# New AAS-Auditing & Assurance Standards:-

| Old No. | New No. | Name of New AAS | Ranking |
|---|---|---|---|
| AAS-1 | SA 200 | Basic Principals Governing an Audit | A |
| AAS-2 | SA 200A | Objective & Scope of an Audit of Financial Statements | B |
| AAS-3 | SA 230 | Documentation | C |
| AAS-4 | SA 240 | The Auditor's Responsibility to Consider Fraud & Error In An Audit of Financial Statements | A |
| AAS-5 | SA 500 | Audit Evidence | A |
| AAS-6 | SA 400 | Risk Assessment & Internal Control | A |
| AAS-7 | SA 610 | Relying upon the work of an Internal Auditor | B |
| AAS-8 | SA 300 | Audit Planning | C |
| AAS-9 | SA 620 | Using the work of an Expert | B |
| AAS-10 | SA 600 | Using the work of Another Auditor | B |
| AAS-11 | SA 580 | Management Responsibility/Management Representation | B |
| AAS-12 | SA 299 | Joint Auditors | A |
| AAS-13 | SA 320 | Audit Materiality | A |
| AAS-14 | SA 520 | Analytical Procedures | C |
| AAS-15 | SA 530 | Audit Sampling | A |
| AAS-16 | SA 570 | Going Concern | C |
| AAS-17 | SA 220 | Quality control of an Audit Work | C |
| AAS-18 | SA 540 | Audit of Accounting Estimates | C |
| AAS-19 | SA 560 | Subsequent Events | C |
| AAS-20 | SA 310 | Knowledge of Client Business | B |
| AAS-21 | SA 250 | Consideration of Laws & Regulations in an Audit of F/S | C |
| AAS-22 | SA 510 | Initial Engagements – Opening Balances | C |
| AAS-23 | SA 550 | Related Parties | C |
| AAS-24 | SA 402 | Audit Considerations Relating To Entities Using Service Organizations | C |
| AAS-25 | SA 710 | Comparatives | C |
| AAS-26 | SA 210 | Terms of Audit Engagement N91,N92 | A |
| AAS-27 | SA 260 | Communications of Audit matters with those charged with Governance | C |
| AAS-28 | SA 700 | The Auditor's Report on Financial Statements | A |
| AAS-29 | SA 401 | Audit in Computer Information Environment System | A |
| AAS-30 | SA 505 | External Confirmations | A |
| AAS-31 | SRS 4410 | Engagement to Compile Financial Information | C |
| AAS-32 | SRS 4400 | Engagement to perform regarding financial Information | C |
| AAS-33 | SRE 2400 | Engagement to Review Financial Statement | C |
| AAS-34 | SA 501 | Audit Evidence for additional consideration of specific item | C |
| AAS-35 | SAE 3400 | The Examination of Prospective Financial Information | C |

**The above given New No.s are Effective from 1/04/2008**
S.A.= Standard on Auditing
S.R.S=Standard on Related Services
S.R.E= Standard on Revenue Engagement
S.A.E.=Standard On Assurance Engagement

## AAS-1: SA-200: Basic Principals Governing an Audit

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| **1. Integrity, Objectivity and Independence** | Auditor should be interest free. He must possess qualities such as honesty, sincereness, fairness, objectivity, etc. |
| **2. Skills and Competence:** | Auditor must have adequate training, competence and experience. |
| **3. Confidentiality:** | Auditor must not disclose any confidential information regarding his client to any third party. However, he may disclose, if –<br>• There is a specific permission of client or<br>• Required by law. |
| **4. Work performed by others:** | Auditor may rely on work done by others i.e. other auditors or experts or his assistants provided he exercised due skill and care and there is nothing to doubt. |
| **5. Documentation:** | Matters providing evidence should be carefully documented. |
| **6. Planning:** | For proper conduct of work in efficient and timely manner. |
| **7. Audit Evidence:** | Sufficient and appropriate evidence should be obtained by performing compliance and substantive procedures. |
| **8. Accounting Systems and Internal Controls:** | Mgt. is responsible for maintaining the same. The auditor has to check their adequacy. |
| **9. Conclusion and Reporting:** | Auditor is required to express opinion on financial information on the basis of conclusions drawn from evidences.<br>He is required to conclude whether -<br>• Financial information is prepared using consistent and acceptable accounting policies.<br>• Compliance of relevant regulations, legal requirements, accounting policies.<br>• Disclosure of material Matters<br>There should be clear expression of opinion in report. If the report is other than unqualified, auditor should state the reason for the same. |

## AAS-4: SA-240: The Auditor's Responsibility to Consider Fraud & Error In An Audit of Financial Statements

The term 'General. Purpose F/S' include Balance Sheet, Profit and Loss Account and other statements and explanatory notes which from part thereof.

<table>
<tr><td rowspan="1">1. Fraud</td><td colspan="2">Fraud refers to intentional misrepresentations of financial information by management, employees, or third parties.<br>A fraud may involve:-<br>1. Manipulation or falsification of accounting records<br>2. Misappropriation of assets<br>3. Suppression or omission of effects of transactions from records or documents<br>4. Wrong accounting procedures<br>5. Misapplication of accounting policies</td></tr>
<tr><td>2. Error</td><td colspan="2">Error refers to the unintentional mistakes in F/S. for e.g.<br>1. Mathematical or clerical mistake<br>2. Oversight or misrepresentation of facts<br>3. Misapplication of accounting policies</td></tr>
<tr><td rowspan="2">3. Responsibility for detection of fraud and error</td><td>On part of those charged with governance and management</td><td>➢ Prevention & detection of fraud & error is their responsibility<br>➢ For this management establishes internal control.</td></tr>
<tr><td>On part of Auditors</td><td>➢ He must work in accordance with AAS.<br>➢ If there is indication of misstatement he should extend his procedures to confirm/ dispel the doubt.<br>➢ He should maintain documentation.<br>➢ But he can't be held responsible for prevention of fraud & error.</td></tr>
<tr><td>4. Inherent limitation of audit</td><td colspan="2">➢ Test nature of Audit (Sampling)<br>➢ Professional judgment of Auditor<br>➢ Persuasive nature of Audit evidence rather than conclusive<br>➢ Risk of not detecting fraud is higher (fraud involves ways to conceal it)<br>➢ Persons responsible for proper maintenance of I.C. of system may themselves override it.<br>➢ Auditor is expected to obtain reasonable not absolute assurance.<br>Auditor is concerned only with material items.</td></tr>
<tr><td rowspan="3">5. Discussion and inquiries</td><td>With members of Audit team</td><td>Susceptibility of Fraud & Error in financial statements.</td></tr>
<tr><td>With management</td><td>Regarding account & internal control systems</td></tr>
<tr><td>With those charged with governance</td><td>Regarding fraud by management</td></tr>
<tr><td>6. Audit Risk (As per AAS-6 /SA 400 )</td><td colspan="2">When assessing inherent risk and control risk in accordance with AAS-6, the auditor should consider how the F/S might be materially misstated as a result of fraud or error. Based on his assessment of inherent and control risk, the auditor should design substantive procedures to reduce to an acceptably low level the risk that misstatements resulting from fraud and error that are material to the F/S taken as whole will not be detected</td></tr>
<tr><td>7. Procedures when circumstances indicate a possible misstatement</td><td colspan="2">• Perform procedures to determine whether the F/S is materially misstated.<br>• Consider it's impact in relation to other aspects of audit,<br>Otherwise, consider a necessity for a disclosure in the F/S and if adequate disclosures are not made, the necessity for a suitable disclosure in audit report.</td></tr>
<tr><td>8. Documentation</td><td colspan="2">➢ Fraud risk factors<br>➢ His response to same</td></tr>
<tr><td>9. Mgt. representation (As per AAS-11/ SA 580)</td><td colspan="2">➢ Management responsibility for A/c & I.C. system to prevent & detect F & E.<br>➢ Aggregated uncorrected misstatements are immaterial for financial information in opinion of management.<br>➢ It has disclosed the auditor<br>1. All facts</td></tr>
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| | |
|---|---|
| | ➢ Known frauds &<br>➢ Suspected frauds<br>Management' assessment of risk of presence of fraud & error. |
| **10. Communication** | ***of fraud & error***<br>• At appropriate level<br>• Timely basis<br>➢ If management is involved, consider communicating to those charged with governance.<br>➢ If required, communicate to regulatory authority.<br><br>***of weakness in I.C. system***<br>➢ If I.C. fails to prevent/ detect misstatement.<br>Then, communicate this fact to management. |
| **11. Auditor unable to complete the engagement** | As per this AAS: WITHDRAW & disclose such facts to the Incoming auditor |

Important points:-

1. **Subsequent discovery of fraud or error**: Due to the inherent limitations of an audit the subsequent discovery of fraud or error does not, in itself, indicate that the auditor has not done the audit properly.
2. **When Fraud or error is by a member of management, t**he auditor should reconsider the reliability of any representations made by same person to the auditor.

**If auditor has indication of misstatement (i.e. doubtful situation)**

↓

He should carry out extended procedures in respect of same

- Doubt is dispelled ↓ O.K.
- Doubt is confirmed ↓ He should consider whether it is indicative of error or fraud
  - Error
  - Fraud ↓ He should consider its effects
- Unable to conclude ↓ He should consider disclosure in financial statement
  - If mgt. does it ↓ O.K.
  - Else ↓ Effect on A.R.

He asks mgt. for suitable disclose in financial statement

➢ If mgt. does it – O.K.

➢ Else – effect on A.R.

## AAS-11: SA-580: Management Responsibility/Management Representation

**Mgt. Representation –** written / oral confirmation by them w.r.t. items included in F/S.

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| **1.Meaning** | The representation of management is normally contained in a letter called Letter of representation or Over all management certificates. |
| **2.Obtain an Acknowledgement** | **Obtain an acknowledgement** from, management as to its responsibility for preparing & presenting financial information- **Ex -**For F/S as a whole, For Accounting Policies, Investments, Provision for claims, etc.<br>. |
| **3.On what matters- MRL necessary** | • The auditor should exercise his professional judgment in determining the matters on which he wishes to obtain such representation in writing.<br>• However, Representation should be obtained from management in writing on material items when other sufficient & appropriate audit evidence cannot be reasonably expected to exist. |
| **4.Types of Management Representation Letter** | 1. Letter issued by Mgt...<br>*2.* Letter from auditor outlining his understanding, duly acknowledged and confirmed by Mgt... |
| **5.Elements of Management Representation Letter(MRL)** | • Addressed to Auditor.<br>• Dated and signed by proper authority.<br>• MRL date should be receive before or at the date of audit report.<br>• For specific transfer there may be separate MRLs. |
| 6.Mgt. Representation as Audit Evidence : | 1. He should use his professional judgment to decide the areas in which MRL is required.<br>2. Mgt. Representation should be in writing.<br>3. Auditor should seek corroborative evidences.<br>4. Evaluate its reasonableness and consistency.<br>5. Person rendering Mgt. Representation should be well informed.<br>6. Mgt. Representation Letter can't be substitute for other audit evidences.<br>7. Sometimes it may be only evidence<br>**MR CAN'T be substitute for other audit evidence.** |
| 7.Contradiction | If a representation is contradicted by other evidence, the auditor shall modify or increase the audit procedures & reconsider the other representations made by management. |
| 8.Documentation | The auditor should document the management representation in his working papers. A written representation is better than oral representation. |

**Contradictory View with management:-**

**Auditor asks for MRL**

Mgt. provides → ↓ OK

Mgt. Refuses → ↓ Auditor should himself prepare it with a request to acknowledge the same.

Mgt. Acknowledges ↓

Mgt. Refuses ↓

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| | OK | Limitation on Scope of work of auditor |

## AAS-16: SA-570: Going Concern

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| **1. Going Concern-Meaning** | • An entity is said to be a going concern if it is likely to continue in existence for a foreseeable future time, generally extending beyond a period of one year.<br>• An entity's continuance as a going concern for the foreseeable future is assumed in the preparation of F/S in the absence of information to the contrary.<br>• If this assumption is unjustified the value of assets & liabilities may need to be adjusted.<br>• It is a fundamental accounting assumption (AS-1) |
| **2. Auditor's Consideration:** | whether going concern assumption adopted by Mgt. holds goods OR NOT |

**3. VNegative Indicators of Going Concern:-**

| Financial Indicators | Operating Indicators | Other Indicators |
|---|---|---|
| 1. Negative net worth/working cap.<br>2. Arrears / discontinuance of Dividends<br>3. Adverse financial ratio<br>4. Substantial losses (operating).<br>5. Borrowings approaching maturity but no prospects of renewal / repayment<br>6. Short term borrowing for long term asset financing.<br>7. No payment to creditors on due date.<br>8. No compliance with terms in loan agreement.<br>9. Negative cash flow from operation.<br>10. Rearrangement with creditors for reduction liability.<br>11. Change from creditors to cash on delivery transaction with supplier. | 1. Loss of key Mgt. without replacement.<br>2. Loss of major market or supplier.<br>3. Labour unrest strikes etc<br>4. Loss of major licence, franchise, etc. | 1. Pending legal proceedings<br>2. Change in Govt. Policy affecting the entity adversely<br>3. Non-compliance with Statutory requirements |

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| **4. Audit Evidence in case of Going Concern** | But in case of question regarding going concern, auditor should obtain sufficient and appropriate evidence *e.g.*<br>• Analysis and discuss cash flow, profit and other relevant forecast.<br>• Review the terms of debentures and loans<br>• Discussion with Mgt..about their future plans, say, Liquidating of assets, Capital |

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| | Structure Planning etc.<br>• Reviewing events after Balance sheet date.<br>• Taking legal advice.<br>• Analyse future plans of Mgt.. |
| **5. Audit conclusion and Reproting:** | • Conclude whether Going Concern assumption is valid or not.<br>• If not, then the F/S would be a misleading; the auditor should express an ADVERSE OPINION |

**Audit procedures – Conclusion and Reporting**

If doubt regarding Going Concern Assumption

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Obtain Audit Evidence

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Evaluate those Evidences & Conclude whether

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**Going Concern is Appropriate**

- Due to Mitigatory Factors ↓ auditor considers whether it needs to be disclosed in F/S by the Mgt. If
  - Yes ↓ Ask mgt. to disclose the same
    - If mgt. do not disclose ↓ qualify the report
    - If mgt. discloses ↓ clean report/ modified(disclosure)
  - No ↓ clean report
- Otherwise ↓ clean *report*

**Going concern is inappropriate**

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The effect is material and pervasive ↓ Adverse report

**Going concern question is not resolved**

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Whether financial statements disclose such fact

- Yes ↓ Modified report (But he may provide disclosure in his audit report as well)
- No ↓ Adverse Report

## AS-21: SA-250: Consideration of Laws & Regulations in an Audit of F/S

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| **Introduction** | An auditor might not be aware about the various applicable laws on the entity.<br>But, he should recognize that any non-compliance might materially affect the F/S. |
| Responsibility of compliance of such laws and regulations | • Responsibility of compliance rests with the MGT<br>• It should monitor the various legal requirements & ensure that operating procedures are designed to meet the requirements.<br><br>The following procedures may assist management in discharging its responsibilities for the prevention & detection of non-compliance with laws and regulation.<br>• Developing and following a code of conduct.<br>• Ensuring employees are properly trained and understand the code of conduct and punishing strictly for non compliance.<br>• Establishing a legal department to assist in monitoring legal requirements. |
| Auditor's Consideration | → Auditor is/can *not* be held *responsible* for preventing non-compliance.<br>→ The *risk* of non-detention of non-compliance is *higher*.<br>→ But audit may reveal condition/events compliance.<br>→ Thus he should accordingly plan and perform audit. For this, he should perform :<br>1. He should obtain *general understanding* of<br>(A) Legal and regulatory *framework* applicable to entity and<br>(B) How entity comply with it.<br>2. Perform procedures to *identity non-compliance* to be considered when *preparing F/S. specifically.*<br>Inquire mgt. as to compliance<br>Inspect correspondence with relevant authorities<br>3. Sufficient and appropriate evidence for compliance with those laws and regulation having effect on material amounts and disclosures in F/S. (*such laws are known and considered w.r.t. F/S)*<br>→ Except 1, 2, 3, auditor need not test compliance.<br>→ However, there may be instances of possible non-compliance came to auditors notice (*fine penalty, etc.)*<br>→ Written MRL → that Mgt. has disclosed to auditor all known / possible non-compliance effecting preparation of F/S<br><br>**Procedures :** When non-compliance is discovered *:*<br>→ Understanding nature/circumstances etc. to evaluate possible effect on f.st.<br>→ Documentation and discuss with Mgt..<br>→ May consult entity's lawyer.<br>→ Consider implication of non-compliance w.r.t. other phases of audit (*Reliability of MRL*).<br>→ If unable to obtain information about suspected non-compliance – consider its effect on Auditors Report |

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| Management Representation Letter (MRL) | In case of actual / possible non-compliance a WRITTEN Representation should be obtained. |
| Assumption of Compliance | In the absence of evidence to the contrary, the auditor is entitled to assume the compliance with these laws and regulations. |

**Communication / Reporting of non-compliance**

To the Appropriate Level of Mgt, Material non-compliances can be expressed by way of qualified / adverse opinion

| To Mgt. | To Users of Audit Report If he | To Regulatory Authorities |
|---|---|---|
| → Communicate it to Board of Directors and Senior mgt. | Concludes that Non-compliance has Material. Effect on F/S.<br>↓<br>qualify/adverse<br><br>Is unable to determine non-compliance due to limitations imposed by<br>Mgt./Entity ↓ Qualify / disclaim<br>Circumstances ↓ Consider its Effect on Auditor's Report | Only if required by statute etc. |

**Withdrawal from Engagement :**

→ He may withdraw if Mgt. doesn't take remedial steps considered necessary by auditor, even if non-compliance is not material to F/S.

→ He may seek legal advice (*e.g.* Mgt. involvement in non-compliance)

→ When incoming auditor communicates, tell him *reasons* of such withdrawal (not of its affairs)

**Very Imp. : - MATERIALITY of non-compliance being IRRELEVANT**

## AAS-22: SA-510: Initial Engagements – Opening Balances

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| **Concept** | • Audit of the Opening Balances in case of initial audit engagements.<br>• When F/S are audited for 1st time or<br>• Some other auditor audited the F/S for preceding period. |
| **Opening Balance** | A/c. Balances existing at beginning of the period i.e. closing balance of preceding period brought forward (b/f) to current period.<br>⇒ It reflects the effect of :<br>(i) Transaction / Events of preceding period, and<br>(ii) A/c. policies applied in preceding period. |
| **Obtain Audit Evidence** | Obtain sufficient app. evidence that :<br>• *Correctly brought forward (b/f).*<br>• Opening Balance *don't* contain *misstatements* affecting current period F/S and |

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| | • *Consistent* application of appropriate *A/c. policy*. |
| **Audit Procedure`** | 1. A/c Policies being consistently followed<br>2. Correct balances of various a/c's have been correctly b/f (brought forward)<br>3. Type of preceding period's. Auditors Report – clean / modified<br>4. Nature of opening Balance – risk of misstatement.<br>5. Materiality of opening balance for current period F/S.<br>6. Nature of Op. Bal. & risk of their misstatement in the current period<br>7. The Op. Bal. do not contain misstatements that materially affect the financial statements of the current period. |
| **For Other Assets & Liabilities such as investments and long term debt:** | • The auditor will ordinarily examine the records underlying ht opening balances or<br>• The auditor may obtain confirmation of opening balances from third parties. |

**F/S for preceding period**

***Audited by some other Auditor***

Sufficient Appropriate evidence (for Op. BAL.)
By having audited F/S

Or

Generally reliance
On them

During C.Y. audit, indication of Misstatement in Opening balance
↓
Extended procedures

***Not Audited***

Extended Procedure
(i) **CA & CL:** Audit Evidence as Part of audit procedure during current year.
(ii) **Others:** may check records underlying op. balance or seek external confirmations.

**Audit Reporting and Conclusions:-**

| S.No. | Type of problem with Opening Balances | Opinion to be framed in Audit Report |
|---|---|---|
| a) | Unable to obtain sufficient audit evidence | Qualified / Disclaimer of opinion |
| b) | Material misstatements that affect the current period financial statements | Qualified / Adverse opinion |