the more likely that actual misstatement in the population may exceed tolerable misstatement. ☞ If the projected misstatement is > the auditor's expectations of misstatement used to determine the sample size, the auditor may conclude that there is an unacceptable sampling risk that the actual misstatement in the population exceeds the tolerable misstatement.

Some Past Attempts Questions

S.N.	Questions	Marks and Attempt	Answer
1.	While planning the audit of S Ltd. you want to apply sampling techniques. What are the **risk factors you should keep in mind?**	**[4 Marks]** **[May 2010]**	**Refer Para No. 5 (C) on Page no. 50**
2.	Write short note on **Sampling Risk.**	**[4 Marks]** **[Nov. 2006]**	**Refer Para No. 5 (C) on Page no. 50**

Standard on Auditing (SA) 540 (Revised)

Auditing Accounting Estimates, including Fair Value Accounting Estimates & Related Disclosures

1. Effective Date [Para – 5]

This SA is effective for audits of financial statements for periods beginning **on or after April 1, 2009.**

2. Scope of this SA [Para – 1]

- This SA deals with the auditor's responsibilities regarding accounting estimates, including fair value accounting estimates, and related disclosures in an audit of financial statements.
- It includes requirements and guidance on misstatements of individual accounting estimates, and indicators of possible management bias.

3. Objectives [Para – 6]

The objective of the auditor is to obtain sufficient appropriate audit evidence whether in the context of the applicable financial reporting framework –

(a) Accounting estimates, including fair value accounting estimates, in the financial statements, whether recognized or disclosed, are reasonable; and

(b) Related disclosures in the financial statements are adequate.

4. Nature of Accounting Estimates [Para – 2, 3 & 4]

- The nature and reliability of information available to management to support the making of an accounting estimate varies widely, which thereby affects the degree of estimation uncertainty associated with accounting estimates.
- The degree of estimation uncertainty affects, in turn, the risks of material misstatement of accounting estimates, including their susceptibility to unintentional or intentional management bias.
- A difference between the outcome of an accounting estimate and the amount originally recognized or disclosed in the financial statements does not necessarily represent a misstatement of the financial statements. This is particularly the case for fair value accounting estimate.

5. Definitions [Para – 7]

(a)	**Accounting Estimate**	An approximation of a monetary amount in the absence of a precise means of measurement. This term is used for an amount measured at fair value where there is estimation uncertainty, as well as for other amounts that require estimation.
(b)	**Estimation Uncertainty**	The susceptibility of an accounting estimate and related disclosures to an inherent lack of precision in its measurement.
(c)	**Auditor's Point Estimate or Auditor's Range**	The amount, or range of amounts, respectively, derived from audit evidence for use in evaluating management's point estimate.
(d)	**Management bias**	**A** lack of neutrality by management in the preparation and presentation of information.
(e)	**Management's Point Estimate**	The amount selected by management for recognition or disclosure in the financial statements as an accounting estimate.
(f)	**Outcome of an Accounting Estimate**	The actual monetary amount which results from the resolution of the underlying transaction(s), event(s) or condition (s) addressed by the accounting estimate.

6. Requirements

<table>
<tr><td colspan="3"><u>A. Risk Assessment Procedures and Related Activities</u> –</td></tr>
<tr><td>8</td><td>Understanding the Entity</td><td>The Auditor shall obtain an understanding of the following in order to provide a basis for the identification and assessment of the risks of material misstatement for Accounting Estimates –
(a) The requirements of the applicable financial reporting framework relevant to accounting estimates, including related disclosures.
(b) How management identifies those transactions, events and conditions that may give rise to the need for accounting estimates to be recognised or disclosed in the financial statements. In obtaining this understanding, the auditor shall make inquiries of management about changes in circumstances that may give rise to new, or the need to revise existing, accounting estimates How management makes the accounting estimates, and an understanding of the data on which they are based, including –
1. The method, including where applicable the model, used in making the accounting estimate;
2. Relevant controls;
3. Whether management has used an expert;
4. The assumptions underlying the accounting estimates;
5. Whether there has been or ought to have been a change from the prior period in the methods for making the accounting estimates, and if so, why; and
6. Whether and, if so, how management has assessed the effect of estimation uncertainty</td></tr>
<tr><td>9</td><td>Review of Prior Period Estimates</td><td>☞ The auditor shall review the outcome of accounting estimates included in the prior period financial statements, or, where applicable, their subsequent re-estimation for the purpose of the current period.
☞ The nature and extent of the auditor's review takes account of the –
1. Nature of the Accounting Estimates, and
2. Whether the information obtained from the review would be relevant to identifying and assessing risks of material misstatement of accounting estimates made in the current period financial statements.
☞ The review is not intended to call into question (evaluate) the judgments made in the prior periods that were based on information available at that time.</td></tr>
<tr><td colspan="3"><u>B. Identifying and Assessing RMM</u> –</td></tr>
<tr><td>10</td><td colspan="2">In identifying and assessing the risks of material misstatement, the auditor shall evaluate the degree of estimation uncertainty associated with an accounting estimate.</td></tr>
<tr><td>11</td><td colspan="2">The auditor shall determine whether, in the auditor's judgment, any of those accounting estimates that have been identified as having high estimation uncertainty give rise to significant risks.</td></tr>
<tr><td colspan="3"><u>C. Response to the Assessed RMM</u> –</td></tr>
<tr><td>12</td><td>Determining Compliance</td><td><u>Based on the assessed risks of material misstatement, the auditor shall determine-</u>
☞ Whether management has appropriately applied the requirements of the applicable financial reporting framework relevant to the accounting estimate; and
☞ Whether the methods for making the accounting estimates are appropriate and have been applied consistently, and whether changes, if any, in accounting estimates or in the method for making them from the prior period are appropriate in the circumstances.</td></tr>
</table>

13	**Responding to Risks**	**<u>In responding to the assessed risks of material misstatement, the auditor shall</u> –** **1.** Determine whether events occurring up to the date of the auditor's report provide audit evidence regarding the accounting estimate. **2.** Test that whether the method of measurement and the assumptions used by the management in making accounting estimates are reasonable and appropriate. **3.** Test the operating effectiveness of the controls over how management made the accounting estimate, together with appropriate substantive procedures. **4.** Develop a point estimate or a range to evaluate management's point estimate.
14	**Special Skills**	While responding to the assessed risks of material misstatement the auditor shall consider whether specialized skills or knowledge in relation to one or more aspects of the accounting estimates are required in order to obtain sufficient appropriate audit evidence.

<u>D.</u> <u>Further Substantive Procedures to respond to Significant Risks</u> –

15 & 16	**Estimation Uncertainly**	(a) For accounting estimates that give rise to significant risks, the auditor shall evaluate the following – ☞ How management has considered **alternative assumptions**, outcomes and estimation uncertainty in making the accounting estimate. ☞ Whether the significant **assumptions** used by management **are reasonable.** ☞ Appropriate application of the financial reporting framework, and in this respect, **management's intent** to carry out specific courses of action and its **ability** to do so. (b) If, in the auditor's judgment, management has not adequately addressed the effects of estimation uncertainty on the accounting estimates that give rise to significant risks, the auditor shall, if considered necessary, **develop a range** with which to evaluate the reasonableness of the accounting estimate.
17	**Recognition and Measurement Criteria**	For accounting estimates that give rise to significant risks, the auditor shall obtain sufficient appropriate audit evidence whether the following are in accordance with the requirements of the applicable financial reporting framework – (a) Management's decision regarding recognition of accounting estimates in the financial statements; and (b) The selected measurement basis for the accounting estimates.

<u>E.</u> <u>Evaluating Reasonableness of Accounting Estimates and Determining Mis – Statements</u> – The auditor shall evaluate, based on the audit evidence, whether the accounting estimates in the financial statements are either reasonable in the context of the applicable financial reporting framework, or are misstated. **[Para – 18]**

<u>F.</u> <u>Disclosures Related to Accounting Estimates</u> –

(a) The auditor shall obtain sufficient appropriate audit evidence about whether the disclosures in the financial statements related to accounting estimates are in accordance with the requirements of the applicable financial reporting framework. **[Para – 19]**

(b) For accounting estimates that give rise to significant risks, the auditor shall also evaluate the adequacy of the disclosure of their estimation uncertainty in the financial statements in the context of the applicable financial reporting framework. **[Para – 20]**

G. Indicators of Possible Management Bias – The auditor shall review the judgments and decisions made by management in the making of accounting estimates to identify whether there are indicators of possible management bias. Indicators of possible management bias do not themselves constitute misstatements for the purposes of drawing conclusions on the reasonableness of individual accounting estimates. **[Para – 21]**

H. Written Representations – The auditor shall obtain written representations from management whether management believes that significant assumptions used by it in making accounting estimates are reasonable. **[Para – 22]**

I. Documentation – The audit documentation shall include –

(a) The basis for the auditor's conclusions about the reasonableness of accounting estimates and their disclosure that give rise to significant risks; and

(b) Indicators of possible management bias, if any.

Some Past Attempts Question

S.N.	Question	Marks and Attempt	Answer
1.	While auditing Z Ltd., you observe **certain material financial statement assertions have been based on estimates** made by the management. As the auditor how do you minimize the risk of material misstatements?	**[6 Marks] [May 2011]**	**Refer Para No. 8 & 9 on Page no. 54**

Standard on Auditing (SA) 550 (Revised)
Related Parties

1. Effective Date [Para – 8]

This SA is effective for audits of financial statements for periods beginning **on or after April 1, 2008.**

2. Scope of this SA [Para – 1]

This SA deals with the auditor's responsibilities regarding RPRs and transactions of the FSs.

3. Objectives [Para – 6]

The auditor must obtain an in-depth and comprehensive understanding of the related party relationships and transactions, in order to be able to –

1. To recognize the fraud risk factors from related party relationships and transactions, that are relevant to the identification and assessment of material misstatements due to fraud; and
2. To conclude whether the financial statements, insofar as they are affected by those relationships and transactions –
    a. Achieve a true and fair presentation.
    b. Are not misleading.

4. Definitions [Para – 10]

(a)	**Parties are related when**	If at any time during the reporting period, one party has the ability to control or exercise significant influence over the other party in making financial and/or operating decisions
(b)	**Arm's length transaction**	It refers to one, in the ordinary course of business, between consenting parties, the consent being free from any influence, who endeavors to safeguard their own legitimate interests.

6. Requirements

S.N.	Aspects	Descriptions
1.	**Understand the Entity's Related Party Relationships and Transactions**	**<u>In order to understand the auditor shall require</u> –** (a) The identity of the entity's related parties, including changes from the prior period. (b) The nature of the relationships between the entity and these related parties. (c) Whether the entity entered into any transactions with these related parties during the period. (d) The auditors shall inquire and perform other risk assessment procedures, to test internal controls, in order to – 1. Identify, account for and disclose related party relationships and transactions. 2. Authorize and approve significant transactions and arrangements with the related parties. 3. Authorize and approve significant transactions and arrangements outside the normal course of business.
2.	**Be alert for Related Party Information when reviewing**	It is a genuine possibility that the auditor may not have all the information regarding related parties made available or for may conceal the related parties transaction in such a case the auditor shall inspect the following indications for the existence of related party relationships or transactions that the management may not have

	records or documents	identified or disclosed – 1. Bank, legal and third party confirmations. 2. Minutes of meetings of shareholders and those charged with governance. 3. Other records or documents. In case the auditor identifies significant transactions outside the entity's normal course of business, he shall inquire management about – (a) The nature of the transactions. (b) Involvement of related parties.
3.	**Identification and Assessment of the risks of material misstatement associated with Related Party transactions and relationships**	Related party relationships and transactions can be both harmless as well as harmful to the truth and fairness of the transactions and the financial statements. There are sufficient cases to prove that related party transactions have been arranged to circumvent rules and regulations on the milder side, and even perpetrate deceit and fraud on the extreme side. For this purpose, the auditor shall – (a) Identify and assess the risk of material misstatement associated with related party transactions. (b) Determine whether the risks derived are significant risks. If the auditor identifies fraud risk factors, he shall identify and assess the risk of material misstatement due to fraud in accordance with SA 240.
4.	**Respond to the risks of material misstatement associated with related party relationships and transactions**	The response of the auditor to these situations is of significant importance. As a part of his response to the possibility of these misstatements, the auditor should design and perform further audit procedure, to obtain sufficient appropriate audit evidence about the assessed risks of material misstatement associated with related party relationships and transactions.
5.	**Identify previously unidentified or undisclosed related parties or significant transactions**	In case of abnormal transactions arranged either to avail benefits by avoiding taxes and other regulations or to window-dress the financial statements for various purposes, that the management may not disclose such relationships. There may be genuine mistake by management or the auditor the transactions may not have been identified. However this standard emphasizes on the **intentional concealment** of such information. If the auditor has significant related party transactions that the management has not previously identified or disclosed. The auditor shall – 1. Promptly communicate to the members of the engagement team where financial reporting framework establishes related party requirements, 2. Request management to identify all transactions with newly identified related parties. 3. Inquire as to why the controls over related party relationships and transactions were unable to identify and/or disclose the same – (a) Perform substantive procedures relating to newly identified related parties or significant related party transactions. (b) Reconsider the risk that other related parties or transactions may exist, that the management has not previously identified or disclosed to the auditor. (c) If the non-disclosure by management appears intentional, evaluate implications of the same on the audit.
6.	**Identified significant related party transactions outside the entity's normal course of**	For identified significant related party transactions outside the entity's normal course of business, the auditors shall – 1. Inspect underlying contracts or agreements and evaluate whether – a. Business rationale of transactions suggests intention of fraudulent financial reporting or concealment of misappropriation of assets. b. Terms of transactions are consistent with management's explanations

	business	c. Transactions have been appropriately accounted for and disclosed. 2. Obtain audit evidence that the transactions have been appropriately authorized and approved.
7.	**Assertions that related party transactions were conducted on terms equivalent to those prevailing in an arm's length transaction**	In case of management assertions that related party transactions are devoid of fraudulent malafide intent, the auditor shall evaluate that whether – (a) The related party transactions were conducted on terms suitable to the company. (b) The related party transactions were conducted at arms length price.
8.	**Evaluation of the accounting for and disclosure of identified related party relationships and transactions**	In forming an opinion on the financial statements, the auditor shall evaluate – (a) Whether the identified related part relationships and transactions have been appropriately accounted for and disclosed. (b) Whether the effects of the related party relationships and transactions 1. Prevent financial statements from achieving true and fair presentation, 2. Cause the financial statements to be misleading.
9.	**Written Representations**	If the financial reporting framework establishes related party requirements, the auditor shall obtain written representations from management that – (a) They have disclosed to the auditor the identity of the related parties and the related party relationships and transactions, (b) They have appropriately accounted for and disclosed such relationships and transactions.
10.	**Communication with those charged with those charged with governance**	The Auditor shall communicate with those charged with governance significant matters arising during the audit in connection with the entity's related parties.
11.	**Documentation**	**The auditor shall include in the audit documentation** – (a) The names of the identified related parties, (b) The nature of related party relationships.

Some Past Attempts Questions

S.N.	Questions	Marks and Attempt	Answer
1.	In the course of audit of Q Ltd, its statutory auditor wants to be sure of the **adequacy of related party disclosures?** Kindly guide the auditor in identifying the **possible source of related party information.**	[8 Marks] [May 2012]	**Refer Point No. 6 – S.N. (1, 2, 5, 6 & 9) on Page no. 57 & 58**
2.	How can an Auditor **identify Related Parties?**	[8 Marks] [Nov. 2002]	

Standard on Auditing (SA) 560 (REVISED)
SUBSEQUENT EVENTS

1. Effective Date

This Standard on Auditing becomes operative for all audits relating to accounting periods beginning **on or after 1st April, 2009.**

2. Scope of this SA

(SA) deals with the auditor's responsibilities relating to subsequent events in an audit of financial statements i.e. the auditor has considered the effect of the event and transactions that occur upto the date of auditor report.

3. Objectives

The objectives of the auditor are to –

(i) Obtain sufficient appropriate audit evidence of the subsequent events occurring that require adjustments or disclosure in the financial statements and

(ii) Respond appropriately to facts which may have caused the auditor to amend the report if were known at the time of reporting.

4. Definitions

(a) ***Date of the financial statements***- The last date of the financial statements.

(b) ***Date of approval of the financial statements*** – The date on which recognized authority have asserted that they have taken responsibility for those financial statements.

(c) ***Date of the auditor's report*** – The date the auditor dates the report.

(d) ***Date the financial statements are issued*** – The date on which auditor's report and the audited financial statements are made available to third parties.

5. Subsequent Events

Events occurring between the date of the financial statements and the date of the auditor's report, and facts that become known to the auditor after the date of the auditor's report.

6. Events occurring Between the Date of the Financial Statements and the Date of the Auditor's Report

The auditor shall perform audit procedures to obtain and identify sufficient appropriate audit evidence that require adjustments of or disclosure in the financial statements. The auditor shall assess the risk in determining the nature and extent of audit procedures which shall include –

(a) Obtain an understanding of whether the management has identified any subsequent event.

(b) Inquire whether any subsequent events have occurred which might affect the financial statements.

(c) The auditor must go through the minute's book and also inquire of meeting for which minutes are yet not prepared.

(d) Reading the entity's latest subsequent interim financial statements, if any.

Note → The events which require adjustments of or disclosure should be appropriately reflected in the financial statements. For this the auditor should request written representation.

7. Facts Which Become Known to the Auditor After the Date of the Auditor's Report but Before the Date the Financial Statements are Issued

Such events which may cause the auditor to amend the report the auditor shall discuss and determine whether financial statements need amendments and if so how the management is planning to address the matter in the financial statements.

1. If management amends the financial statements, the auditor shall extend the audit procedures to the date of the new amended report. When law or regulation or the financial reporting framework does not prohibit management from restricting the amendment the auditor can restrict the audit procedures to the new amended date. In such case the auditor shall –
   (a) Amend the report to include an additional date and indicate that the audit procedures are restricted to the amendments in the financial statements of the financial statements. OR
   (b) Provide a new or amended auditor's report that includes a statement in an Emphasis of Matter paragraph or Other Matter that conveys that auditor's procedures on subsequent events are restricted solely to the amendment of the financial statements.
2. In some entities, when there is need to amend financial statements but the same is not permitted by law or regulation then;
   (a) If the report is not given auditor shall modify his opinion.
   (b) If report is given but before making available to third party than auditor shall notify management to issue amended financial statement.
   (c) If the financial statements are issued without amendments the auditor shall take appropriate action to prevent reliance on his report.

8. Facts which become known to the Auditor after the Financial Statements have been issued

The auditor has no obligation to perform any audit procedures but such events which may have caused to amend report the auditor shall –

(a) Discuss and determine whether financial statements need amendments and if so, how the management is planning to address the matter in the financial statements.
(b) If management amends the financial statements, the auditor shall extend the audit procedures to the date of the new amended report and amend the report to include an additional date and indicate that the audit procedures are restricted to the amendments in the financial statements give a note of reason of amendments.
(c) If management does not amend financial statement where auditor believes they need to be amended, auditor will seek to prevent future reliance on the auditor's report. OR
(d) If the financial statements are issued without amendments the auditor shall take appropriate action to prevent reliance on his report.

<u>Some Past Attempts Questions</u>

S.N.	Questions	Marks and Attempt	Answer
1.	Briefly explain the **audit procedures on subsequent events?**	[4 Marks] [Nov. 2009]	**Refer Point No. 5 & 6 on Page no. 60**
2.	Briefly describe the **auditor's responsibility regarding subsequent events.**	[10 Marks] [May 2001]	**Refer Point No. 5, to 8 on Page no. 60 & 61**

Standard on Auditing (SA) 570 (REVISED)
GOING CONCERN

1. Effective Date

This Standard on Auditing becomes operative for all audits relating to accounting periods beginning **on or after 1st April, 2009.**

2. Scope of this SA

This (SA) deals with the auditor's responsibility in the audit of financial statements with respect to management's use of the going concern assumption in the preparation and presentation of the financial statements.

3. Going Concern Assumption

Under this going concern assumption entity is viewed as continuing in business for the foreseeable future for preparation of financial statements, and the assets & liabilities will be able to realize and discharge its liabilities in the normal course of business.

4. Responsibilities of Management

Going concern assumption is the fundamental principle in the preparation of the financial statements of the entity. For this the management responsibility is making a judgment of the entity's ability to continue in the uncertain future outcomes of events or conditions.

☞ **Factors relevant to management judgment are –**

(a) The degree of uncertainty associated with the outcome of the event or condition

(b) The size and complexity of the entity.

(c) The nature and condition of the business.

(d) Information available at the time of making judgment.

5. Responsibilities of the Auditor

The auditor's responsibility is to –

(a) To obtain sufficient appropriate audit evidence about the appropriateness of management's use of the going concern assumption in the preparation and presentation of the financial statements;

(b) To conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern; and

(c) To determine the implications for the auditor's report. Due to inherent limitations of the auditor's ability to predict future events or conditions, the absence of any reference to going concern uncertainty in an auditor's report cannot be viewed as a guarantee as to the entity's ability to continue as a going concern.

6. Risk Assessment Procedures and Related Activities

The auditor shall consider whether there are events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. In so doing, he shall –

(a) discuss the assessment with management on the significant doubt on the entity's ability to continue as going concern and whether the management has planned to address; or

(b) If not done, he shall discuss with the management on whether the events or conditions that exists will cast doubt on going concern of the entity.

Note → The auditor shall remain alert throughout the audit for audit evidence of events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.

7. Evaluating Management's Assessment

The auditor shall –

a. Evaluate management's assessment of the entity's ability to continue as a going concern and shall cover the same period as that used by management and in case the period is less than 12 months from the date of financial statement he should request to extend the same to atleast 12 months.

b. All relevant information should be considered of which the auditor is aware as a result of the audit.

8. Period Beyond Management's Assessment

The auditor shall inquire of events or conditions beyond the period of management's assessment that may cast significant doubt on the entity's ability to continue as a going concern.

9. Additional Audit Procedures When Events or Conditions are Identified

When events or conditions have been identified the auditor need to determine whether or not a material uncertainty exists. These additional procedures shall include –

1. Requesting management to start the assessment when the same has not been performed.
2. Evaluating management's future plans to determine whether this would improve the situations and are feasible in such circumstances.
3. While analyzing the cash flow forecast evaluating the –
   (a) Reliability of the data.
   (b) Determining adequate support for the forecast.
   (c) Considering additional information since the date of last assessment
   (d) Requesting written representation regarding future plans of actions and its feasibility.

10. Audit Conclusions and Reporting

Based on the audit evidence obtained, the auditor shall conclude whether, a material uncertainty exists related to events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern. Appropriate disclosure of the nature and in case of existence of material uncertainty appropriate disclosures should be made.

11. Use of Going Concern Assumption Appropriate but a Material Uncertainty exists

In this situation the auditor shall determine whether the Financial Statements –

1. Describe the principal events or condition and disclose that it may be unable to realize its assets and discharge liabilities in normal course of business.
2. In case appropriate disclosure is made the auditor shall express unmodified opinion and highlight the existence of material uncertainty by referring to the disclosures made in the financial statements **(i.e. Emphasis On Matter Para as per SA – 706)** .
3. If adequate disclosure is not made in the financial statements, the auditor shall express a qualified or adverse opinion as appropriate.
4. If use of Going Concern Assumption is inappropriate, in this case the auditor shall express an adverse opinion.
5. If management is unwilling to Make or Extend its Assessment- In this case the auditor shall consider the implication of the management unwillingness to extend or make the assessment.
6. **Communication with Those Charged with Governance-** When all those charged with governance are involved in managing the entity, the communication shall include –
   (a) Whether the events or conditions constitute a material uncertainty;

(b) Whether the use of the going concern assumption is appropriate;

(c) The adequacy of related disclosures in the financial statements.

12. Significant Delay in the Approval of Financial Statements

When there is significant delay the auditor shall inquire the reasons and perform additional audit procedures to conclude the existence of a material uncertainty in the financial statements.

13. Events or condition that may cast doubt on going concern Assumptions

☞ **Financial**

(a) Net liability or net current liability position.

(b) Fixed-term borrowings approaching maturity without realistic prospects of renewal or repayment; or excessive reliance on short-term borrowings to finance long-term assets.

(c) Indications of withdrawal of financial support by creditors.

(d) Negative operating cash flows indicated by historical or prospective financial statements. "Adverse key financial ratios.

(e) Substantial operating losses or significant deterioration in the value of assets used to generate cash flows.

(f) Arrears or discontinuance of dividends.

(g) Inability to pay creditors on due dates.

(h) Inability to comply with the terms of loan agreements.

(i) Change from credit to cash-on-delivery transactions with suppliers

(j) Inability to obtain financing for essential new product development or other essential investments.

☞ **Operating**

(a) Management intentions to liquidate the entity or to cease operation.

(b) Loss of key management without replacement.

(c) Loss of a major market, key customer (s), franchise, license, or principal supplier (s).

(d) Labour difficulties.

(e) Shortages of important supplies.

(f) Emergence of a highly successful competitor.

☞ **Other**

(a) Non- compliance with capital or other statutory requirements.

(b) Pending legal or regulatory proceedings against the entity that may, if successful, result in claims that the entity is unlikely to be able to satisfy.

(c) Changes in law or regulation or government policy expected to adversely affect the entity.

(d) Uninsured or underinsured catastrophes when they occur.

Some Past Attempts Questions

S.N.	Questions	Marks and Attempt	Answer
1.	A Company's **net worth is eroded and creditors are unpaid due to liquidity constraints.** The management represents to the statutory auditor that the **promoter's wife is expected to give an unsecured loan** to meet the liquidity constraints and that **negotiations are underway to secure large export orders.** Comment.	**[4 Marks]** **[June 2009]**	**Refer Point No. 5 & 10 on Page no. 62 & 63**
Ans.	In this case, it is subjective, but prima-facie a mere expectation of future cash flows from the promoter's wife without any firm commitment and the possibility of an export order being negotiated, may not that be sufficient appropriate audit evidence of mitigating factors for resolving the going concerns question under SA 570 "Going Concern".		
3.	R & Co. is the statutory auditor of S Ltd. For the financial year ended on 31^{st} March 2012, S Ltd had disclosed in the notes (Note No. X) **"The state pollution control board had ordered the closure of the company's only manufacturing plant on the ground that it is environmentally damaging, which the company had challenged in a law suit.** Pending the outcome of the law suit the financial statements are prepared on a going concern basis". Further the financial statements prepared by the management of S Ltd **include financial statements of certain branches which are audited by other auditors.** What are the reporting responsibilities of R & Co?	**[10 Marks]** **[May 2012]**	**Refer Point No. 10 & 11 on Pg no. 63 Also Refer Below**
Ans.	**<u>This question involves two broad aspects with respect to reporting requirements i.e.</u>** (i) One which deals with Going Concern aspect where the company has gone for legal suit and (ii) Other is work done by other auditors. **(i) As per SA 620, "Using the Work of an Auditor's Expert",** if expertise in a field is necessary to obtain sufficient appropriate audit evidence, he may determine to use the work of an auditor's expert. On the basis of expert's opinion he may decide to rely or not on assessment of management. **(ii) Please See SA – 600 for Ans. of 2^{nd} Part.**		
3.	While examining the going concern assumption of an entity, **what important indications should be evaluated and examined?**	**[5 Marks]** **[Nov. 2005]**	**Refer Point No. 13 on Page no. 64**

Standard on Auditing (SA) 580 (REVISED)
WRITTEN REPRESENTATIONS

1. *Effective Date*

This Standard on Audit becomes operative for all audits relating to accounting periods beginning **on or after 1st April, 2009.**

2. *Scope of this SA*

Auditor's responsibility to obtain written representation and where appropriate, those charged with governance. Written representations are the audit evidence as they provide necessary information in connection with the audit of the entity, although they do not provide sufficient appropriate audit evidence on their own about any matter which the auditor has to deal with. Also this does not affect the nature and extent of other audit evidence which the auditor needs to obtain to fulfill

3. *Objective of the Standard is to -*

(a) Obtain written representation from the management that the management believes that it has fulfilled the fundamental responsibilities that constitute the premise / basis on which audit is conducted.

(b) Support other audit evidence relevant to the financial statements or specific assertions in the financial statements.

(c) Respond appropriately to written representations provided by management and also if management does not provide the written representations requested by the auditor.

4. *Definition*

☞ **Written Representations** – A written statement provided by the management to the auditor to confirm certain matters or to support other audit evidence but do not include financial statements, the assertions therein, or supporting books and records. Auditor shall send request to management with appropriate responsibilities and knowledge of matters concerned.

5. *Responsibility of Management*

In the case of a fair presentation framework, management is responsible for the preparation and *fair* presentation of the financial statements in accordance with the applicable FRF, or the preparation of financial statements ***that give a true and fair view*** in accordance with the applicable financial reporting framework.

6. *Nature of Written Representation as a Audit Evidence*

(a) Audit evidence is all the information used by the auditor in arriving at the conclusions on which the audit opinion is based. Written representations are **necessary information** that the auditor requires in connection with the audit of the entity's financial statements. Accordingly, similar to responses to inquiries, written representations are audit evidence

(b) Although written representations provide necessary audit evidence, they do **not provide sufficient appropriate audit evidence** on their own about any of the matters with which they deal.

(c) The fact that management has provided reliable written representations does **not affect the nature or extent of other audit evidence** that the auditor obtains about the fulfillment of management's responsibilities, or about specific assertions.

7. Requirements

S.N.	Aspects	Descriptions
1.	**Written Representations about management's responsibilities**	a. **Preparation and Presentation of Financial Statements** – The auditor shall obtain a written representation that the management has fulfilled its responsibility for the preparation and presentation of financial statements as set out in the terms of audit engagement. b. **Information provided to auditor** – The auditor shall obtain written representation that management has provided the auditor with the relevant information and that all transactions have been recorded and are reflected in the financial statements. c. **Description of management's responsibilities** – Management's responsibilities shall be described in the representations.
2.	**Other Written Representations**	In case auditors determines that it is necessary to obtain more other written representation, as required by other SA's to support other audit evidence, he can request for such other representations also.
3.	**Date and period covered of representations**	The date of the representations shall be, as near as possible near to the date of audit report and in no case should be after the date of audit report.
4.	**Form of representations**	(a) It should be in the form of representation letter addressed to the auditor. (b) In case if any law or regulations requires management to made written public statements about its responsibilities, them such matter need be included in the representation letters.
5.	**Doubt as to reliability of written representations**	(a) If the auditor has concerns about the **competence, integrity, ethical values or diligence** of the management, or about its commitment to or enforcement or these, he shall determine the effect that such concerns may have in the reliability of representations (oral or written) and audit evidence in general. (b) If representations are **inconsistent** with other audit evidence, the auditor shall perform audit procedures to **attempt to resolve** the matter or reconsider the assessment of the management. (c) If the auditor concludes that these are **unreliable**, he shall take appropriate actions, including determining the possible effect on the opinion in the auditor's report.
6.	**Requested representations not provided**	**If the management does not provide one or more of the requested written representations, the auditor shall –** (a) Discuss with management. (b) Re-evaluate the integrity of management and evaluate the effect on reliability of the representations (oral or written). (c) Take appropriate actions and consider the effect on reports.
7.	**Representations about management's responsibilities effect on Audit Report**	**The auditor shall disclaim an opinion on the financial statements if –** (a) He concludes that there is **sufficient doubt** about the integrity of the management, and reliability of their written representations or (b) Management does **not provide** the written representations.

Some Past Attempts Questions

S.N.	Questions	Marks and Attempt	Answer
1.	In the course of audit of ABC Ltd. its **management refuses to provide written representations.** As an auditor what is your duty?	**[4 Marks]** **[May 2010]**	**Refer Point No. 7 – S.N. 6 & 7 on Page no. 67**
2.	Explain what is **meant by "Written Representations"** and indicate to what **extent an auditor can place reliance on such representations?**	**[6 Marks]** **[May 2006]**	**Refer Point No. 5 & 6 on Page no. 66**
Ans.	**<u>Conclusion</u> –** It must be note that **representations by the management cannot be the substitute for other audit evidence that the auditor could reasonably expected to be available.** For example, a representation by the management as to existence, quantity and cost of inventories is not substitute for adopting audit procedures regarding verification and valuation of inventories. If a representation by management is contradicted by other evidence, the auditor should examine the circumstances and, when necessary, reconsider the reliability of other representations made by the management as well.		
3.	What are your views on the following? An auditor of Sagar Ltd. was **not able to get the confirmation about the existence and value of certain machineries.** However, the **management** gave him a **certificate** to prove the existence and value of the machinery as appearing in the books of account. The **auditor** accepted the same without any further procedure and **signed the audit report.** Is he right in his approach?	**[5 Marks]** **[Nov. 2004]**	**Refer Point No. 5 & 6 on Page no. 66**
Ans.	**<u>Conclusion</u> –** 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. Therefore, the approach adopted by the auditor is not right.		

Standard on Auditing (SA) 600 (Revised)
USING THE WORK OF ANOTHER AUDITOR

1. Effective Date –

This Standard on Auditing becomes operative for all audits relating to accounting periods beginning **on or after 1st April, 2002**.

2. Introduction –

The auditor while relying on the work performed by others he should exercise adequate skill and care on which he relied and has no reason to believe that he should not have relied. This SA is applied to where an auditor uses the work of another auditor but does not apply to joint auditor. When the auditor concludes that the financial statement of a component is immaterial, SA would not apply. Whereas several components, individually though immaterial, together may be material for the entity as a whole, the SA would apply.

Note → 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.

3. Definition –

(a) **"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.

(b) **"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.

(c) **"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.

4. Acceptance as Principal Auditor-

For this purpose the auditor would consider –

(a) The materiality of the portion of the financial information which he audits;
(b) His degree of knowledge regarding the business of the components;
(c) The risk of material misstatements in the financial information of the component 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 him having significant participation in such audit.

5. The Principal auditor's Procedures-

When planning to use the work of another auditor, the principal auditor may consider –

(a) The professional competence of the other auditor in the context of specific assignment

(b) Evaluate the work performed by another to obtain sufficient appropriate audit evidence.

(c) Advise the other auditor of the use that is to be made of his work and report.

(d) 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;

(e) Advise the other auditor of the significant accounting, auditing and reporting requirements

(f) The nature, timing and extent of procedures which will depend on the circumstances of the engagement and the principal auditor's knowledge of the professional competence of the other auditor.

(g) The principal auditor should consider the significant findings of the other auditor.

(h) He may also decide that supplemental tests of the records or the financial statements of the component are necessary.

6. Documentation-

The principal auditor should document in his working papers the –

(a) The components whose financial information was audited by other auditors;

(b) Their significance to the financial information of the entity as a whole;

(c) The names of the other auditors;

(d) And any conclusions reached that individual components are not material.

(e) The principal auditor should also document the procedures performed and the conclusions reached.

7. Co-ordination Between Auditors for this purpose-

(a) The principal auditor may find it necessary to issue written communications (s) to the other auditor so that there is proper coordination between the two.

(b) 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.

(c) 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.

8. Reporting Considerations

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

(b) 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. **[Refer Appendix also]**

9. Division of Responsibility

(a) The principal auditor would not be responsible in respect of the work entrusted to other auditors, except in circumstances which should have aroused his suspicion about the reliability of the work performed by other auditors.

(b) 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.

Appendix

Announcement

SA – 600 (R) – Using the work of another Auditor

Manner of Disclosure in the Auditor's Report of the Fact of Inclusion of Unaudited Financial Statements/ Information of Component/s in the Financial Statements Audited by the Principal Auditor(s)

……………………………………………………………………………………………………

1. An **Independent Auditor** of the Financial Statements of an entity may, at times, need to **rely upon work of the other auditors.**

   For example, in an audit of the stand alone financial statements of an entity the Independent Auditor thereof (the Principal Auditor) may need to rely upon the Financial Statements of the entity's component/s such as branch/es, division/s, etc., which have been audited by other Independent Auditor/s.

   Similarly, in an audit of the consolidated financial statements of a group, the independent auditor thereof (the Principal Auditor), may need to rely upon the work of the independent auditors of the components of the group such as subsidiary/ies, joint venture/s, associate/s, etc., whose audited financial statements/ information have been included in the consolidated financial statements and have been audited by their respective independent auditors (the Component Auditors).

2. There may also be **a situation** where the financial statements of one or more components included in the stand alone financial statements of an entity/ consolidated financial statements of a group have **not been audited either by the Principal Auditor or the Component Auditor/s.**

3. Members have sought **guidance on the appropriate manner of disclosure of information in the independent auditor's report of the Principal Auditor about the fact** that the financial statements/ information pertaining to certain/ all components, included in the stand alone financial statements of an entity/ consolidated financial statements of a group are unaudited.

4. The **Council at its 331st meeting** held on 10th Feb., 2014 considered the above matter and decided as under –

<table>
<tr><th>S. N.</th><th>Situation</th><th>Disclosures in the Principle Auditor's Report</th></tr>
<tr><td>1.</td><td>Component/s is/are unaudited and such component/s is/are not material to the Financial Statements of the Entity/ Consolidated Financial Statements of the Group.</td><td rowspan="2">The Principal Auditor may or may not disclose the fact of such component/s in the Principal Auditor's report. In case the Principal Auditor decided to make such disclosure, the same would be done under the "Other Matters" paragraph, pursuant to SA 706, Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report. An illustrative manner of reporting is given in Ill. 2 in the Appendix of SA – 706.</td></tr>
<tr><td>2.</td><td>Component/s is/are audited by auditor/s other than the Principal Auditor and such component/s is/are not material to the Financial Statements of the entity/ Consolidated Financial Statement of the Group.</td></tr>
</table>

3.	Component/s is/are **audited** by auditor/s other than the Principal Auditor **and** such component/s **is/ are material** to the Financial Statements of the entity/ Consolidated Financial Statements of the Group	The principal auditor would **need to disclose the fact** of such component/s in the Principal Auditor's report. Such disclosure would be done under the "Other Matters" paragraph, pursuant to SA 706, ***Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report.*** An Illustrative manner of reporting is given in Illustration 2 in the Appendix to SA 706.
4.	Component/s is/are **unaudited and** such component/s **is/are material** to the Financial Statements of the entity/ Consolidated Financial Statements of the Group	The Principal Auditor **needs to consider** its/ their **impact on the auditor's opinion** on the Financial Statements of the entity/ Consolidated Financial Statements of the Group, in terms of the principles laid down in SA 705, ***Modifications to the Opinion in the Independent Auditor's Report.***

Some Past Attempts Questions

S.N.	Questions	Marks and Attempt	Answer
1.	R & Co. is the statutory auditor of S Ltd. For the financial year ended on 31st March 2012, S Ltd had disclosed in the notes (Note No. X) **"The state pollution control board had ordered the closure of the company's only manufacturing plant on the ground that it is environmentally damaging, which the company had challenged in a law suit.** Pending the outcome of the law suit the financial statements are prepared on a going concern basis". Further the financial statements prepared by the management of S Ltd **include financial statements of certain branches which are audited by other auditors.** What are the reporting responsibilities of R & Co?	[10 Marks] [May 2012]	**See Below**
Ans.	**This question involves two broad aspects with respect to reporting requirements i.e.** **(i) One which deals with Going Concern aspect where the company has gone for legal suit and** **(ii) Other is work done by other auditors.** **(i) Please See SA – 570 for Ans. of 1st Part.** **(ii) As per Sec. 227** of the Companies Act, 1956, the auditor has to state that whether the report on the accounts of any branch office audited under section 228 by a person other than the company's auditor has been forwarded to him and how he has dealt with the same in preparing the auditor's report. Further, as per **SA 600 Using the work of Another Auditor,** 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.		
2.	"There should be **sufficient liaison between a principal auditor and other auditors".** Discuss the above statement and state in this context the reporting considerations, when the **auditor uses the work performed by other auditor.**	[8 Marks] [Nov. 2002]	**Refer Point No. 7 & 8 on Page no. 70 And also Appendix also to point no. 8 on Page no. 71 & 72**

Standard on Auditing (SA) 610 (REVISED)
USING THE WORK OF INTERNAL AUDITORS

1. Effective Date

This Standard on auditing becomes operative for all audits relating to accounting periods beginning **on or after 1st April 2010**.

2. Scope

(a) This SA deals with the external auditor's (EA) responsibilities regarding the work of internal auditors (IA) when the ***external auditor has determined, in accordance with SA 315 Risk of Material Misstatement***, that the internal audit function is likely to be relevant to the audit. But it does not cover when IA is not permitted to provide access to his papers or when IA gives direct assistance to EA.

(b) ***Relationship between the Internal Audit Function and the External Auditor -*** though the objectives of the internal audit function and the external auditor are different, some of the ways in which they achieve their respective objectives may be similar. The EA has sole responsibility for the audit opinion expressed, and that responsibility is not reduced by the EAs use of the work of the IAs.

3. Objectives

The objectives of the EA, are to determine –

(a) Whether, and to what extent, to use specific work of the IA's and

(b) If so, whether such work is adequate for the purposes of the audit.

4. Definitions

(a) ***Internal audit function –*** An appraisal activity established or provided as a service to the entity. Its functions include, amongst other things, examining, evaluating and monitoring the adequacy and effectiveness of internal control.

(b) ***Internal auditors (IA) -*** Those individuals who perform the activities of the internal audit function. Internal auditors may belong to an internal audit department or equivalent function.

5. Requirements

EA has to determine whether and to What Extent to Use the Work of the IA;

1. Whether the work of the IA is likely to be ***adequate for purposes of the audit***; and

2. If so, the planned effect of the work of the ***IA on the nature, timing or extent of his procedures***.

3. To determine the adequacy of the work of IA the ***EA shall evaluate*** –

   (a) The objectivity of the internal audit function;

   (b) The technical competence of the IA;

   (c) Whether the work of the IA is likely to be carried out with due professional care; and

   (d) Whether there is likely to be effective communication between the IA and the EA.

4. In determining the ***effect of IAs work on audit procedures of EA***, he shall consider:

   (a) The nature and scope of specific work performed, or to be performed, the IA;

   (b) The assessed risks of material misstatement at the assertion level for particular classes of transactions, account balances, and disclosures; and

(c) The degree of subjectivity involved in the evaluation of the audit evidence gathered by the IA in support of the relevant assertions.

5. To determine the ***adequacy of specific work performed by the IA for the EAs purposes***, EA shall evaluate whether –

(a) The work was performed by IA having ***adequate technical training and proficiency***;

(b) The work was ***properly supervised, reviewed and documented***;

(c) ***Adequate audit evidence*** has been obtained to enable the IA's ***to draw reasonable conclusions***;

(d) Conclusions reached are appropriate in the circumstances and any reports prepared by the IA's are consistent with the results of the ***work performed; and***

(e) Any ***exception or unusual matters disclosed*** by the IA's are properly resolved.

6. Documentation

When the EA uses specific work of the IA, he shall document conclusion regarding the evaluation of the adequacy of the work of the IA, and the audit procedures performed by the EA on that work.

Some Past Attempts Questions

S.N.	Questions	Marks and Attempt	Answer
1.	You are appointed statutory auditor of X Ltd. X Ltd. has an internal audit system and reports for the same are given to you. Mention the **factors** you will consider **to ensure** that the said **system of internal audit** of X Ltd. **is commensurate with the size of the company and nature of its business.**	[8 Marks] [June 2009]	**Refer Audit Under Co's Act, 1956 Para 4 (vii) of CARO – 2003 on Page no. 49 & 50**
2.	In the course of the statutory audit of Z Ltd, its statutory auditors, having determined that the work of internal auditor is likely to be adequate for the purpose of statutory audit, wanted to **use the work of internal auditor in respect of physical verification of fixed assets.** How an evaluation of this specific work done by the internal auditor can be done?	[5 Marks] [May 2012]	**Refer Point No. 5 Requirements – (1, 2, 3, 4 & 5) on Page no. 74 & 75**
3.	Enumerate, in brief, the important **aspects to be evaluated by the external auditor** in determining the efficiency and extent of reliance to be placed on the work and function of an Internal Auditor.	[6 Marks] [May 2005]	**Refer Point No. 5 Requirements – (1, 2, 3, 4 & 5) on Page no. 74 & 75**

Standard on Auditing (SA) 620 (Revised)
Using the Work of an Auditor's Expert

1. Effective Date –

This SA is effective for audits of financial statements for periods beginning **on or after April 1, 2010**.

2. Scope of this SA –

This Standard on Auditing (SA) deals with the auditor's responsibilities regarding the use of an individual or organisation's work in a field of expertise other than accounting or auditing, when that work is used to assist the auditor in obtaining sufficient appropriate audit evidence. This SA does not deal with –

(a) Situations where the engagement team includes a member with expertise in specialised area of accounting or auditing, which is dealt with in SA 220 (Revised) ;or

(b) The auditor's use of the work of an individual or organisation possessing expertise in a field other than accounting or auditing, whose work in that field is used by the entity to assist the entity in preparing the financial statements (a management's expert), which is dealt with in SA 500 (Revised) .

3. Objectives –

The objectives of the auditor are –

(a) To determine whether to use the work of an auditor's expert; and

(b) If using the work of an auditor's expert, to determine whether that work is adequate for the auditor's purposes.

4. The Auditor's Responsibility for the Audit Opinion –

The auditor has sole responsibility for the audit opinion expressed, and that responsibility is not reduced by the auditor's use of the work of an auditor's expert. Nonetheless, if the auditor concludes that the work of that expert is adequate for the auditor's purposes, the auditor may accept that expert's findings or conclusions in the expert's field as appropriate audit evidence.

5. Definitions

(a) **Auditor's expert** – An individual or organisation possessing **expertise** in a field other than accounting or auditing, whose work in that field is used by the auditor to assist the auditor in obtaining sufficient appropriate audit evidence.

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

(b) **Expertise** – Skills, knowledge and experience in a particular field.

(c) **Management's expert** – An individual or organisation possessing expertise in a field other than accounting or auditing, whose work in that field is used by the entity to assist the entity in preparing the financial statements.

6. Determining the need for an auditor's expert –

If expertise in a field other than accounting or auditing is necessary to obtain sufficient appropriate audit evidence, the auditor shall determine whether to use the work of an auditor's expert.

7. The competence, capabilities and objectivity of the auditor's expert –

The auditor shall evaluate whether the auditor's expert has the necessary competence, capabilities and objectivity for the auditor's purposes.

8. Obtaining an understanding of the field of expertise of the auditor's expert –

The auditor shall obtain a sufficient understanding of the field of expertise of the auditor's expert to enable the auditor to –

(a) Determine the **nature, scope and objectives** of that expert's work for the auditor's purposes; and

(b) Evaluate the **adequacy** of that work for the auditor's purposes.

9. Agreement with the Auditor's Expert –

The auditor shall agree, in writing when appropriate, on the following matters with the auditor's expert –

(a) The **nature, scope and objectives** of that expert's work;

(b) The respective **roles and responsibilities** of the auditor and that expert;

(c) The **nature, timing and extent** of **communication** between them including the form of any report to be provided by that expert; and

(d) The need for the auditor's expert to observe **confidentiality** requirements.

10. Evaluating the Adequacy of the Auditor's Expert's Work –

The auditor shall evaluate the adequacy of the auditor's expert's work for the auditor's purposes, including –

(a) The relevance and reasonableness of that **expert's findings or conclusions,** and their consistency with other audit evidence;

(b) If that expert's work involves use of **significant assumptions and methods,** the relevance and reasonableness of those assumptions and methods in the circumstances;

(c) If that expert's work involves the **use of source data** that is significant to that expert's work, the relevance, completeness, and accuracy of that source data.

(d) If the auditor determines that the work of the auditor's expert is **not adequate** for the auditor's purposes, the auditor shall –

1. Agree with that expert on the nature and extent of **further work** to be performed by **that expert**; or
2. Perform **further audit procedures** appropriate to the circumstances.

11. Nature, timing and extent of audit procedures –

The nature, timing and extent of the auditor's procedures with respect to the requirements in para 7-10 above, will vary depending on the circumstances. In determining the nature, timing and extent of those procedures, the auditor shall consider matters including –

(a) The nature of the matter to which that expert's work relates;

(b) The risks of material misstatement in the matter to which that expert's work relates;

(c) The significance of that expert's work in the context of the audit;

12. Reference to the auditor's expert in the auditor's report

The auditor shall not refer to the work of an auditor's expert in an auditor's report containing an unmodified opinion unless required by law or regulation to do so. If such reference is required by law or regulation, the auditor shall indicate in the auditor's report that the reference does not reduce the auditor's responsibility for the audit opinion.

If the auditor makes reference to the work of an auditor's expert in the auditor's report because such reference is relevant to an understanding of a modification to the auditor's opinion, the auditor shall indicate in the auditor's report that such reference does not reduce the auditor's responsibility for that opinion.

Some Past Attempts Question

S.N.	Question	Marks and Attempt	Answer
1.	Y Ltd. engaged an actuary to ascertain its employee cost, gratuity and leave encashment liabilities. As the auditor of Y Ltd., you would like to use the report of the actuary as audit evidence. How do you **evaluate the work of the actuary?**	**[8 Marks] [May 2011] & [Nov. 2002]**	**See Below, but Students can also Refer Point No. 6 to 10 on Page no. 76 & 77**

Ans.

As per SA 620 "Using the Work of an Auditor's Expert", when management has used a management's expert in preparing the financial statements, the auditor's decision on whether to use an auditor's expert may also be influenced by such factors as –

(a) The nature, scope and objectives of the management's expert's work.

(b) Whether the management's expert is employed by the entity, or is a party engaged by it to provide relevant services.

(c) The extent to which management can exercise control or influence over the work of the management's expert.

(d) The management's expert's competence and capabilities.

(e) Whether the management's expert is subject to technical performance standards or other professional or industry requirements.

(f) Any controls within the entity over the management's expert's work.

However, an evaluation of the work of an expert can be done considering the following facts –

1. When the auditor plans to use the expert's work as audit evidence, he should satisfy himself as to the expert's skills and competence by considering the expert's –
   - Professional qualifications, licence or membership in an appropriate professional body, and
   - Experience and reputation in the field in which the evidence is sought.
2. The **objectives and scope** of the experts' work.
3. A **general outline** as to specific items in the expert's report.
4. **Confidentiality** of the client's information used by the expert.
5. The **source data used**.
6. The **assumptions and methods** used and, if appropriate, their comparison with the prior period.
7. The results of the expert's work in the light of auditor's **overall knowledge of the business** and of the results of his audit procedures.
8. The auditor should also **satisfy** himself that the substance of the expert's findings **is properly reflected in the financial statements**.
9. Consider whether the expert has **used the appropriate source data**, by **making inquiries** of the expert.
10. **Conducting audit procedures** on the data by the client to the expert to obtain **reasonable assurance that the data are appropriate.**

2.	While doing audit, Ram, the Auditor requires reports from experts for the purpose of Audit evidence. What types of reports/opinions he can obtain and to what extent he can rely upon the same?	**[4 Marks]** **[Nov. 2010]**	**See Below**
Ans.	As per SA 620, "Using the Work of an Auditor's Expert", 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. While doing audit, Ram, the auditor can obtain the following types of reports, or options or statements of an expert for the purpose of audit evidence – (a) Valuations of certain types of assets, for example, land and buildings, plant and machinery, works of art, and precious stones. (b) 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. (c) Determination of amounts using specialised techniques or methods, for example, an actuarial valuation. (d) The measurement of work completed and to be completed on contracts in progress for the purpose of revenue recognition. (e) Legal opinions concerning interpretations of agreements, statutes, regulations, notifications, circulars, etc. When the auditor intends to use the work of an expert, he should seek reasonable assurance that the expert's work constitutes appropriate audit evidence in support of the financial information, by considering the sufficiency, relevance and reliability of 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.		
3.	Z Ltd. had appointed an **outside expert to assess accrued gratuity liability** of the company. Based on the said report, the company provides ₹ 80 Lakhs as gratuity in the financial statements. Comment.	**[5 Marks]** **[June 2011]**	**Same as given in 1. Or Students can Refer Below Ans. also.**
Ans.	**(a)** SA 620 states that while using the work of an expert, auditor should consider the **materiality** of the item, nature and complexity of the item, the other audit evidence available and **professional qualifications, experience and reputation in the field of the concerned expert.** (b) The auditor should ensure that the expert has used appropriate source data, has made consistent **assumptions, has applied correct methods and that results of expert's work are in line with auditor's overall knowledge of the business and match with results of his audit procedures.** (c) The auditor should also ensure that substance **of expert's findings is properly reflected in the financial information.**		