A COMPLETE GUIDE FOR

ADVANCED AUDITING

(CA FINAL)

Applicable for CA Final Nov., 2015 Exams onwards

Short Notes for Quick Revision

CA is now Easy with Easy Ca™

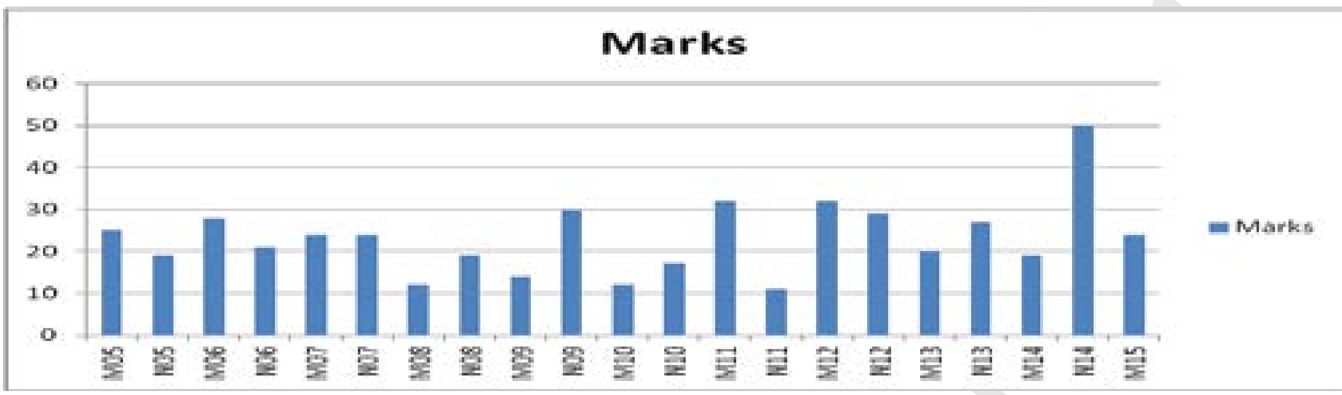
2nd Edition

Advanced Auditing and Professional Ethics

It Covers
- ICAI Study Material
- ICAI Practice Manual
- Solved Question Papers of Last 35 Exams & Practice Manual
- Upto date Amendments Including CARO 2015 & Format of New Audit Report Under Companies Act, 2013.

CA Sumit Aggarwal

1A AUDITING AND ASSURANCE STANDARDS



SA No.	Title of the Standard	Page
1-99	Standards on Qualitiy Control (SQCs)	
SQC 1	Quality Control for firms that Perform Audits and Reviews of Historical Financial Information and Other Assurance and Related Services Engagements. (w.e.f. Ist April' 2009)	1.3
200-299	**General Principles and Responsibilities**	
SA 200	Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing (w.e.f. 1st April' 2010)	1.5
SA 210	Agreeing the Terms of Audit Engagements (w.e.f. 1st April' 2010)	1.9
SA 220	Quality Control for an Audit of Financial Statements (w.e.f. 1st April' 2010)	1.13
SA 230	Audit Documentation (w.e.f. 1st April' 2009)	1.14
SA 240	The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements (w.e.f. 1st April' 2009)	1.16
SA 250	Consideration of Laws and Regulations in an Audit of Financial Statements (w.e.f. 1st April' 2009)	1.23
SA 260	Communication with Those Charged with Governance (w.e.f. 1st April' 2009)	1.27
SA 265	Communicating Deficiencies in Internal Control to Those Charged With Governance and Management (w.e.f. 1st April' 2010)	1.30
SA 299	Responsibility of Joint Auditors (w.e.f. Ist April' 1996)	1.31
300-499	**Risk assessment and response to assessed risks**	
SA 300	Planning an Audit of Financial Statements (w.e.f. 1st April' 2008)	1.34
SA 315	Identifying and Assessing the Risk of Material Misstatement through Understanding the Entity and Its Environment and Internal Controls (w.e.f. 1st April' 2008)	1.35
SA 320	Materiality in Planning and Performing an Audit (w.e.f. 1st April' 2010)	1.41
SA 330	The Auditor's Responses to Assessed Risks (w.e.f. 1st April' 2008)	1.43
SA 402	Audit Considerations Relating to an Entity Using a Service Organisation (w.e.f. 1st April' 2010)	1.46
SA 450	Evaluation of Misstatements Identified During the Audit (w.e.f. 1st April' 2010)	1.49
500 - 599	**Audit Evidence**	
SA 500	Audit Evidence (w.e.f. 1st April' 2009)	1.52
SA 501	Audit Evidence—Specific Considerations for Selected Items (w.e.f. 1st April' 2010)	1.53

	General Clarification	
	General Clarification (GC)-AASB/2/2004 on SA 210 (Refer SA 210)	
	General Clarification (GC)-AASB/1/2002 on SA 620 (Refer SA 620)	

SQC 1	QUALITY CONTROL FOR FIRMS THAT PERFORM AUDITS AND REVIEWS OF HISTORICAL FINANCIAL INFORMATION AND OTHER ASSURANCE AND RELATED SERVICES ENGAGEMENTS. (W.E.F. IST APRIL' 2009)

1. **Introduction:** The objective of the SQC is to implement quality control procedures at the firm level that provide reasonable assurance that:
   - The firm performs engagements in accordance with professional standards and regulatory and legal requirements, and
   - Enable the firm to issue reports that are appropriate in the circumstances.

2. **Element of Quality Control:** The firms system of quality control should include policies and procedures w.r.t. following:
   - Leadership responsibilities for quality within the firm
   - Ethical requirements
   - Independence
   - Acceptance & continuance of client relationship & specified engagements
   - Human resources
   - Engagement performance
   - Monitoring

2.1. **Leadership Responsibilities for Quality of an audit:** The engagement partner should take responsibility for the overall quality on each audit engagement to which that partner is assigned. Engagement team should have appropriate competence and capabilities to perform the audit engagement in accordance to the professional standards and regulatory and legal requirements.

2.2. **Ethical Requirements:** The firm should establish policies & Procedures to ensure compliance with relevant ethical requirements which include:
   - Integrity
   - Objectivity
   - Professional competence & due care
   - Confidentiality
   - Professional behavior

2.3. **Independence:** Firm should establish policies and procedures designed to provide it with reasonable assurance that the firm, its personnel and where applicable, other subject to independence requirements, maintain independence where required. For that purpose:
   - Firm should communicate Independence requirements to personnel.
   - Identify circumstances that create threats to Independence.
   - Take appropriate action to eliminate those threats or reduce them to an acceptable level or if considered appropriate, to withdraw from engagements.
   - At least annually, firm should obtain written confirmation of compliance with independence from relevant firm personnel.
   - For listed entity, audit engagement partner should be rotated after pre-defined period (maximum 7 Years).
   - For all audit or attestation engagements where regulatory or other authorities require the rotation of personnel after a specified period, the firm's policies and procedures should address these requirements.

2.4 **Acceptance and Continuance of Client Relationship and Specified Engagements:**
   - Firm should ensure that it will undertake / continue relationships only where it:
     ◊ Has considered integrity of client.
     ◊ Is competent to perform the engagement.

- ◊ Can comply with legal and ethical requirements
- When issues have been identified, and the firm has decided to accept or continue the engagement, the firm should document how the issues were resolved.
- After taking up work, if firm obtains information that would have caused it to decline an engagement, if information had been available earlier, then consider:
  - ◊ Communicating it to appointing authority & regulatory authority; &
  - ◊ Possibility of withdrawing from the engagement or from both the engagement & client relationship.

2.5. Human Resources:

- Firm should establish policies & Procedures which provide a reasonable assurance that it has sufficient personnel (capable, competent & committed) to perform its engagement as per professional standard & regulatory requirements & to issue appropriate reports.
- Firm should assign appropriate staff to perform engagements.

2.6. Engagement Performance - Consultation: Consultation includes discussion, at the appropriate level, with individuals within or outside the firm who have relevant specialized expertise. Firm should establish policies and procedures designed to provide it with reasonable assurance that:

- Appropriate consultation takes place on different matters
- The nature and scope of such consultations are documented; and
- The conclusions resulting from such consultations are documented and implemented.

2.7 Monitoring:

- The firm should establish policies and procedures designed to provide it with reasonable assurance that the policies and procedures related to the system of QC is adequate, relevant, operating effectively and complied with in practice. This will includes ongoing evaluation of firms system of QC including a periodic inspection of completed engagements.
- The firm should evaluate the effect of deficiencies noted as a result of monitoring process and should determine whether they are either:
- Instances, that may not indicate insufficiency of firm Q.C
- Systematic, repetitive or other significant deficiencies requiring prompt corrective action.
- Firm should also communicate to relevant engagement partner, deficiencies noted and recommendations for appropriate remedial action.
- The Firm should also ensure proper dealing with complaints & Allegations about non-compliance with legal or Professional standards & firm's system of Q.C.

3. Difference of Opinion: The firm should establish policies and procedures to resolve difference of opinion within engagement Team, with those consulted & engagement partner & engagement QC reviewer. Conclusions reached should also be documented and implemented. The report should not be issued until the matter is resolved.

4. Engagement Q.C. Review:

- For audits of the financial statements of listed entities, and those other audit engagements, if any, for which the firm has determined that an engagement quality control review is required, the engagement partner shall:
  - ◊ Determine that an engagement quality control reviewer has been appointed;
  - ◊ Discuss the significant matters arising during the audit engagement, with the engagement quality control reviewer;
- The engagement quality control reviewer shall perform an objective evaluation of the significant judgments made by the engagement team, and the conclusions reached in formulating the auditor's report. This evaluation shall involve:
  - ◊ Discussion of significant matters with the engagement partner;
  - ◊ Review of the financial statements and the proposed auditor's report;
  - ◊ Evaluation of the conclusions reached in formulating the auditor's report, and consideration of whether the proposed auditor's report is appropriate.
- For Engagement of Q.C. Review, the firm should establish policies and procedures setting out:
  - ◊ NTE of an engagement quality control review.
  - ◊ Criteria for the eligibility of engagement quality control reviewer; and

◊ Documentation requirements for an engagement quality control review.

5. **Completion of assembly of Final Engagement Files:** The firm should establish policies and procedures for engagement teams to complete the assembly of final engagement files on a timely basis after the engagement reports have been finalized.

6. **Confidentiality, safe custody etc. of Engagement Documentation:** The firm should establish policies and procedures designed to ensure the confidentiality, safe custody, integrity, accessibility and retrievability of engagement documentation. This engagement documentation should also to be retained for sufficient period. (At least for 7 years)

7. **Documentation:** The firm should establish policies and procedures requiring appropriate documentation to provide evidence of the operation of each element of its system of Q.C.

SA 200	OVERALL OBJECTIVES OF THE INDEPENDENT AUDITOR AND THE CONDUCT OF AN AUDIT IN ACCORDANCE WITH STANDARDS ON AUDITING (W.E.F. 1ST APRIL' 2010)

1. **Overall objectives of the Independent Auditor [M93]:** While auditing the financial statements, the overall objectives of the auditor are:
   - To obtain reasonable assurance about whether the financial statements are free from material misstatements thereby enabling the auditor to express an opinion on whether financial statement are prepared as per applicable financial reporting framework; and
   - To report on financial statements and communicate as required by the SAs, in accordance with the auditor's findings.
   - If reasonable assurance cannot be obtained and qualified opinion is insufficient then he should either disclaim the opinion or **withdraw** from engagement, where withdrawal is legally permitted.

2. **Definitions :**

2.1 **Applicable Financial Reporting Framework:** means, framework/law/regulations followed by the management in preparation of financial statements. (Example: Schedule III of the Co. Act, 2013, Accounting Standards etc.)

2.2 **Audit Evidence:** Information used by the auditor in arriving at the conclusions on which the auditor's opinion is based.

2.3 **Professional Judgment:** The applicable of relevant training, knowledge and experience in taking appropriate decisions during audit engagement.

2.4 **Professional Skepticism:** An attitude that includes a questioning mind being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence.

2.5 **Risk of Material Misstatement:** Risk that financial statements are misstated prior to audit. It consists of two components: Inherent risk and control Risk.

2.6 **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. Misstatement can arise from error or fraud.

3. **Reasonable Assurance:** Auditor is required to obtain reasonable assurance as to whether the financial statements are free from material misstatements. However, reasonable assurance is not absolute assurance. This is due to inherent limitations of an audit. Thus, auditor obtains sufficient and appropriate audit evidence to reduce audit risk to an acceptable low level.

4. **Inherent limitations of an Audit [M89 M11]:** Auditor cannot obtain absolute assurance. (Cannot reduce audit risk to Zero). This is due to inherent limitations of an audit due to which auditor obtains persuasive evidence rather than conclusive. It arises from:

4.1 Nature of Financial Reporting:

- Preparation of financial statement involves judgment by mgt. For Example, accounting estimates. Moreover, auditor has to consider whether these estimates appear to be reasonable.
- There may be subjective decisions.
- Evidences w.r.t. such items can only be persuasive.

4.2 Nature of Audit Procedures:

- Mgt. or others may not provide complete information.
- Moreover frauds may involve carefully designed schemes to conceal it. Thus auditor may not detect them.

4.3 Limitations w.r.t. Time and Cost:

- Users expect that the auditor will form an opinion on financial statements within reasonable time and cost.
- Thus auditor resorts to test procedures (not 100% checking).
- Moreover, he directs more efforts to risky areas.

Due to aforesaid inherent limitations, there is unavoidable risk that some material mis-statement may remain undetected.

5. Requirements/ Responsibilities of the Auditor:

5.1 Ethical Requirements: The auditor is subject to following relevant ethical requirements including independence.

- Integrity
- Objectivity
- Professional competence and due care
- Confidentiality and
- Professional behavior
- He is also required to comply with code of ethics issued by ICAI.

5.2 Professional Skepticism: The Auditor shall plan and perform an audit with professional skepticism recognising that the circumstances may exist, that causes the financial statements to be materially mis-stated. He should recognize the conditions indicating possible misstatements. It includes being alert to, for example:-

- Contradictory evidence
- Conditions indicating possible frauds
- Conditions questioning reliability

Moreover, it requires critical assessment of audit evidence gathered. By maintaining professional skepticism, overall risk can be reduced.

5.3 Professional Judgment: The Auditor shall exercise professional judgement in planning and performing an audit of financial statements. Professional judgement depends on facts & circumstances known to the auditor. Professional judgement should also be exercised throughout the Audit. Professional judgement is necessary regarding decisions about:-

- Materiality
- Audit risk
- NTE of audit Procedure
- Sufficiency & appropriateness of audit evidence
- Drawing of conclusions based on the audit evidence obtained.

6. Sufficient & appropriate Audit Evidence and Audit Risk: To obtain reasonable assurance, the auditor shall obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion. Sufficiency is the measure of quantity of audit evidence whereas appropriateness is the measure of quality of audit evidence.

7. Conduct of an Audit in Accordance with SAs: The auditor shall comply with all SAs relevant to the audit. An SA is relevant to the audit when the SA is in effect and the circumstances addressed by the SA exist. The auditor should have an understanding of the entire text of an SA to apply it properly. He should represent compliance with SAs in auditor's report only if he has complied with requirements of all relevant SAs. If he fails to achieve an objective in relevant SAs, in that case, he should consider the need to modify the audit report, or withdraw from the engagement. It is a significant matter requiring documentation as well.

No.	Question Bank	Exam	Marks	Refer Point/ Ans.
1	What are the overall objectives of the Auditor under SA 200?	M93	4	1
2	Discuss the inherent limitations of an audit.	M89 M11	4	4
3	"An auditor is responsible for expressing his opinion on financial statements in statutory audit". Comment.	M95	4	Ans - 1
4	Enumerate (in brief) the basic principles governing an audit.	N03 N05 N06 PM	4	Ans - 2
5	"The auditors need not review accounting policies unless there is a change in the basis of accounting ''.	M00 M08 PM	8	Ans - 3
6	Explain briefly duties and responsibilities of an auditor in case of material misstatement resulting from Management Fraud.	N09 PM	6	Ans - 4

Answer

Ans - 1:

- The primary objective of audit is to enable the auditor to express his opinion on the financial statements prepared within the framework of recognized accounting policies and relevant statutory requirements.
- The opinion that he expresses should be of the "true and fair" view of the financial position and the operational results reflected in the financial statements.
- As per SA 200, auditor can express his opinion on the financial statements only after obtaining reasonable assurance. To obtain reasonable assurance, the auditor shall obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion.

Ans - 2: Basic Principles Governing an Audit:

SA 200 on "Overall objectives of an Independent Auditor and the conduct of an audit in accordance with SAs" issued by the ICAI describes the basic principles which govern the auditor's professional responsibilities and which should be complied with whenever an audit of financial information of any entity is carried out. The basic principles as stated are as under:

- **Integrity, Objectivity and Independence:** The auditor should be honest, straightforward and sincere in his approach to his professional work. He must be fair and must not allow prejudice or bias to override his objectivity. He should maintain an impartial attitude and both be and appear to be free of any interest which might be regarded, whatever its actual effect, as being incompatible with integrity and objectivity.
- **Confidentiality:** The auditor should respect the confidentiality of information acquired in the course of his work and should not disclose any such information to a third party without specific authority or unless there is a legal or professional duty to disclose.
- **Skills and Competence:** The audit should be performed and the report should be prepared with due professional care by persons who have adequate training, experience and competence in auditing.
- **Work Performed by Others:** When the auditor delegates work to assistants or uses work performed by other auditors and experts, he will be entitled to rely on work performed by others provided he exercise adequate skill and care and is not aware of any reasons to believe that he should not have so relied. The auditor should carefully direct supervise and review work delegated to assistants and obtains reasonable assurance that work performed by other auditors or experts is adequate for his purpose since he will continue to be responsible for forming and expressing his opinion on the financial information.
- **Documentation:** The auditor should document matters which are important in providing evidence that the audit was carried in accordance with the basic principles.
- **Planning:** Planning enables the auditor to conduct an effective audit in an efficient and timely manner.

Primarily, planning should be based on the knowledge of the client's business. Plans should be further developed and revised as necessary during the course of the audit.

- **Audit Evidence:** The auditor should obtain sufficient appropriate audit evidence through the performance of compliance and substantive procedures to enable him to draw reasonable conclusions there from on which to base his opinion on the financial information.
- **Accounting System and Internal Control:** The auditor should reasonably assure himself that the accounting system is adequate and that all the accounting information which should be recorded has in fact been recorded and internal controls normally contribute to such assurance.
- **Audit Conclusion and Reporting:** The auditor should review and assess the conclusions drawn from the audit evidence obtained and from his knowledge of business of the entity as the basis for the expression of his opinion on the financial information. This review and assessment involves forming an overall conclusion as to whether:
  - ◊ the financial information has been prepared using acceptable accounting policies which have been consistently applied,
  - ◊ the financial information complies with relevant regulations and statutory requirements,
  - ◊ There is an adequate disclosure of all material matter relevance to the proper presentation of the financial information, subject to statutory requirements, where applicable.

Ans - 3:

The auditor while conducting an audit should critically examine the accounting policies adopted by the client and test them for conformity with the accounting standards and recommendations of the Institute. The Companies Act, 2013 as well as many other statutes requires that the financial statements of an enterprise should give a true and fair view of its financial position and working results. This requirement is implicit even in the absence of a specific statutory provision to this effect. However, what constitutes a 'true and fair' view has not been defined either in the Companies Act, 2013 or in any other statute. The pronouncements of the Institute seek to describe the accounting principles and the methods of applying these principles in the preparation and presentation of financial statements so that they give a true and fair view. The 'Preface to the Statements of Accounting Standards' issued by the Institute in 1979 states as under:

"While discharging their attest function, it will be the duty of the members of the Institute to ensure that the Accounting Standards are implemented in the presentation of financial statements covered by their audit reports. In the event of any deviation from the Standards, it will be also their duty to make adequate disclosures in their reports so that the users of such statements may be aware of such deviations."

In cases where no pronouncement of the Institute exists, the auditor should examine the acceptability of the said accounting policy. The view presented in the financial statements of an enterprise of its state of affairs and of the profit or loss can be significantly affected by the accounting policies followed in the preparation and presentation of the financial statements. The accounting policies followed vary from enterprise to enterprise. Disclosure of significant accounting policies followed is necessary if the view presented is to be properly appreciated. It is also quite clear that there is no single list of accounting policies which are applicable to all circumstances. The differing circumstances in which enterprises operate in a situation of diverse and complex economic activity make alternative accounting principles and methods of applying those principles acceptable. The choice of the appropriate accounting principles and the methods of applying those principles in the specific circumstances of each enterprise calls for considerable judgement by the management of the enterprise. The auditor is further required to determine whether the relevant information is properly disclosed in the financial statements by considering the judgements that management has made in preparing the financial statements; accordingly, the auditor assesses the selection and consistent application of accounting policies, the manner in which the information has been classified, and the adequacy of disclosure.

Thus, the auditor should determine himself as to whether or not the said treatment is consistent with the basic principles of accounting. Therefore, it would not be correct to state that the auditor need not review the accounting policies unless there is a change in the basis of accounting.

Ans - 4:

Misstatement in the financial statements can arise from fraud or error. The term fraud refers to an

'Intentional Act' by one more individuals including management and TCWG. The primary responsibility for the prevention and detection of fraud rests with CWG and the management of the entity.

“SA 200A” indicates that an audit conducted in accordance with the “SA” is designed to provide a reasonable assurance, that the FS taken as a whole are free from any material misstatement, whether caused by error or fraud. Owing to the inherent limitations of an audit, there is some unavoidable risk, that some material misstatements may not be detected, even though the audit is properly planned and performed in accordance with the “SA” generally accepted in India. An audit does not guarantee that all material misstatement will be detected.

Certain levels of management may be in a position to override the control procedures designed to prevent similar frauds by other employees. The auditor's opinion on the FS is based on the concept of obtaining reasonable assurance. Hence, the auditor does not guarantee that material misstatements will be detected.

SA 210 | AGREEING THE TERMS OF AUDIT ENGAGEMENTS (W.E.F. 1ST APRIL' 2010)

1. **Introduction:** This SA is applicable to engagement relating to (a) audit of financial statements; and (b) other services like management consultancy, tax, accountancy etc. The clients and the auditor should agree on the terms of engagement by way of audit engagement letter, to avoid any misunderstanding. Auditor should send audit engagement letter preferably before commencement of engagement.
2. **Preconditions for an Audit:** Before accepting an audit engagement, auditor is required to ensure existence of preconditions. Accordingly, Pre-conditions to be examined are:
   - Determine whether the financial reporting framework to be applied in the preparation of the financial statements is acceptable; and
   - Obtain the agreement of management that it acknowledges and understands its responsibilities for followings:
     - ◊ The preparation of the F.S. in accordance with the applicable FRF.
     - ◊ Exercising necessary internal control to enable the preparation of F.S. that are free from material misstatement, whether due to fraud or error.
     - ◊ To provide the auditor with (a) Access to all relevant information such as records, documentation and other matters; (b) Additional information that the auditor may request from management for the purpose of the audit; and (c) Unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.
3. **Limitation on Scope prior to Audit Engagement Acceptance:** If management or TCWG impose a limitation on the scope of the auditor’s work, and auditor believes that such limitation will result in the auditor disclaiming an opinion on the FSs, the auditor should not accept such a limited engagement as audit engagement, unless required by law or regulation to do so.
4. **Principal contents of Audit Engagement Letter:**

4.1 Following are the mandatory items to be included in Audit Engagement Letter:
- The Objective and scope of the audit
- The responsibilities of the auditor
- The responsibilities of the management
- Identification of the applicable financial reporting framework for the preparation of the financial statements
- Reference to the expected form and content of any reports to be issued by the auditor and a statement that there may be circumstances in which a report may differ from its expected form and content.

4.2 Followings items are optional to be included in Audit Engagement Letter, wherever relevant:
- The fact that because of the inherent limitations of an audit, together with the inherent limitations of internal control, there is an unavoidable risk that some material misstatements may not be detected, even though the audit is properly planned and performed in accordance with SAs.
- The expectation that management will provide written representations.

- The agreement of management to make available to the auditor draft financial statements and any accompanying other information till time to allow the auditor to complete the audit in accordance with the proposed timetable.
- The agreement of management to inform the auditor of facts that may affect the financial statements, of which management may become aware during the period from the date of the auditor's report to the date the financial statements are issued.
- The basis on which fees are computed and any billing arrangements.
- A request for management to acknowledge receipt of the audit engagement letter and to agree to the terms of the engagement outlined therein.
- The fact that the audit process may be subjected to a peer review under the Chartered Accountants Act, 1949.
- Arrangements concerning the involvement of other auditors and experts in some aspects of the audit.
- Arrangements concerning the involvement of internal auditors and other staff of the entity.
- Any restriction of the auditor's liability when such possibility exists.
- A reference to any further agreements between the auditor and the entity.
- Any obligations to provide audit working papers to other parties.

5. **Recurring Audits [M13]:** The auditor may decide not to send a new audit engagement letter or other written agreement each period. However, the following factors may make it appropriate to revise the terms of the audit engagement or to remind the entity of existing terms:
   - Any indication that the entity misunderstands the objective and scope of the audit.
   - Any revised or special terms of the audit engagement.
   - A recent change of senior management.
   - A significant change in ownership.
   - A significant change in nature or size of the entity's business.
   - A change in legal or regulatory requirements.
   - A change in the financial reporting framework adopted in the preparation of the financial statements.
   - A change in other reporting requirements.

6. **Acceptance of change in Engagement Terms:**
   - The auditor should not agree to a change in the terms of the audit engagement, where there is no reasonable justification for doing so.
   - Before agreeing, to change, he should also consider, any legal or contractual implications of the change.
   - If the auditor is not agree with changed terms of the audit engagement & client doesn't permit him to continue with original audit engagement, then the auditor should Withdraw from the audit engagement and consider any obligation to report the circumstances to other parties such as those charged with governance, owners or regulators.

7. **Additional Consideration**

7.1 **Financial Reporting Standards (FRS) Supplemented by Law or Regulation:** If FRS established by an authorized or recognized standards setting organization are supplemented by law or regulation, the auditor should determine whether there are any conflicts between the FRS and the additional requirements. If such conflicts exist, the auditor should discuss with management the nature of the additional requirements and shall agree whether:

- The additional requirements can be met through additional disclosures in the financial statements; or
- The description of the applicable financial reporting framework in the financial statements can be amended accordingly.

If neither of the above actions is possible, the auditor should determine whether it will be necessary to modify the auditor's opinion in accordance with SA 705 (Revised).

7.2 **Financial Reporting Framework prescribed by Law or Regulation:** If the auditor has determined that the financial reporting framework prescribed by law or regulation would be unacceptable but for the fact that it is prescribed by law or regulation. Auditor shall accept the audit engagement only if the following conditions are present:

- Management agrees to provide additional disclosures in the financial statements required to avoid the financial statements being misleading, and
- It is recognized in the terms of the audit engagement that:
  - ◊ The auditor's report on the financial statements will incorporate an Emphasis of Matter paragraph, drawing users' attention to the additional disclosures, in accordance with SA 706(Revised), and
  - ◊ Unless the auditor is required by law or regulation to express the auditor's opinion on the financial statements by using the phrases "present fairly, in all material respects", or "give a true and fair view" in accordance with the applicable financial reporting framework, the auditor's opinion on the financial statements will not include such phrases.

If the conditions outlined above are not present and the auditor is required by law or regulation to undertake the audit engagement, the auditor shall:

- Evaluate the effect of the misleading nature of the financial statements on the auditor's report; and
- Include appropriate reference to this matter in the terms of the audit engagement.

7.3. Auditor's Report Prescribed by Law or Regulation: Some times, the law or regulation applicable to the entity prescribed the layout or wording of the auditor's report in a form or in terms that are significantly differ from the requirement of SAs. In these circumstances, the auditor should evaluate:

- Whether, users might misunderstand the assurance obtained from the audit of the financial statements and, if so,
- Whether, additional explanation in the auditor's report can mitigate possible misunderstanding.

If the auditor concludes that additional explanation in the auditor's report can't mitigate possible misunderstanding, the auditor should not accept the audit engagement, unless required by law or regulation to do so.

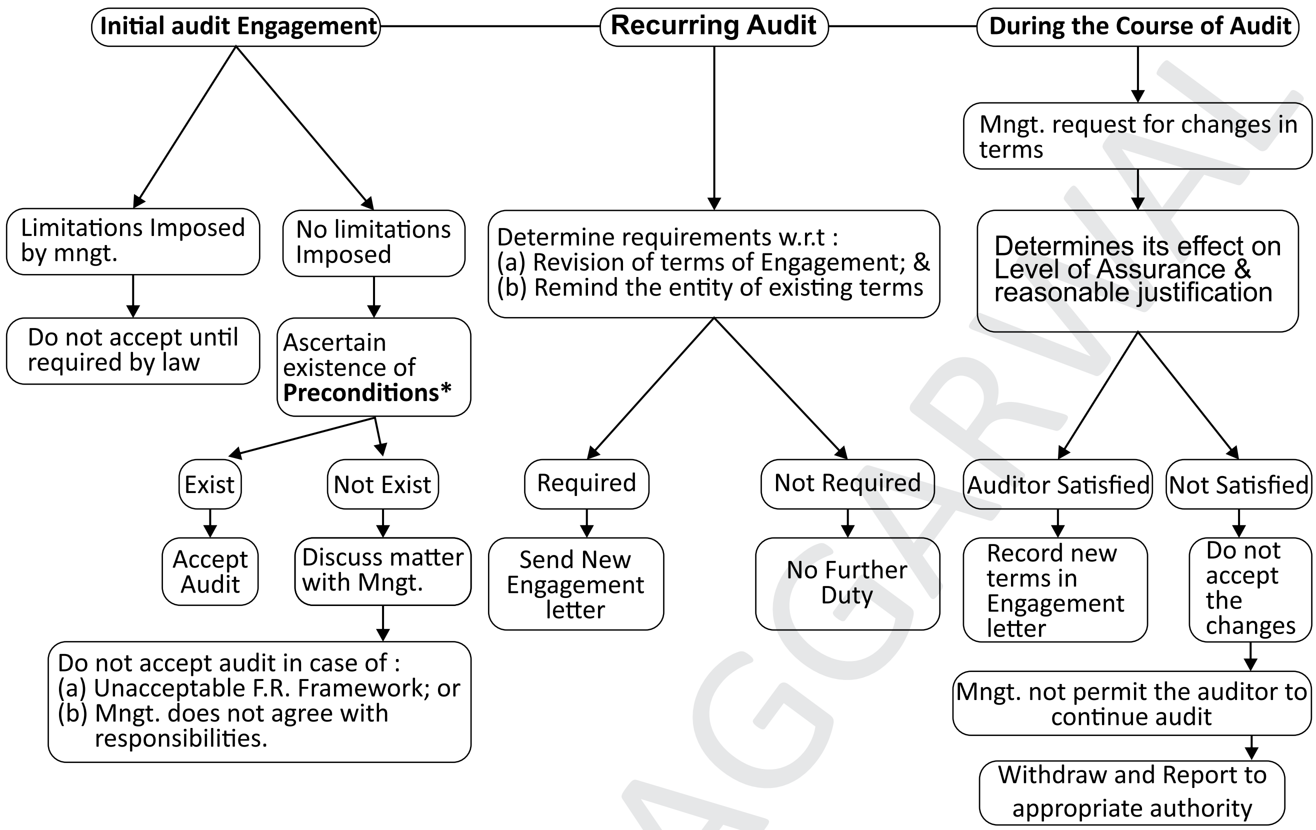
An audit conducted in accordance with law or regulation does not comply with SAs. Accordingly, the auditor should not include any reference within the auditor's report to the audit having been conducted in accordance with SAs.

8. GENERAL CLARIFICATION (GC) – AASB/2/2004 ON SA 210

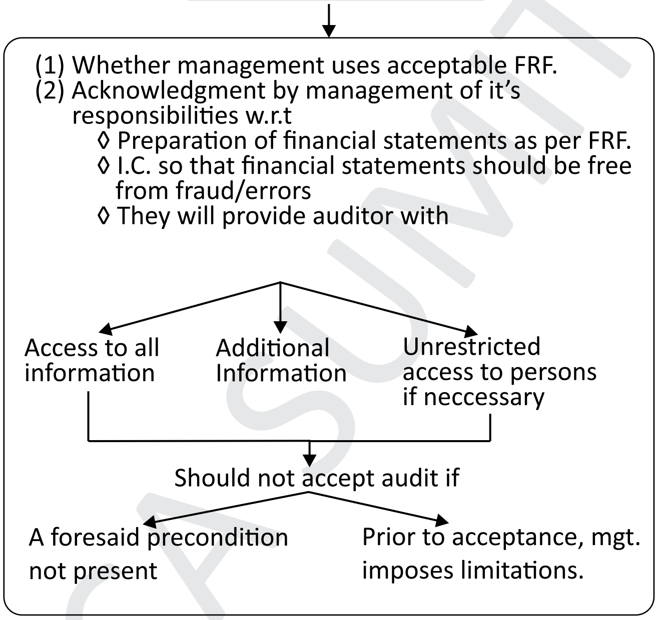
- Whether it is necessary that the engagement letter issued by the auditor should be acknowledged by addressee and returned to the auditor to indicate that the client's understanding of the terms of the engagement is in accordance with SA 210.
- As prescribed in SA 210, the objective and scope of an audit and the auditor's obligations are, normally, laid down in the ***applicable statute or regulations and the pronouncements of the ICAI,*** the audit engagement letters would be informative for the clients."
- From the above it is clear that the basic purpose of issuing an engagement letter is that the auditor and the client should agree on the terms of the engagement.
- The auditor and the client are normally considered to be agreeing on the terms of the engagement ***if the objective and scope of an audit and the auditor's obligations are laid down in the statute or regulations governing the engagement.*** Examples of such engagements include audit u/s 143 of the Companies Act, 2013, audit of public sector banks, etc. In such cases, it is not necessary that the engagement letter sent by the auditor in accordance SA 210 is acknowledged by the addressee and returned to the auditor.
- It shall be sufficient compliance with the requirements related to sending the audit engagement letter, if an engagement letter is appropriately delivered to the client and the auditor retains the evidence for such delivery. In such cases, the audit engagement letters would be informative for the clients.
- If, however, the client seeks any further explanations or clarification in regard to any terms, conditions or other contents of the engagement letter issued, it might indicate that there exists a difference in understanding of the terms of audit engagement either on the part of the client or on the part of the auditor. In such cases, the auditor should take necessary steps to resolve the issues.
- There may be certain engagements where the objective and scope of the engagement and the auditor's obligations are not laid down in the applicable statute or regulations. In such situations, the auditor should request the client that a copy of the engagement letter be acknowledged by the addressee and returned to the auditor to establish that (a) the client's understanding of the arrangements for the engagement is in accordance with the engagement letter issued by the auditor; and (b) that the auditor has complied with the requirements of the standard in so far as they are related to sending the audit engagement letter.

9. Format of Audit Engagement Letter [N07]: Refer Chapter 24

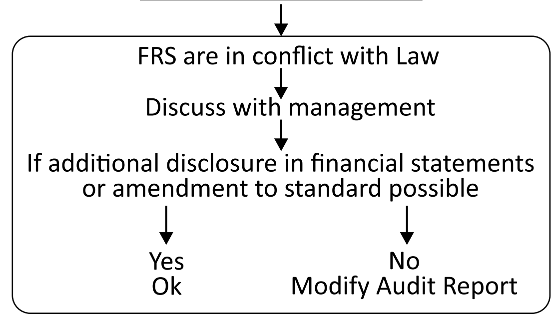
Summary SA 210



*Preconditions of an Audit



Additional Consideration:



No.	Question Bank	Exam	Marks	Refer Point/ Ans.
1	R & Co, a firm of Chartered Accountants have not revised the terms of engagements and obtained confirmation from the clients, for last 5 years despite changes in business and professional environment. Please elucidate the circumstances that may warrant the revision in terms of engagement.	M13 PM	4	5
2	M/s. PQR & Company, Chartered Accountants have been appointed Statutory Auditors of a listed Company for the year ended 31st March, 2008. Draft an appropriate engagement letter to be sent to the Board of Directors for the same.	N07 PM	8	9

SA 220 QUALITY CONTROL FOR AN AUDIT OF FINANCIAL STATEMENTS (W.E.F. 1ST APRIL' 2010)

1. **Objective:** The objective of the auditor is to implement quality control procedures at the engagement level that provide the auditor with reasonable assurance that:
   - The audit complies with professional standards and regulatory and legal requirement; and
   - The auditor's report issued is appropriate in the circumstances.
2. **Responsibility of the Engagement Partner:** To ensure quality control for an audit of financial statements for particular audit engagement, the engagement partner should follow the following requirements:
   - **Leadership Responsibilities:** The engagement partner should take responsibility for the overall quality on each audit engagement to which that partner is assigned.
   - **Ethical Requirement:** Member of the engagement team should comply with relevant ethical requirements.
   - **Independence:** The engagement partner should form a conclusion on compliance with independence requirements.
   - **Acceptance and Continuation of Client Relationship and Audit Engagement:** The engagement partner shall be satisfied that appropriate procedures regarding the acceptance and continuance of client relationship and audit engagements have been followed.
   - **Assignment of Engagement Teams:** The engagement partner should satisfied himself that engagement team have the appropriate competence and capabilities to
     - ◊ Perform the audit engagement in accordance with professional standards and regulatory and legal requirements, and
     - ◊ Enable an auditor's report that is appropriate in the circumstances to be issued.
   - **Engagement Performance:** The engagement partner should take responsibility for the direction, supervision and performance of the audit engagement team and should satisfy that sufficient appropriate audit evidence has been obtained to support the conclusions and the auditor's report.
   - **Consultation:** The engagement partner should take responsibility for the engagement team that they are taking appropriate consultation for difficult matters.
   - **Difference of Opinion:** If difference of opinion arises, the engagement team should follow the firm's policies and procedures for dealing with and resolving differences of opinion.
3. **Engagement Quality Control Review:** For audits of financial statements of listed entities and those other audit engagement for which the engagement quality control reviews is enquired, the engagement partner should:
   - Determine that an engagement quality control reviewer has been appointed; and
   - Discuss significant matters arising during audit engaement with the engagement quality control reviewer.

   The Engagement Quality Control Reviewer should evaluate the following:
   - Discussion of significant matters with the engagement partner.
   - Review of the financial statements and the proposed auditor's report.
   - Review of selected audit documentation; and
   - Conclusion reached in formulating the auditor's report and consideration of whether the proposed

auditor's report is appropriate.

4. **Monitoring:** An effective system of quality control includes a monitoring process designed to provide the firm with reasonable assurance that its policies and procedures relating to the system of quality control are relevant, adequate and operating effectively.

5. **Documentation:**

5.1 The Auditor shall document:
- Issue identified w.r.t. compliance with relevant ethical requirements and how they were resolved.
- Conclusions on compliance with independence requirements that apply to the audit engagement, and any relevant discussions with the firm that support these conclusions.
- Conclusions reached regarding the acceptance and continuance of client relationships and audit engagements.
- The nature and scope of, audit conclusions resulting from, consultations undertaken during the course of the audit engagement.

5.2 The Engagement Quality Control Reviewer shall document, for the Audit Engagement reviewed that:
- The procedures for engagement quality control review have been performed.
- The engagement quality control review has been completed on or before the date of the auditor's reports.
- The reviewer is not aware of any unresolved matters.

SA 230	AUDIT DOCUMENTATION (W.E.F. 1ST APRIL' 2009)

1. **Scope of this SA:** This SA deal with auditor's responsibility to prepare audit documentation for an audit of financial statements. The specific documentation requirements of other SAs do not limit the application of this SA. Laws or regulations may establish additional documentation requirements.

2. **Nature and Purpose of Audit Documentation:** Audit documentation refers to the working papers prepared or obtained and retained by the auditors for his audit work. Audit documentation serves the following purpose:
   - Evidence that support the auditor opinion in his audit report; and
   - Evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements.

   Audit documentation serves a number of additional purposes including the following:
   - Assisting the engagement team to plan and perform the audit.
   - Assisting members of the engagement team responsible for supervision to direct and supervise the audit work.
   - Enabling the engagement team to be accountable for its work.
   - Retaining a record of matters of continuing significance to future audits.
   - Enabling the conduct of quality control reviews and inspections in accordance with SQC 1.
   - Enabling the conduct of external inspection in accordance with applicable legal, regulatory or other requirements.

3. **Experienced Auditor:** An individual (whether internal or external to the firm) who has practical audit experience, and a reasonable understanding of:
   - Audit processes
   - SAs and applicable legal and regulatory requirements
   - The business environment in which the entity operates; and
   - Auditing and financial reporting issues relevant to the entity's industry.

4. **Form, Content and Extent of Audit Documentation:** The auditor should prepare audit documentation that is sufficient to enable an experienced auditor having no previous connection with the audit to understand:-
   - The nature, timing and extent of the audit procedures performed to comply with the SA, and applicable legal and regulatory requirements.
   - The results of the audit procedures performed, and the audit evidence obtained; and

- Significant matters arising during the audit and the conclusions reached thereon and significant professional judgments made in reaching those conclusion.

If the auditor identified information that is inconsistent with the auditor's final conclusion regarding significant matter, the auditor should document how the auditor addressed the inconsistency.

The auditor should document discussions of significant matters with management, including the nature of discussion and when and with whom the discussions took place.

5. **Factor Governing Form & Content of Working Papers:** The form, content and Extent of audit documentation depend on factors such as:-
   - The size and complexity of the entity.
   - The nature of the audit procedure to be performed.
   - The identified risk of material misstatement.
   - The significance of the audit evidence obtained.
   - The nature and extent of exceptions identified.
   - The audit methodology and tool used.

6. **Departure from a Relevant Requirement:** If, in exceptional circumstances, the auditor departs from a relevant requirement in a SA, the auditor should document the reasons for the departure and alternative procedures performed.

7. **Matters Arising after the Date of the Auditor's Report:** If, it exceptional circumstances, the auditor performs new or additional audit procedures or draws new conclusions after the date of the auditor's report, the auditor should document:
   - The circumstances encountered.
   - The new or additional audit procedures performed, audit evidence obtained, and conclusions reached, and their effect on the auditor's report; and
   - When and by whom the resulting changes to audit documentation were made and reviewed.

8. **Assembly of the Final Audit File:**
   - The auditor should assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis after the date of the auditor's report. (SQC -1: Time limit 60 days after the date of the auditor's report)
   - After the assembly, the auditor should not delete audit documentation of any nature before the end of its retention period. (SQC-1 : minimum 7 years)
   - In exceptional circumstances, if the auditor finds it is necessary to modify existing audit documentation or add new documentation after the assembly of the final audit file, the auditor should document, the (a) specific reasons for making such modification/addition; and (b) when and by whom they were made and reviewed.

No.	Question Bank	Exam	Marks	Refer Point/ Ans.
1	As an auditor how would you deal with the following: The statutory auditor of the holding company demands for the working paper of the auditors of the subsidiary company, of which you are the auditor?	Case Study		Ans - 1

Answer

Ans- 1:

As per SA 230, "Audit Documentation" working papers are the property of the auditor. The auditor may, at his discretion, make portion of or extracts of his working papers available to his client.

SA 600 "Using the Work of Another Auditors" also states that an auditor should respect the confidentiality of information acquired during the course of his audit work and should not disclose such information unless there is a legal or professional duty to disclose.

As per ICAI Guidelines, statutory auditor of an enterprise do not have right of access to the audit working papers of the branch auditor. An auditor can rely on the work of another auditor, without having any right of access to the audit working papers of other auditor.

Conclusion: Statutory auditor of Holding company cannot have access to audit working papers of the subsidiary company's auditor. He can however, asks the auditor to answer certain questions about the manner in which the audit is conducted and certain other clarifications regarding audit.

SA 240 — THE AUDITOR'S RESPONSIBILITIES RELATING TO FRAUD IN AN AUDIT OF FINANCIAL STATEMENTS (W.E.F. 1ST APRIL' 2009)

1. **Characteristics of Fraud:** Misstatement in the financial statements can arise from either fraud (intentional) or error (unintentional). Fraud refers to intentional misrepresentation of financial information by one or more individuals among employees, management those charged with governance, or third parties. The auditor is concerned with fraud that causes a material misstatement in the financial statements.

2. **Responsibility for the Prevention and Detection of Fraud:** The primary responsibility for the prevention and detection of fraud rests with management and those charged with governance and for this purpose they should implement and continuously operate an adequate system of internal control which may reduce the opportunities for fraud to take place.

3. **Auditor's Responsibilities relating to fraud in an audit of Financial Statements [N09]:**
   - An auditor is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free material misstatement, whether caused by fraud or error.
   - When obtaining reasonable assurance, the auditor is responsible for maintaining an attitude of professional skepticism throughout the audit.
   - As described in SA 200, due to the inherent limitation of an audit, there is an unavoidable risk that some material misstatement of the financial statements will not be detected, even though the audit is properly planned and performed in accordance with the SAs.
   - The risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting one resulting from error. This is because fraud may involve sophisticated and carefully organized schemes designed to conceal it.
   - It is difficult for the auditor to determine whether misstatements in judgment areas such as accounting estimates are caused by fraud or error.
   - The risk of the auditor not detecting a material misstatement resulting from management fraud is greater than for employee fraud because management can easily manipulate accounting records.
   - If conditions cause the auditor to believe that a document may not be authentic or that terms in document have been modified, the auditor shall investigate further.
   - Where responses to inquiries of management or TCWG are inconsistent, the auditor shall investigate the inconsistencies.

4. **Objectives:** The objectives of the auditor are:
   - To identify and assess the risks of material misstatement in the financial statements due to fraud.
   - To obtain sufficient appropriate audit evidence about the assessed risks of material misstatement due to fraud. and
   - To respond appropriately to identified or suspected fraud.

5. **Professional Skepticism:** Professional skepticism means an approach that would ensure that if something is wrong, it is detected. This attitude of auditor helps him in identifying and evaluating
   - Matter that increase the risk of material misstatements resulting from fraud or error,
   - Circumstances that make the auditor to suspect material misstatements, and
   - The question of managements' representations reliability. The auditor is entitled to accept the records and documents as genuine unless, there is some evidence to the contrary.

6. **Discussion with the Audit Team:** The auditor must discuss with the other members of the audit team regarding the possibility and suspicion of material misstatement in the financial statement resulting from fraud or error. This discussion should occur notwithstanding the engagement team member's beliefs that management and those charged with governance are honest and have integrity.

7. **Risk Assessment Procedures and Related Activities:** When performing risk assessment procedures and related activities to obtain an understanding of the entity and its environment, including the entity's internal control, required by SA 315, the auditor should perform the following procedures to obtain information for use in identifying the risks of material misstatement due to fraud:-

7.1 **Enquiring Management and Others within the Entity:** The auditor should enquire the management on the following matters:
- Management understands regarding the accounting and internal control systems to prevent and detect error.
- Awareness of any known fraud by the management.
- Management's process for identifying & responding to the risks of fraud in the entity, including any specific risks of fraud.
- Management's communication, if any, to those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity.
- Management's communication, if any, to employees regarding its views on business practices and ethical behavior.
- For those entities that have an internal audit function, the auditor should make inquiries of internal auditor.

7.2 **Enquiring Those Charged with Governance**
- He should obtain an understanding of how they supervise management's processes.
- The auditor shall ask whether they have knowledge of any fraud affecting the entity.

7.3 **Unusual or Unexpected Relationships Identified:** The auditor should evaluate whether unusual or unexpected relationships identified in performing analytical procedures, may indicate risks for material misstatement due to fraud.

7.4 **Other Information:** The auditor should consider whether other information obtained by the auditor indicates risks of material misstatement due to fraud.

8. **Evaluation of Fraud Risk Factors:** The auditor should evaluate whether the information obtained from the other risk assessment procedures and related activities performed indicates that one or more fraud risk factors are present. However, fraud risk factors may not necessarily indicate the existence of fraud.

9. **Identification and Assessment of the Risks of Material Misstatement Due to Fraud:**
- In accordance with SA 315, the auditor should identify and assess the risks of material misstatement due to fraud at the financial statement level, and at the assertion level for classes of transactions, account balances and disclosures.
- The auditor should, based on a presumption that there are risks of fraud in revenue recognize, evaluate which types of revenue, revenue transactions or assertions give rise to such risks.
- The auditor should treat those assessed risks due to fraud as significant risks and accordingly, to the extent not already done so, the auditor should obtain an understanding of the entity's related controls, including control activities, relevant to such risks.

10. **Auditor Response:**

10.1 **Responses to the Assessed Risks of Material Misstatement Due to Fraud:**
- In accordance with SA 330, the auditor should determine overall responses to address the assessed risks of material misstatement due to fraud at the financial statement level. In determining overall responses, the auditor should:
- Assign and supervise audit team as per their capability;
- Evaluate whether accounting policies adopted by the entity, indicate fraudulent financial reporting, resulting from management's effort to manage earnings; and
- Incorporate surprise element in the selection of the nature, timing and extent of audit procedures.

10.2 **Responses to Assessed Risks of Material Misstatement Due to Fraud at the Assertion Level:** The auditor should design and perform further audit procedures whose nature, timing and extent are responsive to the assessed risks of material misstatement due to fraud at the assertion level.

10.3. **Responses to Risks Related to Management Override of Controls:** Management is in a unique position to perpetrate fraud because of management's ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls. The auditor should design and perform audit procedures in the area relating to (a) Journal Entries (b) Accounting Estimates, and (c) Unusual transactions. The auditor should also determine whether the auditor needs to perform extra audit procedures.

11. **Evaluation of Audit Evidence:**

- The auditor should evaluate whether analytical procedures are consistent with the auditor's understanding of the entity and its environment.
- When the auditor identifies a misstatement, the auditor should evaluate whether such a misstatement is indicative of fraud. If there is such an indication, the auditor should evaluate the implications of the misstatement in relation to other aspects of the audit, particularly the reliability of management representations.
- If the auditor identifies a misstatement, and the auditor has reason to believe that it is or may be the result of fraud and that management is involved, the auditor should re-evaluate the assessment of the risks of material misstatement due to fraud and its resulting impact on the NTE of audit procedures.
- When the auditor confirms that, or is unable to conclude whether, the financial statements are materially misstated as a result of fraud; the auditor should evaluate the implications for the audit.

12 **Auditor Unable to Continue the Engagement [N06]:** If, as a result of a misstatement resulting from fraud or suspected fraud, the auditor encounter exceptional circumstances that bring into question the auditor's ability to continue performing the audit, the auditor shall:

- Determine the professional and legal responsibilities applicable in the circumstances, including whether there is a requirement for the auditor to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities.
- Consider whether, it is appropriate to withdraw from the engagement, where withdrawal from the engagement is legally permitted; and
- If the auditor withdraws:
  - ◊ Discuss with the appropriated level of management and those charged with governance, the auditor's withdrawal from the engagement and the reasons for the same; and
  - ◊ Determine whether there is a professional or legal requirement to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities, the auditor's withdrawal from the engagement and the reasons for the same.

13 **Management Representations:** The auditor should obtain a management representation that:

- They acknowledge their responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud.
- They have disclosed to the auditor the result of its assessment of the risk of fraud.
- They have disclosed to the auditor their knowledge of fraud or suspected fraud affecting the entity involving (a) Management; (b) Employees who have significant roles in internal control; or (c) Others; and
- They have disclosed to the auditor, its knowledge of any allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators or others.

14. **Communications to Management and TCWG:** If the auditor has identified a fraud or has indication of fraud, the auditor should communicate these matters to the appropriate level of management on a timely basis. He should also communicate with TCWG, any other matters related to fraud that are, in the auditor's judgment, relevant to their responsibilities.

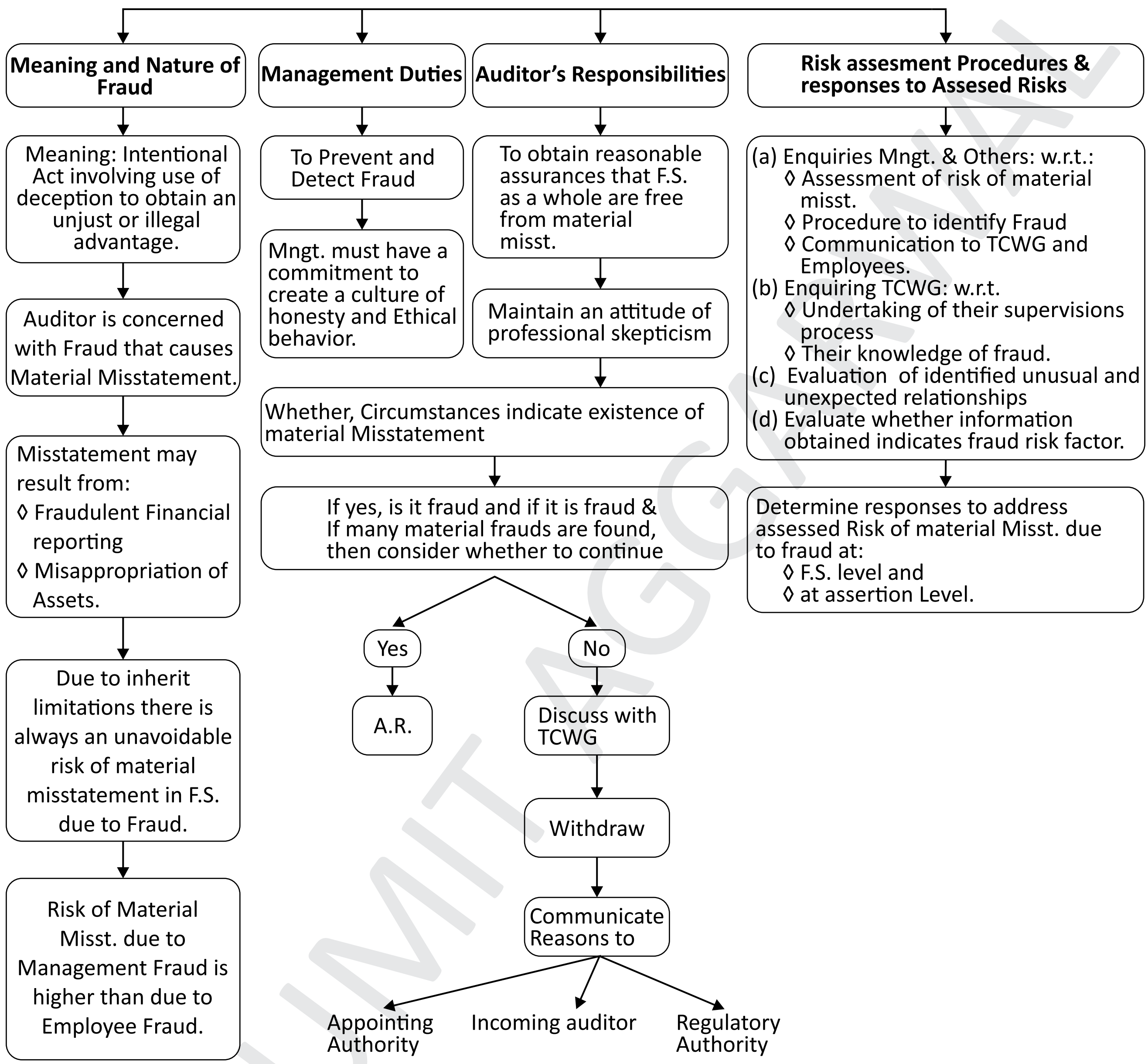
15. **Communications to Regulatory and Enforcement Authorities:** As per SA 200, the auditor should not disclose the client's information to anybody without the client's permission or under any regulatory requirement. But in certain circumstances, the statute, the law or courts may override the duty of confidentiality.

16. **Documentations:** The auditor should document the following in his working papers:

- The risk factors identified at present.
- The auditor response to those risk factors.

- Inquiring of management regarding the risk of fraud in the entity.
- Entity programme for prevention or detection of fraud.

Summary SA 240



No.	Question Bank	Exam	Marks	Refer Point/ Ans.
1	Explain briefly duties and responsibilities of an auditor in case of material misstatement resulting from Management Fraud.	N09 PM	6	3
2	As a Statutory Auditor, how would you deal with a misstatement resulting from fraud or suspected fraud during the audit and conclude that it is not possible to continue the performance of audit.	N06 PM	5	12
3	The teeming and lading fraud was detected and the amount involved was subsequently deposited by the Executive Director of the company and, therefore, need not be reported upon.	N99	4	Ans - 1

4	The Managing Director of 'the Company has committed a "Teeming and Lading" Fraud. The amount involved has been however subsequently after the year end deposited in the company.	N99 M05 PM	4	Ans - 1
5	While conducting statutory Audit of ABC Ltd., you come across IOUs amounting to Rs. 2 crores as against a cash balance shown in books of Rs. 2.10 crores. You also observe that despite similar high balances throughout the year, small amounts of Rs. 50,000 are withdrawn from the bank to meet day-today expenses.	J09 PM	5	Ans - 2
6	In the course of audit of A Ltd. you suspect that the management has indulged in fraudulent financial reporting. State the possible source of such fraudulent financial reporting.	M12 PM	6	Ans - 3
7	M/s Honest Limited has entered into a transaction on 5th March, 2013, near year-end, whereby it has agreed to pay Rs. 5 lakhs per month to Mr. Y as annual retainer-ship fee for "engineering consultation". No amount was actually paid, but Rs. 60 lakhs is provided in books of account as on March 31, 2013. Your inquiry elicits a response that need-based consultation was obtained round the year, but there is no documentary or other evidence of receipt of the service. As the auditor of M/s Honest Limited, what would be your approach?	N13 PM	5	Ans - 4
8	In the course of audit of K Ltd., its auditor Mr. 'N' observed that there was a special audit conducted at the instance of the management on a possible suspicion of a fraud and requested for a copy of the report to enable him to report on the fraud aspects. Despite many reminders it was not provided. In absence of the special audit report, Mr. 'N' insisted that he be provided with at least a written representation in respect of fraud on/by the company. For this request also, the management remained silent. Please guide Mr. 'N'.	M14 PM	5	Ans - 5
9	In the books of accounts of M/s ABC Ltd. huge differences are noticed between the control accounts and subsidiary records. The Chief Accountant informs that this is common due to huge volume of business done by the company during the year. As a Statutory Auditor, how would you deal?	PM		Ans-6

Answer

Ans - 1:

- The Managing Director of the company has committed a "Teeming and Lading" fraud. The fact that the amount involved has been subsequently deposited after the year end is not important because the auditor is required to perform his responsibilities as laid down in SA 240, "The Auditor's responsibilities relating to Fraud in an Audit of Financial Statements".
- First of all, as per SA 240, the auditor needs to perform procedures whether the financial statements are materially misstated. Because an instance of fraud cannot be considered as an isolated occurrence and it becomes important for the auditor to perform audit procedures and revise the audit risk assessment.
- Secondly, the auditor needs to consider the impact of fraud on financial statements and its disclosure in the audit report.
- Thirdly, the auditor should communicate the matter to the Chairman and Board of Directors.
- Finally, in view of the fact that the fraud has been committed at the highest level of management, it affects the reliability of audit evidence previously obtained since there is a genuine doubt about representations of management. Finally, the auditor shall have to report under CARO, 2003 indicating the nature and amount involved in respect of fraud noticed during the year.

Ans - 2:

- According to SA 240, "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements" when, the auditor comes across such circumstances indicating the possible misstatements resulting from the fraud, then the auditor needs to consider the impact of fraud on financial statements and its disclosure in the audit report. In this case, the circumstances indicate that the possible misstatement in financial statements is due to fraud and error and the auditor must investigate further to consider effect on financial statements.

- The Guidance Note on Audit of Cash and Bank balances also mentions that if the entity is maintaining an unduly large balance of cash, he should carry out surprise verification of cash more frequently to ascertain whether it agrees. If cash in hand is not in agreement with the book balance, he should seek explanations and if the same are not satisfactory should state the said fact appropriately in his Audit Report.

Ans - 3:

As per SA 240, "The Auditor's responsibilities relating to Fraud in an Audit of Financial Statements", fraudulent financial reporting involves intentional misstatements or omissions of amounts or disclosures in financial statements to deceive financial statement users. It may be accomplished by manipulation, falsification, or alteration of accounting records or supporting documents from which the financial statements are prepared. or Misrepresentation in, or intentional omission from, the financial statements of events, transactions or other significant information or intentional misstatements involve intentional misapplication of accounting principles relating to measurement, recognition, classification, presentation, or disclosure etc.

It often involves management override of controls, misappropriation of assets etc, that otherwise may appear to be operating effectively. Fraud can be committed by management overriding controls using such techniques as:

- Recording fictitious journal entries, particularly close to the end of an accounting period, to manipulate operating results or achieve other objectives.
- Inappropriately adjusting assumptions and changing judgments used to estimate account balances.
- Omitting, advancing or delaying recognition in the financial statements of events and transactions that have occurred during the reporting period.
- Concealing, or not disclosing, facts that could affect the amounts recorded in the financial statements.
- Engaging in complex transactions that are structured to misrepresent the financial position or financial performance of the entity.
- Altering records and terms related to significant and unusual transactions.
- Embezzling receipts (for example, misappropriating collections on accounts receivable or diverting receipts in respect of written-off accounts to personal bank accounts).
- Stealing physical assets or intellectual property (for example, stealing inventory for personal use or for sale, stealing scrap for resale, colluding with a competitor by disclosing technological data in return for payment).
- Causing an entity to pay for goods and services not received (for example, payments to fictitious vendors, kickbacks paid by vendors to the entity's purchasing agents in return for inflating prices, payments to fictitious employees).
- Using an entity's assets for personal use (for example, using the entity's assets as collateral for a personal loan or a loan to a related party).

Ans - 4:

As per SA 240 on "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements", fraud can be committed by management overriding controls using techniques such as recording fictitious journal entries, particularly close to the end of an accounting period, to manipulate operating results or to achieve other objectives.

Keeping in view the above, it is clear that Company has passed fictitious journal entries close to the end of an accounting period to manipulate the operating results. Also Auditor's enquiry elicited a response that need-based consultation was obtained round the year, but there is no documentary or other evidence of receipt of the service, is not acceptable. Accordingly, the auditor would adopt the following approach:

If, as a result of a misstatement resulting from fraud or suspected fraud, the auditor encounters exceptional circumstances that bring into question the auditor's ability to continue performing the audit, the auditor should:

- Determine the professional and legal responsibilities applicable in the circumstances, including whether there is a requirement for the auditor to report to the person or persons who made the auditor appointment

or, in some cases, to regulatory authorities;
- Consider whether it is appropriate to withdraw from the engagement, where withdrawal is legally permitted; and
- If the auditor withdraws:
    - ◊ Discuss with the appropriate level of management and TCWG, the auditor's withdrawal from the engagement and the reasons for the withdrawal; and
    - ◊ Determine whether there is a professional or legal requirement to report to the person(s) who made the auditor appointment or, in some cases, to regulatory authorities, the auditor's withdrawal from the engagement and the reasons for the withdrawal.

Ans - 5 : Auditors Responsibilities Relating to Fraud

- As per SA 240, "The Auditor's Responsibilities relating to Fraud in an Audit of FS", the primary responsibility for the prevention and detection of fraud rests with both TCWG and management. In addition an auditor conducting an audit in accordance with SAs is responsible for obtaining reasonable assurance that the FS taken as a whole are free from material misstatement, whether caused by fraud or error.
- As per SA 580, "Written Representations (WR)", If management does not provide one or more of the requested WR, the auditor shall discuss the matter with management; re-evaluate the integrity of management and evaluate the effect that this may have on the reliability of representations (oral or written) and audit evidence in general; and take appropriate actions, including determining the possible effect on the opinion in the auditor's report.
- The auditor shall disclaim an opinion on the FS if the auditor concludes that there is sufficient doubt about the integrity of management such that the WR are not reliable; or management does not provide the WR.
- Further the auditor is also required to report as per Paragraph 4 (xxi) of CARO, 2003, if there is any fraud on or by the company has been noticed or reported during the year. If yes, the nature and the amount involved is to be indicated.
- In the given case, in the course of audit of K Ltd., its auditor Mr. N observed that there was a special audit conducted at the instance of the management on a possible suspicion of fraud. Therefore, the auditor requested for special audit report, which was not provided by the management despite of many reminders. Mr. N also insisted for WR in respect of fraud on/by the company. For this request also management remained silent.
- Hence, the fact is required to be reported as per Paragraph 4(xxi) of the CARO, 2003 and the auditor should also disclaim an opinion on the FS.

Ans - 6 :

- The huge differences found between control accounts and subsidiary records in the books of ABC Ltd indicate that there may be material misstatements requiring detailed examination by the auditor to ascertain the cause.
- The contention of Chief Accountant cannot be accepted simply because the company has done huge volume of business.
- Such a phenomenon indicates that recording of transactions is not being done properly or the accounting system in the company which might have several branches spread over the country fails to capture all transactions in time.
- It would also be interesting to see whether it is a recurring phenomenon or such reconciliation could not be done at a subsequent date.
- Having regard to all these circumstances, it appears from the facts of the case that these differences indicate the possibility of some kind of material misstatements.
- As per SA 240, "The Auditor's Responsibilities relating to Fraud in an Audit of Financial Statements", when the auditor identifies a misstatement, the auditor shall evaluate whether such a misstatement is indicative of fraud. If there is such an indication, the auditor shall evaluate the implications of the misstatement in relation to other aspects of the audit, particularly the reliability of management representations, recognizing that an instance of fraud is unlikely to be an isolated occurrence.
- When the auditor confirms that, or is unable to conclude whether, the FSs are materially misstated as a result of fraud the auditor shall evaluate the implications for the audit.

SA 250 CONSIDERATION OF LAWS AND REGULATIONS IN AN AUDIT OF FINANCIAL STATEMENTS (W.E.F. 1ST APRIL' 2009)

1. **Scope of this SA:** This SA deals with the auditor's responsibility to consider laws and regulations when performing an audit of financial statements. This SA does not apply to other engagements in which the auditor is specifically engaged to test and report on non-compliance of specific laws or regulations.

2. **Effect of Laws and Regulation:**
   - The provision of some laws or regulation have a direct impact on the financial statements in that, they determine the reported amounts and disclosures in an entity's financial statements such as tax and labour laws, and
   - Other laws or regulation are to be complied with by management but do not have a direct effect on an entity's financial statements such as compliance with environmental regulations etc.
   - Some entities operate in heavily regulated industries (such as banks and chemical companies).
   - Non-compliance with laws and regulation may result in fines, litigation of other consequences for the entity that may have a material effect on the financial statements.

3. **Responsibility of Management for Compliance with Laws and Regulations:** It is the responsibility of management to ensure that the entity's operations are conducted in accordance with the provisions of laws and regulations. For this purpose management may apply the following procedures:
   - Monitoring legal requirements and ensuring that operating procedures are designed to meet these requirements.
   - Instituting and operating appropriate systems of internal control.
   - Developing, Publishing and following a code of conduct.
   - Ensuring employees are properly trained and understand the code of conduct.
   - Monitoring compliance with the code of conduct and acting appropriately to discipline employees who fail to comply with it.
   - Engaging legal advisors to assist in monitoring legal requirements.
   - Maintaining a register of significant laws and regulations with which the entity has to comply within its particular industry and a record of complaints.

4. **Responsibility of the Auditor:**
   - The requirements in this SA are designed to assist the auditor in identifying material misstatement of the financial statements due to non-compliance with laws and regulations.
   - However, the auditor is not responsible for preventing non compliance and cannot be expected to detect non-compliance with all laws and regulations.
   - "The auditor is responsible for obtaining reasonable assurance that the financial statements, taken as a whole, are free from material misstatement, whether caused by fraud or error." Owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements in the financial statements may not be detected, even though the audit is properly planned and performed in accordance with the SAs.
   - Sometimes the auditor may be specifically required to report, as part of the audit of the financial statements, on whether the entity complies with certain provisions of laws or regulations.

5. **The Auditor's Consideration of Compliance with Laws and Regulations [N14]:**
   - As part of obtaining an understanding of the entity and its environment the auditor should obtain a general understanding of (a) the legal and regulatory framework applicable to the entity and the industry or sector in which the entity operates; and (b) How the entity is complying with that framework.
   - The auditor should obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements.
   - The auditor should perform the following audit procedures to identify instances of non-compliance with other laws and regulations that may have a material effect on the financial statements:
     - ◊ Inquiring of management; and
     - ◊ Inspecting correspondence, if any, with the relevant licensing or regulatory authorities. (e.g. RBI License for NBFC Companies).
   - During the audit, the auditor should remain alert to the possibility that other audit procedures applied

(e.g.; Reading Minutes, Claim & assessment, Account balances or disclosures, Inquiring with management etc.) may bring instances or non-compliance or suspected no-compliance with laws and regulations to the auditor's attention.

- The auditor should obtain written representation that all known instances of non-compliance or suspected non-compliance with laws and regulations have been disclosed to the auditor and the effects of these have been considered while preparing financial statements.
- Thus, the auditor is responsible for obtaining reasonable assurance that the financial statements, taken as a whole, are free from material misstatement, whether caused by fraud or error. In conducting an audit of financial statements, the auditor takes into account the applicable legal and regulatory framework.

6. Indicator of Non-Compliance:

- Investigation by regulatory organizations and government departments.
- Payment of fines or penalties.
- Payments for unspecified services or loan to consultants, related parties, employees or government employees.
- Purchases at prices significantly above or below market price.
- Unusual payments towards legal and retainer ship fees.
- Unusual payments of sales commission or agent fees.
- Unusual payments in cash.
- Unauthorized transactions or improperly recorded transaction.
- Adverse media comment.

7. Audit Procedures When Non-Compliance is Identified or Suspected:

- If the auditor becomes aware of information concerning a instance of non compliance or suspected non-compliance, the auditor should obtain:
  - ◊ An understanding of the nature of the act and the circumstances in which it has occurred; and
  - ◊ Further information to evaluate the possible effect on the financial statements.
- If the auditor suspects that, there may be non-compliance, the auditor should discuss the matter with management and TCWG.
- If management or TCWG do not provide sufficient information, the auditor should consider the need to obtain legal advice.
- If sufficient information about suspected non-compliance cannot be obtained, the auditor should evaluate the effect of the lack of sufficient appropriate audit evidence on the auditor's opinion.
- The auditor should also evaluate the implications of non-compliance in relation to other aspects of the audit, including the auditor's risk assessment and the reliability of written representations, and should take appropriate actions.
- In exceptional cases, the auditor may consider whether, unless prohibited by law or regulations withdrawal from the engagement is necessary when management or TCWG do not take remedial action that the auditor consider appropriate in the circumstances, even when the non-compliance is not material to the financial statements. When deciding whether withdrawal from the engagement is necessary, the auditor may consider seeking legal advice.
- If withdrawal from the engagement is prohibited, the auditor may consider alternative actions, including describing the non-compliance in an Other Matter(s) paragraph in the auditor's report.

8. Reporting Non-Compliance:

8.1 Reporting Non-Compliance to Those Charged with Governance:

- Unless all of TCWG are involved in management of the entity, the auditor should communicate with TCWG, matters involving non compliance with laws and regulations that come to the auditor's attention.
- If, in the auditor's judgment, the non-compliance is believed to be intentional and material, the auditor should communicate the matter to TCWG as soon as practicable.
- If the auditor suspects that management or TCWG are involved in non-compliance, the auditor should communicate the matter to the next higher level of authority at the entity (such as an audit committee or supervisory board). Where no higher authority exists, or if the auditor believes that the communication may not be acted upon, the auditor should consider the need to obtain legal advice.

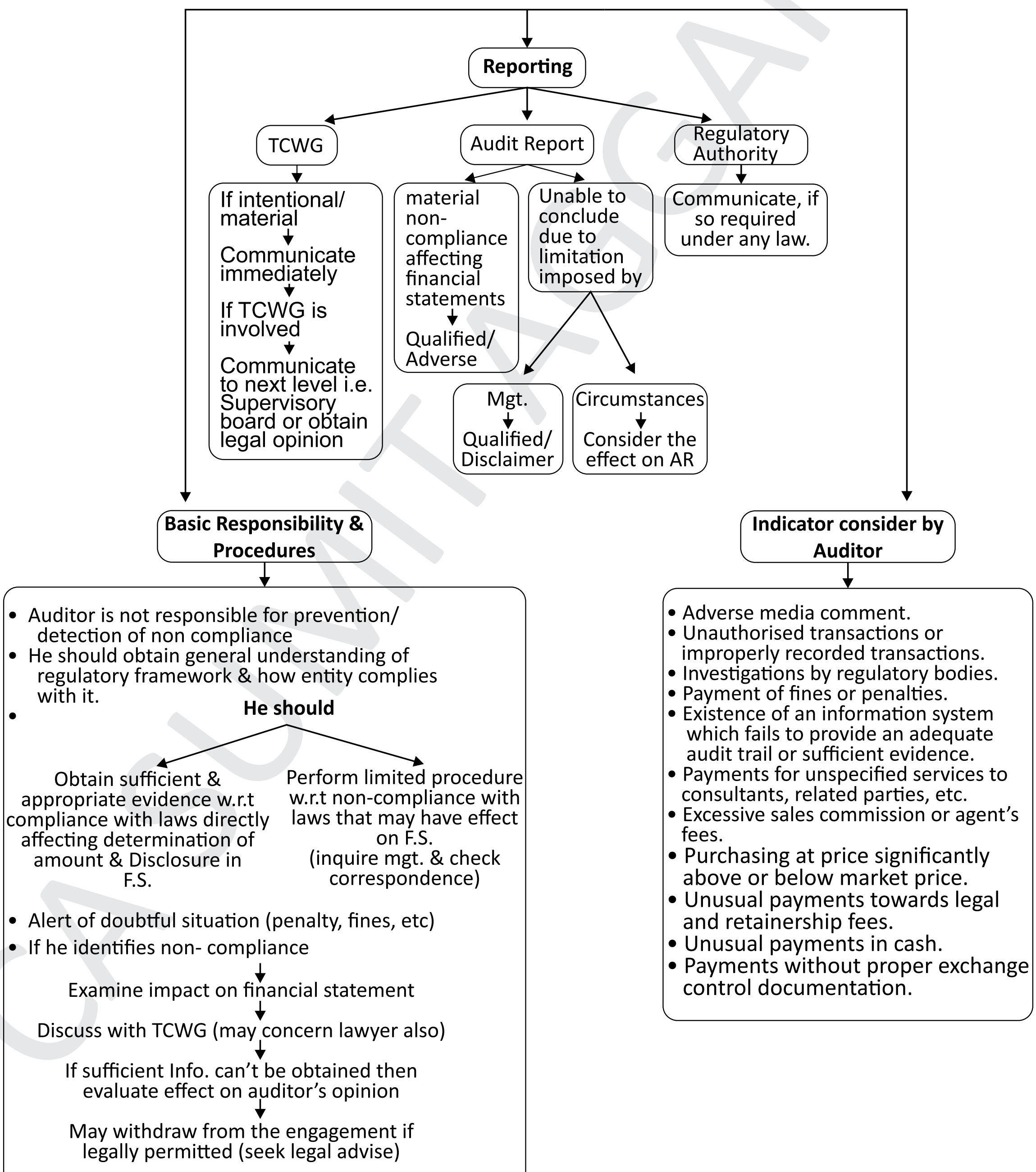
8.2. Reporting Non-Compliance in the Auditor's Report on the Financial Statements:

- If the auditor concludes that the non-compliance has a material effect on the financial statements, and has not been adequately reflected in the financial statements, the auditor should, express a qualified or adverse opinion on the financial statements.
- If the auditor is prevented by management or TCWG from obtaining sufficient appropriate audit evidence, the auditor shall express a qualified opinion or disclaim an opinion on the basis of limitation on the scope of the audit.
- If the auditor is unable to determine whether non-compliance has occurred because of limitation imposed by the circumstances rather than by management or TCWG, the auditor should evaluate the effect on the auditor's opinion in accordance with SA 705.

8.3 **Reporting Non-Compliance to Regulatory and Enforcement Authorities:** If the auditor has identified or suspects non-compliance with laws and regulations, the auditor should determine whether the auditor has a responsibility to report the identified or suspected non-compliance to parties outside the entity.

9. **Documentation:** The auditor should document identified or suspected non-compliance with laws and regulations and the results of discussion with management and those TCWG and other parties outside the entity.

Summary of SA 250



No.	Question Bank	Exam	Marks	Refer Point/ Ans.
1	What are the roles and responsibilities of the statutory auditors in relation to compliance with the laws and regulations by the entity?	N14	5	5
2	While verifying the employee records in a company, it was found that a major portion of the labour employed was child labour. On questioning the management, the auditor was told that it was outside his scope of the financial statement audit to look into the compliance with other laws. Comment.	N05	5	Ans - 1
3	State the reporting responsibility of an auditor in the context of non-compliance of Law and Regulation in an audit of Financial Statement.	N06 PM	8	Ans - 2
4	Big and small Ltd. received a show cause notice December 2013 from the Central Excise department intending to levy a sum of Rs. 25 lakhs. The Company replied to the above notice in January, 2014 contending that it is not liable for the proposed levy. No further action was initiated by the Central Excise department up to the finalization of the audit for the year ended on 31st March, 2014. As the Auditor of the Company, how would you deal with this matter in your report?	N14 PM	3	Ans - 3

Answer

Ans - 1:

- As per SA 250, "Consideration of Laws and Regulations in an Audit of Financial Statements", the auditor shall obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations generally recognised to have a direct effect on the determination of material amounts and disclosures in the financial statements including tax and labor laws.
- Further, non-compliance with other laws and regulations may result in fines, litigation or other consequences for the entity, the costs of which may need to be provided for in the financial statements, but are not considered to have a direct effect on the financial statements.
- In the instant case, major portion of the labour employed in the company was child labour. While questioning by auditor, reply of the management that it was outside his scope of financial audit to look into the compliance with other laws is not acceptable as it may have a material effect on financial statements.
- Thus, auditor should ensure the disclosure of above fact and provision for the cost of fines, litigation or other consequences for the entity. In case if the auditor concludes that non-compliance has a material effect on the financial statements and has not been adequately reflected in the financial statements, the auditor shall express a qualified or adverse opinion on the financial statement.

Ans - 2:

The auditor should as soon as practicable, either communicate with the audit committee, the Board of Directors and senior management or obtain evidence that they are appropriately informed regarding non-compliance that comes to the auditors attention.

- If in the auditor's Judgment, the non compliance is believed to be intentional and / or material, the auditor should communicate the findings without delay.
- If the auditor suspects that members of senior management, including members of the Board of Directors, are involved in non-compliance, the auditor should communicate the matter to the next higher level of authority at the entity, such as, the audit committee or Board of Directors, to the users of the auditor's report or FS.
- If the auditors conclude that the non-compliance has a material effect on the FS and has not been properly reflected in the FS the auditor should express a qualified or an adverse opinion.
- If the auditor is precluded by the entity from obtaining sufficient and appropriate audit evidence to evaluate whether non-compliance is, or is likely to have occurred that have or may have material impact on the financial statements, the auditor should express a qualified opinion or a disclaimer of opinion on

the FS on the basis of a scope limitations..

- If the auditor is unable to determine whether non compliance has occurred because of limitations, imposed by the circumstances rather than by the entity, the auditor should consider the effect on the auditor's report.
- The auditor's duty of confidentiality would ordinarily preclude reporting non compliance to third party. However, in certain circumstances, that duty of confidentiality is overridden by statement, law or by courts of laws.

Ans - 3:

Compliance of Laws and Regulations: As per SA 250 “Consideration of Laws and Regulations in an Audit of Financial Statement”, the auditor shall obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations generally recognised to have a direct effect on the determination of material amounts and disclosures in the financial statements including tax and labour laws.

During the audit, the auditor shall remain alert to the possibility that other audit procedures applied may bring instances of non-compliance or suspected non-compliance with laws and regulations to the auditor’s attention. Then the auditor should discuss the matter with management and, where appropriate, TCWG.

If management or, as appropriate, TCWG do not provide sufficient information that supports that the entity is in compliance with laws and regulations and, in the auditor’s judgment, the effect of the suspected non-compliance may be material to the financial statements, the auditor shall consider the need to obtain legal advice. In case, if the auditor concludes that the non-compliance has a material effect on the FSs, and has not been adequately reflected in the FSs, the auditor shall express a qualified/adverse opinion on the financial statements.

Further, as per AS 29 "Provisions, Contingent liabilities and Contingent Assets", future events that may affect the amount required to settle an obligation should be reflected in provision where there is sufficient objective evidence that the event will occur.

In the given case of Big and Small Ltd., issuance of show cause notice by Excise Department does not tantamount to demand payable by the Company. In so far as the Company has replied to the notice and no further correspondence was received from the Department. This show cause notice may be an alert or indication of non-compliance for the auditor. So auditor need to discuss with management and apply additional procedure. If the auditor concludes that there is non-compliance then provision for the same should be made as per AS 29. If the management does not accept the request, the auditor should qualify the audit report accordingly or vice versa.

SA 260	COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE (W.E.F. 1ST APRIL' 2009)

1. **Scope of this SA:** This SA deal with the auditor’s responsibility to communicate with TCWG in relation to an audit of financial statements. This SA does not establish requirements regarding the auditor’s communication with an entity’s management or owners unless they are also charged with a governance role.
2. **Objective:** The auditor’s objective is to communicate clearly with TCWG in relation to:
   - Their responsibilities for the financial statement audit, and an overview of the planned scope and timing of the audit;
   - Obtain information relevant to the audit;
   - Provide timely observation arising from the audit that are significant and relevant to their responsibility to oversee the financial reporting process; and
   - Promote effective two way communication.
3. **Definitions:**

3.1 Those Charged with Governance (TCWG):

- The person(s) or organization(s) (e.g., a corporate trustee) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity.
- For some entities TCWG may include management personnel, for example, executive members of a governance board of a private or public sector undertaking or an owner-manager.
- In some cases, TCWG are responsible for approving the entity's financial statements (in other cases management has this responsibility).

3.2 Management:

- The person(s) with executive responsibility for the conduct of the entity's operations.
- For some entities, management includes some or all of those charged with governance, for example executive members of a governance board or an owner-manager.
- Management is responsible for the preparation of the financial statements, overseen by TCWG and in some cases management is also responsible for approving the entity's financial statements.

4. Those Charged with Governance:

- The auditor should determine the appropriate person(s) within the entity's governance structure with whom to communicate.
- When the auditor communicates with a subgroup of TCWG, for example, an audit committee, or an individual, the auditor should determine whether he should also need to communicate with the governing body.
- **Governance = Management:** This may applicable in case of small business where a single owner manages the entity and no one else has a governance role. In these cases, if matter required by this SA is communicated with person(s) with management responsibilities and those person(s) also have governance responsibilities; the matters need not be communicated again with those same person(s) in their governance role.
- If appropriate person(s) with, whom to communicate may not be clearly identifiable from the applicable legal framework or other engagement circumstances, (for e.g. family owned entities, some non-profit organizations and some government entities) in such case, the auditor may need to discuss and agree with the engaging party the relevant person(s) with whom to communicate.

5. Matter to be communicated to TCWG:

5.1 Auditor's Responsibilities in relation to the Financial Statement Audit: The auditor should communicate with TCWG that:

- The auditor is responsible for forming and expressing an opinion on the financial statements; and
- The audit of the financial statements does not relieve management or TCWG of their responsibilities.

5.2 The overall Scope and Timing of the Audit: Which includes

- How the auditor proposes to address the significant risks of material misstatements.
- Auditors approach to internal control.
- Application of concept of materiality.

5.3 Significant Findings from the Audit: which includes:

- The auditor's view about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures.
- Significant difficulties/matters, if any, encountered during audit.
- Written representations, the auditor is requesting.

5.4 Auditor's Independence: In the case of listed entities, the auditor should communicate with TCWG "a statement that the engagement team and others in the firm as appropriate, have complied with relevant ethical requirements regarding independence."

6. The Communication Process:

- The auditor should communicate with TCWG the form, timing and expected general content of communications.
- Significant finding from the audit should be communicated in writing.
- Matter regarding auditor's independence should be communicated in writing.
- Communication should be on a timely basis.

- The auditor should evaluate whether the two-way communication has been adequate for the purpose of the audit. If it has not, the auditor should evaluate the effect on the auditor's assessment of the risks of material misstatement and ability to obtain sufficient appropriate audit evidence.

7. Documentation:

- Where the matters required by this SA to be communicated are communicated orally, the auditor should document them, and when and to whom they were communicated.
- Where matters have been communicated in writing, the auditor should retain a copy of the communication as part of the audit documentation.

Summary SA 260

Matter to be communicated to TCWG

- Auditor responsibility in relation to F.S. audit
- The overall scope and timing of the audit.
- Significant finding from audit w.r.t.:
  - ➢A/c Policy
  - ➢A/c Estimate
  - ➢Material weakness in I.C.
  - ➢Matter discuss with mgt.
  - ➢Other significant matter.
- In case of Listed Co., a statement that the engagement team and others in the firm as appropriate have complied with relevant ethical requirements regarding independence.

Communication process

- In writing, when oral communication is not adequate
- On timely basis.

Following communication should be in writing

- Matter of Independence (Listed Co.)
- Significant finding
- Responsibility of mgt. and auditor
- Scope of audit.

No.	Question Bank	Exam	Marks	Refer Point/ Ans.
1	The auditors should communicate audit matters of governance interest arising from the audit of financial statements with those charged with the governance of an entity". Briefly state the matters to be included in such Communication.	N06 PM	8	Ans - 1
2	Compare and explain the following: "Reporting to Shareholders vs. Reporting to those Charged with Governance."	N14	2	Ans - 2

Answer

Ans - 1:

SA 260 deals with communications of audit matters with TCWG. The following are the audit matters of governance interest which are to be communicated.

- The general approach and overall scope of audit including expected limitations.
- The selection of or change in significant accounting policies and practices that have a material effect on

the entity's financial statements.

- The potential effect on the financial statements of any significant risks and exposures.
- Material uncertainties that may cast significant doubt on the entity's ability continue as a going concern.
- Adjustment to financial statements arising out of audit which have a significant effect on the financial statement.
- Disagreement with management on matters which could have significant impact to the financial statements and to audit report.
- Others matters like material weakness in internal control measures, questions on management integrity and fraud involving management.
- Expected modifications to the audit report.
- Other matters agreed in terms of audit engagement.

Ans - 2:

REPORT		
S.No.	**Reporting to Shareholders**	**Reporting to those Charged with Governance**
1	Section 143 of the Co. Act, 2013 deals with the provisions relating to reporting to Shareholders. Thus, it is a Statutory Audit Report which is addressed to the members.	Standard on Auditing 260 deals with the provisions relating to reporting to those Charged with Governance (TCWG).
2	Statutory Audit Report is on true and fair view and as per prescribed Format.	It is a reporting on matters those charged with governance like scope of audit, audit procedures, audit modifications, etc.
3	Statutory Audit Reports are in public domain.	Reporting to TCWG is an internal document i.e. private report.

SA 265 — COMMUNICATING DEFICIENCIES IN INTERNAL CONTROL TO THOSE CHARGED WITH GOVERNANCE AND MANAGEMENT (W.E.F. 1ST APRIL' 2010)

1. **Scope of this SA:** This SA deals with the auditor's responsibility to communicate appropriately to TCWG and management, deficiencies in internal control that, the auditor has identified in an audit of financial statements.

2. **Definitions:**

2.1 **Deficiency in Internal Control:** This exists when:

- A control is designed, implemented or operated in such a way that it is unable to prevent, or detect and correct, misstatement in the financial statements on a timely basis; or
- A control necessary to prevent, or detect and correct, misstatements in the financial statements on a timely basis is missing.

2.2 **Significant Deficiency in Internal Control:** A deficiency or combination of deficiencies in internal control that, in the auditor's professional judgment, is of sufficient importance to merit the attention of TCWG.

3. **Requirements:**

- The auditor should determine whether, on the basis of the audit work performed, the auditor has identified one or more deficiencies in internal control.
- If the auditor has identified one or more deficiencies in internal control, the auditor should determine, whether individually or in combination, they constitute significant deficiencies.
- The auditor should communicate in writing significant deficiencies in internal control identified during the audit to TCWG and management on a timely basis.
- The auditor should also communicate to management, other deficiencies in internal control identified during the audit that have not been communicated to management by other parties and that, in the

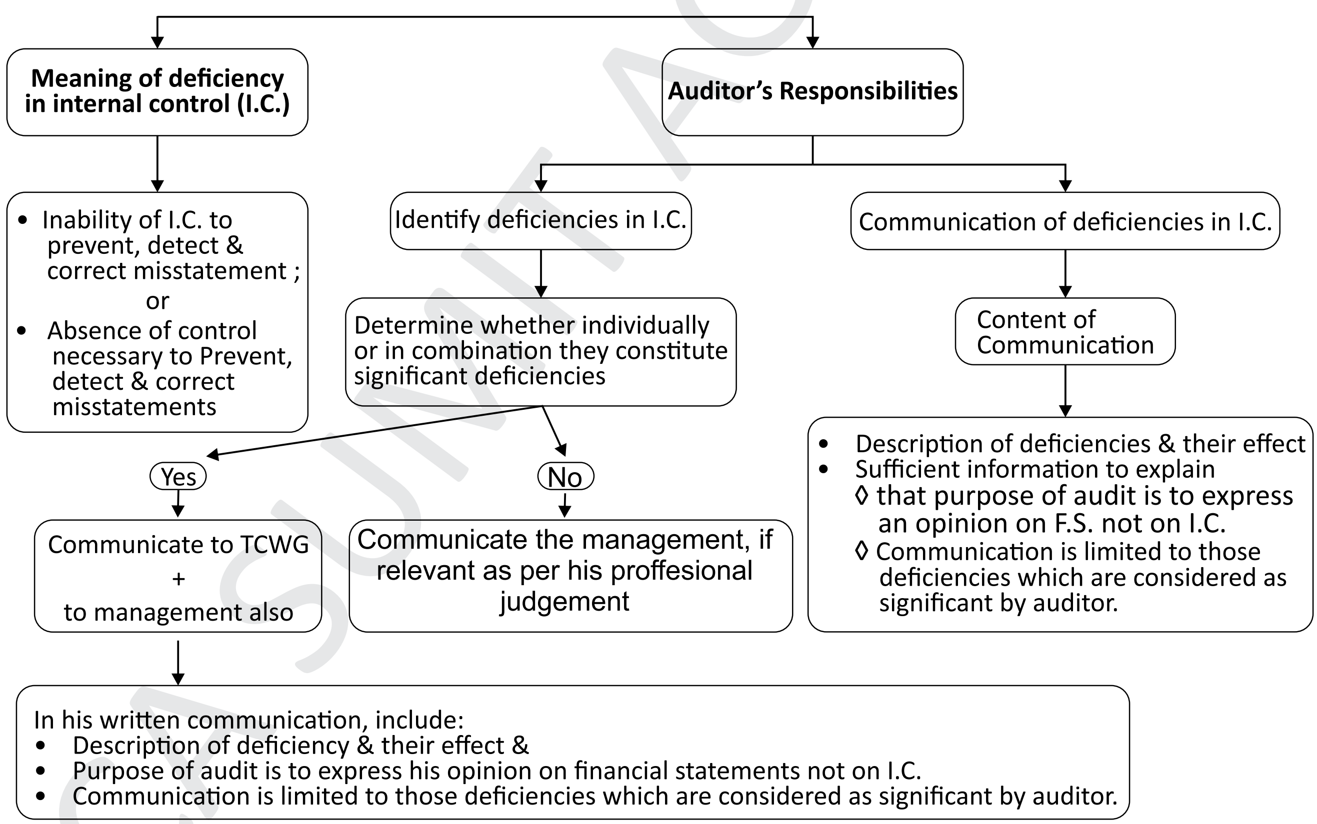
auditor's professional judgment, are of sufficient importance to merit management's attention.

- The auditor should include the following matter, in the written communication of significant deficiencies in internal control:
  - ◊ A description of the deficiencies and an explanation of their potential effects; and
  - ◊ Sufficient information to enable TCWG and management to understand the context of the communication. In particular, the auditor should explain that:
  - ◊ The purpose of the audit was for the auditor to express an opinion on the financial statements;
  - ◊ The audit included consideration of internal control relevant to the preparation of the financial statements in order to design audit procedures that are appropriate in the effectiveness, but not for the purpose of expressing an opinion on the effectiveness of internal control; and
  - ◊ The matters being reported are limited to those deficiencies that the auditor has identified during the audit and that the auditor has concluded are of sufficient importance.

4. Previous Communication/Continuous Deficiencies: Management and TCWG may already be aware of significant deficiencies that the auditor has identified during the audit and may have chosen not to remedy them because of cost or other considerations. In such cases, the auditor has the following responsibilities:

- In case of known significant deficiencies, the auditor should repeat the communication, if remedial action has not yet been taken.
- In case of known other than significant deficiencies, the auditor need not repeat the communications in the current period except in case of :-
  - ◊ A change of management, or
  - ◊ If new information has come to the auditor's attentions that alters the prior understanding of the auditor and the management regarding the deficiencies.

Summary SA 265



SA 299	RESPONSIBILITY OF JOINT AUDITORS (W.E.F. IST APRIL' 1996)

1. Introduction:

- This Standard deal with the professional responsibility when two or more auditors are accepting an appointment as Joint Auditors.
- This SA does not deal with the relationship between a principal auditor who is appointed to report on the financial statements of an entity and another auditor who is appointed to report on the financial statements of one or more divisions or branches included in the financial statements of the entity's (e.g. Central Statutory auditor and Branch Auditor).

2. **Division of Work:**
   - The joint auditors should by mutual discussion divide the total work of audit among themselves. Division of audit may be based on: -
     - ◊ Geographical location (Plant Wise/Branches/Regional Office etc.)
     - ◊ Period of time.
     - ◊ Component of financial statement (Assets wise/Liability wise/Income/Expenditure).
     - ◊ Functional areas.
   - Certain area of work which is important in nature may not be divided and carried on by all the joint auditors.
   - Division of work among the joint auditors should be in writing and agreed by all the auditors and this division of work may also be communicated to client.
3. **Coordination:** If a joint auditor comes across matter which are relevant to the other joint auditors, and deserve their attention, then he should communicate it immediately in writing to all other joint auditors, before finalization of the audit.
4. **Responsibility among Joint Auditors:** Each joint auditor is responsible for the work allocated to him. Each joint auditor is also responsible for drafting his own audit programme and determines NTE etc. However in following cases, all the joint auditors are jointly and severally responsible.
   - Audit work which is not divided among the joint auditors and is carried out by all of them.
   - Collective decision taken by all the joints auditors concerning the NTE of the audit procedures to be carried out.
   - Matters which are brought to the notice of the joint auditors by any one of them and on which there is an agreement among the joint auditors.

   Compliance and disclosure requirements of the relevant statue.
   - The responsibility of obtaining and evaluating information and explanation from the management is generally a joint responsibility of all the auditors.
   - It is the separate and specific responsibility of each joint auditor to study and evaluate the prevailing system of internal control relating to the work allocated to him, the extent of enquiries to be made in the course of his audit.
   - If any matter brought to the notice of other joint auditors by an auditor after submission of the audit report, then the other joint auditor would not be responsible for such matter.
5. **Reliance on Other Joint Auditor Work:**
   - Each joint auditor is entitled to assume that the other joint auditors have carried out their part of the audit work in accordance with the generally accepted audit procedures.
   - It is not necessary for a joint auditor to review the work performed by other joint auditors or perform any test in order to ascertain whether the work has actually been performed in such a manner.
   - Each joint auditor is entitled to rely upon the work carried by other joint auditors.
6. **Reporting Responsibilities:** Where the joint auditors are in disagreement with regards to any matters to be covered by the report, each one of them should express his own opinion through a separate report. A joint auditor is not bound by the views of the majority of the joint auditors, regarding matters to be covered in the audit report.

Summary SA 299

Division of work between Joint Auditors

- By Mutual discussion on the basis of identifiable units or specified areas
- If it is not possible, then division of work w.r.t. following:
  - Assets/Liabilities; or
  - Income/Expenditure; or
  - Period
- Work should not be divided for Important areas
- Proper documentation of work divided.

Co-ordination between Joint Auditors

- If one auditor comes to know a matter relevant for other, he should communicate it immediately to other joint auditor before submission of report. Communication should be in writing.

Responsibility of Joint Auditors

- Separate
  - For work allocated
- Joint & several
  - For work not divided
  - For joint decision w.r.t. NTE of audit procedures Disclosure requirements in FS.
  - For matters brought to knowledge of all by any of them and on which they all agree.
  - Compliance of audit report with statutory requirement.

Reporting

- Generally: - Single Report
- If disagree:- Separate Report
- No one is bound by Majority

No.	Question Bank	Exam	Marks	Refer Point/ Ans.
1	Write a short note on "Responsibility of Joint Auditors".	N04 PM	4	refer SA
2	ABC & Co. and DEF & Co., Chartered Accountant Firms were appointed as joint auditors of Good Health Care Limited for 2009-10. A special audit was conducted u/s 233A of the Companies Act, 1956 during March 2011 and observed gross understatement of revenue. The revenue aspects were look after by DEF & Co., but there was no documentation for the division of work between the joint auditors.	N11 PM	4	Ans - 1

Answer

Ans - 1:

As per SA 299 "Responsibilities of Joint Auditor" where joint auditors are appointed, they should, by mutual discussion, divide the work among themselves. Further the work so divided should be adequately documented and preferable communicated to the entity. In respect of audit work divided among the joint auditors, each joint auditor is responsible only for the work allocated to him, whether or not he has prepared a separate report on the work performed by him. However for the work not divided, all joint auditors are jointly and severally responsible.

In the present case, though the revenue aspects were looked after by DEF & Co., but as there is no documentation for division of the work between them, both the joint auditors will be held responsible for it.

Conclusion: Both Joint auditors are jointly and severally responsible.

SA 300 | PLANNING AN AUDIT OF FINANCIAL STATEMENTS (W.E.F. 1ST APRIL' 2008)

1. **Objective:** The objective of the auditor is to plan the audit so that it will be performed in an effective manner.
2. **Involvement of Key Engagement Team Members:** The engagement partner and other key members of the engagement team should involve in planning the audit.
3. **Preliminary Engagement Activities:** The auditor should undertake the following activities at the beginning of the current audit engagement.
   - Performing procedures as required by SA 220 (Quality control for audit Work) regarding the continuance of the client relationship.
   - Evaluating compliance with ethical requirement, including independence, as required by SA 220 and communication with previous auditors; and
   - Establishing an understanding of the term of the engagement, as required by SA 210. (Terms of Audit Engagements)
4. **Planning Activities:-** The auditor should establish an overall audit strategy that sets the scope, timing and direction of the audit and guide the overall development of the audit plan. In establishing the overall audit strategy, the auditor should consider the following factors:
   - Consider the result of preliminary engagement activities, and where applicable, whether knowledge gained during other engagements of same clients is relevant.
   - Identify the characteristics of the engagement, that define its' scope.
   - Ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required.
   - Consider the factors that, in the auditor's professional judgment, are significant in directing the audit team.
   - Knowledge of client's business, accounting systems, policies and internal control procedure.
   - Establishing the degree of reliance to be placed on internal control.
   - The analytical procedures to be applied as risk assessment procedures.
   - The determination of materiality.
   - The involvement of experts.
   - Determine the NTE of resources necessary to perform the engagement.
   - The auditor should plan the NTE of direction and supervision of engagement team members and the review of their work.
   - The auditor should also update and change the overall audit strategy and the audit plan as necessary during the course of the audit.
5. **Documentation:** The auditor should document:
   - The overall audit strategy.
   - The audit plans.
   - Any significant changes made during the audit engagement to the overall audit strategy or the audit plan, and the reason for such changes.

Summary SA 300

Preliminary Engagement Activities
- Performing procedures as required by SA 220 w.r.t. continuous of Client relationship
- Evaluate compliance with Ethical Requirements (SA 220)
- Understanding of the term of Engagement (SA 210)

Planning Activities

Establishment of Audit Strategy
- Identify the Characteristics of Engagement that define it's scope
- Ascertain Reporting Objectives.
- Determination of Materiality.
- Degree of Reliance on I.C.
- Analytical procedure to be applied.
- Consider the factor that is significant in directing the audit team.
- Consideration of result of Preliminary Engagement Activities.
- NTE of audit procedures to be performed.

Development of Audit Plan
- NTE of Risk Assessment Procedures (SA 315)
- NTE of further Audit Procedures (SA 330)
- Other Planned Audit Procedure.

Documentation
- Audit Strategy
- Audit Plan
- Any Significant Change in Audit Strategy and Audit Plan and the Reason for the change.

SA 315	IDENTIFYING AND ASSESSING THE RISK OF MATERIAL MISSTATEMENT THROUGH UNDERSTANDING THE ENTITY AND ITS ENVIRONMENT AND INTERNAL CONTROLS (W.E.F. 1ST APRIL' 2008)

1. **Scope of this SA:** This 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.

2. **Objective:** The objective of the auditor is to identify and assess risks of material misstatement at the financial statement level and assertion levels. To obtain this objective the auditor should perform risk assessment procedures which include:
   - Inquiries with management
   - Analytical Procedures
   - Observation and Inspection

   Where Auditor has performed other engagements with the same entity, auditor should consider whether information obtained during previous engagements is relevant for identifying the risk of material misstatement. If Auditor intends to use his/her previous experiences with the entity, he shall determine whether changes have occurred since previous audit that may affect its relevance on current audit.

3. **Obtaining an understanding of the Entity and its Environment:** Obtaining an understanding of entity and its environment including entity's internal control is a continuous, dynamic process of gathering, updating and

analyzing information throughout the audit. Auditor is required to obtain an understating of following as a part of risk assessment procedures:

- Industry, regulatory, and other external factors including applicable financial reporting framework.
- The nature of the entity, including:
  - ◊ Its operations;
  - ◊ Its ownership and governance structures;
  - ◊ The types of investments that the entity is making and plan to make; &
  - ◊ The way that the entity is structured and how it is financed.
- The entity's selection and application of accounting policies, including the reasons for changes thereto.
- The entity's objectives and strategies, and those related business risks that may result in risks of material misstatement.
- The measurement and review of the entity's financial performance.

Auditor should use his professional judgment to determine the extent of understanding required. Auditor primary consideration is whether the understanding that has been obtained is sufficient to meet the objective stated in the SA.

4. Internal Control:

4.1 Meaning of Internal Control: Internal Control may be defined as the process designed, implemented and maintained by TCWG, management and other personnel to provide reasonable assurance about the achievement of an entity's objectives with regard to

- Reliability of financial reporting,
- Effectiveness and efficiency of operations,
- Safeguarding of assets, and
- Compliance with applicable laws and regulations.

4.2 Components of Internal Control: It includes the followings:

4.2.1 Control Environment: The control environment includes the governance and management functions and the attitudes, awareness, and actions of those charged with governance and management concerning the entity's internal control and its importance in the entity. The control environment sets the tone of an organization, influencing the control consciousness of its people.

4.2.2 Risk Assessment Process: The entity's risk assessment process forms the basis for how management determines the risks to be managed. If that process is appropriate to the circumstances, including the nature, size and complexity of the entity, it assists the auditor in identifying risks of material misstatement. Whether the entity's risk assessment process is appropriate to the circumstances is a matter of judgment.

4.2.3 Information System: The information system relevant to financial reporting objectives, which includes the accounting system, consists of the procedures and records designed and established to:

- Initiate, record, process, and report entity transactions;
- Resolve incorrect processing of transactions;
- Process and account for system overrides or bypasses to controls;
- Transfer information from transaction processing systems to the general ledger;
- Capture information relevant to financial reporting for events and conditions other than transactions, such as the depreciation and amortisation of assets; and
- Ensure information required to be disclosed by the applicable FRF is accumulated, recorded, processed, summarized and appropriately reported in the F.S.

4.2.4 Risk for which Substantive Procedures Control Activities relevant to Audit: Control activities are the policies and procedures that help ensure that management directives are carried out. Control activities, whether within IT or manual systems, have various objectives and are applied at various organisational and functional levels.

4.2.5 Monitoring of Controls: Monitoring of controls is a process to assess the effectiveness of internal control performance over time. It involves assessing the effectiveness of controls on a timely basis and taking necessary corrective actions.

4.3 Material Weakness in Internal Control:

- The auditor shall evaluate whether, on the basis of the audit work performed, the auditor has identified a material weakness in the design, implementation or maintenance of internal control.
- The auditor shall communicate material weaknesses in internal control identified during the audit on a timely basis to management at an appropriate level of responsibility, and, as required by SA 260.

5. Identifying and Assessing the risk of Material Misstatement:

5.1 The Auditor shall identify and assess the risks of Material Misstatement at:

- The **financial statement level;** and
- The **assertion level** for classes of transactions, account balances, and disclosures; to provide a basis for designing and performing further audit procedures.

5.2 For this purpose, the Auditor shall:

- Identify risks,
- Assess and evaluate the identified risks,
- Relate the identified risks to what can go wrong at the assertion level,
- Consider the likelihood of misstatement.

5.3 Risk that requires Special Consideration: In exercising judgment as to which risks are significant risks, the auditor shall consider the following:

- Whether the risk is a risk of fraud;
- Risk is related to recent significant economic, accounting, or other developments;
- The complexity of transactions;
- Whether the risk involves significant transactions with related parties;
- The degree of subjectivity in the measurement of financial information; and
- Whether the risk involves significant unusual transactions.

5.4 Risk for which Substantive Procedures alone do not provide Sufficient Appropriate Audit Evidence: Such risks may relate to the inaccurate or incomplete recording of routine and significant classes of transactions or account balances, the characteristics of which often permit highly automated processing with little or no manual intervention. In such cases, the entity's controls over such risks are relevant to the audit and the auditor shall obtain an understanding of them.

5.5 Revision of Risk Assessment: 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 is obtained. The auditor shall revise the assessment and modify the further planned audit procedures accordingly.

6. Conditions and Events that may indicate risk of Material Misstatement:

- Operation exposed to volatile market, for example, future trading.
- Going concern and liquidity issues including loss of significant customers.
- Changes in the industry in which the entity operated.
- Entities or business segments likely to be sold.
- Change in the IT environment.
- Changes in key personnel including departure of key executives.
- Constraints on the availability of capital and credit.
- Changes in the supply chain.
- Significant amount of non-routine or non-systematic transactions including intercompany transactions and large revenue transactions at period end.

SUMMARY SA 315

Objective

Identification and Assessment of Risk of Material Misstatement :

- At FS level.
- At assertion level for class of transaction, A/c Balance & disclosure.

For this purpose, the auditor shall:

- Identify risks.
- Assess and evaluate the identified risks.
- Relate the identified risks to what can go wrong at the assertion level.
- Consider the likelihood of misstatement.

Risk Assessment Procedures

Obtain an understanding of entity & its environment including I.C. (Relevant Industry, Regulatory and other External factors including FRF etc.)

It includes:

- Inquiries with management
- Analytical Procedures
- Observation and Inspection
- Consider knowledge gain in previous audit and other engagement if any.

Component of I.C.

- Control Environment
- Risk Assessment Process
- Information System relevant to FR (A/c system etc)
- Control Activities relevant to Audit (Segregation of duties, Physical Controls etc)
- Monitoring of Controls

Risk that required special consideration

- Risk of fraud.
- Risk related to recent significant economic, accounting, or other developments.
- The complexity of transactions.
- Transactions with related parties.
- Significant unusual transactions.

No.	Question Bank	Exam	Marks	Refer Point/ Ans.
1	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.	N05 PM	4	Ans - 1
2	What are general matters to be considered by an auditor while taking up a engagement?	N07 PM	4	Ans - 2
3	Z Ltd. has its entire operations including accounting computerized. As the audit partner you are concerned about inherent and control risk for material financial statement assertions. What could be the areas you look forward for deficiencies and risk identification?	M11	4	Ans - 3
4	While carrying out the statutory audit of a large entity, what are the substantive procedures to be performed to assess the risk of material misstatement?	N12 PM	8	Ans - 4
5	As the auditor of a large multi locational company, in the planning process, you are requested to identify the inherent audit risk at the account balance and class of transaction level.	M13 PM	4	Ans - 5
6	What are the major sources of obtaining information about the client's business?	N07 PM	4	Ans - 6

Answer

Ans - 1: Assessment of Risk and Acceptable Level

SA 315 and SA 330 "Identifying and Assessing the Risk of Material Misstatement Through Understanding the Entity and its Environment" and "The Auditor's Responses to Assessed Risks" establishes 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. SA 315 and SA 330 require that the auditor should use professional judgment 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 sufficient appropriate audit evidence to reduce detection risk, and therefore audit risk, to an acceptably low level. The auditor should use his professional judgment to assess audit risk and to design audit procedures to ensure that it is reduced 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.

Ans - 2: The Auditor should Consider the following General Matter while taking up a New Engagement:

- General Economic factors:
  - ◊ The market and competition
  - ◊ Cyclical or seasonal activity
  - ◊ Government policies
- The industry: important conditions affecting the client's business
  - ◊ The market and competitions
  - ◊ Cyclical or seasonal activity,
  - ◊ Changes in product technology
  - ◊ Business risk
- The entity:
- Management and ownership
- Operating Management
- The entity's business - products markets, suppliers, expenses, operations.
  - ◊ Nature of business (for example manufacturing whole seller, financial services, import /exports).
  - ◊ Location of production facilities, warehouses, offices.
  - ◊ Employment (for example, by location, supply, wage levels, union contracts, pension commitments, Government regulation)
  - ◊ Products or services markets.
- Financial performance-factors concerning the entity's financial condition and profitability.
- Reporting environment-external influences which affect management in the preparation of the financial statements.
- Taxation both direct and indirect.
- Legislation
- Regulatory environment and requirements

Ans -3:

The auditor in accordance with SA 315 "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment", should make an assessment of inherent and control risk for material financial statement assertions. In a CIS environment the risk of a Material financial statement ascertain being erroneously stated could arise from the deficiencies in the following case as

- Program Development and maintenance.
- Operations including processing of data.
- System software support.

- Physical CIS security.
- Control over access to specialized utility program.

These deficiencies would tend to have a negative impact on all application systems that are processed through the computer.

Ans - 4: Substantive Procedures to be performed to assess the risk of material misstatement:

As per SA 330, "The Auditor's Response to Assessed Risk", substantive procedure is an audit procedure designed to detect material misstatements at the assertion level. They comprise tests of details and substantive analytical procedures.

Test of Details: The nature of the risk and assertion is relevant to the design of tests of details. For example, tests 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. On the other hand, tests of details related to the completeness assertion may involve selecting from items that are expected to be included in the relevant financial statement amount and investigating whether they are included. In designing tests of details, the extent of testing is ordinarily thought of in terms of the sample size.

Substantive Analytical Procedure: Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time. The application of planned analytical procedures is based on the expectation that relationships among data exist and continue in the absence of known conditions to the contrary. However, the suitability of a particular analytical procedure will depend upon the auditor's assessment of how effective it will be in detecting a misstatement that, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated.

In some cases, even an unsophisticated predictive model may be effective as an analytical procedure. For example, 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. The use of widely recognised trade ratios (such as profit margins for different types of retail entities) can often be used effectively in substantive analytical procedures to provide evidence to support the reasonableness of recorded amounts

Ans -5: Evaluating Inherent Risk - To assess inherent risk, the auditor would use professional judgement to evaluate numerous factors, having regard to his experience of the entity from previous audit engagements of the entity, any controls established by management to compensate for a high level of inherent risk, and his knowledge of any significant changes which might have taken place since his last assessment. Inherent audit risk at the level of Account Balance and Class of Transactions is:

- Quality of the accounting system.
- Financial statements are likely to be susceptible to misstatement, for example, accounts which required adjustment in the prior period or which involve a high degree of estimation.
- The complexity of underlying transactions and other events which might require using the work of an expert.
- The degree of judgement involved in determining account balances.
- Susceptibility of assets to loss or misappropriation, for example, assets which are highly desirable and movable such as cash.
- The completion of unusual and complex transactions, particularly at or near period end.
- Transactions not subjected to ordinary processing.

Ans - 6: The Auditor can Obtain Information about Client's Business from the following Sources:

- The client's annual Reports to shareholders.
- Minutes of meetings of shareholders, board of directors and important committees.
- Internal financial management report for current and previous periods including budgets, if any.
- The previous year's audit working papers and other relevant files.
- Discussions with the client.
- Visits to the client's premises and plant facilities to the management.
- The client's policy and procedures manual.
- Relevant publications of the ICAI and other professional bodies, industry publication, trade Journals,

magazines, newspapers or text books.
- Consideration of the state of the economy and its effects on the client's business.

SA 320 | Materiality in Planning and Performing an Audit (w.e.f. 1st April' 2010)

1. **Scope of this SA:** 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.

2. **Concept of Audit Materiality:** Any item in the financial statement is said to be material if it influences the mind of the reader of those financial statements. It depends upon the size, nature of the item, circumstances of the cases etc. The auditor should use his judgment to decide the materiality of an item. Some items, which individually may not be material but collectively, might be material. Materiality could be either qualitative or quantitative. The auditor should consider materiality both from (a) overall financial statements point of view; and (b) individual accounts balance point of view. The auditor should consider the concept of materiality when:
   - Determining the nature, timing and extent of audit procedures;
   - Evaluating the effect identified misstatements on the audit; and
   - Forming the opinion in the auditor's report.

   FRF often discuss the concept of materiality in the context of the preparation and presentation of financial statements. Although FRF may discuss materiality in different terms, they generally explain that:
   - Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users of the F.S.;
   - Judgments about materiality are made in the light of surrounding circumstances, and are affected by the size or nature of a misstatement, or a combination of both; and
   - Judgments about matters that are material to users of the F. S. are based on a consideration of the common financial information needs of users as a group.
   - The possible effect of misstatements on specific individual users, whose needs may vary widely, is not considered.

   If the applicable FRF does not include a discussion of the concept of materiality, the characteristics referred above provide the auditor with such a frame of reference.

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

4. **Definition of Performance Materiality:** Performance materiality means the amount or amounts set by the auditor at less than materiality for the financial statements as a whole to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole. If applicable, performances 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. The auditor shall determine performance materiality for purpose of assessing the risks of material misstatement and determining the NTE of further audit procedures.

5. **Determining Materiality for the Financial Statements as a whole, when Planning the Audit [N13]:** When establishing the overall strategy, the auditor should determine materiality for the financial statements as a whole. Determining materiality involves the exercise of professional judgment. A percentage is often applied to a chosen benchmark as a starting point in determining materiality for the financial statements as a whole. Factors that may affect the identification of an appropriate level of benchmark include the following:
   - The elements of the financial statements (for example, assets, liabilities, equity, revenue, expenses).
   - 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).
   - 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.
   - 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

- The relative volatility of the benchmark.

If, there is one or more particular item for which misstatements of lesser amounts, than the materiality level for the financial statements as a whole could reasonably be expected to influence the economic decisions of users, taken on the basis of the financial statements, the auditor should also determine the materiality levels to be applied to those particular items.

6. Revision as the Audit Progresses:

- The auditor should revise materiality for the financial statements as a whole *(and, if applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures*) in the event of becoming aware of information during the audit that would have caused the auditor to have determined a different amount (or amounts) initially.
- If the auditor concludes that a lower materiality (from the materiality determined initially) is appropriate, the auditor should determine whether it is necessary to revise performance materiality, and whether the NTE of the further audit procedures remain appropriate.

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

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

No.	Question Bank	Exam	Marks	Refer Point/ Ans.
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.	N13 PM	4	5
2	State your view on following: "Auditor's assessment of materiality may be different at the time of planning the engagement than at the time of evaluating the result of his audit procedures."	1997	4	Ans - 1
3	"Materiality and Audit Risk is determined at the time of Audit Planning and should not be changed during the course of audit". Please offer your comments on the statement.	N99	4	Ans - 2

Answer

Ans - 1:

SA 320 on "Audit Materiality" recommends that the auditor should consider materiality and its relationship with audit risk when conducting an audit.

- SA 300 "Audit Planning" also requires the auditor to consider the materiality levels for audit purpose and from the initial stages.
- Thus, the auditor has to access the materiality aspect right from the initial stages of audit planning and throughout the process of conducting the audit till the audit report is prepared.
- Audit materiality related to specific assertions helps the auditor decide as to what items to examine and whether to use sampling and analytical procedure.
- This enables the auditor to select audit procedures that can be expected reduce audit risk to an acceptable low level.

- However, such selection of audit procedures would undergo a change as audit work progress.
- The assessment of materiality and audit risk may also change because of change in circumstances.
- For example: Auditor may estimate certain assertions to be examined at a specific amount as per his experience in prior periods audit. But if, after performing he finds actual results of the entity to be substantially different, he would like to cover more items (reducing the materiality level).

Ans - 2:

As per SA 320 the concept of materiality is not judged from just one point of view but it is result of interacting forces and factors.

When planning the audit, the auditor considers what would make the financial statements materially misstated. His consideration of materiality at the planning stage enables him to decide which items should be examined by application a sampling and analytical procedures.

The statement that materiality and Audit risk is determined at the time of Audit planning and not changed during course of audit is not correct. After the commencement of audit, the materiality level may be changed depending upon the progress of the audit and their findings or change in circumstances. If actual results of operation are substantially different, the assessment of materiality and audit risk may also change. Thus the above statement is incorrect.

SA 330 | THE AUDITOR'S RESPONSES TO ASSESSED RISKS (W.E.F. 1ST APRIL' 2008)

1. **Scope of this SA:** This SA deals with the auditor's responsibility to address the risk of material misstatement identified and assessed by the auditor in accordance with SA 315 "Identify and assessing the risk of material misstatement through understanding the entity and its environment".

2. **Objective:** The auditor should design and perform further audit procedure whose NTE are based on and are responsive to the assessed risks of material misstatement at the financial statement level. The overall objective of this exercise is to reduce audit risk to an acceptable low level by obtaining sufficient appropriate audit evidence.

3. **Audit procedures Response to the Assessed Risks of Material Misstatement at the Assertion level:**

3.1 **Further Audit Procedures:** In designing further audit procedures to be performed, the auditor should:
- Consider the likelihood of material misstatement due to the particular characteristics of the relevant class of transactions, accounts balance, or disclosure (i.e. the inherent risk); and whether the risk assessment takes into account the relevant controls (i.e., the control risk).
- Obtaining more relevant or reliable audit evidence because of a higher assessment of risk (e.g. third party evidence).

3.2 **Test of Controls:** The auditor should design and perform tests of controls to obtain sufficient appropriate audit evidence for effectiveness of relevant controls when:
- He expects that the controls are operating effectively, or
- Substantive audit procedures alone cannot provide sufficient appropriate audit evidence at the assertion level.

The auditor should perform test of controls for a particular time or throughout the period.

3.3 **Using Audit Evidence obtained during an Interim Period:** When the auditor obtains audit evidence about the operating effectiveness of controls during an interim period, the auditor should:
- Consider significant change to those controls, if any; and
- Determine the additional audit evidence to be obtained for the remaining period.

3.4 **Using Audit Evidence obtained in Previous Audit:** The auditor's decision on whether to rely on audit evidence obtained in previous audits for control is a matter of professional judgment. In addition, the length of time between retesting such controls is also a matter of professional judgment. If auditor is using audit evidence obtained during previous audit, he should examine, whether significant changes in controls have occurred subsequent to the previous audit. If there have been changes, the auditor should test the controls in the current audit. If there have not been such changes, the auditor should test the controls at least once in every third audit, and should test some controls in each audit. Factors that may warrant a re-test of controls are:

- A deficient control environment.
- Deficient monitoring of controls.
- A significant manual element to the relevant controls.
- Personnel changes that significantly affect the application of the control.
- Changing circumstances that indicate the need for changes in the control.
- Deficient general IT-controls.

3.5 **Control over Significant Risk:** When the auditor plans to rely on controls over significant risk, the auditor should test those controls in the current period.

3.6 **Evaluating the Operating Effectiveness of Controls:**

- A material misstatement detected by the auditor's procedures a strong indicator of the existence of a significant deficiency in internal control. However, the absence of misstatement does not provide audit evidence that controls are effective.
- The auditor shall communicate material weaknesses in internal control identified during the audit on a timely basis to management at an appropriate level and TCWG.

4. **Substantive Procedures:** The audit should design and perform substantive procedures for each material class of transactions, account balance, and disclosure. The auditor substantive procedures related to financial statement closing process include:

- Reconciliation of financial statements with the underlying accounting records; and
- Examining material journal entries and other adjustments made during the course of preparing the financial statements.

When the auditor has determined a significant risk, the auditor should perform substantive procedures that are specifically responsive to that risk. When substantive procedures are performed at an interim date, the auditor should also cover remaining period by performing substantive procedures.

5. **Adequacy of Presentation and Disclosure:** The auditor should perform audit procedures to evaluate whether the overall presentation of the financial statements, including the related disclosures, is in accordance with the applicable FRF.

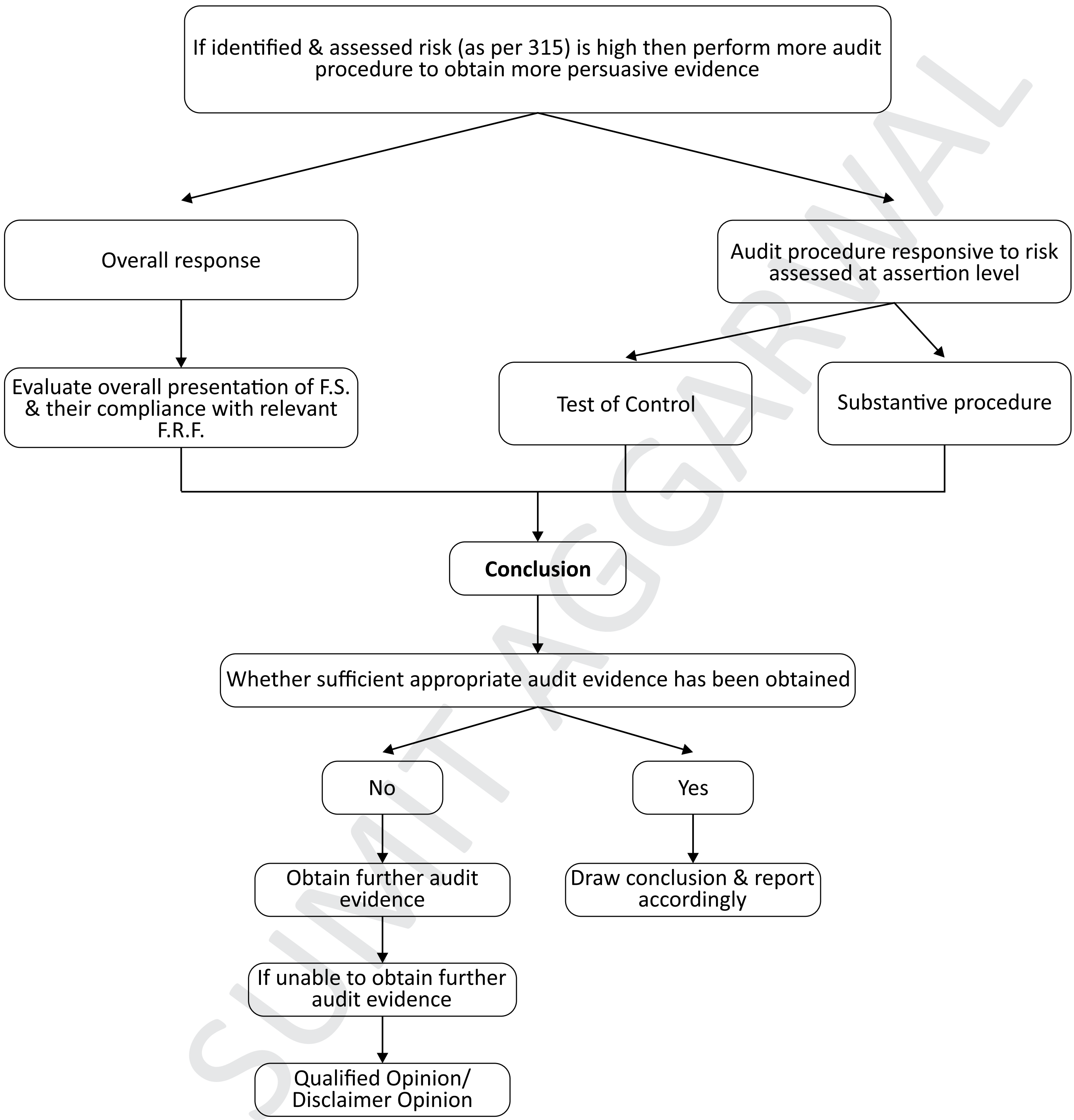
6. **Evaluating the sufficiency and Appropriateness of Audit Evidence:** The auditor should conclude whether sufficient appropriate audit evidence has been obtained. If the auditor has not been obtained sufficient appropriate audit evidence as to a material financial statement assertion, the auditor should try 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.

7. **Documentation:** The auditor should document:

- The overall responses to address the assessed risk of misstatement at the financial statement level.
- The NTE of the further audit procedures performed.
- The linkage of those procedures with the assessed risks at the relevant assertion level.
- The result of the audit procedures.

If auditor use audit evidence about the operating effectiveness of controls obtained in previous audits, the auditor should document the conclusions reached about relying on such controls that were tested in a previous audit.

Summary SA 330



No.	Question Bank	Exam	Marks	Refer Point/ Ans.
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.	M13 PM	4	Ans - 1

2	While commencing the statutory audit of ABC Company Limited, what should be the considerations of the auditor to assess Risk of Material Misstatement and his response to such risks?	N14	4	Ans - 2

Answer

Ans - 1:

As per SA-330 on "The Auditor's Responses to Assessed Risks", changes may affect the relevance of the audit evidence obtained in previous audits such that Auditing Standards, Statements and Guidance Notes. There may no longer be a basis for continued reliance.

The auditor's decision on whether to rely on audit evidence obtained in previous audits for control is a matter of professional judgment. In addition, the length of time between retesting such controls is also a matter of professional judgment. Factors that may warrant a re-test of controls are:

- A deficient control environment.
- Deficient monitoring of controls.
- A significant manual element to the relevant controls.
- Personnel changes that significantly affect the application of the control.
- Changing circumstances that indicate the need for changes in the control.
- Deficient general IT-controls.

Ans - 2:

Considerations of Auditor for Assessing the Risk of Material Misstatement: As per SA 315 "Identifying and Assessing the Risk of Material Misstatement through understanding the Entity and its Environment", the auditor shall identify and assess the risks of material misstatement at the financial statement level; and the assertion level for classes of transactions, account balances, and disclosures to provide a basis for designing and performing further audit procedures. For this purpose, the auditor shall:

- Identify risks throughout the process of obtaining an understanding of the entity and its environment, including relevant controls that relate to the risks, and by considering the classes of transactions, account balances, and disclosures in the financial statements;
- Assess the identified risks, and evaluate whether they relate more pervasively to the financial statements as a whole and potentially affect many assertions;
- 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
- 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.

Auditor's Responses to the Assessed Risk of Material Misstatement: According to SA 330 "The Auditor's Responses to Assessed Risks", the auditor shall design and implement overall responses to address the assessed risks of material misstatement. In designing the audit procedures to be performed, the auditor shall:

- 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:
  - ◊ The likelihood of material misstatement due to the particular characteristics of the relevant class of transactions, account balance, or disclosure; and
  - ◊ Whether the risk assessment takes into account the relevant controls, thereby requiring the auditor to obtain audit evidence to determine whether the controls are operating effectively; and
- Obtain more persuasive audit evidence the higher the auditor's assessment of risk.

SA 402 — AUDIT CONSIDERATIONS RELATING TO AN ENTITY USING A SERVICE ORGANISATION (W.E.F. 1ST APRIL' 2010)

1. **Scope of This SA:** This SA deal with the auditor's responsibility to obtain sufficient appropriate audit evidence

when auditor's client uses the services of one or more service organization. The auditor should consider how a service organization affects the client's accounting and internal control systems so as to plan and develop an effective audit approach. This SA does not apply to services provided by financial institutions such bankers, Security Brokers etc. Services provided by the Service organizations includes IT Services, maintenance of accounting records, Tax compliance services, facilities management, maintenance of safe custody of assets such as investment etc.

2. **Objective:** The objectives of the user auditor, when the user entity uses the services of a service organization, are:
   - To obtain an understanding of the nature and significance of the services provided by the service organization and their effect on the user entity's internal control (a) relevant to the audit, (b) sufficient to identify and assess the risks of material misstatement; and
   - To design and perform audit procedures responsive to those risks.

3. **Obtaining an understanding of the services provided by a Service Organization, including Internal Control [M11 N13]:**
   - When obtaining an understanding of the user entity in accordance with SA 315, the user auditor shall obtain an understanding of how a user entity uses the services of a service organization in the user entity's operations, including:
     - ◊ The nature of the services provided by the service organization and their significance to the user entity.
     - ◊ The nature and materiality of the transactions processed or accounts or financial reporting processes affected by the service organization;
     - ◊ The degree of interaction between the activities of the service organization and those of the user entity; and
     - ◊ The nature of the relationship between the client and the service organization, including the relevant contractual terms.
   - The user auditor should evaluate the design and implementation of relevant controls at the user entity that relate to the service provided by the service organization.
   - The user auditor should determine whether a sufficient understanding of the nature and significance of the services provided by the service organization and their effect on the user entity's internal control relevant to the audit has been obtained.
   - If the user auditor is unable to obtain a sufficient understanding from the user entity, the user auditor should obtain that understanding from one or more of the following procedures:
     - ◊ Obtaining a Type 1 or Type 2 report, if available;
     - ◊ Contacting the service organization, through the user entity, to obtain specific information;
     - ◊ Visiting the service organization and performing procedures; or
     - ◊ Using another auditor to perform procedures that will provide the necessary information about the relevant controls at the service organization.

4. **Type 1 Report:** Report on the description and design of controls at a service organization. The contents of this report are:
   - A description of the service organization's accounting and internal control System; and
   - An opinion by the service organization's auditor that:
     - ◊ The above description is accurate;
     - ◊ The systems controls have been placed in operation; and
     - ◊ The accounting and internal control systems are suitably designed to achieve their stated objectives.

   Such reports of service auditor help the auditor of the client in obtaining an understanding of the accounting and internal control systems installed and operated by the service organizations.

5. **Type 2 Report:** Report on the ***description, design, and operating*** effectiveness of controls at a service organization. The contents of this report are:
   - A description of the service organisation's accounting and internal control System; and
   - An opinion by the service organisation's auditor that:
     - ◊ The above description is accurate;
     - ◊ The systems controls have been placed in operation; and
     - ◊ The accounting and internal control system are suitably designed to achive their stated objectives.
     - ◊ The accounting and internal control systems are operating effectively based on the results of the test

of control by the service auditor.

The Client's auditor should consider whether the controls tested by the service auditor are relevant to the client's transactions. The client's auditor can also use such report as an evidence of lower risk assessment. Based on the control risk assessment, the client's auditor determines the nature, timing and extent of substantive procedures. He may also request the auditor of the service organisation to perform substantive tests in certain areas.

6. **Using a Type 1 or Type 2 Report to Support the user's auditors understanding of the Service Organization:** In determining of sufficiency and appropriateness of the audit evidence provided by a Type 1 or Type 2 report, the user auditor should be satisfied as to:
   - The service auditor's professional competence (except where the service auditor is a member of the Institute of Chartered Accountants of India) and independence from the service organization; and
   - The Nature and content of the report (Type 1 or Type2).

7. **Type 1 and type 2 Reports that exclude the services of a Sub-service Organization:** If the user auditor plans to use a Type 1 or a Type 2 report that excludes the services provided by a subservice organization and those services are relevant to the audit of the client's financial statements, the user auditor shall apply the requirements of this SA with respect to the services provided by the subservice organization also.

8. **Test of Control:** When the user auditor's risk assessment includes an expectation that controls at the service organization are operating effectively; the user auditor shall obtain audit evidence about the operating effectiveness of those controls from one or more of the following procedures:
   - Obtaining a Type 2 report, if available;
   - Performing appropriate tests of controls at the service organization; or
   - Using another auditor to perform tests of controls at the service organization on behalf of the user auditor.

9. **Fraud, Non-compliance with laws and regulations and uncorrected misstatement in relation to activities at the Service Organization:**
   - The user auditor shall inquire of management of the user entity whether the service organization has reported to the user entity, or whether the user entity is otherwise aware of, any fraud, noncompliance with laws and regulations or uncorrected misstatements affecting the FS of the user entity.
   - The user auditor shall 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.

10. **Reporting by the User Auditor:**

    The user auditor should modify the opinion in the user auditor's report, if the user auditor is unable to obtain sufficient appropriate audit evidence regarding the services provided by the service organization. The user auditor should not refer to the work of a service auditor in user auditor's report containing an unmodified opinion unless required by law or regulation to do so.

    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 should indicate that such reference does not diminish the user responsibility for that opinion.

No.	Question Bank	Exam	Marks	Refer Point/ Ans.
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 a agency in relation to the audit.	M11	4	3
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.	N13 PM	5	3

3	A Company gets its accounting data processed by a third party to achieve cost reduction. As a Statutory Auditor of such a company, what are the additional precautions/checks that you would consider for conduct of the audit?	M06 PM	8	Ans - 1

Answer

Ans - 1: Precaution to be taken by auditor in case accounting data processed by third party

Processing of accounting data may be given to a third party on account of various considerations such as economy, own computer working to full capacity, an interim measures restricting accessibility to sensitive information, etc. A client may use a service organization such as one that executes transactions and maintains related accountability or records transactions and processes related data (e.g., a computer systems service organization).

If a client uses a service organization, certain policies, procedures and records maintained by the service organization might be relevant to the audit of the financial statements of the client. Consequently, the auditor would consider the nature and extent of activities undertaken by service organizations so as to determine whether those activities are relevant to the audit and, if so, to assess their effect on audit risk. SA 402, "Audit Considerations Relating to an Entity Using a Service Organization ", When obtaining an understanding of the user entity in accordance with SA 315, the user auditor shall obtain an understanding of how a user entity uses the services of a service organization in the user entity's operations, including :

- Terms of contract and relationship between the client and service organisation.
- Extent of Interaction between client's accounting and internal control system and service organisation.
- The nature and extent of the services provided by the service organization and the significance of those services to the user entity, including the effect thereof on the user entity's internal control;
- The nature and materiality of the transactions processed or accounts or financial reporting processes affected by the service organization;

Moreover, the auditor of client must also consider the availability of third-party reports from service organizations auditors, internal auditors or regulatory agencies as a means of providing information about the accounting and internal controls of the service organisation and its operational effectiveness.

SA 450	**EVALUATION OF MISSTATEMENTS IDENTIFIED DURING THE AUDIT (W.E.F. 1ST APRIL' 2010)**

1. **Scope of This SA:** This SA deal with the auditor's responsibility to evaluate:
- The effect of identified misstatements on the audit; and
- Effect of uncorrected misstatements, if any on the financial statements.

2. **Definition [M11 M13]:**

2.1 **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 FRF. Misstatement can arise from error or fraud.

2.2 **Cause of Misstatement:** Misstatement may result from:
- An inaccuracy in gathering or processing data from which the financial statements are prepared;
- An omission of an amount or disclosure;
- An incorrect accounting estimate arising from overlooking, or clear misinterpretation of facts; and
- Judgments of management, concerning accounting estimates that the auditor considers unreasonable or the selection and application of accounting policies that the auditor considers inappropriate.

2.3 **Uncorrected Misstatement:** Misstatements that the auditor has accumulated during the audit and that have not been corrected.

2.4 **Accumulation of Identified Misstatements:** The auditor should accumulate misstatements identified during the audit, other than those that are clearly trivial.

3. **Consideration of Identified Misstatements as the Audit Progresses:** The auditor should determine whether the overall audit strategy and audit plan need to be revised if:
   - The nature of identified misstatements and the circumstances of their occurrence indicate that other misstatements may exists and when they aggregated with misstatements accumulated during the audit, could be material; or
   - The aggregate of misstatements accumulated during the audit approaches materiality determined in accordance with SA 320.

4. **Communication and Correction of Misstatements:**
   - The auditor should communicate on a timely basis all misstatements accumulated during the audit when the appropriate level of management, unless prohibited by law or regulation. The auditor should request management to correct all the misstatements.
   - If management refuses to correct some or all of the misstatements communicated by the auditor, the auditor should obtain an understanding of management reasons for not making the corrections and shall take that understanding into account when evaluating whether the financial statements as a whole are free from material misstatement.

5. **Evaluating the Effect of Uncorrected Misstatements:**
   - Prior to evaluating the effect of uncorrected misstatements, the auditor should reassess materiality considering the actual financial results.
   - The auditor should determine whether uncorrected misstatements are material individually or in aggregate. In making this determination, the auditor should consider:
     - ◊ The size and nature of the misstatements, both in relation to particular item and the financial statements as whole; and
     - ◊ 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.

6. **Communication with Those Charged with Governance:** The auditor should communicate with TCWG, uncorrected misstatements and their effect (individually or in aggregate), may have on the opinion in the auditor's report, unless prohibited by law or regulation. The auditor should request that uncorrected misstatements be corrected. The auditor should also communicate the effect of uncorrected misstatements related to prior periods.

7. **Written Representation:** As per management, if effect of such uncorrected misstatement is immaterial then the auditor shall request for a written representation from management and, where appropriate, TCWG that whether they believe the effects of uncorrected misstatements are immaterial, individually and in aggregate, to the financial statements as a whole. A summary of such items shall be included in or attached to the written representation. If the management refuses to adjust the financial information and the results of extended audit procedures do not enable the auditor to conclude that the aggregate of uncorrected misstatements is not material, the auditor should report accordingly.

8. **Documentation:** The audit documentation shall include:
   - The amount below which misstatements would be regarded as clearly trivial.
   - All misstatements accumulated during the audit and whether they have been corrected.
   - The auditor's conclusion as to whether uncorrected misstatements are material, individually or in aggregate and the basis for that conclusion.

No.	Question Bank	Exam	Marks	Refer Point/ Ans.
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.	M11	4	2

2	In audit plan for T Ltd, as the audit partner you want to highlight the sources of misstatements, arising from other than fraud, to your audit team and caution them. Identify the sources of misstatements.	M13 PM	4	2
3	Discuss the impact of uncorrected misstatements identified during the audit and the auditor's response to the same.	N14	5	5, 6, 7
4	State your views on the following: "The auditor should taken into account the aggregate of all uncorrected misstatements including those involving estimates in his assessment of materiality in audit”	M02	4	Ans - 1
5	While auditing accounts of a public limited company for the year ended 31st March 2003, an auditor found out an error in the valuation of inventory, which affects the financial statement materially - Comment as per SA.	N03 PM	5	Ans - 2

Answer

Ans - 1:-

- SA (450) requires that in forming his opinion on the financial information, the auditor should consider, whether the effect of aggregate uncorrected misstatements on the financial information is material.
- An auditor also considers qualitative aspects of misstatements.
- The aggregate of uncorrected misstatements comprises:
  - ◊ Specific mis-statements identified by the auditor including the effect of uncorrected mis-statements identified during the audit of previous periods; and
  - ◊ The auditor’s best estimate of other mis-statements which cannot be specifically identified.
- If the analytical procedure indicated that mis-statements might exist, the auditor applies extended procedures to enable him to estimate the aggregate mis-statements in the balance or class.
- When an auditor uses audit sampling, he projects the amount of known misstatements identified by him in his sample to the items in the population
- Finally, he considers the aggregated material misstatements.
- If auditor determines that the aggregate of uncorrected mis-statements is material, he should request the management to adjust the financial information.
- The adjustment of financial information may involve, for example, appropriate disclosure of inadequately disclosed matters.
- However, if the management refuses to adjust the financial information, the auditor should express a qualified or adverse opinion as may be appropriate.

Ans - 2: Errors in Valuation of Inventories and Auditor’s Responsibilities:

SA 240, “The Auditor’s Responsibilities Relating Fraud in an Audit of Financial Statements”, requires that if circumstances indicate the possible existence of fraud or error, the auditor should consider the potential effect of the suspected fraud or error on the financial information. If the auditor believes the suspected fraud or error could have a material effect on the financial information, he should perform such modified or additional procedures as he determines to be appropriate. SA 240 also requires that when the auditor identifies a misstatement, the auditor shall evaluate whether such a misstatement is indicative of fraud. If there is such an indication, the auditor shall evaluate the implications of the misstatement in relation to other aspects of the audit,” particularly the reliability of management representations, recognizing that an instance of fraud is unlikely to be an isolated occurrence. Further, SA 320 Materiality in Planning and Performing an Audit, also requires that in such circumstances, the auditor should consider requesting the management to adjust the financial information or consider extending his audit procedures. If the management refuses to adjust the financial information and the results of extended audit procedures do not enable the auditor to conclude that the aggregate of uncorrected misstatements is not material, the auditor should express a qualified or adverse opinion, as appropriate. In the instant case, the auditor has detected the material errors affecting the financial statements; the auditor should communicate his findings to the management on a timely basis, consider the implications on true and fair view and also ensure that appropriate disclosures have been made.

SA 500 | AUDIT EVIDENCE (W.E.F. 1ST APRIL' 2009)

1. **Audit Evidence [M97 M05]:** Audit evidence means the 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. The auditor should obtain sufficient and appropriate audit evidence through the performance of compliance and substantive procedures to enable him to draw reasonable conclusions which provide basis for his opinion on the financial information.

1.1 **Compliance Procedures:** are tests designed to obtain reasonable assurance, that those internal controls on which audit reliance is to be placed are in effect.

1.2 **Substantive Procedures:** Substantive tests seek to provide evidence as to the accuracy of an amount or account balance. The auditor must carry out substantive tests on all aspects of the financial statements, as compliance tests do not provide sufficient relevant and reliable evidence on which to base his opinion. **Substantive tests are conducted, in areas which are not subject to internal control and are hence judgmental in nature e.g.** valuation of stock, provision for doubtful debts etc. Substantive tests are two types:

- Test of details of transactions and balances.
- Analysis of significant ratios and trends including the resulting enquiry of unusual fluctuations and items.

The auditor substantive procedures related to financial statement closing process include (a) reconciliation of 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.

2 **Methods of obtaining Audit Evidence:** The auditor may obtain audit evidence by following methods:

2.1 **Inspection:** It consists of examining various records, documents and tangible assets. Examination of these records and assets provides evidence of varying degree of reliability depending upon their nature, source and effectiveness of internal control over their processing. Inspection of tangible assets provides reliable evidence regarding their existence. Four major categories of documentary evidence, which provide different degree of reliability, are:

- Documentary evidence originating from and held by third parties;
- Documentary evidence originating from third party and held by entity;
- Documentary evidence originating from the entity and held by third parties;
- Documentary evidence originating from and held by the entity.

Inspection of tangible assets is one of the methods to obtain reliable evidence with respect to their existence but not necessarily as to their ownership or value.

2.2 **Observation:** In consists of witnessing a process or procedure being performed by others. Observation of physical verification of inventories by the auditor will help in gathering reliable evidence as to their existence, physical condition and control.

2.3 **Inquiry and Confirmation [M03]:** Inquiry consists of seeking appropriate information from knowledgeable persons inside or outside the entity. Inquiries may range from formal written inquiries addressed to third parties to informal oral inquiries addressed to persons inside the entity. Responses to inquires may provide the auditor with information which he did not previously possess or may provide him with corroborative evidence.

Confirmation consists of the response to an inquiry to corroborate' information contained in the accounting records. For example, the auditor requests confirmation of receivables by direct communication with debtors.

2.4 **Computation/Recalculation:** It consists of checking the arithmetical accuracy of source documents and accounting records and doing calculation to arrive at facts and figures.

2.5 **Analytical Procedures:** Analytical review refers to studying significant ratios and trends and investigating unusual fluctuations.

2.6 **Reperformance:** Reperformance involves the auditor's independent execution of procedures or controls that were originally performed as part of the entity's internal control.

3. **Reliability of Audit Evidence:**
   - The reliability of audit evidence is increased when it is obtained from independent sources outside the entity.
   - The reliability of audit evidence that is generated internally is increased when the related controls (including control for preparation and maintenance of records) are effective.
   - Audit evidence in documentary form, whether paper, electronic, or other medium, is more reliable than evidence obtained orally.
   - Audit evidence obtained directly by the auditor is more reliable than audit evidence obtained indirectly.
   - Audit evidence provided by original documents is more reliable than audit evidence provided by photocopies or facsimiles, or documents that have been filmed, digitized or otherwise transformed into electronic form, the reliability of which may depend on the controls over their preparation and maintenance.

4. **Using the work of a Management's Expert:** The auditor should:
   - Evaluate the competence, capabilities and objectivity of that expert;
   - Obtain an understanding of the work of that expert; and
   - Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion.

5. **When using information produced by the Entity:** The auditor shall evaluate whether the information is sufficiently reliable for the auditor's purposes. The auditor should also obtain audit evidence to verify the accuracy and completeness of that information.

6. **Inconsistency in, or doubts over reliability of Audit Evidence:** If, audit evidence obtained from one source is inconsistent with that obtained from another source; or if, the auditor has doubts over the reliability of information to be used as audit evidence. The auditor should determine what modifications or additions to audit procedures are necessary to resolve the matter, and should consider the effect of that matter, if any, on other aspects of the audit.

No.	Question Bank	Exam	Marks	Refer Point/ Ans.
1	Write short notes on "Audit Evidence".	M97	4	1
2	Write short notes on "Obtaining Audit Evidence, in performing compliance and substantive procedures".	M05 PM	10	1
3	Write short notes on "Inquiry"	M03 PM	4	2.3

SA 501 — AUDIT EVIDENCE—SPECIFIC CONSIDERATIONS FOR SELECTED ITEMS (W.E.F. 1ST APRIL' 2010)

1. **Scope of this SA:** This SA deal with specific considerations by the auditor in obtaining sufficient audit evidence with respect to certain aspect of inventory, litigation and claims involving the entity, and segment information in audit of financial statements.

2. **Objective:** The objective of the auditor is to obtain sufficient appropriate audit evidence regarding the:
   - Existence and condition of inventory
   - Completeness of litigation and claims involving the entity; and
   - Presentation and disclosure of segment information in accordance with the applicable financial reporting framework.

3. **PART – 'A' INVENTORY:**
   - When inventory is material to the financial statements the auditor should obtain sufficient appropriate

audit evidence regarding the existence and condition of inventory by:

◊ Attending physical inventory counting, unless impracticable.

◊ Performing audit procedures over the entity's final inventory records to determine whether they accurately reflect actual inventory count results.

- If physical inventory counting is conducted at a date other than the date of the financial statements, the auditor should also perform audit procedures to obtain audit evidence about whether changes in inventory between the count date and the date of financial statements are properly recorded.
- If the auditor is unable to attend physical inventory counting due to unforeseen circumstances, the auditor should make or observe some physical counts on an alternative date and perform audit procedures on intervening transactions.
- If attendance at physical inventory counting is impracticable, he should perform alternative audit procedures to obtain sufficient & appropriate evidences regarding the existence and condition of inventory. If it is not possible to do so, the auditor should modify the opinion in the auditor's report.
- When inventory under the custody and control of a third party is material to the financial statements, the auditor should obtain sufficient appropriate audit evidence regarding the existence and condition of that inventory by performing one or both of the following:
  ◊ Request confirmation from the third party.
  ◊ Perform inspection or other audit procedures appropriate in the circumstances.

4. PART 'B' Litigation and Claims:

- The auditor should design and perform audit procedures in order to identify and claims involving the entity which may give rise to a risk of material misstatement, including:
  ◊ Inquiry with management and, where applicable, others within the entity, including in-house legal counsel.
  ◊ Reviewing minutes of meetings and correspondence between the entity and its legal counsel.
  ◊ Reviewing legal expense accounts.
- If the auditor assess 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 exists, the auditor should, in addition to the procedures required by other SA, seek direct communication with the entity's external legal counsel. If law, regulation or the respective legal professional body prohibits the entity's external legal counsel from communicating directly with the auditor, the auditor should perform alternative audit procedures.
- If management refuses to give the auditor permission to communicate or meet directly, or the entity's external legal counsel refuse to respond appropriately to the letter of inquiry, or is prohibited from responding; and
- If the auditor is unable to obtain sufficient appropriate audit evidence by performing alternative audit procedures; the auditor should modify the opinion in the auditor's report in accordance with SA 705.
- **Written Representation:** The auditor should request for written representation from the management and where, appropriate, those charged with governance, that all known actual or possible litigation and claims whose effect should be consider while preparing financial statements have been disclosed to the auditor and appropriately accounted for and disclosed in accordance with the applicable financial reporting framework.

5. Part C "Segment Information": The auditor should obtain sufficient appropriate audit evidence regarding the presentation and disclosure of segment information in accordance with the applicable financial reporting framework by:

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

No.	Question Bank	Exam	Marks	Refer Point/ Ans.
1	You are the auditor of Easy Communications Ltd. for the year 2007-08. The inventory as at the end of the year i.e. 31.3.08 was Rs. 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?	N08 PM	5	Ans- 1

Answer

Ans - 1:-

As per SA 501, "Audit Evidence – Additional Considerations For Specific Items" the auditor should perform audit procedures, designed to obtain sufficient appropriate audit evidence during his attendance at physical inventory counting.

If the auditor is unable to be present at the physical inventory count on the date planned due to unforeseen circumstances, the auditor should take or observe some physical counts on an alternative date and where necessary, perform alternative audit procedures to assess whether the changes in inventory between the date of physical count and the period end date are correctly recorded. The auditor would also verify the procedure adopted, treatment given for the discrepancies noticed during the physical count. The auditor would also ensure that appropriate cut off procedures were followed by the management. He should also get management's written representation on (a) the completeness of information provided regarding the inventory and (b) assurance with regard to adherence to laid down procedures for physical inventory count.

By following the above procedure it will be ensured that the physical verification conducted by the management was in order.

SA 505 EXTERNAL CONFIRMATIONS (W.E.F. 1ST APRIL' 2010)

1. Definitions:

1.1 External Confirmation: Audit evidence obtained as a direct written response to the auditor from a third party in paper, electronic or other form.

1.2 Positive Confirmation Request: A request that the confirming party respond directly to the auditor both in case of agreement and disagreement with the information provided in the request.

1.3 Negative Confirmation Request: A request that the confirming party respond directly to the auditor only if the confirming party disagree with the information provided in the request. It is considered to be less persuasive than the positive confirmation request. Auditor should use them only if all of following are present:

- The assessed level of inherent and control risk is low.
- Internal Control is effective.
- A large number of small balances are involved.
- A substantial number of errors is not expected; and
- The auditor has no reasons to believe that respondents will disregard these requests.

2. External Confirmation Process: The process includes: -

- Selecting items for confirmation.
- Designing the confirmation request.
- Communicating the confirmation request to the appropriate third party.
- Obtaining the response from third party.
- Evaluating the information or lack thereof, including the reliability of that information.

3. Management's refusal to allow the Auditor to send a Confirmation Request [M05] [M11]: In such case, the auditor should:

- Inquire management's reasons for refusal and seek audit evidence as to their validity and reasonableness.
- Evaluate the implication of management's refusal 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
- Perform alternative audit procedures designed to obtain relevant and reliable audit evidence.
- If the auditor concludes that management's refusal is unreasonable, or auditor is unable to obtain relevant and reliable audit evidence from alternative audit procedures, then the auditor should communicate with TCWG (SA 260) and consider effect on his audit report (SA 705).

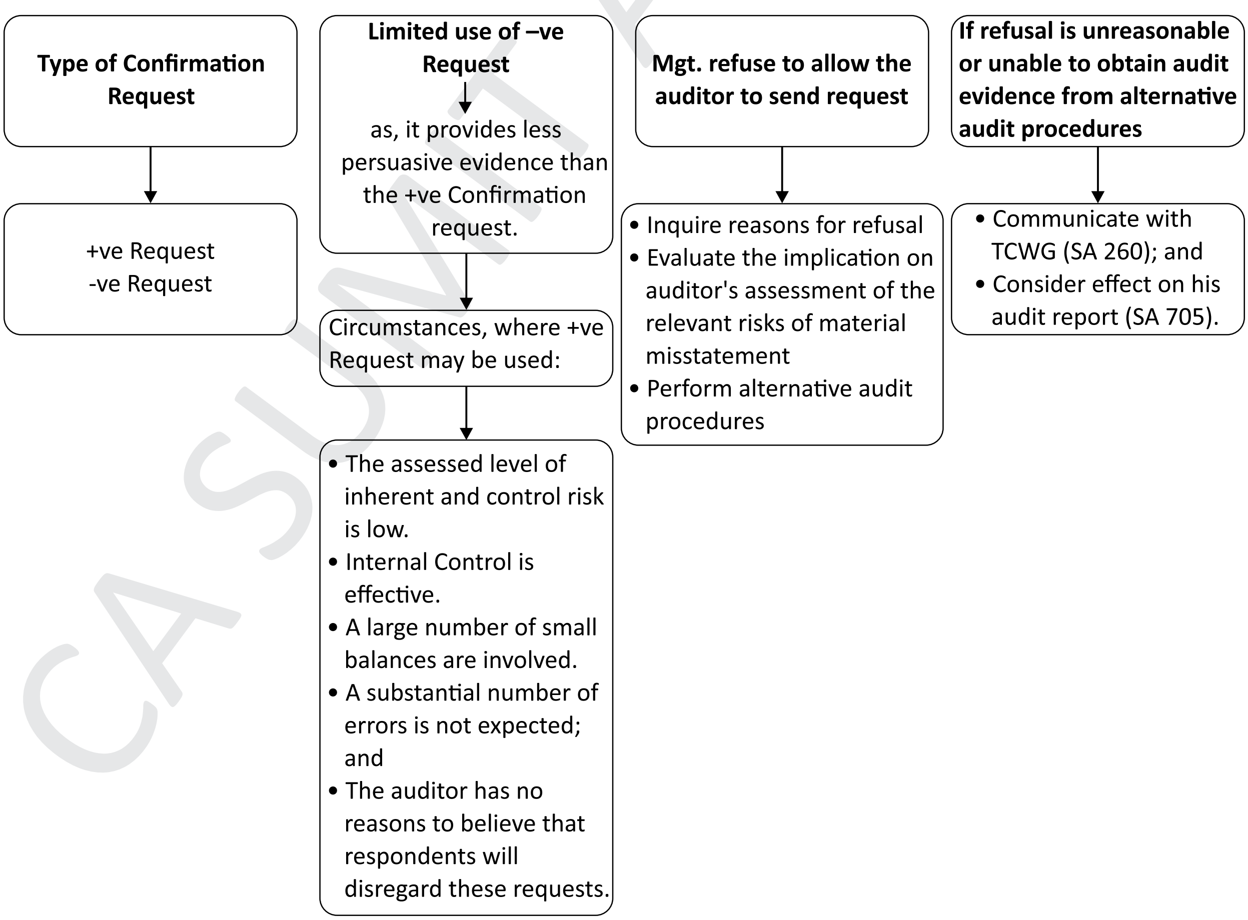
4. **Situations where External Confirmation may be required [M07]:**
   - Accounts balances and their components.
   - Bank Balance and other information from bankers.
   - Confirmation of loans from others.
   - Stock held by third parties.
   - Investments purchased but delivery not taken.

5. **Reliability of Response:** If auditor has doubts about the reliability of response, then he should obtain further audit evidences to resolve these doubts. If response is found to be unreliable, it may indicate fraud risk factor, and then he should consider its effect on NTE of other audit procedures.

6. **No response to Positive Confirmation Request:** In that case, the auditor should follow up with second and sometimes a third request to those who do not respond. Where the auditor is unable to obtain response, the auditor should use alternative procedures. However, if auditor determines that response is necessary & thus alternative audit procedures do not provide sufficient appropriate audit evidences, he should determine its effect on audit report.

7. **Evaluating results of the Confirmation Process:** The auditor should evaluate whether the results of the external confirmation process provide relevant and reliable audit evidence, or whether performing further audit procedures is necessary.

<u>Summary SA505</u>



No.	Question Bank	Exam	Marks	Refer Point/ Ans.
1	As a Statutory Auditor, how would you deal with the following? "The accountant of C Ltd has requested you, not to send balance confirmations to a particular group of debtors since the said balances are under dispute and the matter is pending in the Court".	M05 PM	4	3
2	The management of S Ltd. requests you not to seek confirmation from its debtors. As the auditor of S Ltd., what can be an apropriate response?	M11	6	
3	Situations where external confirmations can be used.	M07 PM	4	4
4	Moon Limited replaced its statutory auditor for the Financial year 2008-09. During the course of audit, the new auditor found a credit item of Rs. 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.	N09 PM	5	Ans - 1
5	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?	M13 PM	4	Ans - 2
6	During the course of audit of Star Limited the auditor received some of the confirmation of the balances of creditors outstanding in the balance sheet through external confirmation by negative confirmation request. In the list of Sundry Creditors there are number of creditors of small balances except one, old outstanding of Rs. 15 Lacs, of whom, no confirmation on the credit balance received. Comment with respect to Standard of Auditing.	M14 PM	5	Ans - 3

Answer

Ans - 1:

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 Rs 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 by way of a qualification in his audit report to the members.

Q:-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?

Ans - 2:

- SA 505, "External Confirmations", establishes standards on the auditor's use of external confirmation as a means of obtaining audit evidence. It requires that the auditor should employ external confirmation procedures in consultation with the management. The auditor may come across certain situations in which the management may request him not to seek external confirmation from certain parties because of dispute with the creditors, etc. The management, for example, might make such a request on the grounds that due to a dispute with the particular creditor, the request for confirmation might aggravate the sensitive negotiations between the entity and the creditor.

- In such cases, when an auditor agrees to management's request not to seek external confirmation regarding certain creditors, the auditor should consider validity of grounds for such a request and assess management's integrity and obtain evidence to support the same. The auditor should also ask the management to submit its request in a written form, detailing therein the reasons for such a request.
- If the auditor of H Ltd agrees to management's request not to seek external confirmation regarding a particular matter, the auditor should document the reasons for acceding to the management's request and should apply alternative procedures to obtain sufficient appropriate evidence regarding that matter. While considering the validity of request, in case the auditor of H Ltd reaches at a conclusion that the same was not valid, he may appropriately modify the report.

Ans - 3:

- As per SA 505, "External Confirmation", Negative Confirmation is a request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request. Negative confirmations provide less persuasive audit evidence than positive confirmations. Accordingly, a failure of a confirming party to respond to a negative confirmation request provides significantly less persuasive audit evidence than does a response to a positive confirmation request.
- In the instant case, the auditor sent the negative confirmation requesting the creditors having outstanding balances in the balance sheet while doing audit of Star Limited. One of the old outstanding of Rs. 15 lacs has not sent the confirmation on the credit balance. In case of non response, the auditor may examine subsequent cash disbursements or correspondence from third parties, and other records, such as goods received notes. Further non response for negative confirmation request does not means that there is some misstatement as negative confirmation request itself is to respond to the auditor only if the confirming party disagrees with the information provided in the request.
- But, if the auditor identifies factors that give rise to doubts about the reliability of the response to the confirmation request, he shall obtain further audit evidence to resolve those doubts.

SA 510 | EXTERNAL CONFIRMATIONS (W.E.F. 1ST APRIL' 2010) INITIAL AUDIT ENGAGEMENTS – OPENING BALANCES (W.E.F. 1ST APRIL' 2010)

1. **Scope of this SA:** This SA deals with the auditor's responsibilities relating to opening balances when conducting an initial audit engagement.

2. **Objective:** The objectives of the auditor with respect to opening balances are to obtain sufficient appropriate audit evidence about whether:
   - Opening balances contain misstatements, that materially affect the current period's financial statements; and
   - Appropriate accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, or changes thereto are properly accounted for and adequately presented and disclosed in accordance with the applicable FRF.

3. **Definitions**:

3.1 **Initial Audit Engagement:** An engagement in which either:
- The financial statements for the prior period were not audited; or
- The financial statements for the period were audited by a predecessor auditor.

3.2 **Opening Balances:** 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 effect of transactions and events of prior periods and accounting policies applied in the prior period. Opening balances also include matters requiring disclosures that existed at the beginning of the period, such as contingencies and commitments.

3.3 **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.

4. **Audit Procedures & Reporting:**

4.1 For Opening Balances: The auditor should obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements.

- The auditor should ensure that, whether the prior period's closing balances have been correctly brought forward to the current period or, when appropriate, any adjustment have been disclosed as prior period items in the current year's Profit and Loss A/c.
- The auditor should also determine whether the opening balances reflect the application of appropriate accounting policies.
- If the ***prior period's financial statements were audited by a another predecessor auditor,*** the auditor may be able to obtain sufficient appropriate audit evidence regarding the opening balances, by perusing the copies of the audited financial statements including the other documents such as schedules, notes to accounts etc. The current auditor can place reliance on the closing balances contained in the financial statements of preceding periods, until the current auditor gets the indications of any misstatement in opening balances.
- When the ***prior period's FS are not audited,*** the auditor should obtain appropriate audit evidence for opening balance. For current assets and liabilities, some audit evidence can be obtained from the current period. For example for the opening debtors there will be collection during current period and for opening creditors there will be payments in current period, these will provide some evidence of existence of opening debtors and creditors. To obtain some evidence for other assets and liabilities, other connected records may be examined for opening balances of these assets and liabilities, like fixed assets register etc.
- If the auditor obtains audit evidence that the ***opening balances contain misstatement*** that could materially affect the current period's financial statements, the auditor should 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 financial statements, the auditor should communicate the misstatements with the appropriate level of management and TCWG in accordance with SA 450.
- If the auditor concludes that the ***opening balances contain a misstatement that materially affects the current period's financial statements,*** and the effect of the misstatement is not properly accounted for or not adequately presented or disclosed, the auditor should express a qualified opinion or an adverse opinion.
- If the ***auditor is unable to obtain sufficient appropriate*** audit evidence regarding the opening balances, the auditor shall express a qualified opinion or a disclaimer of opinion.

4.2 For Consistency of Accounting Policies: The auditor should 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 FRF.

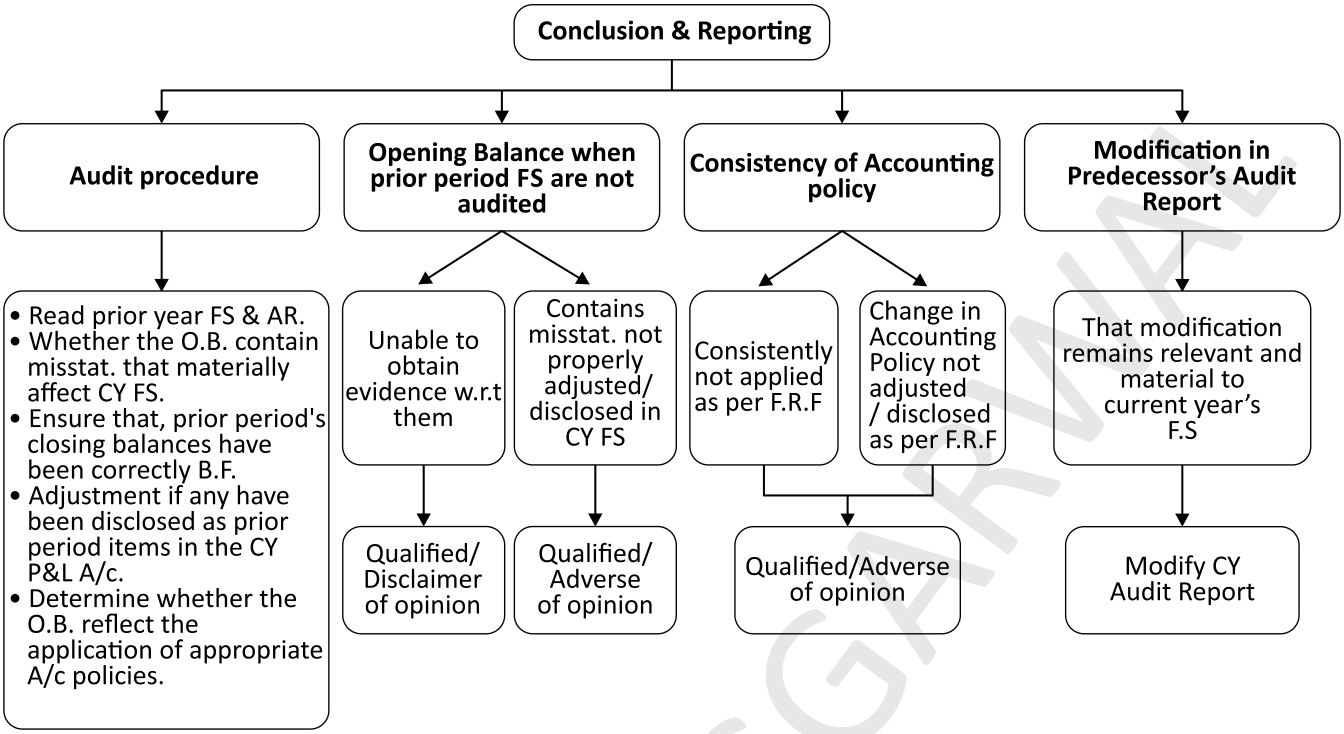
If it is not, the auditor shall express a qualified opinion or an adverse opinion.

4.3 For Modification to the Opinion in the Predecessor Auditor's Report: If the prior period's financial statements were audited by another auditor and there was a modification to the opinion, the auditor should evaluate the effect of the matter ***"giving rise to the modification"*** on the current period's financial statements in accordance with SA 315. If that matter remains relevant and material to the current period's financial statements, the auditor should modify the auditor's opinion on the current period's financial statements.

5. Illustration: Circumstances resulting in qualified opinion:

- The auditor appointed after the end of the previous financial year, thus did not observe the counting of the physical inventory at the beginning of the current period and was unable to obtain sufficient appropriate audit evidence regarding the opening balances of inventory.
- The possible effects of the inability to obtain sufficient appropriate audit evidence regarding opening balances of inventory are deemed to be material but not pervasive to the entity's result of operations and cash flows.
- The State of Affairs at year end gives a true and fair view.
- An opinion that is qualified regarding the results of operations and cash flows and unmodified regarding State of Affairs is considered appropriate in the circumstances.

Summary SA 510



No.	Question Bank	Exam	Marks	Refer Point/ Ans.
1	Q. You have been appointed as the auditor of Good Health Ltd. for 2007-08 which was audited by CA Trustworthy in 2006-07. As the Auditor of the company state the steps you would take to ensure that the Closing Balances of 2006-07 have been brought to account in 2007-08 as Opening Balances and the Opening Balances do not contain misstatements. Comment.	N08 PM	5	Ans - 1
2	(a) What are 'Initial Audit Engagements'? (b) 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. (c) If, after performing the procedure, you are not satisfied about the correctness of 'Opening Balances'; what approach you will adopt in drafting our audit report in two situations mentioned in(b) above?	N04 PM	16	

Answer

Ans - 1:-

(a) Initial Audit Engagement: Opening Balances: As per SA 510 initial audit engagement is an engagement in which either:

- The financial statements for the prior period were not audited; or
- The financial statements for the prior period were audited by a another auditor.

(b) Financial Statements Audited by Another Auditor: If the prior period's financial statements were audited by a predecessor auditor, the auditor may be able to obtain sufficient appropriate audit evidence regarding the opening balances by perusing the copies of the audited financial statements including the other relevant documents relating to the prior period financial statements such as supporting schedules to the audited financial statements. Ordinarily, the current auditor can place reliance on the closing balances contained in the financial statements for the preceding period, except when during the performance of audit procedures for the current period the possibility of misstatements in opening balances is indicated.

(c) Drafting Audit Report: If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor shall express a qualified opinion or a disclaimer of opinion, as appropriate. Further, if the auditor concludes that the opening balances contain a misstatement that materially affects the current period's financial statements and the effect of the misstatement is not properly accounted for or not adequately presented or disclosed, the auditor shall express a qualified opinion or an adverse opinion.

SA 520 | ANALYTICAL PROCEDURES (W.E.F. 1ST APRIL' 2010)

1. **Objectives of Auditor w.r.t. Analytical Procedures:**
   - Obtain relevant & reliable audit evidences when using Substantive analytical Procedures; and
   - Design & perform analytical procedures with auditors understanding of entity.

2. **Analytical Procedures meaning:** Evaluation of financial information through analysis of relationship among financial & non-financial data. It includes comparisons of the entity's financial information with, for example:
   - **Trend Analysis:** Comparable information for prior periods.
   - **Data Analysis:** Anticipated results of the entity, such as budgets or forecasts.
   - **Inter-firm Analysis:** Similar industry information, such as a comparison of the entity's ratio of sales to accounts receivable with industry average or with other entities of comparable size in the same industry.

   Various methods may be used to perform analytical procedures. These methods range from performing simple comparisons to performing complex analyses using advanced statistical techniques.

3. **Substantive Analytical Procedures (SAP):** When using substantive analytical procedures, he should consider the following four factors:
   - **Suitability of particular SAP:** He should determine suitability of SAP for a particular item. These are generally adopted for those transactions that tend to be predictable over time. For example, it can be used to compare gross profit ratio in a stable entity.
   - **Reliability of Data to be compared:** It is influenced by the following factors:
     - ◊ Source of information available (for example it is more reliable if obtained from some independent source).
     - ◊ Relevance of the information available (budgets should be realistic).
     - ◊ Comparability of information available (Entities should be comparable).
     - ◊ Control over preparation of information (if last year's financial statements are audited).
   - **Development of expectation:** He should develop an expectation of recorded values. These expectations should be sufficiently precise so that any misstatement can be easily identified.
   - **Difference of Recorded amount from expected values that is acceptable:** Determine the amount of any difference of recorded amounts from expected values that is acceptable without further investigation.

4. **Analytical Procedures that assist when Forming overall Conclusion:** The auditor should design and perform analytical procedures near the end of the audit that assist the auditor while forming an overall conclusion as to whether the financial statements are consistent with the auditor's understanding of the entity.

5. **Investigating results of Analytical Procedures:** If auditor identifies fluctuations or a significant difference between recorded & expected values, he should investigate such differences by:
   - Inquiring of management and thereafter obtaining appropriate audit evidences relevant to management's responses; and
   - Performing other audit procedures as necessary in the circumstances.

No.	Question Bank	Exam	Marks	Refer Point/ Ans.
1	Write short notes on "Extent of reliance upon ARP depends upon several factors".	M99	10	Ans - 1
2	Indicate briefly the purposes for which analytical procedures are applied by the auditor.	M99	6	Ans - 2
3	What are the considerations to be kept in mind while performing analytical procedures on data prepared by the client.	M09 PM	6	Ans - 3
4	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.	N13 PM	4	Ans - 4

Answer

Ans - 1:

Reliance on the results of analytical procedures will depend on the auditor's assessment of the risk that the analytical procedures may identify relationships as expected when a material misstatement exists. In any case, the extent of reliance that the auditor places on the results of analytical procedures depend on following factors

- Materiality of the items involved in relation to the financial information taken as a whole.
- Other audit procedures directed towards the same audit Objectives e.g. other procedures performed by the auditor in reviewing the collectability of accounts receivable.
- Accuracy - with which the expected results of analytical procedures can be predicted.
- The auditor should also test the control over the preparation of information used in applying analytical procedures.

For e.g. If the auditor has concluded that Internal controls over purchase order processing are weak, he may have to rely more on tests of details of transactions and balances rather than on analytical procedures in drawing his conclusions on purchases.

Thus such assessment of controls will enable the auditor to have greater confidence in the reliability of information and therefore in the results of analytical procedures.

Ans - 2: Analytical procedures is a substantive technique which can be used at

- Initial planning stage of the audit.
- During the course of the detailed audit work and
- At or near the completion of the audit when reviewing the financial statements.

As per SA 520, the purposes of Analytical procedures are:

- They assist the auditor in planning the nature, timing and extent of other audit procedures.
- They serve as substantive procedures when their use can be more effective or efficient than tests of details in reducing detection risk for specific financial statement assertions and
- To provide evidence as to the completeness, accuracy and validity of the date produced by the accounting system, based on inter - relationship between financial data.

As an overall review of the financial statements in the final review stage of an audit these analytical procedures will provide information useful to auditor in two ways.

(a) Confirming conclusions formed during earlier stages of the audit.

(b) Highlighting areas which may require closer attention and in respect of which more detailed audit evidence should be sought.

Ans - 3:

The considerations to be kept in mind by an auditor while performing analytical procedures on data prepared by the client are as follows:

- Objective of such procedures and the extent to which he may be able to rely on their results.
- Nature of the entity and the degree to which information can be dis-aggregated, for example, analytical procedures may be effective when applied to financial information on individual sections of an operation or to FS or components of a diversified entity, than when applied to the FS of the entity as whole.
- Availability of information, both financial, such as budgets or forecasts, and non-financial such as the number of units produced or sold.
- Sources of information available.
- Reliability, Relevancy & Comparability of the information available
- Knowledge gained 'by the auditor during previous examinations.
- Testing the controls over the preparation of non financial information, if any, used in applying analytical procedures.

Ans - 4: Analytical Procedures:

- Analytical Procedures consist of the comparison of data from different sources to determine, if reported information looks ‘odd’ or ‘wrong’. Analytical Procedures include comparison of financial information with Prior Period Information (such as budgets, forecast etc).
- **Analytical Procedures 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.
- **Analytical Procedures 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 occupancy 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.

SA 530 | AUDIT SAMPLING (W.E.F. 1ST APRIL' 2009)

1. **Scope of this SA:** This 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.

2. **Definitions:**

2..1 **Audit Sampling:** The application of audit procedures to less than 100% of items within a population in such a way, that all sampling units have a chance of selection in order to provide with a reasonable basis on which to draw conclusion about the entire population.

2..2 **Population:** The entire set of date from which a sample is selected and about which the auditor wishes to draw conclusions.

2..3 **Sampling Risk [M06 M10]:** Sampling risk arises from the possibility that the auditor’s conclusion, based on a sample, may be different from the conclusion that would be reached if the entire population were subjected to the same audit procedure. Sampling risk arises during audit sampling due to inherent limitations. Sampling risk can be reduced by adopting statistical sampling techniques and drawing reasonable conclusions from analysis of sample transactions. The auditor is faced with sampling risk both in tests of control and substantive procedures. Sampling risk can lead to two types of erroneous conclusions:

- In case of a ***test of controls,*** Risk that controls of sample are ***more effective*** than those of entire population are, or in the case of a ***test of details,*** that a ***material misstatement does not exist in sample*** when in fact it does exist in population. The auditor is primarily concerned with this type of erroneous conclusion because it affects ***audit effectiveness*** and is more likely to lead to an inappropriate audit opinion.
- In the case of a ***test of controls,*** that controls of sample tested are ***less effective*** than those of entire population are, or in the case of a ***test of details,*** that a ***material misstatement exists in sample*** when

in fact it is not material at the level of entire population. This type of erroneous conclusion affects ***audit efficiency*** as it would usually lead to additional work to establish that initial conclusions were incorrect. This would waste auditor's time in verifying less risky items, which could have been used for more risky areas.

2.4 **Non-sampling risk:** The risk that the auditor reaches an erroneous conclusion for any reason not related to sampling risk.

2.5 **Sampling unit:** The individual items constituting a population such as credit entries on bank statement, sales invoices, or monetary units.

2.6 **Statistical & Non-Statistical Sampling [M12]:** Statistical sampling is a method of sampling based on mathematical and statistical 'techniques. The theory of probability and theory of random numbers may be considered in the determination of sample size and sample composition. Statistical sampling has wide application in case of homogeneous population e.g. transactions involving compliance testing, payroll checking vouching of invoices and petty cash vouchers. Statistical sampling that has the following characteristics:

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

A sampling approach that does not have above characteristics is considered non-statistical sampling.

2.7 **Anomaly:** A misstatement or deviation that is demonstrably not representative of misstatement or deviations in a population.

2.8 **Stratification:** The process of dividing a population into sub-population, each of which is a group of sampling units which have similar characteristics (often monetary value).

2.9 **Tolerable Misstatement [M14]:** 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.

Further, while designing a sample, the auditor determines tolerable misstatement in order to address the risk that the aggregate of individually immaterial misstatements may cause the FS to be materially misstated and provide a margin for possible undetected misstatements.

Tolerable misstatement is the application of performance materiality, to a particular sampling procedure. Tolerable misstatement may be the same amount or an amount lower than performance materiality.

2.10 **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.

3. **Methods of Sampling [N14]:**

3.1 **Random Sample:** This method is applied through random number generators, for example, random number tables. Each sampling unit has equal probability of being selected.

3.2 **Systematic Sample:** In this method the number of sampling units in the population is divided by the sample size to give a sampling interval, for example 50, and having determined a starting point within the first 50, each 50th sampling unit thereafter is selected. Although the starting point may be determined haphazardly, the sample is more likely to be truly random if it is determined by use of a computerised random number generator or random number tables.

3.3 **Monetary Unit sampling:** This method is a type of value-weighted selection in which sample size, selection and evaluation results in a conclusion in monetary amounts.

3.4 **Haphazard Selections:** In this method the auditor selects the sample without following a structured technique. Although no structured technique is used, the auditor would nonetheless avoid any conscious bias or predictability and thus attempt to ensure that all items in the population have a chance of selection. Haphazard selection is not appropriate when using statistical sampling.

3.5 **Block selection:** This method involves selection of a block(s) of contiguous items from within the population. Block selection cannot ordinarily be used in audit sampling because most populations are structured such that items in a sequence can be expected to have similar characteristics to each other, but different characteristics from items elsewhere in the population. Although in some circumstances it may be an appropriate audit procedure to examine a block of items, it would rarely be an appropriate sample selection technique when the auditor intends to draw valid inferences about the entire population based on the sample.

4. Steps for Audit Sampling:

- Determining sample size.
- Selection of items to sample.
- Performing audit procedures on selected sample.
- Analysis of nature, causes of deviations & misstatements.
- Projecting misstatement.
- Evaluating results of sample.

4.1. Sample Design, Size and Selection of Items for Testing:

- The auditor should determine a sample size sufficient to reduce sampling risk to an acceptably low level.
- The sample size can be determined by the application of a statistically – based formula or through the exercise of professional judgment.
- The auditor should select items for the sample in such a way that each sampling unit in the population has a chance of selection.

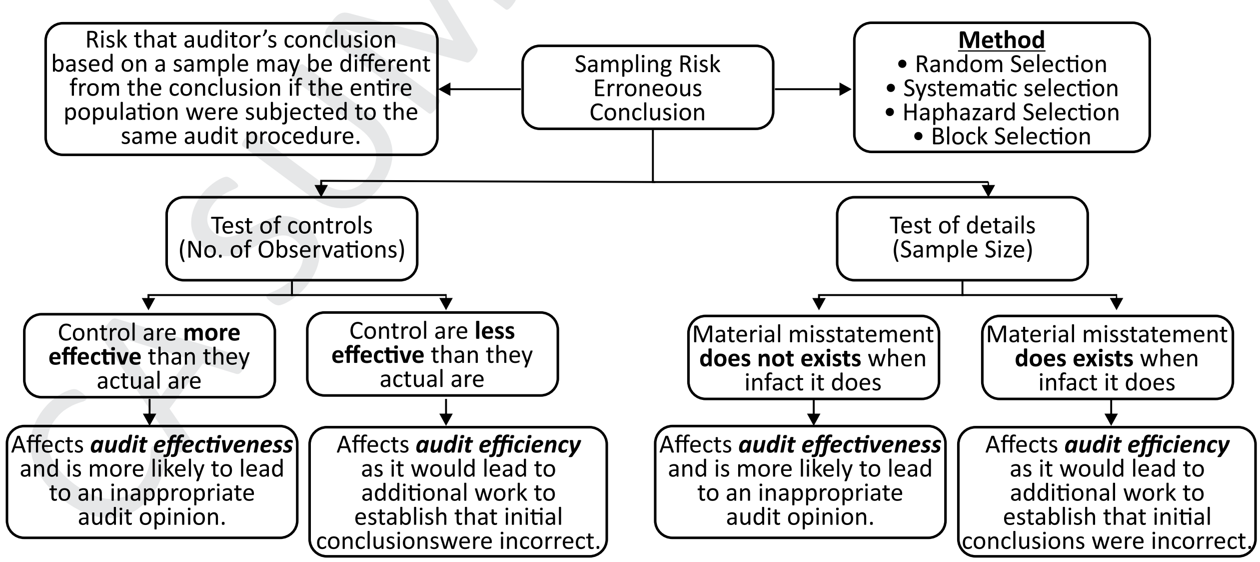
4.2. Performing Audit Procedures on Selected Sample: The auditor shall perform audit procedures, appropriate to the purpose, on each item selected. If the auditor is unable to apply the designed audit procedures, or suitable alternative procedures, to a selected item (Example when documentation related to that item has been lost) the auditor should treat item as a deviation or a misstatement.

4.3. Analysis of Nature and Cause of Deviations and Misstatements: The auditor shall investigate the nature and causes of any deviations or misstatements identified, and evaluate their possible effect. In the extremely rare circumstances when the auditor considers a misstatement or deviation discovered in a sample to be an anomaly, the auditor should obtain a high degree of certainty that such misstatement or deviation does not affect the remainder of the population.

4.4. Projecting Misstatement: The auditor should project the possibility of misstatement to the entire population. When projecting misstatement, the auditor should consider the qualitative aspects of error found.

4.5. Evaluating results of Audit Sampling: The auditor shall evaluate, (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.

Summary SA 530



No.	Question Bank	Exam	Marks	Refer Point/ Ans.
1	Write short notes on "Sampling Risk". Write short notes on "Sampling Risk".	M06 PM	4	2.3
2	While planning the audit of S Ltd. you want to apply sampling techniques. What are the risk factors you should keep in mind?	M10 PM	4	
3	Write a short note on "Statistical and non statistical sampling".	M12 PM	4	2.6
4	Write short notes on “Tolerable misstatement”.	M14	4	2.9
5	Describe the principal methods of selection of samples.	N14	4	3
6	An auditor while analysing the errors in a sample need not consider the qualitative aspects of errors detected". Please comment.	N01 PM	8	Ans - 1

Answer

Ans - 1:

According to “SA 530” after carrying out the appropriate audit procedures on each sample item, the auditor should

- Analyse any errors detected in the sample
- Project the errors found in the sample to the population
- Reassess the sampling risk.

The Auditor should judge whether an item is an error or not, the auditor would also need to define the conditions that constitute the error keeping in view the audit objectives. If the audit evidence regarding a specific sample cannot be obtained, the auditor may adopt alternative audit procedures. The auditor should analyse cause of the error and its impact on the other phases of the audit. If there is some common feature in the error, extended procedures may be carried out by the auditor.

The auditor should project the possibility of error to the entire population by a suitable method and consider the qualitative aspects of error found. Where the population is divided into sub-population, the projection of errors is done separately for each sub- population and the results are combined.

The auditors also need to consider whether errors in population exceed the tolerable error. If it is so, either the sampling risk may be revised or extended procedures or alternate procedures may be performed.

Therefore, auditor cannot be satisfactorily satisfied by detecting errors only but also would need to consider the qualitative aspects of such errors.

SA 540 | AUDITING ACCOUNTING ESTIMATES, INCLUDING FAIR VALUE ACCOUNTING ESTIMATES, AND RELATED DISCLOSURES (W.E.F. 1ST APRIL’ 2009)

1. **Nature of Accounting Estimates:** Some financial statement items cannot be measured precisely, but can only be estimated. For purpose of this SA, such financial statement items are referred to as accounting estimates. The degree of estimation uncertainty affects the risks of material misstatement of accounting estimates.

2. **Objective of Auditor:** The objective of the auditor is to obtain sufficient appropriate audit evidence whether accounting estimates, including fair value accounting estimates are reasonable; and related disclosures in the financial statements are adequate.

3. **Definitions**

3.1 **Accounting Estimates:** An approximation of a monetary amount in the absence of a precise means of measurement. For example, Provision for bad and doubtful debts, Provision to meet warranty cost/claims, Provision for retirement benefits etc.

3.2 **Outcome of an Accounting Estimate:** The actual monetary amount which results from the resolution of the underlying transactions and events.

4. **Risk Assessment Procedures and Related Activities:** In order to identify and assess the risks of material misstatement for accounting estimates, the auditor should obtain an understanding of the following:

- The requirements of the applicable FRF relevant to accounting estimates.
- How management identifies those transactions, events and conditions that may give rise to the need for accounting estimates to be recognized 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.

The estimation making process adopted by the management i.e. How management makes accounting estimates (methods, assumptions, relevant controls, compare with earlier years estimates, use of expert etc.)

The auditor should review and consider the subsequent events after the balance sheet date but before the completion of audit to judge the appropriateness of the accounting estimates.

5. **Responses to the Assessed Risks of Material Misstatement:** Based on the assessed risks of material misstatement, the auditor should determine whether management has appropriately applied the applicable FRF and whether the methods of measurement are appropriate in the circumstances and have been applied consistently. For accounting estimates that give rise to significant risks, the auditor should evaluate the following:

- How management has considered alternative assumptions or outcomes, and why it has rejected them.
- How management has addressed estimation uncertainty in making the accounting estimates.
- Whether the significant assumptions used by management are reasonable.
- Management's decision to recognize or not to recognize the accounting estimates in the financial statements.

6. **Measurement and Disclosures Related to Accounting Estimates:** The auditor should obtain sufficient appropriate audit evidence about whether the accountings estimate and their disclosure in the financial statements is appropriate. For accounting estimates that give rise to significant risk, the auditor should check adequacy of the disclosure of their estimation uncertainty in the financial statements.

7. **Indicators of Possible Management Bias:** The auditor shall review the judgments and decisions made by management in making of accounting estimates to identify whether there are indicators of possible management bias.

8. **Written Representations:** The auditor should obtain written representations from management whether management believes significant assumptions used by it in making accounting estimates are reasonable.

9. **Documentation:** The audit documentation shall include:

- The basis for the auditor's conclusions about the reasonableness of accounting estimates and their disclosure that give rise to significant risk; and
- Indicators of possible management bias, if any.

No.	Question Bank	Exam	Marks	Refer Point/ Ans.
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?	M11 PM	6	4

SA 550 RELATED PARTIES (W.E.F. 1ST APRIL' 2010)

1. **Scope of this SA:** This SA deals with the auditor's responsibilities regarding related party relationships and transactions when performing an audit of financial statements.

2. **Objective:** The objectives of the auditor are *(Irrespective of whether the applicable FRF establishes related party requirements),* to obtain an understanding of related party relationships and transactions sufficient to be able:
   - To recognize fraud risk factors, if any, arising from related party relationships and transactions that are relevant to the identification and assessment of the risks of material misstatement due to fraud; and
   - To conclude whether the financial statements, (*insofar as they are affected by those relationships and transactions)*, (a) achieve a true and fair presentation; or (b) are not misleading; and

   In addition, *(where the applicable FRF establishes related party requirements),* to obtain sufficient appropriate audit evidence about whether related party relationships and transactions have been appropriately identified, accounted for and disclosed in the financial statements in accordance with the framework.

3. **Definitions:**

3.1 **Arm's Length Transaction:** A transaction conducted on such terms and conditions between a willing buyer and a willing seller who are unrelated and are acting independently of each other and pursuing their own best interests.

3.2 **Related Party:** A party that is either (a) a related party as defined in the applicable FRF; or (b) Where the applicable *FRF* establishes minimal or no related party requirements, then following shall be considered related party:
   - A person or other entity that has control or significant influence, directly or indirectly through one or more intermediaries, over the reporting entity;
   - Another entity over which the reporting entity has control or significant influence, directly or indirectly through one or more intermediaries; or
   - Another entity that is under common control with the reporting entity through having:
     - ◊ Common controlling ownership;
     - ◊ Owners who are close family members; or
     - ◊ Common key management.

   However, entities that are under common control by a state (i.e., a national, regional or local government) are not considered related unless they engage in significant transactions or share resources to a significant extent with one another.

4. **Understanding the Entity's Related Party Relationships and Transactions:**
   - The auditor should inquire of management regarding:
     - ◊ The identity of the entity's related parties, including changes from the prior period;
     - ◊ The nature of the relationships between the entity and these related parties; and
     - ◊ Whether the entity entered into any transactions with these related parties during the period and, if so, the type and purpose of the transactions.
   - The auditor should inquire of management and others within the entity, and perform other risk assessment procedures to obtain an understanding of the controls, if any, that management has established to:
     - ◊ Identify, account for, and disclosed related party relationships and transactions in accordance with the applicable FRF;
     - ◊ Authorise and approve significant transactions and arrangement (a) with related party; and (b) outside the normal course of business.

5. **Maintaining Alertness for Related Party Information when Reviewing Records or Documents:** During the audit, the auditor should remain alert, when inspecting records or documents that may indicate the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor. If the auditor identified significant transactions outside the entity's normal course of business the auditor should inquire of management about (a) The nature of these transactions; and (b)

Whether related parties could be involved.

6. **Sharing Related Party Information with the Engagement Team:** The auditor should share relevant information obtained about the entity's related parties with the other members of the engagement team.

7. **Identification and Assessment of the Risks of Material Misstatement Associated with Related Party Relationships and Transactions:**
   - The auditor should identify and assess the risks of material misstatement associated with related party relationships and transactions and determine whether any of those risks are significant risks.
   - If the auditor identifies fraud and risk factors the auditor should consider such information when identifying and assessing the risks of material misstatement due to fraud in accordance with SA 240.

8. **Identification of Previously Unidentified or Undisclosed Related Parties or Significant Related Party Transactions:** If the auditor identifies related parties relationship or significant related party transactions that management has not previously identified or disclosed to the auditor, the auditor should:
   - Promptly communicate the relevant information to the other members of the audit team.
   - Where the applicable FRF establishes related party requirements, the auditor should:
     - ◊ Request management to identify all transactions with the newly identified related parties for the auditor's further evaluation; and
     - ◊ Inquire as to why the entity's controls over related party relationships and transactions failed to enable the identification or disclosure of the related party relationships or transactions.
   - Perform appropriate substantive audit procedures relating to such newly identified related parties or significant related party transactions.
   - Reconsider the risk, and perform additional audit procedures as necessary; and
   - If such non-disclosure by management appears intentional, evaluate their implications for the audit.

9. **Identified Significant Related Party Transactions outside the Entity's Normal Course of Business:** In that case:
   - The auditor should inspect the underlying contracts or agreements, if any, and evaluate whether:
     - ◊ The business rationale (or lack thereof) of the transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets;
     - ◊ The terms of the transactions are consistent with management's explanations; and
     - ◊ The transactions have been appropriately accounted for and disclosed in accordance with the applicable FRF; and
   - Obtain audit evidence that the transactions have been appropriately authorized and approved.

10. **Assertions That Related Party Transactions Were Conducted on Terms Equivalent to Those Prevailing in an Arm's Length Transaction:** When management has made an assertion in the financial statements to the effect that a related party transaction was conducted on terms equivalent to those prevailing in an arm's length transaction, the auditor should obtain sufficient appropriate audit evidence about the assertion.

11. **Evaluation of the Accounting for and Disclosure of Identified Related Party Relationships and Transactions:** In forming an opinion on the financial statements the auditor should evaluate:
   - Whether, the identified related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the applicable FRF; and
   - Whether, the effects of the related party relationships and transactions:
     - ◊ Prevent the financial statements from achieving true and fair presentation; or
     - ◊ Cause the financial statements to be misleading.

12. **Written Representations:** Where the applicable *FRF* establishes related party requirements, the auditor should obtain written representations from management & TCWG that:
   - They have disclosed to the auditor the identity of the entity's related parties and all the related party relationships and transactions of which they are aware; and
   - They have appropriately accounted for and disclosed such relationships and transactions in accordance with the requirements of the framework.

13. **Documentation:** The auditor should include in the audit documentation the names of the identified related parties and the nature of the related party relationships.

<table>
<tr><th>No.</th><th>Question Bank</th><th>Exam</th><th>Marks</th><th>Refer Point/ Ans.</th></tr>
<tr><td>1</td><td>How can an Auditor identify Related Parties?</td><td>N02</td><td>8</td><td rowspan="4">Ans - 1</td></tr>
<tr><td>2</td><td>Elaborate how the Statutory Auditor can verify the existence of related parties for the purpose of reporting under Accounting Standard 18.</td><td>M06 PM</td><td>8</td></tr>
<tr><td>3</td><td>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.</td><td>M12 PM</td><td>8</td></tr>
<tr><td>4</td><td>As an auditor how will you verify the existence of related parties?</td><td>N12</td><td>8</td></tr>
<tr><td>5</td><td>In the course of your audit you have come across a related party transaction which prima facie appears to be biased. How would you deal with this?</td><td>N14</td><td>4</td><td>Ans - 2</td></tr>
</table>

Answer

Ans - 1:-

The duties of an auditor with regard to reporting of transactions with related parties as required by Accounting Standard 18 are given in SA 550 on Related Parties.

SA 550 “Related Parties”, during the audit, the auditor shall remain alert, when inspecting records or documents, for arrangements or other information that may indicate the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor.

The auditor should review information provided by the management of the entity identifying the names of all known related parties. Since it is the management, which is primarily responsible for identification of related parties, SA 550 requires that to identify names of all known related parties; the auditor may inspect records or documents that may provide information about related party relationships and transactions, for example:

- Entity income tax returns, & Information supplied by the entity to regulatory authorities.
- Shareholder registers to identify the entity’s principal shareholders.
- Statements of conflicts of interest from management and those charged with governance.
- Records of the entity’s investments and those of its pension plans.
- Contracts and agreements with key management or those charged with governance.
- Significant contracts and agreements not in the entity’s ordinary course of business.
- Specific invoices and correspondence from the entity’s professional advisors.
- Life insurance policies acquired by the entity.
- Significant contracts re-negotiated by the entity during the period.
- Internal auditors’ reports.
- Documents associated with the entity’s filings with a securities regulator (e.g, prospectuses).
- Arrangements that may indicate the existence of previously unidentified or undisclosed related party relationships or transactions for example (a) Participation in unincorporated partnerships with other parties (b) Guarantees and guarantor relationships.

In addition, the auditor needs to be alert for transactions which appear unusual in the circumstances and which may indicate the existence of previously unidentified related parties. Example includes:

- Complex equity transactions, such as corporate restructurings or acquisitions.
- Transactions with offshore entities in jurisdictions with weak corporate laws.
- The leasing of premises or the rendering of management services by the entity to another party if no consideration is exchanged.
- Sales transactions with unusually large discounts or returns.
- Transactions with circular arrangements, for example, sales with a commitment to repurchase.

- Transactions under contracts whose terms are changed before expiry.
- Finally, the auditor should also obtain a written representation from the management concerning the completeness of information provided regarding the identifications of related parties.

Ans - 2:-

The duties of an auditor with regard to reporting of transactions with related parties as required by AS 18 are given in SA 550 on Related Parties. As per SA 550 on, “Related Parties”, the auditor should review information provided by the management of the entity identifying the names of all known related parties. Since it is the management, which is primarily responsible for identification of related parties, SA 550 requires that to identify names of all known related parties, the auditor may inspect records or documents that may provide information about related party relationships and transactions.

In the given case, the auditor is finding a related party transaction which prima facie appears to be biased. So the auditor is required to confirm the same. For identified significant related party transactions outside the entity’s normal course of business, the auditor shall inspect the underlying contracts or agreements, if any, and evaluate whether:

- The business rationale (or lack thereof) of the transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets,
- The terms of the transactions are consistent with management’s explanations; and
- The transactions have been appropriately accounted for and disclosed in accordance with the applicable FRF.
- The auditor should also obtain audit evidence that the transactions have been appropriately authorised and approved.
- After obtaining further information on significant transactions outside the entity’s normal course of business enables the auditor to evaluate whether fraud risk factors, if any, are present and, where the applicable
- FRF establishes related party requirements, to identify the risks of material misstatement.
- In addition, the auditor needs to be alert for transactions which appear unusual in the circumstances and which may indicate the existence of previously unidentified related parties.
- Where the applicable FRF establishes related party requirements, the auditor shall obtain written representations from management and, where appropriate, TCWG that they have disclosed to the auditor the identity of the entity’s related parties and all the related party relationships and transactions of which they are aware; and they have appropriately accounted for and disclosed such relationships and transactions in accordance with the requirements of the framework.

Finally, the auditor should report on the basis of this fact that the related party relationships and transactions prevent the financial statements from achieving true and fair presentation (for fair presentation frameworks); or they are not cause for the financial statements to be misleading (for compliance frameworks).

SA 560 | SUBSEQUENT EVENTS (W.E.F. 1ST APRIL' 2009)

1. **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.

2. **Events Occurring Between the date of the Financial Statements and the date of the Auditor’s Report [N09]:** The auditor should perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor’s report that require adjustment or disclosure in the financial statements have been identified. The auditor is not, however, expected to perform additional audit procedures ***on matters to which,*** previously applied audit procedures have provided satisfactory conclusions.

   The auditor shall perform the procedures required above so that they cover the period from the date of the financial statements to the date of the auditor’s report, or as near as practicable thereto. To identify the subsequent events, the auditor should:

   - Review the procedures that management followed to identify the subsequent events.

- Inquiring of management as to whether any subsequent events have occurred after the balance sheet date, which might affect the financial statements.
- Read the minutes of board of directors, executive committee, meeting of shareholders held after the balance sheet date.
- Inquire about the latest position of legal cases.
- Read the entity's latest subsequent interim financial statements, if any.

If auditor identifies events, that require adjustment or disclosure in the financial statements, the auditor should determine whether each such event is appropriately reflected in those financial statements.

3. **Written Representations:** The auditor should request the management to provide a written representation that all events occurring subsequent to the date of the financial statements and for which the applicable FRF requires adjustment or disclosure have been adjusted or disclosed.

4. **Facts Which Become Known to the Auditor After the Date of the Auditor's Report but Before the Date the Financial Statements are Issued:** The auditor has no obligation to perform any audit procedures regarding the financial statements after the date of the auditor's report. However, when after the date of the auditor's report but before the date the financial statements are issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report, the auditor should:

- Discuss the matter which management and where appropriate TCWG.
- Determine whether the financial statements need amendment, if yes; inquire how management intends to address these matters in the financial statements.

If management amends the financial statements, the auditor should:

- Carry out the audit procedures necessary in the circumstances on the amendment; and
- Amend the auditor's report to include (a) an additional date restricted to that amendment, and (b) a statement in an Emphasis of Matter paragraph or Other Matters paragraph that conveys that auditor's procedures on subsequent events are restricted solely to the amendment of the financial statements as described in the relevant note to the financial statements.

In some entities, management may not be required by the applicable law, regulation or the FRF to issue amended financial statements and, accordingly, the auditors need not to provide an amended or new auditor's report.

However, when management does not amend the financial statements in circumstances where, the auditor believes they need to be amended, then:

- If the auditor's report has not yet been provided to the entity, the auditor should modify the opinion; or
- If the auditor's report has already been provided to the entity, the auditor should notify management and TCWG, not to issue the financial statements to third parties before the necessary amendments have been made. If the financial statements are nevertheless subsequently issued without the necessary amendments, the auditor should take appropriated action, to seek to prevent reliance on the auditor's report.

5. **Facts which become known to the Auditor after the Financial Statements have been issued:** The auditor has no obligation to perform any audit procedures regarding the financial statements after the financial statements have been issued. However, when, after the financial statements have been issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report, the auditor should:

- Discuss the matter which management and where appropriate TCWG.
- Determine whether the financial statements need amendment, if yes; inquire how management intends to address these matters in the financial statements.

If management amends the financial statements, the auditor should:

- Carry out the audit procedures necessary in the circumstances on the amendment; and
- Amend the auditor's report to include (a) an additional date restricted to that amendment, and (b) a statement in an Emphasis of Matter paragraph or Other Matters paragraph that conveys that auditor's procedures on subsequent events are restricted solely to the amendment of the financial statements as described in the relevant note to the financial statements.

- Review the steps taken by management to ensure that anyone in receipt of the previously issued financial statements together with the auditor's report thereon is informed of the situation.
- If management does not take the necessary steps to ensure that anyone in receipt of the previously issued financial statements is informed of the situation, the auditor should take appropriate action to seek to prevent future reliance on the auditor's report.

6. **Dual Dating:** The auditor amends the auditor's report to include an additional date restricted to that amendment. The date of the auditor report on the financial statements prior to their subsequent amendment by management remain unchanged, because this date informs the reader as to when the audit work on those financial statements was completed. However an additional date is included in the auditor's report to inform users that the auditor's procedures subsequent to that date were restricted to the subsequent amendment of the financial statements. The following is an illustration of such an additional date:

"(Date of auditor's report), except as to Note Y, which is as of (date of completion of audit procedures restricted to amendment described in Note Y)".

No.	Question Bank	Exam	Marks	Refer Point/ Ans.
1	Briefly explain the audit procedures on subsequent events.	N09 PM	4	2
2	Briefly describe the auditor's responsibility regarding subsequent events.	M01 PM	10	Ans - 1
3	A fire broke out on 15.05.2012, in which material worth Rs. 50 lakhs which was lying in stock since 01.03.2012 was totally destroyed. The financial statements of the company have not been adopted till the date of fire. The management of the company argues that since the loss occurred in the year 2012-13, no provision for the loss needs to be made in the financial statements for 2011-12.	N12 PM	5	Ans - 2

Answer

Ans - 1:-

Subsequent Events and Auditor's Responsibility: When the auditor draws up his audit plan, checking of subsequent events is an important audit procedure irrespective of the level of test checks employed for checking of the transactions during the year. In fact more detailed check is normally required for subsequent events to confirm certain assertions contained in the financial statements, e.g., the payment made by debtors after the close of accounting period would confirm that outstanding debtors on the date of the balance sheet date have been realized. SA 560 on "Subsequent Events" establishes standards on the auditor's responsibility regarding subsequent events. SA 560 on "Subsequent Events" states that the term "subsequent events" refers to 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.

AS 4 on " Contingencies and Events Occurring after the Balance Sheet Date" deals with all those significant events, both favorable and unfavorable, that occur between the balance sheet date and the date on which the financial statements are approved by the Board of Directors in the case of a company and by the corresponding approving authority in the case of any other entity. As per AS 4, two types of events can be identified:(a) those which provide further evidence of conditions that existed at the balance sheet date; and (b) those which are indicative of conditions that arose subsequent to the balance sheet date. SA 560 lays down that, the auditor should consider the effect of subsequent events on the financial statements and on the auditor's report. When the time between the close of the year-end and the adoption of accounts is about to take place, examination of subsequent events gains more importance.

SA 560 further requires, that the auditor should perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report that require adjustment or disclosure in the financial statements have been identified. The auditor is not, however, expected to perform additional audit procedures on matters to which, previously applied audit procedures have provided satisfactory conclusions.

The auditor shall perform the procedures required above so that they cover the period from the date of the financial statements to the date of the auditor's report, or as near as practicable thereto. To identify the subsequent events, the auditor should:

- Review the procedures that management followed to identify the subsequent events.
- Inquiring of management as to whether any subsequent events have occurred after the balance sheet date, which might affect the financial statements.
- Read the minutes of board of directors, executive committee, meeting of shareholders held after the balance sheet date.
- Inquire about the latest position of legal cases.
- Read the entity's latest subsequent interim financial statements, if any.

If auditor identifies events, that require adjustment or disclosure in the financial statements, the auditor should determine whether each such event is appropriately reflected in those financial statements.

Ans - 2:

- This case requires attention to SA 560 "Subsequent Events" and AS 4 "Contingencies and Events occurring after the Balance Sheet Date".
- As per AS 4 "Contingencies and Events occurring after the BS Date", adjustments to assets and liabilities are required for events occurring after the BS date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the balance sheet date or that indicate that the fundamental accounting assumption of going concern (i.e., the continuance of existence or substratum of the enterprise) is not appropriate.
- AS – 4 also requires disclosure of the non-adjusting event, in the report of the approving authority.
- Further, as per SA 560 "Subsequent Events", the auditor should assure that all events occurring subsequent to the date of the FS and for which the applicable FRF requires adjustment or disclosure have been adjusted or disclosed.
- The event took place after the close of the accounting year and does not relate to conditions existing at the balance sheet date. Thus, it will have no effect on items appearing at the BS date because as per AS – 4 "Contingencies and Events Occurring after Balance Sheet Date" have to be adjusted that provide evidence of conditions existing as at the balance sheet date. However, the auditor has to ensure that this loss will not materially affect the substratum of the enterprises as per its size, nature and complexity of operations.
- Thus, subject to satisfaction in respect of non-violation of going concern concept, the company has correctly accounted by not providing provision. However, the auditor is required to ensure the proper disclosure of above mentioned event.

SA 570 | GOING CONCERN (W.E.F. 1ST APRIL' 2009)

1. Going Concern Assumption:

- Under the going concern assumption, an entity is viewed as continuing in business for the foreseeable future. *(As per statement, foreseeable future is generally a period not exceeding one year after the balance sheet date in the absence of information to the contrary).*
- General purpose financial statements are prepared on a going concern basis, unless management either intends to liquidate the entity or to cease operations.
- When, the use of the going concern assumption is appropriate, assets and liabilities are recorded on the basis that the entity will be able to realize its assets and discharge its liabilities in the normal course of business.

2. Responsibilities of Management:

- It is management's responsibility to assess the entity's ability to continue as a going concern even, if the financial reporting framework does not include an explicit requirement to do so.
- In case the financial statements have not been prepared on a going concern basis, the fact would need to

be appropriately disclosed together with the basis on which the financial statements are prepared and the reason why the entity is not regarded as a going concern.

- The detailed requirements regarding management's responsibility to assess the entity's ability to continue as a going concern and related financial statement disclosures may also be set out in law or regulation.

3. **Responsibilities of the Auditor:**
   - The auditor's responsibility is 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 and to conclude whether there is a material uncertainly about the entity's ability to continue as a going concern.
   - The absence of any reference to going concern uncertainly in an auditor's report cannot be viewed as a guarantee as to the entity's ability to continue as a going concern.

4. **Risk Assessment Procedures and Related Activities [N01 N05 N08]:**
   - The auditor should consider whether there are events or conditions that, may cast significant doubt on the entity's ability to continue as a going concern. In doing so, the auditor should determine whether management has already performed a preliminary assessment of the entity's ability to continue as a going concern (discuss with management).
   - The auditor should 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.
   - The following are the examples of events or conditions that individually or collectively, may cast significant doubt about the going concern assumptions.

<table>
<tr><th>Financial indicators</th><th>Operating indicators</th><th>Other indicators</th></tr>
<tr><td>• Negative net worth/working capital
• Borrowings approaching maturity without any chance of renewal/ repayment.
• Non compliance with terms in loan agreement.
• Short term borrowing for long term asset financing.
• Adverse financial ratio.
• Arrears / discontinuance of Dividends.
• Subsequent operating losses.
• No payment to creditors on due date.
• Negative cash flow from operations.
• Rearrangement with creditors for reduction in liability.
• Change from credit to cash on delivery transaction with supplier.</td><td>• Shortages of important supplies.
• Loss of a major market, key customer(s), franchise, license, or principal supplier(s).
• Management intentions to liquidate the entity or to cease operations.
• Loss of key management without replacement.
• Labour unrest, strikes etc.</td><td>• Non-compliance with Statutory requirements.
• 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.
• Changes in law or regulation or government policy expected to adversely affect the entity.
• Uninsured or underinsured catastrophes when they occur.</td></tr>
<tr><td colspan="3">However, such indications may be mitigated by some positive factors. For example: loss of some major supplier may be compensated by available of some alternate source of supply. Similarly, the effect of an entity being unable to make its normal debt repayments may be counter-balanced by management's plans to maintain adequate cash flows by alternative means, such as by disposing of assets, rescheduling loan repayments, or obtaining additional capital.</td></tr>
</table>

5. **Evaluating Management's Assessment:** The auditor should evaluate the management's assessment of the entity's ability to continue as a going concern, in doing so, the auditor should also cover the same period as that used by management to make its assessment. The auditor should also consider whether, management has considered all relevant information of which the auditor is aware.

6. **How to gather Audit Evidence? :** When question of inappropriateness of the going concern assumption arises, the auditor should gather the sufficient appropriate audit evidence to attempt to resolve the questions. The

auditors may gather the sufficient appropriate audit evidence by performing the following procedures:

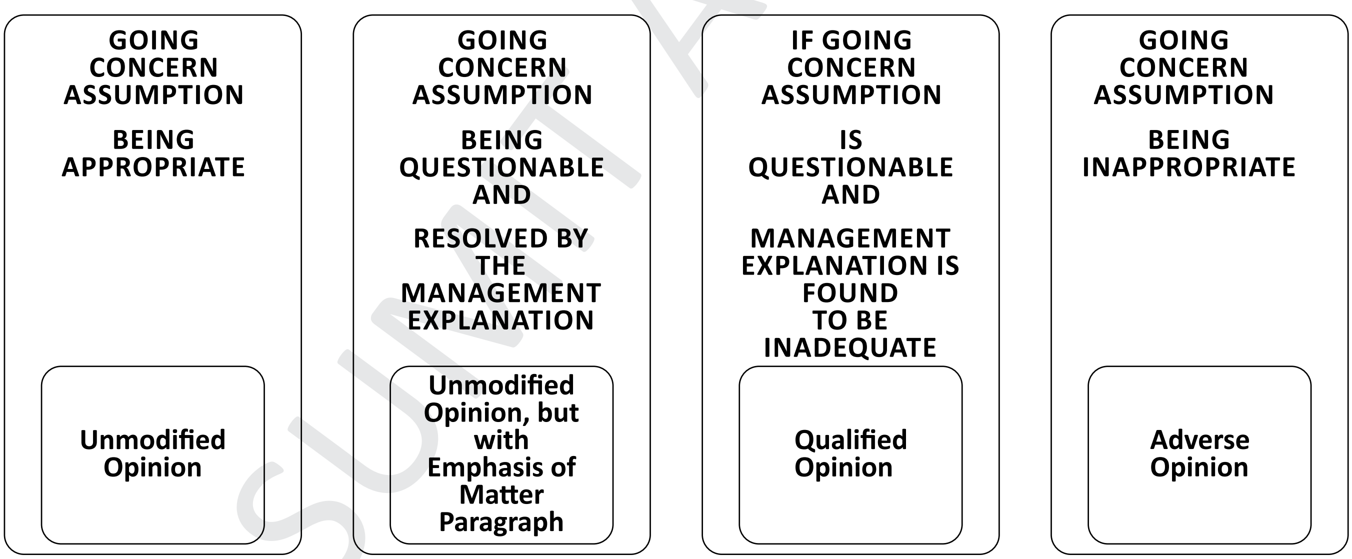
- Review of subsequent events after balance sheet date.
- Review of compliance with long-term debt.
- Analysis of budgeted cash flow, profit/loss.
- Analysis of latest interim financial statements.
- Reading of board of directors minutes, shareholder meeting minutes.

7. **Management unwilling to make or extend its Assessment:** If management is unwilling to make or extend its assessment, when requested to do so by the auditor, the auditor should consider the implications for the auditor's report.

8. **Communication with TCWG:** The auditor should communicate events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern. Such Communication with TCWG shall include the following:
   - Whether, the events or conditions constitute a material uncertainty.
   - Whether, the use of the going concern assumption is appropriate in the preparation and presentation of the financial statements; and
   - The adequacy of related disclosures in the financial statements.

9. **Delay in the approval of Financial Statements:** When there is significant delay in the approval of the financial statements, the auditor should inquire as to the reasons for the delay. When the auditor believes that the delay could be related to events or conditions relating to the going concern assessment, the auditor should perform additional audit procedures as required.

10. **Auditor Report and Going Concern Concept:** After following due audit procedures, the auditor would decide whether question raised about the going concern assumption has been satisfactorily resolved and how this should be reported in his report. For the purpose of the reporting, the auditor can categorise the appropriateness of going concern into following categories.



No.	Question Bank	Exam	Marks	Refer Point/ Ans.
1	Q. On 30th September, 2000 a company's issued and paid up capital was Rs. 25 crores comprising of fully paid equity shares of Rs. 10 each. This included Rs. 50,00,000 capital issued for cash; Rs. 4,50,00,000 capital issued for purchase of a business; Rs. 20 crores on issue of bonus shares from time to time by capitalizing various reserves including Rs.5 crores by capitalizing capital redemption reserve.	N00	8	Ans - 1

	The company had fixed assets costing Rs. 2 crores on which depreciation provision was Rs. 1.95 crores, which was equal to the full cost of depreciable assets. The balance Rs. 5 lakhs represented the cost of land. It has discontinued its operations for last many years. The company had made investments in various companies to the tune of Rs. 30 crores. Unfortunately ail these investee companies have turned out to be BIFR cases. Nothing is expected to be realised on such investments. The company has dues from customers totaling to Rs. 4.95 crores of which Rs. 4.90 crores are due from businesses which have become defunct. The balance Rs. 5 lakhs is due for over 3 years. The accumulated losses are Rs. 10 crores. The amounts due to suppliers are Rs. 3 crores and they are overdue. The balancing figure in the Balance Sheet refers to loan from Financial Institutions. Workers who had put in long years of service have lodged claims for termination benefits of Rs. 10 crores, which have been decreed in their favour. No accounting entry has been passed for the same since the decree on 1.1.1997. In the light of Statement on Standard Auditing Practices (SAP) 16, relating to Going Concern, you are asked to write appropriate paragraph of audit report. Given reason for supporting your report.			
2	Financial indications to be considered for evaluating the assumption of going concern.	N01 PM	4	4
3	While examining the going concern assumption of an entity, what important indications should be evaluated and examined?	N05 PM	6	4
4	What are the Financial indications to be considered by an auditor for evolution of the going Concern assumtion?	N08	4	4
5	R & Co. is the statutory auditor of S Ltd. For the financial year ended on 31.03.2012, 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.?	M12 PM	10	Ans - 2
6	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.	J09 PM	4	Ans - 3

Answer

Ans – 1:

SA 570 on "Going Concern" requires the auditor to consider the appropriateness of the going concern assumption underlying the preparation of the financial statements which may no longer be appropriate. The following indications inter alia have to be taken into consideration in determining the appropriateness of the going concern assumption:

- Financial indications such as negative net worth, adverse key financial ratios, substantial operating losses, inability to pay creditors on due dates, etc.
- Operating indications such as labour difficulties, loss of major market, etc.
- Other indications include pending legal proceedings which may affect the concern adversely, sickness of entity under statutory definition, etc.

Having regard to aforesaid indicators and as per the facts of the case, the company is not a going concern as on September 30, 2000 on account of following reasons:

- The company has discontinued its operations for last many years. Its productive fixed assets are fully depreciated. The only productive asset left is land worth of 5lakhs.
- The claim of workers for termination benefits amounting to Rs. 10 crores though decreed on January 1, 1997 has not been provided for in the books of account.
- The amounts recoverable from customers totaling Rs. 4.95 crores of which Rs. 4.90 crores are due from businesses which are totally defunct are doubtful of recovery in its entirety. Even the balance amount is due for more than three years. Hence, the entire amount is doubtful of recover.
- The company has not been able to pay to its suppliers amounting to to 3 crores which are overdue.
- The company's investment to the tune of to 30 crores is not realizable and is worthless in view of the fact that all investor companies have turned sick.
- The balance figure for term loan from financial institutions works out to be Rs. 17 crores as per records even which the company is unable to pay.
- Thus, in view of the aforesaid financial, operating and other indicators, the assumption of going concern is not appropriate.

Paragraph in the Audit Report: "The Company as at September 30, 2000 has an accumulated loss of Rs. 10 crores, has irrecoverable debts of Rs. 4.95 crores as at that date, the diminution in value of its investments is of Rs. 30 crores as at that date and a non provision of decreed obligations in favour of employees of Rs. 10 crores. The company has discontinued its operations for last many of years and has not been able to honor its obligation to creditors and financial institutions for quite some time. Thus, total accumulated losses are Rs. 54.9 crores (and not as…… reported).

After taking into account the above factors we are of the opinion that the company is not a going concern as at September 30, 2000 and, thus, the usage of going concern assumption in the preparation of financial statements is inappropriate.

In our opinion, subject to the information given in preceding paragraph, the financial statements do not give a true and fair view of the financial position of the company at September 30, 2000 and to the results of its operations for the year then ended". The Companies (Amendment) Act, 2000 also requires that the auditor's report shall also state in thick type or in italics the observation or comments of the auditors which have an" adverse effect on the functioning of the company.

Ans - 2:

This question involves two broad aspects with respect to reporting requirements i.e.

- one which deals with Going Concern (GC) aspect where the company has gone for legal suit and
- other is work done by other auditors.

As per facts of the case, the State Pollution Control Board has issued the closure order for S Ltd., on account of environmental damaging by its only manufacturing plant. However, S Ltd had challenged the same by way of a law suit. Due to pendency of the outcome of the legal suit, the company has prepared its financial statements on going concern basis.

As per SA 570 "Going Concern", under the going concern assumption, an entity is viewed as continuing in business for the foreseeable future. General purpose financial statements are prepared on a GC basis, unless management either intends to liquidate the entity or to cease operations, or has no realistic alternative but to do so. Management's assessment of the entity's ability to continue as a going concern involves making a judgment, at a particular point in time, about inherently uncertain future outcomes of events or conditions.

The auditor's responsibility is to obtain sufficient appropriate audit evidence about the appropriateness of management's use of the GC assumption in the preparation and presentation of the FS and to conclude whether there is a material uncertainty about the entity's ability to continue as a going concern. For this the auditor may take the help of expert.

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.

As per SA 570 Going Concern, pending legal proceedings is a condition that, individually, may cast significant doubt about the GC assumption. Existence of above condition signifies that a material uncertainty exists.

Further, when the auditor concludes that the use of the GC assumption is appropriate in the circumstances but a material uncertainty exists, the auditor should determine whether the financial statements:

- Adequately describe the principal events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and management's plans to deal with these events or conditions; and
- Disclose clearly, that there is a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a GC and, therefore, that it may be unable to realise its assets and discharge its liabilities in the normal course of business.

If adequate disclosure is made in the financial statements, the auditor should express an unmodified opinion and include an Emphasis of Matter paragraph as per SA 706, in the auditor's report to:

- Highlight the existence of a material uncertainty relating to the event or condition that may cast significant doubt on the entity's ability to continue as a going concern; and to
- Draw attention to the note in the financial statements that discloses the matters in the present situation, management of S Ltd. had disclosed the above fact in the financial statement. Further, use of the going concern assumption is appropriate but a material uncertainty exists so assuming the assessment and disclosure of S Ltd. in order, R & Co. should include an Emphasis of Matter paragraph in 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.

Note: Alternative answer is possible assuming that company is not going concern, hence auditor should issue adverse report.

Ans – 3:

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".

SA 580 | WRITTEN REPRESENTATIONS (W.E.F. 1ST APRIL' 2009)

1. **Scope:** This SA deal with the auditor responsibility to obtain WR from management with appropriate responsibilities for the financial statement and knowledge of the matters concerned.

2. **Written Representation:**
   - A written statement by management provided to the auditor to confirm certain matters or to support other audit evidence.
   - Written representations in this context do not include financial statements, the assertions therein, or supporting books and records.
   - WR are necessary information that the auditor requires in connection with the audit of the entity financial statements, hence they are recognized as audit evidence as a response to inquiries.
   - Although WR provide ***necessary audit evidence,*** but they do not provide ***sufficient appropriate audit evidence,*** further it is also not affect the nature or extent of other audit evidence that the auditor obtains.
   - Auditor requires the written representation from the management to support other audit evidence relevant to the F.S. or specific assertions in the F.S.
   - Written representation is generally considered an additional or secondary or supportive document (not primary). In certain exceptional cases WR becomes primary audit evidence (Eg. List of related parties , Intention of management regarding investments etc.,).

3. **Objective of the Auditors :** To obtain written representations that:

- Management believes that they have fulfilled their responsibility for the preparation of the financial statements.
- All relevant information and access as agreed in the terms of the audit engagement has been provided to the auditor.
- All transaction has been recorded and is reflected in the financial statements.
- support other audit evidence relevant to the financial statement, if determined necessary by the auditor or as required by other SAs; and
- Auditor should respond appropriately to WR provided by the management or if they do not provide the WR requested by the auditor.

4. Date of WR and period covered by WR:

- The date of the WR shall be as near as practicable to, but not after, the date of the auditor's report on the financial statements.
- The WR shall be for all financial statements and period(s) referred to in the auditor's report.

5. Form of WR:

- The WR shall be in the form of a representation letter, addressed to the auditor.
- If law or regulation requires management to make written public statements about its responsibilities, the relevant matters covered by such statements need not be included in the representation letter.

6. Doubts as to the Reliability of WR:

- If the auditor has concern about the competence, integrity, ethical values or diligence of management, the auditor should determine their effect on the reliability of representations (oral or written) and audit evidence in general.
- In particular, if WR are inconsistence with other audit evidence, the auditor should perform audit procedure to resolve the matter.
- If the auditor concludes that the WR are not reliable, the auditor should take appropriate actions including determining the possible effect on the opinion in the auditor's report.

7. Management refuse to provide WR [M10]: If management does not provide one or more of the requested representation, the auditor shall:

- Discuss the matter with management,
- Re-evaluate the Integrity of the management and evaluate the effect that this may have on the reliability of representations (oral or written) and audit evidence in general and
- Take appropriate actions, including determining the possible effect on the opinion in the auditor's report.

The auditor should disclaim an opinion on the financial statements if management does not provide written representations.

8. Example of a Management Representation Letter in an Audit of Financial Statements [N11]

Refer: Chapter 24

No.	Question Bank	Exam	Marks	Refer Point/ Ans.
1	In the course of audit of ABC Ltd. its management refuses to provide written representations. As an auditor what is your duty?	M10 PM	4	7
2	State briefly the basic elements of Management Representation Letter.	N11 PM	2	8
3	At the statutory audit of TOR Limited, the physical verification of fixed assets was conducted. However the auditor was not able to confirm the existence of valuables and important machinery. In this connection, the auditor obtained a certificate from the management to prove its existence and value and accepted the same blindly without an further procedures.	N03	4	Ans - 1

4	The Auditor of PQR Pvt. Ltd. having turnover of Rs. 12 crore, was not able to get the confirmation about the existence and value of certain stock. However, a certificate from the Management has been obtained regarding the existence and value of the stock at the year end. The auditor relied on the same and without any further procedure, signed the Audit Report. Is he right in his approach?	N14 PM	5	Ans - 1
4	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?	M04 PM	4	Ans - 1
5	Explain what is meant by " Written Representations" and indicate to what extent an auditor can place reliance on such representations.	M02 PM	6	Ans - 2

Answer

Ans -1: Validity of Written Representation: The physical verification of fixed assets (Certain Machineries/Stocks) is the primary responsibility of the management. The auditor, however, is required to examine the verification programme adopted by the management. He must satisfy himself about the existence, ownership and valuation of fixed assets. In the given case the auditor has not been able to verify the existence and value of some machinery despite the verification procedure followed in routine audit. He accepted the certificate given to him by the management without making any further enquiry.

As per SA 580, when representation relate to matters which are material to the financial information, then the auditor should seek corroborative audit evidence for other sources inside or outside the entity. He should evaluate whether such representations are reasonable and consistent with other evidences and should consider whether individuals making such representations can be expected to be well informed on the matter. “Written Representations” cannot be a substitute for other audit evidence that the auditor could reasonably expect to be available. 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.

Ans -2: Written Representation

- A written statement by management provided to the auditor to confirm certain matters or to support other audit evidence. Written representations in this context do not include financial statements, the assertions therein, or supporting books and records.
- Audit evidence is all the information used by the auditor in arriving at the conclusions on which the audit opinion is based. Thus 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. 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. Furthermore, 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.
- The auditor shall request management to provide a written representation that it has fulfilled its responsibility for the preparation of the financial statements in accordance with the applicable financial reporting framework, including where relevant their fair presentation, as set out in the terms of the audit engagement. Other SAs require the auditor to request written representations. If, in addition to such required representations, the auditor determines that it is necessary to obtain one or more written representations to support other audit evidence relevant to the financial statements or one or more specific assertions in the financial statements, the auditor shall request such other written representations. The date of the written representations shall be as near as practicable to, but not after, the date of the auditor’s report on the financial statements. The written representations shall be for all financial statements and period(s) referred to in the auditor’s report.

The written representations shall be in the form of a representation letter addressed to the auditor. If law or regulation requires management to make written public statements about its responsibilities, and the auditor determines that such statements provide some or all of the representations, the relevant matters covered by such statements need not be included in the representation letter.

- **Extent of Reliance:** SA 580, "Written Representations", states that If the auditor has concerns about the competence, integrity, ethical values or diligence of management, or about its commitment to or enforcement of these, the auditor shall determine the effect that such concerns may have on the reliability of representations (oral or written) and audit evidence in general.
- In particular, if written representations are inconsistent with other audit evidence, the auditor shall perform audit procedures to attempt to resolve the matter. If the matter remains unresolved, the auditor shall reconsider the assessment of the competence, integrity, ethical values or diligence of management, or of its commitment to or enforcement of these, and shall determine the effect that this may have on the reliability of representations (oral or written) and audit evidence in general. If the auditor concludes that the written representations are not reliable, the auditor shall take appropriate actions, including determining the possible effect on the opinion in the auditor's report.

SA 600 USING THE WORK OF ANOTHER AUDITOR (W.E.F. IST APRIL 2002)

1. **Introduction:** When the auditor uses work performed by other auditors, then he should obtain reasonable assurance that such work is going to be quite adequate for the purpose of the audit. Such a situation may arise in case a company which has branches and the branch audits are done by another auditor. Or, in case of the audit of consolidated financial statement, the audit of subsidiary or associated companies is done by another auditor.

Generally when another auditor has been appointed for the branch/division/component (subsidiary/ associate, etc.), the principal auditor would be entitled to rely upon the work of such an auditor, unless there are circumstances to indicate that he should not rely on them. However It should be noted, that this Standard is not applicable in case of joint auditors or predecessor auditor.

"When the auditor delegates work to his assistants, or use the work performed by another auditors and experts, he will continue to be responsible for forming and expressing his opinion on the financial information. However, he will be entitled to rely on the work performed by others, provided he exercises adequate skill and care, and is not aware of any reason to believe that he should not have so relied.

In the case of any independent statutory appointment where the auditor has to rely on the work of another auditor, such as in the case of the work of branch auditors appointed under the Companies Act, the auditor's report should expressly state the fact of such reliance."

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.

Principal auditor means the auditor of with ultimate responsibility for reporting on the financial information of an entity, when the financial information includes the financial information of one or more components *(Branch, division, subsidiary, Joint Venture or associates etc)* audited by another auditor.

2. **Role of Principal Auditor:** The role of principal auditor can be discussed under three headings (a) acceptance of principal auditor, (b) principal auditors' procedures, and (c) coordination between auditors.

2.1 **Acceptance as Principal Auditor:** The auditor should consider whether his own participation is sufficient to be able to act as the principal auditor. For this purpose the auditor should consider the following points:
- Materiality of the portion of the financial statement, which would be audited by the principal auditor.
- His degree of knowledge regarding the business of the components.
- The risk of material misstatements in the financial information audited by the other auditor.
- The performance of additional procedures as set out in this SA.

2.2 **Principal Auditor's Procedures:**
- Examine the professional competence of other auditor.

- Obtain sufficient appropriate audit evidence, that the work of the other auditor is adequate for his purpose.
- Consider the significant findings of the other auditors. If required, he may discuss the audit finding with the other auditor and the management, affecting the financial statements of the components. He may also require that supplementary tests be performed by the other auditors or by him.
- In case a component is situated in a foreign country, he should consider the qualification, experience and expertise of the foreign auditor.

2.3 **Coordination between Principal Auditor & Other Auditors:** There should be coordination between the principal auditor and branch auditor so that they can discharge their responsibility effectively.

3. **Reporting by Principal Auditor:** The principal auditor should qualify or disclaim his audit report if he can't use the work of another auditor and has not been able to perform sufficient additional procedures with respect to the financial information submitted by the other auditor because, there is a limitation on the scope of audit.

4. **Division of Responsibility:** The principal auditor is not responsible for work carried out by the other auditor. The principal auditor report should clearly state the division of responsibility by indicating the extent to which the financial statement of components audited by another auditors have been included in the financial information of the entity e.g. the number of branches/division/subsidiaries etc.

Summary SA 600

Not applicable in case of :
- joint auditors or
- predecessor auditor.

Auditor Responsibility
- Obtain reasonable assurance that work of another auditor is going to be quite adequate for the purpose of the audit.
- He will continue to be responsible for forming and expressing his opinion on the FI, If he delegates work to his assistants, or use the work performed by another auditors and experts.
- However, he will be entitled to rely on the work performed by others, provided he exercises adequate skill and care, and is not aware of any reason to believe that he should not have so relied.

Audit Reporting

Qualify or disclaimer of opinion because of scope limitation:
- If Principle Auditor concludes that, he can't use the work of another auditor.
- Unable to perform sufficient additional procedures w.r.t. FI submitted by other auditor.

Other Aspects
- The principal auditor is not responsible for work carried out by other auditor.
- AR should clearly state the division of responsibility by indicating the extent to which the FS of components audited by other auditors have been included in FI of the entity e.g. the number of branches/division/subsidiaries etc.

No.	Question Bank	Exam	Marks	Refer Point/ Ans.
1	"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.	N02 PM	8	Ans - 1

Answer

Ans - 1:

SA 600 on "Using the Work of another Auditor" lays down the procedure to be applied in situations where a principal auditor reporting on the financial statement of the entity uses the work of another independent auditor. SA 600 contemplates coordination between auditors and requires that there should be sufficient liaison between the principal auditor and the other auditor. For this purpose, the principal auditor may find it necessary to issue written communication(s) to the other auditor.

The other auditor, knowing the context in which his work is to be used by the principal auditor, should co-ordinate with the principal auditor. For example,

- by bringing to the principal auditor's immediate attention any significant findings requiring to be dealt with at entity level,
- Adhering to the time-table for audit of the component, etc.
- Ensuring compliance with the relevant statutory requirements.

Similarly, the principal auditor should advise the other auditor of any matters that come to his attention that he thinks may have an important bearing on the other auditor's work.

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

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

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.

SA 610 USING THE WORK OF INTERNAL AUDITORS (W.E.F. 1ST APRIL' 2010)

1. **Scope of this SA:** This SA deal with the external auditor responsibilities regarding the work of internal auditors, when the external auditor has determined, that the internal audit function is likely to be relevant for his audit.
   - This SA does not applicable, when individual internal auditors provide direct assistance to the external auditor in carrying out his audit procedures or where, in terms of the applicable legal and regulatory framework, it is not permissible for the internal auditor to provide access to his working papers to the third parties.
2. **Relationship between the Internal and External Auditors:** The role and objective of an internal audit function vary widely and dependent upon the size and structure of the entity and management's requirements, while the external auditor has to carry out his function under some statutory requirements. The objectives of the internal audit function and the external auditor are different, but the way in which they achieve their objective may be similar. Thus much of the work of internal auditor may be useful to the external auditor. The external auditor has sole responsibility for the audit opinion expressed, and that responsibility is not reduced by the external auditor with the use of the work of the internal auditors.
3. **Whether the work of Internal Auditor is likely to be adequate for the purpose of the External Auditor [M98 M05]:** The external auditor should as a part of his audit, carryout general evaluation of the internal audit function to determine the extent to which he can place reliance upon the work of the internal auditor. Whether the work of internal auditor is likely to be adequate for the purpose of the external auditor, the external auditor shall evaluate the following:

3.1 The objectivity of the Internal Audit function.

- The status of the internal audit function within the entity and the effect of such status has on the ability of the internal auditors to be objective.
- Whether, the internal audit function reports to TCWG or an officer with appropriate authority, and whether the internal auditors have direct access to TCWG.
- Whether, the internal auditors are free of any conflicting responsibilities.
- Whether, TCWG oversee employment decisions related to the internal audit function.
- Whether there are any constraints or restrictions placed on the internal audit function by management or TCWG.
- Whether, and to what extent, management acts on the recommendations of the internal audit function, and how such action is evidenced.

3.2 The technical competency of the Internal Auditors.

- Whether, the internal auditors are members of relevant professional bodies.
- Whether, the internal auditors have adequate technical training and proficiency as internal auditors.
- Compliance with the mandatory/ recommendatory Standards on Internal Audit (SIAs) issued by Internal Audit Standards Board of the Institute of Chartered Accountants of India (ICAI).
- Whether there are established policies for hiring and training internal auditors.

3.3 Due Professional Care.

- Whether, the work of internal auditor is adequate for him.
- Whether, the work of the internal auditors has been properly planned, supervised, reviewed and documented.
- Whether, there is likely to be effective communication between the internal auditors and external auditor.
- Whether, there is any restrictions placed by the management as regards to the reporting by the internal auditor.
- Whether, conclusion made by internal auditor appears to be appropriate.
- Whether, any exceptions or unusual matters disclosed by the internal auditors are properly resolved.

4. Evaluation of Specific work done by Internal Auditor [M12]:

- The statutory auditor should as a part of his audit, carryout general evaluation of the internal audit function to determine the extent to which he can place reliance upon the work of the internal auditor.
- The NTE of the audit procedures performed on specific work of the internal auditors will depend on the (a) external auditor's assessment of the risk of material misstatement, (b) the evaluation of the internal audit function, and (c) the evaluation of the specific work of the internal auditors. Such audit procedures may include examination of items already examined by the internal auditors, examination of other similar items; and observation of procedures performed by the internal auditors.
- Further, to determine the adequacy of specific work performed by the internal auditors for the external auditor's purposes, the external auditor shall evaluate whether:
  - ◊ The work was performed by internal auditors having adequate technical training and proficiency.
  - ◊ The work was properly supervised, reviewed and documented.
  - ◊ Adequate audit evidence has been obtained to enable the internal auditors to draw reasonable conclusions.
  - ◊ Conclusions reached are appropriate in the circumstances and any reports prepared by the internal auditors are consistent with the results of the work performed; and
  - ◊ Any exceptions or unusual matters disclosed by the internal auditors are properly resolved.

5. The activity of Internal Audit function may include one or more of the following:

- Examination of operating and financial information.
- Review of operating activities.
- Review of accounting system and related internal control.
- Review of compliance with laws and regulations.
- Assessing and managing the risk.
- Physical examination and verifications.

6. Documentation: When the external auditor uses the specific work of the internal auditors, then the external auditors should document conclusions regarding the evaluation of the adequacy of the work of the internal auditors, and the audit procedures performed by the external auditors on that work.

Summary SA 610

Auditor Responsibility

- External auditor has sole responsibility for the audit opinion expressed.
- Responsibility cannot be reduced by the use of work of the internal auditors.
- Evaluate adequacy of Internal Auditor work for External Auditor's Purpose, by evaluating the following:
  - ➢ The objectivity of the internal audit function.
  - ➢ The technical competency of the internal auditors.
  - ➢ Due professional care.
- If adequate, consider its effect on NTE of audit procedures, which depend on:
  - ➢ External auditor's assessment of the risk of material misstatement.
  - ➢ The evaluation of the internal audit function; and
  - ➢ The evaluation of the specific work of the internal auditors.

No.	Question Bank	Exam	Marks	Refer Point/ Ans.
1	Can the Statutory Auditor rely upon the work of an internal auditor? Discuss.	M98	4	3
2	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.	M05	6	
3	In the course of the statutory audit of Z Ltd., its statutory auditors, having determined that the work of the 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?	M12 PM	4	4

SA 620 USING THE WORK OF AN AUDITOR'S EXPERT (W.E.F. 1ST APRIL' 2010)

1. **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 by using the work of an expert. If the auditor using the work of an expert, having followed this SA, and concludes that the work of that expert is adequate for the auditor's purposes. The auditor may accept that expert's findings and conclusions in the expert's field is appropriate audit evidence.

   An expert for the purpose of this SA, is an individual or organization possessing special skill, knowledge and experience in a particular field other than accounting and auditing like a tax consultant, an actuary etc. An expert may be engaged by the client or engaged by the auditor.

2. **Objective of the Auditor:** To determine whether to use the work of an auditor's expert; and If using the work of an expert, to determine whether that work is adequate for his audit purpose. To achieve this objective, the auditor should evaluate whether the auditor's expert has the necessary competence, capabilities and objectivity for the auditor purposes. The auditor should also obtain a sufficient understanding of the field of expertise of the auditor's expert to enable the auditor (a) to determine the nature, scope and objective of that expert's work and (b) to evaluate the adequacy of that work for the auditor purposes.

3. **Procedure to be followed for evaluating the Adequacy of the Auditor's Expert's Work [N01 N02 M11]:** The

auditor should evaluate the adequacy of the auditor's expert's work for the auditor's purposes, including:

- The relevance and reasonableness of that expert's findings or conclusions, and their consistency with other audit evidence.
- If that expert's work involves use of significant assumptions and methods, the relevance and reasonableness of those assumptions and methods in the circumstances; and
- If that expert's work involves use of source data, the relevance and completeness and accuracy of that source data.
- Confidentiality of the client's information used by the expert.
- 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.
- The objectives and scope of the experts' work.
- If the auditors determine that the work of the expert is not adequate for auditor's purposes, the auditor should:
  - ◊ Agree with that expert on the nature and extent of further work to be performed by that expert; or
  - ◊ Perform further audit procedures appropriate to the circumstances.
- Specific procedures to evaluate the adequacy of the auditor's expert's work for the auditor's purposes may include:
  - ◊ Inquiries of the auditor's expert.
  - ◊ Reviewing the auditor's expert's working papers and reports.
  - ◊ Corroborative procedures, such as:
    - » Observing the auditor's expert's work.
    - » Examining published data, such as statistical reports from reputable, authoritative sources.
    - » Confirming relevant matters with third parties.
    - » Performing detailed analytical procedures; and
    - » Re-performing calculations.
  - ◊ Discussion with another expert with relevant expertise when, for example, the findings or conclusions of the auditor's expert are not consistent with other audit evidence.
  - ◊ Discussing the auditor's expert's report with management.

4. Reference to the Auditor's Expert in the Auditor's Report:

4.1 In case of Unmodified/Unqualified Opinion: The auditor should not refer to the work of an auditor's expert in his unqualified audit report unless required by law or regulations. If such reference is required by law or regulation, the auditor should indicate in the audit report that, the reference does not reduce the auditor's responsibility for the audit opinion.

4.2 In case of Modified 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 explain the nature of a modification in the audit opinion, the auditor should indicate in the auditor report that, such reference does not reduce the auditor's responsibility for the audit opinion. The auditor should also require expert permission before making such a reference.

5. Matters where auditor can use the work of Auditor's Expert:

Valuation of complex financial instruments, land and buildings, plant and machinery, jewelery, works of art, antiques, intangible assets, assets acquired and liabilities assumed in business combinations and assets that may have been impaired.

- Actuarial calculation of liabilities associated with insurance contracts or employee benefit plans.
- Estimation of oil and gas reserves.
- Valuation of environmental liabilities, and site clean-up costs.
- Interpretation of contracts, laws and regulations.
- Analysis of complex or unusual tax compliance issues.
- The measurement of the work completed and to be completed on contracts in progress for the purpose of revenue recognition.

6. GENERAL CLARIFICATION (GC)–AASB/1/2002 ON SA 620: The auditor while verifying the accrued liability for retirement benefits or for Group Gratuity Schemes has to use the work of an another expert, i.e., actuary or the insurer itself. In such a case, the issue to be considered is whether it is sufficient for the auditor to rely on the certificate given by insurer or actuary without establishing the reasonableness of the assumptions made by the actuary or the insurer based on the auditor's knowledge of the client's business. It is clarified that the auditor should, while using the certificate issued by the actuary or the insurer, obtain an understanding of the methods used by the actuary or the insurer in determining the liability and should also judge the appropriateness and reasonableness of assumptions, for example, with regard to the following:

- Rate of Return
- Retirement Age
- Age of Employees
- Number of Employees
- Salaries
- Promotion Policies

No.	Question Bank	Exam	Marks	Refer Point/ Ans.
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 an audit evidence. How do you evaluate the work of the actuary?	M11 PM	8	2 & 3
2	Briefly describe how an auditor can use/evaluate the work of an expert.	N01 N02	8	3 & 4
3	Indicate the precise nature of Auditor's liability in the following situations and support your views with' authority, if any: "Based upon the legal opinion of a leading advocate, X Ltd. made a provision of Rs.5 crores towards Income Tax liability. The assessing authority has worked out the liability at Rs.15 crores. It is observed that the opinion of the advocate was inconsistent with legal position with regard to certain revenue items."	M00 PM	4	Ans - 1
4	As a Statutory Auditor how would you deal with the following cases? " M/s LNK's group gratuity scheme's valuation by actuary shows wide variation compared to the previous year's figures".	M04 PM	4	Ans - 2
5	Z Ltd. had appointed an outside expert to assess accrued gratuity liability of the company. Based on the said report, the company provides Rs. 80 lakhs as gratuity in the financial statements.	J09 PM	4	Ans - 3
6	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?	N10 PM	4	Ans - 4
7	The auditor of S Ltd. accepted the gratuity liability valuation based on the certificate issued by a qualified actuary. However, the auditor noticed that the retirement age adopted is 65 years as against the existing retirement age of 60 years. The company is considering a proposal to increase the retirement age.	N11 PM	5	Ans - 5

Answer

Ans – 1:

- As per SA-620 (Using the work of an Expert) an Auditor during the course of an audit may have to place reliance on the work of an expert. During the course of audit, an auditor may seek to obtain, either independently or from client audit evidence by way of report, opinions, valuations and statements of experts.
- The auditor should satisfy himself regarding the expert's skill and competence and consider the objectivity of the expert.
- The question clearly states that the opinion of the advocate was inconsistent with legal position with

regard to certain items. It is auditor's duty to seek reasonable assurance that the expert's work (advocate) constitutes appropriate audit evidence in support of financial information. It is perhaps; quite possible that auditor did not seek reasonable assurance as to appropriateness of source data, assumptions and methods used by the expert properly.

- In fact SA-620 makes it incumbent upon the part of the auditor to resolve the inconsistency by discussion with the management and the expert in case the expert's work did not support the related representation in the financial information. If the auditor has gone through the work of legal expert, such inconsistency could have been detected. This seems apparent having regard to wide differences in the liability as determined by assessing authority.
- Under such circumstances, the auditor should have rejected the opinion of expert and insisted upon making proper provision. However, auditor is liable for negligence in performing audit procedures and in expressing his opinion.

Ans – 2:

Valuation by Actuary: SA 620, "Using the Work of an Auditor Expert" states that the auditor has to evaluate the work of an expert, say, actuary, before adopting the same. This becomes more crucial since M/s LNK's group gratuity scheme's valuation by actuary shows wide variation compared to previous year figures.

There is no doubt that appropriateness, reasonableness of assumptions and methods used are the responsibility of the expert, but the auditor has to determine whether they are reasonable based on the auditor's knowledge of the client's business and result of his audit procedures.

In the given cases the auditor must verify the reasonableness of assumptions made and methods adopted by the actuary in the evaluation particularly with reference to factors such as rate of return on investment, retirement age, number and salary of employees, etc. Accordingly, the auditor has to satisfy himself whether valuation done by the actuary can be adopted, otherwise he may report on his findings for wide variation.

Ans – 3:

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.

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. The auditor should also ensure that substance of expert’s findings is properly reflected in the financial information.

Ans – 4:

As per SA 620, “Using the Work of an 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 opinions or statements of an expert for the purpose of audit evidence:

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

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.

Ans – 5:

- As per SA 620 "Using the Work of an Auditor's Expert", the Expertise of an expert may be required in the actuarial calculation of liabilities associated with insurance contracts or employee benefit plans, however, 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.
- Hence, the auditor shall evaluate the adequacy of the auditor's expert's work for the auditor's purposes, including the relevance and reasonableness of that expert's findings or conclusions, and their consistency with other audit evidence as per SA 500.
- If the expert's work involves use of significant assumptions and methods, then the relevance and reasonableness of those assumptions and methods and if the 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 in the circumstances must be ensured by the auditor.

In the instant case, a qualified actuary has issued a certificate for gratuity liability valuation, for which retirement age adopted is 65 years against the existing retirement age of 60 years; however, the company is considering a proposal to increase the retirement age. In view of SA 500 along with SA 620, the assumption made by actuary has no relevance and reasonableness as presently retiring age is of 60 years. Hence the auditor is required to bring out the facts to the notice of management and advice the modification accordingly. In case of failure of compliance of the same the auditor may qualify the report.

SA 700	FORMING AN OPINION AND REPORTING ON FINANCIAL STATEMENTS (W.E.F. 1ST APRIL' 2012)

1. **Scope of SA:** This SA deals with:
   - Auditor responsibility to form an opinion on the financial statements.
   - Form and content of independent auditor's report when the auditor expresses unmodified opinion. ***(as modified opinion is now covered in SA 705 whereas EOM & OM paragraph are covered in SA 706)***
   - This SA is framed in the context of general purpose financial statements prepared in accordance with ***general purpose framework. (SA 800 deal with special considerations when financial statements are prepared in accordance with special purpose framework)***

2. **General Purpose Framework:** A FRF designed to meet the common financial information need of a wide range of users. It may be of two types:

2.1 **Fair Presentation Framework:** The term ***"fair presentation framework"*** is used to refer to a FRF that requires compliance with the requirement of the FRF and acknowledged that:
   - Management may provide disclosures, beyond those specifically required by the framework.
   - Management may depart from requirements of the framework to achieve fair presentation of financial statements. Such departures are expected to be necessary only in extremely rare circumstances.
     Example: Financial Statements of a company.

2.2 **Compliance Framework:** The term ***"compliance framework"*** is used to refer to a FRF that requires compliance with requirements of the framework, but does not contain acknowledgement as above.

3. **Objectives:** The objectives of the auditor are to:
   - Forming an opinion on the financial statements based on conclusions drawn from audit evidences obtained; and
   - Expressing clearly that opinion (including basis thereof) through a written report.

4. **Forming an Opinion:**
   - Auditor shall from an opinion on whether; the financial statements are prepared, in all material respects, in accordance with applicable FRF (Compliance framework).
   - In order to form such opinion, he should obtain reasonable assurance as to whether; financial statements as a whole are free from material misstatements, whether due to fraud or error.
   - In forming such opinion under compliance framework, he should consider the following points:
     - ◊ Sufficiency 'n' appropriateness of audit evidences obtained.

- ◊ Consistency of accounting Policies with applicable FRF.
- ◊ Reasonableness of Accounting Estimates.
- ◊ Materiality of uncorrected misstatements.
- ◊ Adequacy of disclosures in financial statements.
- ◊ Reliability & relevance of financial information.
- ◊ Adequacy of disclosure of material transactions & Events.
- ◊ Appropriateness of Terminology used in financial statements.

- In case of ***fair presentation framework,*** he should also consider:
  - ◊ The overall presentation, structure and content of the financial statements; and
  - ◊ Whether the financial statements (including notes), represent the underlying transactions & events so as to achieve fair presentation.

5. Expression of Opinion:

5.1 Unmodified Opinion: The auditor should express an ***unmodified opinion*** when, he concludes that:
- Financial statements are ***prepared,*** in all material respects, in accordance with applicable FRF. (Compliance framework)
- Financial statements ***presents fairly*** in all material respects, in accordance with applicable FRF. (Fair presentation framework)

5.2 Modified Opinion: The auditor should express ***modified opinion*** in accordance with SA 705, when he:
- Concludes that financial statements as a whole are not free from material misstatements; or
- Is unable to obtain sufficient and appropriate evidence to conclude that the financial statements as a whole are free from material misstatement.

6. Content of Audit Report [N04]:

6.1 Title: Clearly indicating that it is an "Independent Auditor's Report", so that it can be distinguished from the reports issued by others.

6.2 Addresses: Should be as per the circumstances to members or TCWG or to the shareholders (in case of companies).

6.3 Introductory Paragraph: It includes the following:
- Entity (client) whose financial statements have been audited.
- Indentify the title of each component of the financial statement. (BS, PL etc)
- Refer to the summary of significant accounting Policies & other explanatory information.
- Fact that financial statements have been audited.
- Date & Period covered by each financial Statement.

6.4 Management's Responsibility for the Financial Statements: This section describes the responsibility of those in the organization that are responsible for preparation of financial statements. It states that management is responsible for:
- Preparation of financial statements as per applicable FRF.
- Design, implementation & maintenance of internal controls; and
- Fair presentation of financial statement. (in case, financial statements are prepared as per fair presentation framework)

6.5 Auditor's Responsibility: This Paragraph shall state that:
- The responsibility of the auditor is to express an opinion on the financial statements.
- The audit was conducted in accordance with SA issued by ICAI.
- The auditor complied with ethical requirements.
- The auditor has obtained reasonable assurance as to whether financial statements are free from material misstatements.
- An audit involves procedures to obtain audit evidences about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment including the assessment of the risk of material misstatement of the financial statements.
- An audit also includes evaluation of accounting policies, accounting estimates and overall presentation 'of financial statements; and

- Whether the auditor believes that audit evidences, that the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's report.

6.6 Auditor's Opinion: While expressing an ***unmodified opinion*** on financial statements, he should use the following:

- **In case of fair presentation framework:**
  - ◊ The financial statements present fairly in all material respects, in accordance with the applicable FRF; or
  - ◊ The financial statements give a true & fair view in accordance with the applicable FRF.
- **In case of compliance framework:** Financial statements are prepared in all material respects in accordance with the applicable FRF.

6.7 Other's Reporting Responsibilities: If there is any requirement on other's reporting responsibilities, there shall be a separate heading "Report on other legal and Regulatory Requirements". For example: CARO in case of audit of a company.

6.8 Date of Auditor's Report: It can't be earlier than the date on which:

- The auditor has obtained sufficient appropriate audit evidence on which the auditor's opinion is based including evidence that all components of financial statements have been prepared; and
- The recognized authority (Management/TCWG) has asserted that they have taken the responsibility for those financial statements.

6.9 Place of Signature: Specific location (The city where the audit report is signed)

6.10 Signature of the Auditor: The auditor's report shall be signed.

7 Auditor's Report for audits conducted in Accordance with Both SAs issued by the ICAI and International Standard on Auditing (ISAs): When the auditor in addition to comply with SAs issued by ICAI also comply with each of the ISAs relevant to the audit, he may refer in his audit report that audit have been conducted in accordance with both ISAs as well as SAs issued by the ICAI, but the auditor should do so only if there is no conflict between the requirements in the SAs and ISAs, that would lead the auditor (a) to form a different opinion, or (b) not to include an EOM paragraph that, the particular circumstances, is required by ISAs.

8 Supplementary information that is not required by the applicable FRF, is presented with financial statements:

- Auditor should evaluate whether, it is clearly differentiated from the AFS.
- If not, then he should ask the management to change the way it is presented.
- If management refuses to do so, the auditor should mentions in the audit report that such supplementary information has not been audited.
- If supplementary information cannot be clearly differentiated from the AFS because of its nature and how it is presented, then auditor should cover it in his opinion.

(Supplementary information might be presented to enhance a user's understanding of the applicable financial reporting framework or to provide further explanation of specific financial statement items. Such information is normally presented in either supplementary schedules or as additional notes.)

9 Format of Audit Report: Refer Chapter 24

Summary SA 700

Scope

- Applicable for Unmodified Opinion (Modified opinion covered in SA 705 & EOM & OM para covered in SA 706)
- Applicable for General Purpose FS prepared in accordance with General Purpose Framework (Note FS prepared in accordance with special purpose framework covered in SA 800)

General Purpose Framework

- Fair Presentation Framework → Unmodified opinion If auditor concludes that F.S are prepared in accordance with applicable F.R.F
- Compliance Framework → Unmodified opinion If auditor concludes that F.S presented Fairly in accordance with applicable FRF

↓

Auditor concluded as per both Indian S.A and International S.A

↓

Auditor may refer in his report that audit have been concluded in accordance with both Indian SA & International SA only if there is no conflict between the requirements of both SA.

↓

If Supplementary Information presented with Audited FS, which is not required by the applicable FRF

↓

Examine whether it is clearly differentiated from the Audited FS

↓

If not then ask the way, to change its presentation or mentioned in AR that such supplementary Info, has not been audited.

Content of Audit Report

- Title
- Addresses
- Introductory Para
- Management responsibility Para
  1. Responsible for Preparation of FS as per applicable FRF
  2. I.C for preparation of FS
  3. Fair presentation of FS
- Auditor Responsibility para
  1. Express Opinion
  2. Compliance with SA.
  3. Compliance with Ethical Requirement
  4. Has obtain reasonable assurance
  5. Audit Evidence
  6. To apply proffessional judgement
  7. Evaluation of A/c Policy A/c Estimate, Overall presentations
- Auditor opinion para
  1. FS has been presented Fairly / gives a trues & fair view in accordance with applicable FRF (Fair presentation Fair work)
  2. FS are prepared in all material respect in accordance with app FRF (Compliance frame work)
- Other reporting responsibility (Exp. CARO Under Co. Act 1856)
- Date
- Place
- Sign

No.	Question Bank	Exam	Marks	Refer Point/ Ans.
1	Enumerate the 'Basic Elements of Audit Report' as enshrined in SA 700.	N04 PM	6	6

SA 705 MODIFICATIONS TO THE OPINION IN THE INDEPENDENT AUDITOR'S REPORT (W.E.F. 1ST APRIL' 2012)

1. **Scope of this SA:** This SA deals with the auditor's responsibility to issue an appropriate report in circumstances when, in forming an opinion in accordance with SA 700 (Revised), the auditor concludes that a modification to the auditor's opinion on the financial statements is necessary.

2. **Objective of the Auditor:** To express clearly and appropriately modified opinion on the financial statements that is necessary, when the auditor:
   - Concludes, based on the evidences obtained that the financial statements as a whole are ***not*** free from material misstatements, or
   - Is unable to obtain sufficient and appropriate evidences to conclude that financial statements as a whole are free from material misstatements.

3. **Circumstances in which a Modified Opinion may be issued:** A modified opinion may be expressed in the following circumstances:
   - The auditor concludes that, based on the audit evidence obtained, the F.S. as a whole are ***not free from material misstatement,*** may be due to following reasons:
     ◊ Inappropriate method of selection of Accounting Policies.
     ◊ Accounting policies are not consistent with applicable FRF.
     ◊ Disclosures as required by FRF are not given.
   - The auditor is ***unable to obtain sufficient appropriate audit evidence*** to conclude that the financial statements as a whole are free from material misstatement, may be due to following reasons:
     ◊ Limitations imposed by management.
     ◊ Circumstances beyond entity control (For Ex.: Accounting records destroyed by fire)
     ◊ Circumstances related to Nature and Timing of auditor's work.

4. **Types of Modified Opinion:**
   - A Qualified opinion (True and Fair except for the effect of / possible effect of):
   - An adverse opinion (Not true and Fair)
   - A disclaimer of opinion (Not in a position to express an opinion)

5. **Determining type of Modification:-**

Nature of Matter Giving Rise to the Modification	Auditor's Judgment about the Pervasiveness of the Effects or Possible Effects on the Financial Statements	
	Material but not Pervasive	**Material and Pervasive**
Financial statements are materially misstated	Qualified opinion	Adverse opinion
He is unable to obtain sufficient appropriate audit evidence	Qualified opinion	Disclaimer of opinion

The types of modification depend upon the nature of matter giving rise to modification and auditor's judgment about the pervasiveness of effect/possible effects on the financial statements. Hence qualified opinion is required, when auditor concludes that there is material misstatement in the financial statements, but it is not so pervasive so as to require an adverse opinion, or when his inability to obtain sufficient and appropriate audit evidence is material but not so pervasive so as to require a disclaimer of opinion.

6. **Steps, if auditor unable to Obtain Sufficient Appropriate Audit Evidence, due to management imposed**

limitation, after the auditor has accepted the engagement:

- Acceptance of Engagement.
- He comes to know that management has imposed scope limitation likely to result in qualified opinion or disclaimer of opinion.
- Request the management to remove the same.
- If management remove such limitation, then O.K. & continue & if management refuses to remove the same then,
- Communicate to TCWG and determine, whether it is possible to perform alternative procedures to obtain sufficient appropriate audit evidence.
- If, it is possible then OK and if not, then determine possible effect on financial statement for undetected misstatement.
- If, possible effect is material but not pervasive then qualified opinion.
- If, possible effect is material and pervasive then resign from the audit, if resignation is not possible or practicable then disclaim and communicate with TCWG.

7. **Basis for Modification Paragraph (Qualified/Adverse/Disclaimer):**
   - He shall, in addition to specific elements required by the SA 700, include a paragraph in the auditor's report that provides a description of the matter giving rise to the modification along with its quantification, unless impracticable. If not possible for him to quantify, he shall state this fact therein.
   - Place this Paragraph immediately before the opinion Paragraph.
   - Its heading is "Basis for Qualified Opinion" "Basis for Adverse Opinion" of "Basis for Disclaimer of Opinion" as appropriate.

8. **Wordings of "Qualified Opinion" due to Material mis-statement in the Financial Statements:** The auditor shall state in the opinion paragraph that, in the auditor's opinion, except for the **effects** of the matter(s) described in the ***"Basis for qualified opinion"*** Paragraph:
   - The financial statements present fairly, in all material respect (or give a true & fair view) in accordance with fair presentation framework, or
   - The financial statements present have been prepared in all material respects, in accordance with compliance framework.

9. **Wordings of "Qualified Opinion" due to inability to obtain Evidences:** Same as above para except the following: The word "effects" shall be substituted by "possible effects" in above para.

10. **Wordings of "Adverse Opinion" due to material mis-statement in the Financial Statements:** The auditor shall state in the opinion paragraph that, In the auditor's opinion, because of the significance of matter(s) described in the ***"Basis for adverse opinion"*** Paragraph:

    The financial statements do not present fairly, in all material respect (or give a true & fair view) in accordance with ***fair presentation framework,*** or

    The financial statements have not been prepared in all material respects, in accordance with ***compliance framework.***

11. **Wordings of "Disclaimer of Opinion" due to inability to obtain Sufficient Appropriate Audit Evidence:** Because of significance of the matter described in the "basis for disclaimer" Paragraph:

    The auditor has not been able to obtain sufficient appropriate evidence to provide a basis for an audit opinion; and accordingly

    The auditor does not express an opinion on the financial statements.

12. **Description of Auditor's Responsibility, When the Auditor Expresses a Modified Opinion:** The auditor should amend the description of the auditor's responsibility to state:

    Adverse/Qualified Opinion: That the auditor has obtained sufficient and appropriate evidences to provide a basis for the auditor's Adverse/Qualified opinion.

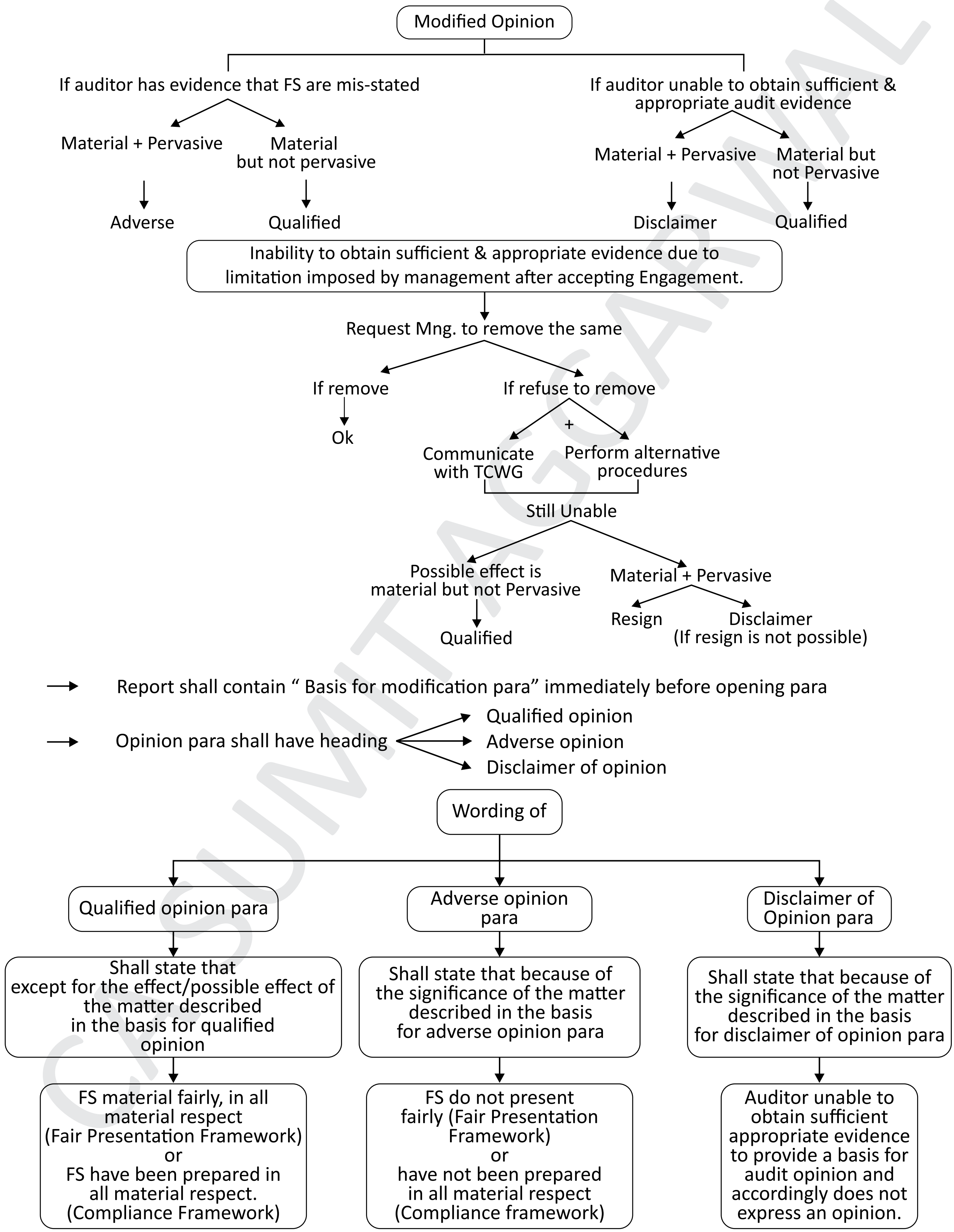
    Disclaimer of Opinion: That the auditor was not able to obtain sufficient appropriate evidence to provide a basis for an audit opinion.

13. **Communication with TCWG:** In case the auditor expects to modify the opinion in the auditor's report, the

auditor should communicate with TCWG, the circumstances that lead to the expected modification and the proposed wording of the modification.

14. Format of Audit Report: Refer Chapter 24

Summary SA 705



No.	Question Bank	Exam	Marks	Refer Point/ Ans.
1	Under the applicable Standards on Auditing, in what circumstances does the report of the statutory auditor require modifications? What are the types of modifications possible to the said report?	N12 PM	8	3,4,5
2	Discuss the various aspects to be considered by the Statutory Auditor before qualifying his report.	M06 PM	8	Ans - 1
3	What are the features of a qualified Audit Report?	N07	8	Ans - 2
4	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 LId 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).	M13	8	Ans - 3
5	What are the professional obligations of the auditor who has resigned from the audit before completion of his term due to non co-operation of the Management in completing certain audit procedures	N14	5	Ans - 4

Answer

Ans – 1:

A Qualified audit report is one where an auditor gives an opinion on the truth and fairness of financial statements, subject to certain reservations. The report should also give detailed reasons along with quantitative impact of the qualifications on financial statements.

A qualified Report is warranted in following situations:

- If the auditor is unable to obtain all the information and explanations which he considers necessary for the purpose of his audit.
- If information as required by law is not furnished.
- If proper books of account have not been kept by the company in accordance with the law.
- If the Balance Sheet and Profit and Loss account are not in agreement with the books of account and returns
- If there is contravention of the provisions of Companies Act having a bearing on the accounts and Transactions of the Company?
- If the profit and loss account and Balance sheet do not comply with the accounting standards referred u/s 133 of Companies Act 2013.

The auditor may have reservations about a particular item or items. In majority of cases, items which are subject matter of the qualification are not so material as to affect the truth and fairness of the whole of the account. Where the issues involved though material do not substantially affect the view presented by the accounts, the audit report should be qualified.

A qualification in the audit report also becomes necessary when an item requiring specific disclosure under the Companies Act, 2013 is not specifically disclosed. The auditor must clearly express the nature of reservations and also give reasons for the qualifications. The qualification must be in clear words and unambiguous. The words "subject to" are essential to state any qualification. The auditors should quantify, wherever possible the effect of those qualifications on the financial statements if the same is material. Where the effect cannot be quantified, the auditor may reflect the effect on the basis of the estimates made by management after carrying out necessary audit tests on such estimates.

Ans – 2: The features of a qualified report are:

- **Clarity:** The Auditor must express the nature of qualification, in a clear and unambiguous manner.
- **Explanation:** Where the Auditor answers any of the statutory affirmations in the negative or with a qualification his report shall state the reasons for 'such answer.
- **Placement:** All qualifications should be contained in the Auditor's Report. When there are notes which are subject matter of a qualification, the same should preferably be annexed to the Auditor's Report. However a reference to the notes to Accounts in the Auditor' Report does not automatically become a qualification.
- **Subject to:** The qualification should be preceded by the words "Except for the possible effects/effects of the matter described in the Basis for Qualified Opinion paragraph" to make it clear that he is making an exception.
- **Quantification:** It is also necessary for the auditor to quantify the effect of individual as well as the total effect of all qualifications on profit or loss and/or state of affairs. If not possible for him to quantify, he shall state this fact therein.
- **Nature of qualification:** Vague statements, the effect of which on accounts cannot be ascertained like 'the debtors balances are subject to confirmation no provision for taxation has been made in view of the loss during the year etc. should be avoided.
- **Violation of law:** Where the company has committed an irregularly resulting in a breach of law, the Auditor should bring the same to the notice of the shareholders by properly qualifying his audit report.
- **Draft Report:** The auditor may discuss the matters of qualification with the management of the company to acquire their views. It is not necessary that the Auditor should accept the managements view and modify his opinion. But it would enable the Auditor to accurately draft the qualifications in his Final Report.

Ans – 3:

As per SA-501 "Audit Evidence-Specific Considerations for Selected Items", 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. In the given case, the auditor has to modify his report. Following factors are to be considered in auditor's reporting responsibility:

- Inventories and the Fixed Assets are material to the financial statements.
- 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.
- Auditor failed to obtain proper and sufficient audit evidence, even by alternative audit procedures.

<u>Draft of the suitable report to be incorporated in the main audit report</u>

"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 ICAI. 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.

<u>Basis for Disclaimer of Opinion</u>

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 Rs. XXX and Rs.XXX, respectively.

<u>Disclaimer of Opinion</u>

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.

<u>Report on Other Legal and Regulatory Requirements</u>

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.

Ans – 3:

SA 705 "Modifications to the Opinion in the Independent Auditor's Report" provides the consequence of an inability to obtain sufficient appropriate audit evidence due to a management-Imposed limitation after the auditor has accepted the engagement. The practicability of resigning from the audit may depend upon the stage of completion of the engagement at the time that management imposes the scope limitation. When the auditor concludes that resignation from the audit is necessary because of a scope limitation, there may be a professional, regulatory or legal requirement for the auditor to communicate matters relating to the resignation from the engagement to regulators or the entity's owners.

In the case of resignation from the company, provisions of the Companies Act, 2013 applies. Section 140 (2) of the Co. Act, 2013, requires the auditor, who has resigned from the company, to file within a period of 30 days from the date of resignation, a statement with the company and the registrar, and in case of government companies, the auditor shall file such statement with the C&AG, indicating the reasons and other facts as may be relevant with regard to his resignation. In case of failure the auditor will be liable for penal provisions.

Alternatively answer may be given as per SA 210, Agreeing the Terms of Audit Engagements.

SA 706	EMPHASIS OF MATTER PARAGRAPHS AND OTHER MATTER PARAGRAPHS IN THE INDEPENDENT AUDITOR'S REPORT (W.E.F. 1ST APRIL' 2012)

1. Objective of the Auditor: Emphasis of Matter Paragraphs or Other Matter Paragraphs is a para included in Auditor's Report to draw user's attention by way of additional communication, to:

(a) A matter although appropriately incorporated in the financial statements, that is of such importance that it is fundamental to user's understanding of financial statements; or

(b) Any other matter (other than those in financial statements) that is relevant to users or auditor's responsibility or the auditor report.

EOM paragraph is not a substitute for need for expression of qualified opinion, adverse opinion or Disclaimer of opinion or the disclosures to be made by management in financial statements as required by applicable FRF.

2. Emphasis of Matters Paragraphs in the Auditor's Report [M08]: To fulfill ***above objective (1 a),*** the auditor should include an ***"Emphasis of Matter paragraphs"*** in the auditor's report. When the auditor includes an ***"Emphasis of Matter paragraph"*** in the auditor report, the auditor should:

Include it immediately, after the opinion paragraph in the auditor's report.

- Use the heading "Emphasis of Matter", or other appropriate heading.
- Include in the paragraph a clear reference; (a) to the matter being emphasized and; (b) to where, relevant disclosure that fully describe the matter can be found in the financial statements; and
- Indicate that the auditor's opinion is not modified in respect of the matter emphasized.

2.1. Circumstances, when "Emphasis of Matter paragraph" can be included in Auditor's Report:

- Substantial doubt about going concern properly disclosed in financial statements.
- Material change in the accounting policy.
- Early application of a new accounting standard (where permitted).
- Uncertainty relating to a pending litigation, properly disclosed in the financial statements by the management.

2.2. Example : "Emphasis of Matter paragraph"

"We draw attention to Note X to the financial statements which describe the uncertainty related to the outcome of the lawsuit filed against the Company by ABC Company. Our opinion is not qualified in respect of this matter."

3. Emphasis *Other* *Matter Paragraphs* in the Auditor's Report: To fulfill ***above objective (1 b),*** the auditor should include an ***"Other Matter paragraph"*** in the auditor's report. When the auditor includes an ***"Other Matter paragraph"*** in the auditor report, the auditor should:

- Include this paragraph, immediately after the opinion paragraph and any Emphasis of Matter paragraph, or elsewhere in the auditor's report if the content of the Other Matter paragraph is relevant to the Other Reporting Responsibilities section.
- Use the heading "Other Matter", or other appropriate heading.

3.1. Circumstances, when "Emphasis of Other Matter paragraph" can be included in Auditor's Report:

- Reason, why auditor is unable to resign from the engagement even though there is a limitation on scope.
- Auditor has been asked to perform and report on additional specified procedures, or to express an opinion on specific matters.
- Law, regulation or generally accepted practice in a jurisdiction may require or permit the auditor to elaborate on matters that provide further explanation.
- Report in respect of the auditor's responsibility in respect of subsidiaries not audited by him, but which form part of the consolidated financial statements under report.
- Auditor's report is intended solely for the intended users, and should not be distributed to or used by other parties.
- Long form audit report (LFAR) in case of audit of a bank.

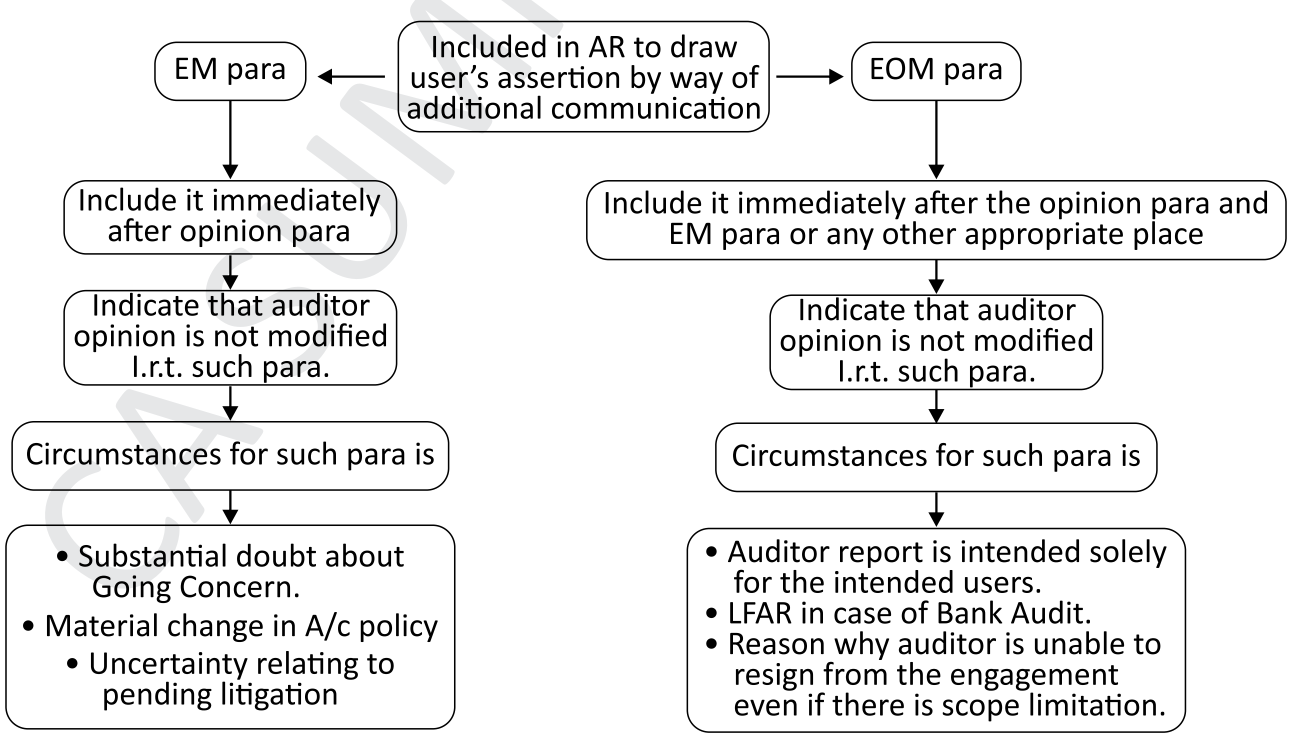
3.2. Example : "Emphasis of Other Matter paragraph"

"We did not audit the financial statements of certain subsidiaries, whose financial statements reflect total assets (net of) Rs. XXXXX as at March 31, 20XX, total revenue of Rs. XXXX and net cash outflows amounting to Rs. XXXX for the year that ended. These financial statements have been audited by other auditors whose reports have been furnished to us by the management, and our opinion is based solely on the reports of the other auditors. Our opinion is not qualified in respect of this matter."

4. Communication with TCWG: If the auditor expects to include an ***Emphasis of Matter*** or an ***Other Matter paragraph*** in the auditor's report, the auditor should communicate with TCWG, regarding this expectation and the proposed wording of this paragraph.

5. Format of Audit Report: refer comparison chart with SA700, SA706, SA706 - Refer Chapter 24

Summary SA 706



No.	Question Bank	Exam	Marks	Refer Point/ Ans.
1	Write short note on "Emphasis of matter paragraph in Audit Reports".	M08 PM	4	2
2	Beta Limited is a company registered with SEBI, having five subsidiaries. M/s XYZ, Chartered Accountants, have been appointed as Statutory Auditors for the audit of the CFS for the year ending March 31, 2013. Out of five subsidiaries, the audit of one subsidiary was conducted by another auditor, M/s Badnam and Company, Chartered Accountants. The "Opinion" Para of audit report furnished by M/s XYZ Chartered Accountants is given below: **Opinion** In our opinion and to the best of our information and according to the explanations given to us the consolidated financial statements give a true and fair view, except the financial statement of one subsidiary whose accounts were audited by M/s Badnam and Company, Chartered Accountants and about the same we are not in a position to express our opinion as the audit has not been performed by us : (i) the case of the consolidated Balance Sheet, of the state of affairs of the Company as at March 31, 2013. (ii) in the case of the consolidated Profit and Loss Account, of the profit/ loss for the year ended on that date. Do you find any deficiencies in the opinion para ? If yes, you are required to give your suggestions and redraft the opinion para.	N13 PM	5	Ans - 1
3	Compare and explain the following: "Audit Qualification vs. Emphasis of Matter."	N14	3	Ans - 2

Answer

Ans – 1: Yes, the opinion para contains the following deficiencies:

- Out of five subsidiaries, the audit of one subsidiary was conducted by another auditor, which would be reported in other matter para.
- After point no. (ii) in the opinion para, point no. (iii) would be appear as under- "in the case of the consolidated Cash Flow Statement, of the cash flows for the year ended on that date."

The redrafted opinion para and other matter para are given hereunder as per SA 706.

Opinion Para

In our opinion and to the best of our information and according to the explanations given to us and based on the consideration of the reports of the other auditors on the financial statements of the subsidiaries as noted below, the consolidated financial statements give a true and fair view in conformity with the accounting principles generally accepted in India:

(a) in the case of the consolidated Balance Sheet, of the state of affairs of the Company as at March 31, 2013;

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

(c) in the case of the consolidated Cash Flow Statement, of the cash flows for the year ended on that date.

Other Matter Para

We did not audit the financial statements of one subsidiary, whose financial statements reflect total assets (net) of Rs. XXX as at March 31, 2013, total revenues of Rs. XXX and net cash outflows amounting to Rs. XXX for the year then ended. These financial statements have been audited by other auditors M/s Badnam and Company, Chartered Accountants whose reports have been furnished to us by the Management, and our opinion is based solely on the reports of the other auditors. Our opinion is not qualified in respect of this matter.

Ans – 2:

REPORT		
S.No.	**Audit Qualification**	**Emphasis of Matter**
1	SA 705 "Modifications to the Opinion in the Independent Auditor's Report", deals with the provisions relating to Audit Qualification.	SA 706 "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report" deals with the provisions relating to Emphasis of Matter.
2	Audit Qualifications are also known as "subject to report" or "except that report".	Emphasis of Matter is a paragraph which is included in auditor's report to draw users' attention to important matter(s) which are already disclosed in Financial Statements and are fundamental to users for understanding of Financial Statements.
3	Audit Qualifications are given when auditor is having reservations on some of the items out of the financial statements (FS) as a whole i.e. Auditor's Judgment about the Pervasiveness of the Effects or Possible Effects on the FS relating to if the impact of material misstatements is not pervasive on the FS but is present at some levels of the FS, qualified report is issued.	Emphasis of Matter is a paragraph which is issued when there is a uncertainty relating to future outcome of exceptional litigation, regulatory action, etc.; or there is early application (where permitted) of a new accounting standard that has a pervasive effect on the FS in advance of its effective date.

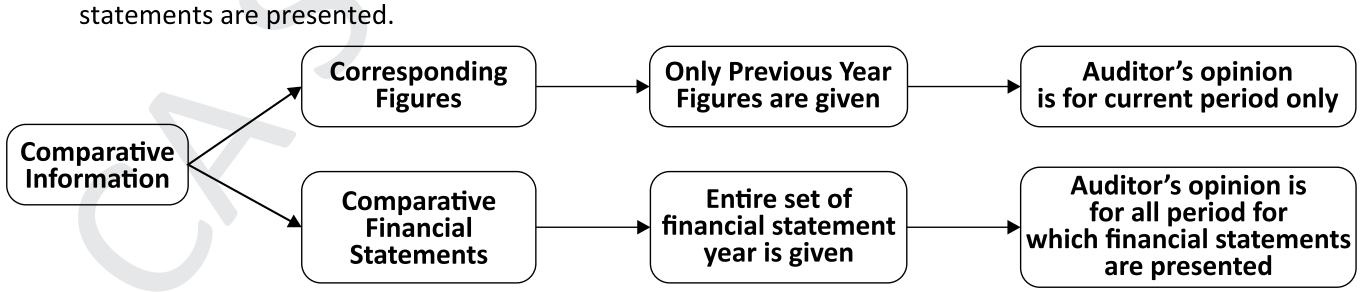
SA 710 — COMPARATIVE INFORMATION—CORRESPONDING FIGURES AND COMPARATIVE FINANCIAL STATEMENTS (W.E.F. 1ST APRIL' 2012)

1. **Scope of this SA:** This SA deals with the auditor's responsibilities regarding comparative information in an audit of financial statements.

2. **The Nature of Comparative Information:** The nature of comparative information that is presented in an entity's F.S. depends on the requirements of the applicable FRF. There are two different broad approaches to the auditor's reporting responsibilities in respect of such comparative information: (a) corresponding figures (b) comparative financial statements. The approach to be adopted is often specified by law or regulation but may also be specified in the terms of engagement.

2.1 **Corresponding Figures:** The auditor opinion on the financial statements refers to the current period only; whereas

2.2 **Comparative Financial Statements:** The auditor's opinion refers to each period for which financial statements are presented.



3. **Definition:**

3.1 **Comparative Information:** The amount and disclosures included in the FS in respect of one or more prior periods in accordance with the applicable FRF.

3.2 Corresponding Figures [M13]: Comparative information where amounts and other disclosures for the preceding period are included as an ***integral part*** of the current period financial statements, and are intended to be read in relation to the amounts and other disclosures relating to the current period. These corresponding figures are not presented as complete financial statements capable of standing alone, but are an integral part of the current period financial statements intended to be read only in relationship to the current period figures. The level of detail presented in the corresponding amounts and disclosures is dictated primarily by its relevance to the current period figures.

3.3 Comparative Financial Statements: Comparative information where amounts and other disclosures for the prior period are included ***for comparison*** with the financial statements of the current period but if audited, are referred to in the auditor's opinion. The level of information included in those comparative financial statements is comparable with that of the financial statements of the current period.

4. Auditor responsibilities in respect of Comparative Information [N03]:

- The auditor shall determine whether the financial statements include the comparative information required by the applicable FRF and whether such information is classified appropriately. For this purpose, the auditor shall evaluate whether:
  - ◊ The comparative information agrees with the amounts and other disclosures presented in the prior period; and
  - ◊ The accounting policies reflected in the comparative information are consistent with those applied in the current period.
  - ◊ There have been changes in accounting policies, whether those changes have been properly accounted for and adequately presented and disclosed.
- In case, auditor has doubt over existence of Possible Material Misstatement, then auditor is required to perform additional audit procedures to obtain sufficient appropriate audit evidence to determine existence of material misstatement. If the auditor had audited the prior period's financial statements, the auditor shall also follow the relevant requirements of SA 560 Revised (Subsequent Event).
- Obtain Written Representation from management to re-affirm that the Written Representation it previously made with respect to the prior period remain appropriate.
- When the financial statements of the prior period have been audited by another auditor or unaudited, then the SA 510 Revised (opening balances) also applies.

5. Audit Reporting in respect of Corresponding Figures: When corresponding figures are presented, the auditor's opinion shall not refer to the corresponding figures except:

- If the auditor's report on the prior period financial statements was modified and the matter which gave rise to the ***modification is unresolved,*** the auditor shall also modify the auditor's opinion on the current period's financial statements.
- If the auditor obtains audit evidence w.r.t. existence of material misstatement in prior period financial statement on which an ***unmodified opinion*** was issued, and misstatement has not been dealt as required by applicable FRF, the auditor shall express a ***qualified opinion or an adverse opinion*** on current period financial statements, w.r.t. the corresponding figures included therein.
- **Prior Period Financial Statements Audited by Predecessor Auditor:** If the financial statements of the prior period were audited by a 'predecessor auditor and the auditor is permitted by law or regulation to refer to the predecessor auditor's report on the ***corresponding figures*** and decides to do so, the auditor shall state in an ***Other Matter Paragraph*** in the auditor's report:
  - ◊ That the financial statements of the prior period were audited by the predecessor auditor.
  - ◊ The type of opinion expressed by the predecessor auditor.
  - ◊ The date of that report.

Example: Other Matter Paragraph

"The FS of Company for the year ended March 31 20X0, were audited by another auditor who expressed an unmodified opinion on those statements on June 30,20X0."

- **Prior Period Financial Statements not Audited:** If the prior period financial statements were not audited, the auditor shall state in an *Other Matter Paragraph* in the auditor's report that, the *corresponding figures* are unaudited.

(This statement does not relieve the auditor from the requirement to obtain sufficient appropriate audit evidence that the opening balances do not contain misstatements that materially affect the current period's financial statements)

6. **Audit Reporting in respect of Comparative Financial Statements:** When comparative financial statements are presented, the auditor's opinion shall refer to each period for which financial statements are presented and on which an audit opinion is expressed.

If opinion on prior period financial statements expressed in current period is different from opinion expressed in the relevant prior period, the auditor shall disclose the reason for difference in ***Other Matter paragraph*** in accordance with SA 706.

6.1 **Prior Period Financial Statements audited by Predecessor Auditor:** If the financial statements of the prior period were audited by a predecessor auditor, in addition to expressing an opinion on the current period's financial statements, the auditor shall state in an Other Matter paragraph:

- That the financial statements of the prior period were audited by a predecessor auditor.
- The type of opinion expressed by the predecessor auditor and, if the opinion was modified, the reasons therefore; and
- The date of that report, unless the predecessor auditor's report on the prior period's financial statement is revised with the financial statements.

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

6.2 **Prior Period Financial Statements not Audited:** If the prior period financial statements were not audited, the auditor shall state in an ***Other Matter Paragraph*** in the auditor's report that, the ***comparative financial statements*** are unaudited.

(This statement does not relieve the auditor from the requirement to obtain sufficient appropriate audit evidence that the opening balances do not contain misstatements that materially affect the current period's financial statements)

7. **Illustration:** Introductory and Reporting Para in case Corresponding Figures: when Auditor's Report on Prior Period as previously issued includes a qualified opinion and matter still unresolved:

<u>Independent Auditor's Report</u>

We have audited the accompanying financial statements of ABC Company Limited ("the Company"), which comprise the balance sheet as at March 31, 20X1, and the statement of profit and loss, and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

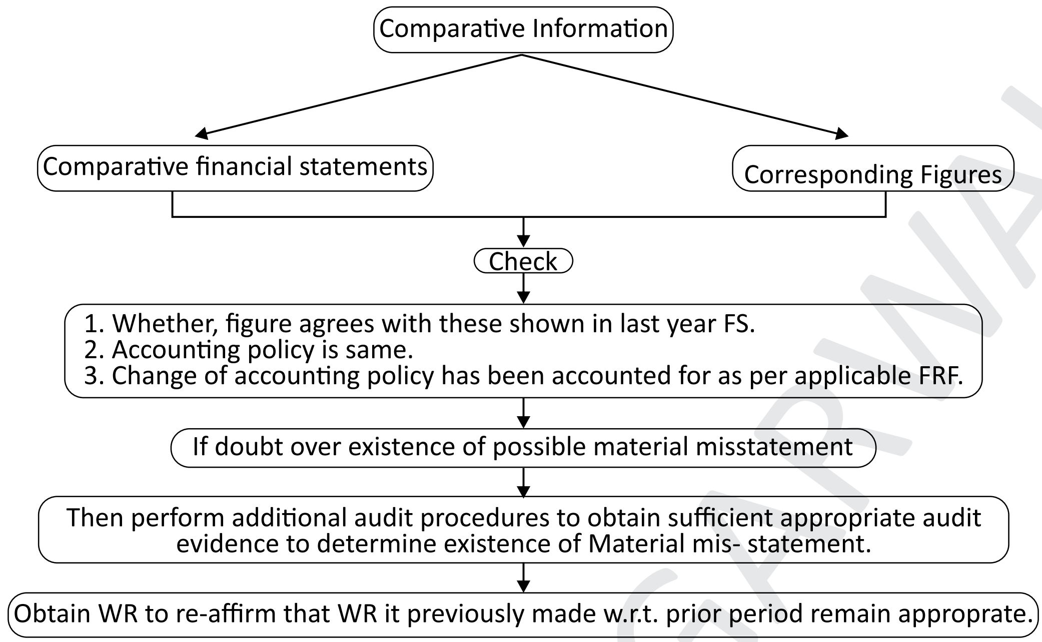
Basis for Qualified Opinion

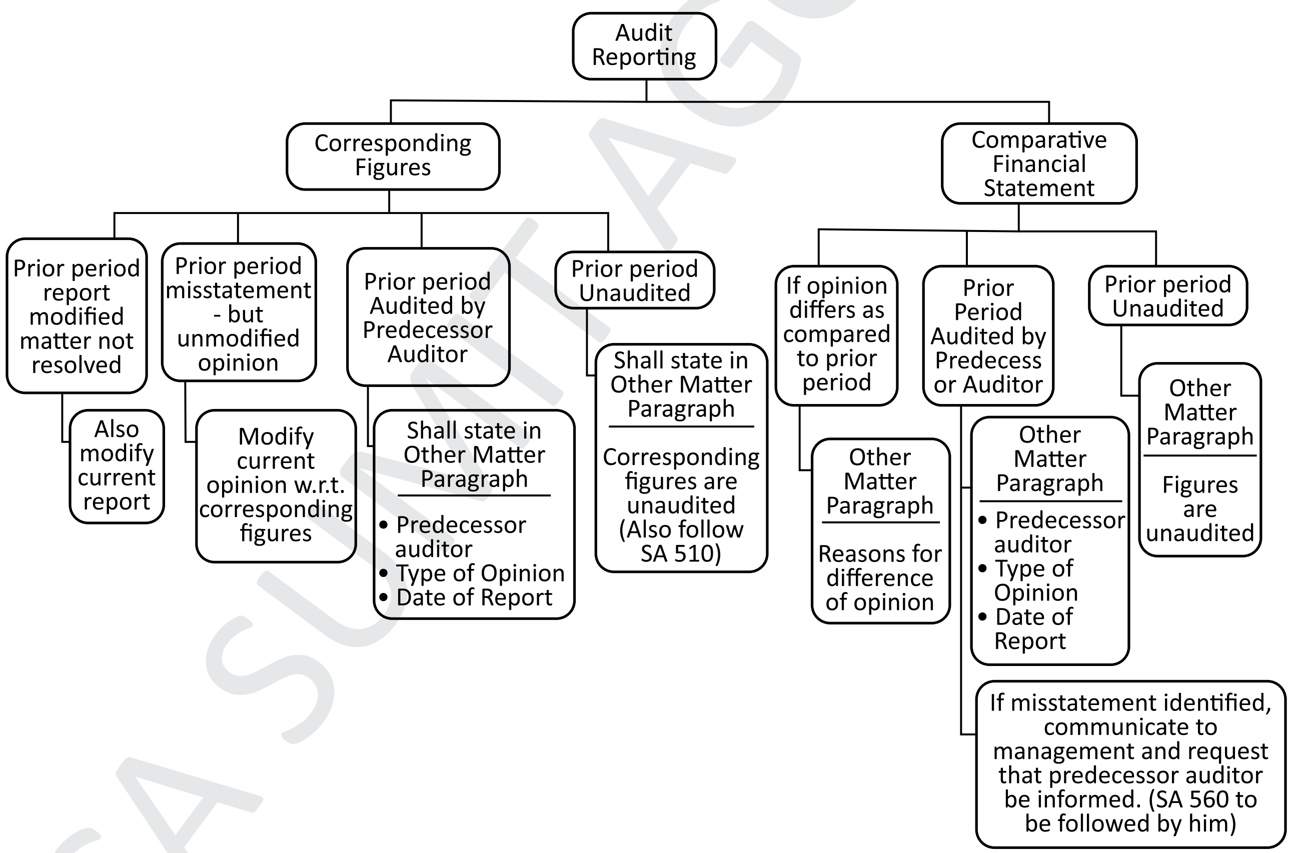
As discussed in Note X to the financial statements, no depreciation has been provided in the financial statements which constitutes a departure from the Accounting Standards to in sub-section (1) of section 129 of the Companies Act, 2013 ("the Act"). This is the result of a decision taken by management at the start of the preceding financial year and caused us to qualify our audit opinion on the financial statements relating to that year. Based on the straight-line method of depreciation and annual rates of 5% for the building and 20% for the equipment, the loss for the year should be increased by Rs. XXX in 20X1 and Rs. XXX in 20X0, property, plant and equipment should be reduced by accumulated depreciation of Rs. XXX in 20X1 and Rs. 20X0, and the accumulated loss should be increased by Rs. XXX in 20X1 and Rs. XXX in 20X0.

Qualified Opinion

In our opinion, except for the effects of the matter described in the Basis for Qualified Opinion paragraph, the financial statements give a true and fair view of the state of affairs of the Company as of March 31, 20X1, and of its results of operations and its cash flows for the year then ended in accordance with the Accounting Standards referred to in subsection (1) of section 129 of the Companies Act, 2013 ("the Act").

Summary SA 710





No.	Question Bank	Exam	Marks	Refer Point/ Ans.
1	Write short note on "Corresponding Figures".	M13 PM	4	3.2

2	Write short notes on "Auditor's responsibilities regarding comparatives".	N03 PM	4	4
3	The audit report of P Ltd. for the year 2012-13 contained a qualification regarding non-provision of doubtful debts. As the statutory auditor of the company for the year 2013-14, how would you report, if: (i) The company does not make provision for doubtful debts in 2013-14? (ii) The company makes adequate provision for doubtful debts in 2013-14?	M09 N14 PM	8, 5	Ans - 1
4	What are the auditor's responsibilities in respect of corresponding figures? IT systems also pose specific risks to an entity's internal control? What are those risks?	M10 PM	4	Ans - 2

Answer

Ans – 1:

Auditor's responsibility in cases where audit report for an earlier year is qualified is given in SA 710 "Comparative Information – Corresponding Figures and Comparative Financial Statements". As per SA 710, When the auditor's report on the prior period, was modified, and the matter which gave rise to the modified opinion is resolved and properly accounted for or disclosed in the financial statements in accordance with the applicable FRF, the auditor's opinion on the current period need not refer to the previous modification.

SA 710 further states that if the auditor's report on the prior period was modified and the matter which gave rise to the modification is unresolved, the auditor shall modify the auditor's opinion on the current period's financial statements. In the Basis for Modification paragraph in the auditor's report, the auditor shall either:

- Refer to both the current period's figures and the corresponding figures in the description of the matter giving rise to the modification when the effects or possible effects of the matter on the current period's figures are material; or
- In other cases, explain that the audit opinion has been modified because of the effects or possible effects of the unresolved matter on the comparability of the current period's figures and the corresponding figures.

In the instant Case, if P Ltd. does not make provision for doubtful debts the auditor will have to modify his report for both current and previous year's figures as mentioned above. If however, the provision is made, the auditor need not refer to the earlier year's modification.

Ans – 2: Auditor's responsibilities in respect of corresponding figure: refer SA 710

Specific Risk to an Entity's internal Control: As per SA 315 "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment", IT system also poses specific risks to an entity's Internal Control. They are:

- Reliance on systems or programs that are inaccurately processing data, processing inaccurate data or both
- Unauthorized access to data that may result in destruction of data or improper changes to data, including the recording of unauthorized or nonexistent transactions, or inaccurate recording of transactions. Particular risk may arise when multiple users access a common database.
- The possibility of IT personnel gaining access beyond those necessary to perform their assigned duties thereby breaking down segregation of duties.
- Unauthorized changes to data in Master files
- Unauthorized changes to systems or programs.
- Failure to make necessary changes to systems or programs.
- In appropriate manual intervention
- Potential loss of data or inability to access data as required.

SA 720 — THE AUDITOR'S RESPONSIBILITY IN RELATION TO OTHER INFORMATION IN DOCUMENTS CONTAINING AUDITED FINANCIAL STATEMENTS (W.E.F. 1ST APRIL' 2010)

1. **Scope of this SA:** In this SA "documents containing audited financial statements" refers to annual reports (or similar documents), that are issued to owners (or similar stakeholders), containing audited financial statements and the auditor's report thereon. This SA may also be applied, adapted as necessary in the circumstance, to other documents containing audited financial statements.

2. **Objective:** The objective of the auditor is to respond appropriately when documents containing audited financial statements and the auditor's report thereon include other information that could undermine the credibility of those financial statements and the auditor's report.

3. **Definitions**

3.1 **Other Information:** Financial and non-financial information (other than the financial statements and the auditor's report thereon) which is included in a document containing audited financial statements and the auditor's report thereon. Example: A report by management, planned capital expenditures, financial ratios, financial summaries or highlights, selected quarterly data etc.

3.2 **Inconsistency:** Other information that contradicts information contained in the audited financial statements.

3.3 **Misstatement of Fact:** Other information that is unrelated to matters appearing in the audited financial statements that is incorrectly stated or presented. A material misstatement of fact may undermine the credibility of the document containing audited financial statements.

4. **Reading Other Information:** The auditor should read the other information to identify material inconsistencies, if any, with the audited financial statements.

The auditor should make appropriate arrangements with management or TCWG to obtain the other information prior to the date of the auditor's report. If it is not possible, the auditor should read such other information as soon as possible.

5. **Material Inconsistencies:** If, on reading the other information, the auditor identifies a material inconsistency, the auditor should determine whether the audited financial statements or the other information needs to be revised.

6. **Auditor's Responsibility with respect to Material Inconsistencies identified in Other Information:** When material inconsistencies identified in Other Information, which requires ***revision of audited financial statements/ other information,*** the auditor's procedures depends upon the timing of availability of other information.

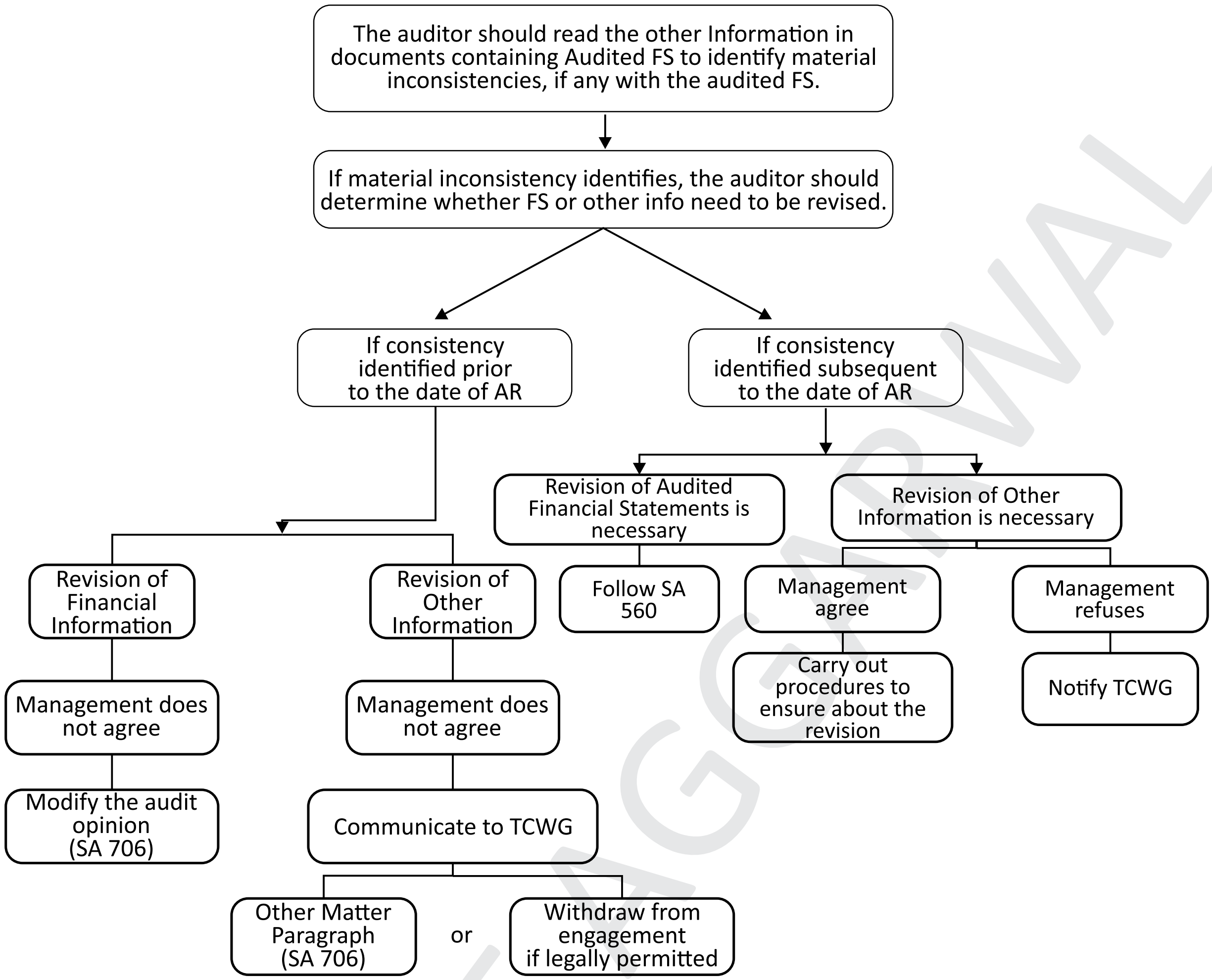
6.1 **If Other Information was obtained prior to the date of the Auditor's Report:**

- If identified misstatement requires ***revision of audited financial statements,*** but management refuses to make the revision; the auditor shall modify the opinion in accordance with SA 705.
- If identified misstatement requires ***revision of other information*** and management refuses to make the revision, the auditor should communicate this matter to TCWG; and (a) Include in the auditor's report an ***Other Matters paragraph*** describing the material inconsistency in accordance with SA 706; or (b) Where withdrawal is legally permitted, withdraw from the engagement.

6.2 **If Other Information was obtained Subsequent to the Date of the Auditor's Report:**

- If identified misstatement requires ***revision of audited financial statements,*** the auditor shall follow the relevant requirements in SA 560 (Subsequent Event).
- If identified misstatement requires ***revision of other information*** and management agrees to make the revision, the auditor should carry out the procedures, necessary under the circumstances.
- If identified misstatement requires ***revision of other information*** and management refuses to make the revision, the auditor should communicate this matter to TCWG; and take any further appropriate action.

Summary SA 720



SA 800	SPECIAL CONSIDERATIONS-AUDITS OF FINANCIAL STATEMENTS PREPARED IN ACCORDANCE WITH SPECIAL PURPOSE FRAMEWORKS (W.E.F. 1ST APRIL' 2011)

1. **Objective:** The objective of the auditor is to address appropriately the special considerations that are relevant to:
   - The acceptance of the engagement.
   - The planning and performance of that engagement; and
   - Forming an opinion and reporting on the financial statements.
2. **Special Purpose Framework:** A FRF designed to meet the financial information needs of specific users. The FRF may be a fair presentation framework or a compliance framework. Example of special purpose frameworks includes:
   - The cash basis of accounting for cash flow information to be prepared for creditors.
   - The financial reporting provisions established by a regulator to meet the requirements of that regulator.
   - The financial reporting provisions of a contract, such as a loan agreement, or a project grant.
3. **Considerations when accepting the Engagement:** The auditor should determine the acceptability of the FRF as per SA 210 (Revised). For this purpose, he should obtain understanding of:
   - The purpose for which financial statements are prepared.
   - The intended users; and
   - The Steps taken by the management to determine acceptability of applicable FRF.
4. **Consideration When Planning & Performing an Audit:** SA 200 (Revised) requires the auditor to comply with

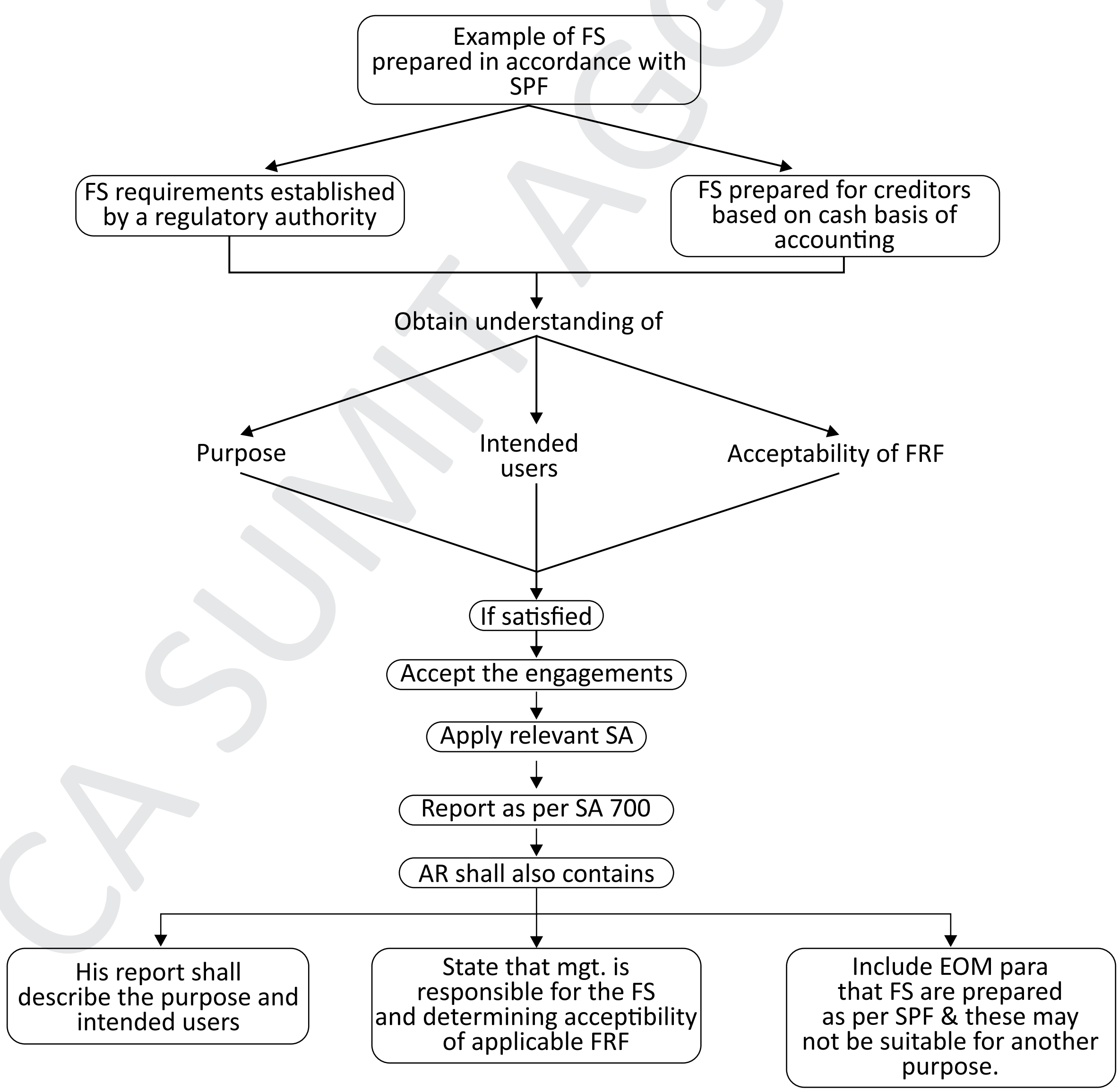
all SAs relevant to the audit. In planning and performing an audit of special purpose financial statements, the auditor should determine whether application of the SAs requires special consideration in the circumstances of the engagement.

5. Forming Opinion & Reporting Considerations: When forming an opinion and reporting on special purpose financial statements, the auditor should apply the requirements of SA 700 (Revised). SA 700 (Revised) deals with the form and content of the auditor's report. In addition of SA 700 (revised), the auditor's report on ***special purpose financial statements*** shall also:

- Refer to the purpose for which the financial statements are prepared and intended users.
- Refer to management's responsibility for determining acceptability of applicable FRF, If management has a choice of FRF in the preparation of such financial statements.
- Alert users, regarding application of special purpose FRF and as such financial statement may not be suitable for another purpose.
- Include an "Emphasis of Matter paragraph alerting users of the auditor's report that the FS are prepared in accordance with a special purpose framework and that, as a result, the financial statements may not be suitable for another purpose. The auditor should include this paragraph under appropriate heading.

6. Illustration of Audit Report on Financial Statements prepared in accordance with Special Purpose Framework: Refer Chapter 24

Summary SA 800



SA 805 — SPECIAL CONSIDERATIONS—AUDITS OF SINGLE FINANCIAL STATEMENTS AND SPECIFIC ELEMENTS, ACCOUNTS OR ITEMS OF A FINANCIAL STATEMENT (W.E.F. 1ST APRIL' 2011)

1. **Objective:** The objective of the auditor is to address appropriately the special considerations that are relevant to:
   - The acceptance of the engagement;
   - The planning and performance of that engagement; and
   - Forming an opinion and reporting on the financial statements.

2. **Definitions:**
   - **"Element of a financial statement** or "element" means an element, account or item of a financial statement";
   - A single financial statement (for example, a cash flow statement) or to a specific element of a financial statement (for example, cash and bank balances) includes the related notes.

3. **Considerations when Accepting the Engagement:**

3.1 **Application of SA:** SA 200 (Revised) requires the auditor to comply with all SAs relevant to audit. In the case of an audit of Single financial statements or of a specific element of a financial statement, this requirement applies irrespective of whether the auditor is also engaged to audit the entity's complete set of financial statements.

3.2 **Acceptability of the FRF:** The auditor should determine the acceptability of the financial reporting framework as per SA 210 (Revised) in the preparation of single financial statements or to a specific element of a financial statement.

3.3 **Form of Opinion:** SA 210 (Revised) requires that the agreed terms of the audit engagement include the expected form of any reports to be issued by the auditor. The auditor should consider whether the expected form of opinion is appropriate in the circumstances.

4. **Consideration when Planning & Performing an Audit:** SA 200 (Revised) requires the auditor to comply with all SAs relevant to the audit as necessary in the circumstances of the engagement.

5. **Forming Opinion & Reporting Considerations:**
   - When forming an opinion and reporting on Single financial statements or of a specific element of a financial statement, the auditor should apply the requirements in SA 700 (Revised) adopted as necessary in the circumstances of the engagement.
   - If he is also auditing entity's full set of financial statements, the auditor should express a separate opinion for each engagement.
   - If the auditor has expressed an adverse opinion or disclaimed an opinion on the complete set of financial statements as a whole:
     - ◊ The auditor should not express an unmodified opinion on a single financial statement of a complete set of financial statements even if report on both financial statements is not published together.
     - ◊ The auditor may issue unmodified opinion for specific element only if:
       - » The auditor is not prohibited by law or regulation from doing so.
       - » Auditor report not published together with auditor report containing the adverse opinion or disclaimer of opinion; and
       - » The specific element does not constitute a major portion of the entity's complete set of financial statements.

6. **Illustration of Audit Report on Audit of a Balance Sheet:** Refer Chapter 24

7. **Illustration of Audit Report on Audit of a statement of Cash Receipt and Disbursement:** Refer Chapter 24

SA 810 ENGAGEMENTS TO REPORT ON SUMMARY FINANCIAL STATEMENTS (W.E.F. 1ST APRIL' 2011)

1. **Scope of This SA:** This SA deal with auditor responsibilities when the same auditor is undertaking audit of complete financial statements (as per SA) as well as audit of SFS.

2. **Summary Financial Statements (SFS):** - SFS is Historical financial information that is derived from financial statements, but contains less detail than financial statements.

3. **Engagement Acceptance:** The auditor should accept the engagement only when he is also engaged to conduct an audit (as per SAs), of those financial statements, from which the SFS have been derived. Before accepting Engagement to report on SFS, the auditor should:
   - Determine whether the applied criteria (The criteria applied by the management in the preparation of SFS) are acceptable.
   - Obtain the agreement of management that acknowledges and understands its responsibilities:
     - ◊ For the preparation of SFS in accordance with the applied criteria.
     - ◊ To make the audited financial statements (AFS) available to the intended users of SFS without undue difficulty (if not possible due to law or regulation, then describe such law or regulation in the summary financial statements); and
     - ◊ To include the auditor's report on SFS in any document that contain the SFS and that includes that the auditor has reported on them.
   - Agree with the management regarding the form of opinion to be expressed on the SFS.

4. **Nature of Audit Procedures:** The auditor should perform the following procedures:
   - Evaluate whether the SFS adequately disclose their summarized nature; & identify the AFS.
   - When SFS are not accompanied by AFS, evaluate whether they describe clearly:
     - ◊ From whom and where AFS are available; or
     - ◊ Law & Regulation that specifies that AFS need not be made available to intended users of SFS and establish the criteria for the preparation of the SFS.
   - Evaluate whether, the SFS adequately disclose the applied criteria.
   - Evaluate whether, the SFS are prepared in accordance with applied criteria.
   - Evaluate whether, the SFS contain necessary information which is not misleading.
   - Evaluate whether, the SFS agree with related information in AFS (by comparing them)
   - Evaluate whether, the AFS are available to intended users without undue difficulty.

5. **Form of Opinion:** When the auditor has concluded that an ***unmodified opinion*** of the SFS is appropriate, the auditor's should, unless otherwise required by law or regulation, use one of the following phrases:
   - The SFS are consistent, in all material respects, with the AFS, in accordance with the applied criteria, or
   - The SFS are a fair summary of the AFS in accordance with the applied criteria.

6. **Elements of the Auditor's Report on SFS:**
   - A title clearly indicating that it is the report of an independent auditor.
   - An addressee
   - An Introductory Paragraph that:
     - ◊ Identifies the SFS on which the auditor is reporting, including the title of each statement included in SFS;
     - ◊ Identifies the AFS;
     - ◊ Refers to the auditor's report on the AFS, the date of that report and the fact that an unmodified opinion has been expressed on the AFS (if it is so);
     - ◊ If the date of the auditor's report on SFS if later than the date of the auditor's report on the AFS, state that SFS and the AFS do not reflect the effects of events that occurred subsequent to the date of the auditor's report on the AFS; and
     - ◊ A statement indicating that SFS do not contain all the disclosures required by FRF applied in the preparation of AFS and that, reading SFS is not a substitute for reading the AFS.
   - A statement on Management's Responsibility: Stating that management is responsible for the preparation

of the SFS in accordance with the applied criteria.
- A statement that auditor's is responsible for expressing an opinion on the SFS based on the procedures required by this SA.
- Auditor's Opinion paragraph on SFS.
- Auditor's Signature: Along with the membership number assigned by the ICAI and the firm registration number, wherever applicable.
- The date of the auditor's report.
- The place of Signature

7. **Qualified Opinion, Emphasis of Matter Paragraph (EOM) or Other Matter Paragraph (OM) in the Auditor's Report on the Audited Financial Statements:** When the auditor's report on the AFS contains a qualified opinion, an EOM or an OM, but the auditor is satisfied that SFS are consistent or are a fair summary of the AFS in accordance with applied criteria, then auditor's report on SFS shall, in addition to the elements discussed above:
   - State that audit report on AFS contains qualified opinion, an EOM or OM paragraph; and
   - Describe the basis for such opinion; and
   - Describe the Effect thereof on SFS, if any.

8. **Adverse Opinion or Disclaimer of Opinion in the Auditor's Report on the Audited Financial Statements:** When the auditor's report on the AFS contains an ***adverse opinion*** or ***disclaimer of opinion,*** then auditor's report on SFS shall, in addition to the elements discussed above:
   - State that the auditor's report on the AFS contains an adverse opinion or disclaimer of opinion;
   - Describe the basis for such opinion; and
   - State that, as a result of the adverse or disclaimer of opinion, it is inappropriate to express an opinion on the SFS.

9. **Modified Opinion on the SFS:** The auditor should express an adverse opinion on the SFS if:
   - SFS are not consistent, in all material respects, with or are not a fair summary of the AFS, in accordance with the applied criteria; and
   - Management does not agree to make the necessary changes.

10. **Comparatives:** If the AFS contain comparatives, but the SFS do not, the auditor should determine whether such omission is reasonable. The auditor should determine the effect of unreasonable omission on the auditor's report on the SFS.

    If SFS contain comparatives that were reported on by another auditor, the auditor's report on SFS shall also contain the matters as per SA 710.

11. **Restriction on Distribution or Use or Alerting Readers to the Basis of Accounting:** When distribution or use of the auditor's report on the AFS is restricted, or the auditor's report on the AFS alerts readers that the AFS are prepared in accordance with a special purpose framework, the auditor should also include a similar restriction or alert in the auditor's report on the SFS.

12. **Unaudited Supplementary Information Presented with Summary Financial Statements:** The auditor should evaluate whether any unaudited supplementary information presented with the SFS is clearly differentiated from the summary financial statements. If not, the auditor should ask management to change the presentation of the unaudited supplementary information. If management refuses to do so, the auditor should explain in the auditor's report on the summary financial statements that such information is not covered by that report.

13. **Illustration 1 of Auditor's Report on Summary Financial Statements:** Refer Chapter 24

14. **Illustration 2 of Auditor's Report on Summary Financial Statements:** Refer Chapter 24

Summary SA 810

- SFS are historical financial information derived from FS, containing less detail than those in FS.
- It is mgt. responsibility to choose the criteria on which SFS are prepared (Applied criteria).
- The auditor should accept the engagement only when he is also engaged to conduct an audit of those FS, from which the SFS have been derived.
- **Before accepting the engagement, auditor should consider:**
   - ◊ Acceptability of Applied criteria.

- ◊ Whether mgt. acknowledge their responsibility.
- ◊ Form of opinion to be expressed on SFS.

- **Audit Procedures:** Whether SFS:
  - ◊ Disclose applied criteria.
  - ◊ Prepared in accordance with applied criteria.
  - ◊ Agree with related info in AFS (by comparing them) and AFS are available to intended users without undue difficulty.

If auditor report on AFS Contains

Qualified, EOM or OM
↓
And auditor is satisfied that SFS is consistent with AFS
↓
AR on SFS state that :
↓
- AR on AFS contains qualified opinion / EOM / OM
- Describe the basis of such opinion
- Describe effect thereof on SFS if any.

↓

Note - Auditor should express and adverseopinion on SFS if SFS are not consistent or not a fair summary of AFS and mgt does not agree to make the necessary changes

Adverse or Disclaimer
↓
AR on SFS state that :
↓
- AR on AFS contains adverse / disclaimer of opinion's
- Describe the basis there of
- State that because of above it is inappropriate to express an opinion on the SFS.

No.	Question Bank	Exam	Marks	Refer Point/ Ans.
1	Write short notes on "Summary Return Report".	M00	4	Ans - 1

Answer

Ans – 1:

Summary Return Reports are also known as Flash Reports. They are significant highlights for immediate attention of top management. Generally all suspected defalcations are reported briefly to the appropriate management official on 'flash' basis often ending up in referral for criminal investigation and legal action. It is common practice in number of companies of issuing a report quite frequently summarizing the various individual reports issued and describing the range of their contents in a very brief and comprehensive manner where only important points are highlighted. Such reports are preliminary issued for audit committees of Board of Directors and for other top level managers who do not have sufficient time to go through the elaborate reports and matters which are required to be brought to their notice for immediate action.

SRE 2400 — ENGAGEMENTS TO REVIEW FINANCIAL STATEMENTS (W.E.F. 1ST APRIL' 2010)

1. Objectives: The objective of a review of financial statements is to enable the practitioner to state whether on the basis of less extensive procedures (than required in audit), anything has come to his attention that causes him to believe that financial statements ***are not prepared*** in accordance with the applicable FRF. ***(Negative Assurance)***

2. General Principles of a Review Engagement:

- Practitioner should comply with code of ethics issued by ICAI.

- He should conduct a review in accordance with the SRE.
- He should plan and perform the review with an attitude of professional skepticism recognizing that circumstances may exist, which cause the financial statements to be materially misstated.
- For the purpose of expressing negative assurance in review report, the practitioner should obtain sufficient appropriate evidence primarily through inquiry and analytical procedures to be able to draw conclusions.

3. **Scope of Review:** The procedures required to conduct a review of financial statements should be determined, having regards to the requirement of this SRE, relevant legislation and regulation & the terms of Review engagement and reporting requirements.

4. **Moderate Assurance:** A review engagement provides a moderate level of assurance that is expressed in the form of ***negative assurance*** which is lesser than assurance given in audit (Due to limited procedures).

5. **Terms of Engagement:** Practitioner and client should agree on terms of review engagement to avoid any misunderstanding. Engagement terms should contain the following:
   - The Objective of the service being performed.
   - Management's responsibility for the financial statements.
   - Scope of the review, including reference to this SRE.
   - Unrestricted access to whatever records, documentation and other information requested.
   - The fact that the engagement cannot be relied upon to disclose errors, violation of laws or other irregularities, for example, fraud or defalcations that may exist.
   - A Statement that an ***audit is not being performed*** and that an audit opinion will not be expressed.

6. **Planning & Documentation:** The auditor should plan the work so that effective engagement will be performed. The auditor should document matters, which are important in providing evidence to support that the engagement was carried out in accordance with this SRE.

7. **Work performed by Others:** Practitioner should be satisfied that such work is adequate for his purpose.

8. **Procedures & Evidences:**
   - Practitioner should apply professional judgment to determine nature, timing and extent of review Procedures.
   - He should apply the same materiality considerations as would be applied in audit opinion on the financial statement. Which includes:
     ◊ Obtaining understanding of the entity's business and its industry;
     ◊ Inquiries concerning the entity's accounting principles, policies and practices;
     ◊ Inquiries concerning all material assertions in the financial statements.
     ◊ Inquiries concerning the entity's procedures for recording, classifying and summarizing transactions;
     ◊ Analytical procedures designed to identify relationships and individual items that appear unusual. Such procedures would include (a) comparison of the financial statements with statements for prior periods (b) comparison of the financial statements with anticipated results and financial position.
   - Practitioner should also inquire about events subsequent to B/S date, affecting financial statements. If he has doubt about that the information may be materially misstated, he should carry out additional or more extensive procedures.

9. **Negative Assurance:** The review report should state that ***nothing*** has come to practitioner's attention based on the review, that causes him to ***believe*** that financial statements ***do not give*** a true and fair view (or not presented fairly) in accordance with appropriate framework; or
   - If matters come to practitioner's attention that impair true and fair view, then describe those matters with quantification on financial statement and either express a qualification of negative assurance, or if effect is so material and pervasive that qualification is not adequate give an adverse statement.
   - If there is material scope limitation, describe the limitation and either express a qualification of negative assurance, or when possible, effect of limitation is so significant don't provide any assurance.

10. **Conclusion & Reporting:** The review report should contain a clear written expression of negative assurance. The review report should contain the following basic elements:
    - Title
    - Addressee
    - Opening or introductory paragraph including (a) Identification of the financial statement on which the

review has been performed; and (b) a statement of the responsibility of the entity's management and the responsibility of the practitioner.

- Scope paragraph, describing the nature of review, including (a) a reference to this SRE to relevant laws or regulations (b) a statement that a review is limited primarily to inquiries and analytical procedures (c) a statement that an audit has not been performed, the procedures undertaken provide less assurance than an audit and an audit opinion is not expressed.
- Statement of negative assurance
- Date of the report
- Place of Signature
- Practitioner's signature and membership number
- Firm's registration number, wherever applicable, as allotted by ICAI.

The practitioner should not agree to change of engagement, where there is no reasonable justification for doing so. If the auditor is unable to agree to a change of the engagement and is not permitted to continue the original engagement, the auditor should withdraw and consider whether there is any obligation to report the circumstances necessitating the withdrawal to other parties, such as the BOD or shareholders.

11. **Example of an Engagement Letter for a Review of Financial Statements:** Refer Chapter 24
12. **Example of Unqualified Review Report:** Refer Chapter 24
13. **Example of Review Reports other than Unqualified/Modified:** As per Chapter 24

SRE 2410	REVIEW OF INTERIM FINANCIAL INFORMATION PERFORMED BY THE INDEPENDENT AUDITOR OF THE ENTITY (W.E.F. 1ST APRIL' 2010)

1. **Interim Financial Information (IFI):** IFI is either a complete or condensed set of financial statements for a period shorter than entity's F.Y. (Example: Quarterly, Half Yearly). This SRE is applicable when independent auditor of the entity's is also engaged to review the IFI. He is having understanding of entity and its environment and I.C., thus he can review IFI with much ease.
2. **General principles of a Review of IFI:** The Auditor should:
   - Comply with ethical requirement relevant to the audit issued by ICAI.
   - Implement quality control procedures as per SQC.
   - Maintain professional skepticism.
3. **Objective**: The objective of an engagement to review IFI is to enable the auditor to express a conclusion whether, on the basis of the review; anything has come to the auditor's attention that causes the auditor to believe that the IFI is not prepared in all material respects, in accordance with an applicable FRF.
4. **Agreeing the Terms of the Engagement:** Terms of Engagement shall cover the following:
   - Objective of review of IFI.
   - Scope of review.
   - Management responsibility for
     - ◊ IFI
     - ◊ Establishing and maintaining effective I.C. relevant to preparation of IFI.
     - ◊ Making all financial records & related information available to auditor.
   - Management's agreement to provide WR to auditor to confirm representations made orally during review, as well as representations implicit in entity's records.
   - Anticipated form and content of report to be issued, including identity of addressee or report.
   - Management's agreement that where any document containing IFI indicates that IFI has been reviewed by entity's auditor, review report will also be included in document.
5. **Procedures for a Review:**
   - Understanding the entity and its environment.

- **Inquiries, Analytical and Other Review Procedures:** Auditor should make inquiries and perform analytical and other review procedures. Ordinarily auditor is not required to perform inspection/observation/ confirmation. Direct external confirmation is also not necessary.
- **Collection of Evidence:** The auditor should obtain evidence that the interim financial information agrees or reconciles with the underlying accounting records.
- **Evaluation of Misstatements:** The auditor should evaluate, whether uncorrected misstatements are material to IFI. However he is not required to obtain reasonable assurance that IFI is free of material misstatements.
- **Auditor's Responsibility for Accompanying Information:** He should read the other information accompanying the IFI to consider, whether it is inconsistent with the IFI. If a matter comes to the auditor's attention that causes the auditor to believe that the other information is misstated, he should discuss the matter with the entity's management.
- **Representation from Management:** For following:
  - ◊ Responsibility for internal control to prevent and detect fraud and error.
  - ◊ IFI is prepared and presented in accordance with applicable FRF.
  - ◊ Uncorrected misstatement is immaterial, both individually and in the aggregate, to IFI.
  - ◊ It has disclosed to the auditor:
    - » All significant facts relating to any frauds or suspected frauds known to management affecting the entity.
    - » Results of its assessment of the risk of fraud.
    - » All known actual or possible non-compliance with laws and regulations affecting the IFI.
    - » All significant events that have occurred subsequent to the B/S date up to the date of the review report that may require adjustment to or disclosure in IFI.

6. **Reporting Elements:**
   - An appropriate title.
   - An addressee, as required by the circumstances of the engagement.
   - Identification of the IFI including title of each statement therein.
   - Management responsibility for preparation of IFI.
   - Statement for Auditor's Responsibility for expressing a conclusion on the IFI.
   - Statement that, review of IFI was conducted in accordance with SRE 2410.
   - Statement that, review is substantially less in scope than an audit.
   - Auditor's Conclusion.
   - The date of the report.
   - Place of signature.
   - Auditor's signature including his Membership number.
   - Firm registration number.
7. **Departure from applicable FRF:** If matter have come to the auditor's attention that cause the auditor to believe that, the IFI is or may be materially affected by a departure from the applicable FRF, and management does not correct the IFI, the auditor should ***modifies (qualified or adverse) the review report.***
8. **Limitation of Scope:** If he is unable to complete review, then auditor should communicate the reason in writing to appropriate level of management /TCWG, and consider, whether it is appropriate to issue a report.
9. **Example of an Engagement Letter for a Review of Interim Financial Information:** Refer Chapter 24
10. **Example of Unqualified Review on Interim Financial Information consists of complete Set of General purpose Financial Statements prepared in accordance with a Financial Reporting Framework:** Refer Chapter 24

SAE 3400	THE EXAMINATION OF PROSPECTIVE FINANCIAL INFORMATION (W.E.F. IST APRIL' 2007)

1. **Prospective Financial Information (PFI):** It means financial information based on the assumptions about the events that may occur in future and possible action by management. It is highly subjective in nature and its preparation requires the exercise of considerable judgment. Prospective financial information can be in the

form of a forecast, a projection, or a combination of both. For example a one year forecast plus a five year projection.

Prospective financial information can include financial statements or one or more financial statements and may be prepared as an internal management tool, for example, to assist in evaluating a possible capital investment; or for the distribution or submission to third parties, for example: a prospectus to provide potential investor with information about future expectations, an annual report to provide information to shareholders, regulatory bodies and other interested parties, other documents for example, cash flow forecasts, for the information of lenders. It is highly subjective in nature; hence it may be of two types:

- **Forecast:** It is based upon assumption as to future events which management expects to take place.
- **Projections:** It is based on hypothetical assumptions which are not necessarily expected to take place; or mixture of best estimate and hypothetical assumptions.

2. **Management's Responsibility:** Management is responsible for the preparation and presentation of the prospective financial information, including the identification and disclosure of prospective financial information; the basis of forecast; and the underlying assumptions. The auditor may be engaged to examine and report on the prospective financial information to enhance its credibility, whether it is intended to use by third parties or for internal purposes.

3. **Level of assurance provided by Auditor:** When reporting on the reasonableness of management's assumptions, the auditor provides only ***a moderate level of assurance.***

   The auditor, because of the following reason, is not in a position to express an opinion as to whether; the results shown in the prospective financial information will be achieved.

   - Prospective financial information relates to events and actions that have not yet occurred and might not occur.
   - Evidence available to support the assumptions is itself generally future-oriented and, therefore, speculative in nature.
   - The types of evidence available in assessing the assumptions, makes it difficult for the auditor to obtain a level of satisfaction, sufficient to provide a positive expression of opinion that the assumptions are free of material misstatement.
   - Auditor may be asked to examine and report on it to enhance its credibility.
   - It relates to events and actions that have not yet occurred and might not occur.
   - Evidences are future oriented and thus speculative.
   - Auditor is not in a position to express opinion as to whether; the results shown in prospective financial information will be achieved.
   - He can provide only moderate assurance (Negative assurance).

4. **Acceptance of Engagement:** The auditor should not accept or should withdraw from engagement, when assumptions are clearly unrealistic or when he believes that it will be inappropriate for its intended use. The auditor and client should agree on the terms of the engagement.

5. **Knowledge of Business:** Auditor should obtain knowledge of the business so that he can be able to evaluate, whether all required assumption have been identified. He should also need to become familiar with the entity's process for preparing prospective financial information. He should also consider the extent of reliance that can be placed on entity's historical financial information.

6. **Period Covered:** Auditor should consider the time period covered by prospective financial information. Assumption becomes more speculative if length of period covered increases. The period would not extend beyond the time for which management has a reasonable basis for the assumptions.

7. **Examination Procedures:** While determining NTE of audit procedure, he should consider:
   - The knowledge obtained during any previous engagement.
   - Management's competence regarding the preparation of prospective financial information.
   - The likelihood of material misstatement.
   - The extent to which the prospective financial information is affected by management's judgment.
   - Source of information and their reliability.
   - Stability of entity's business.
   - The experience of engagement team with the business and the industry in which the entity operates.

8. **Management Representation Letter:** The auditor should obtain MRL regarding completeness of significant assumptions and intended use of PFI and management acceptance, of its responsibility for the PFI.

9. **Documentation:** The auditor should keep proper documentation to support his report and to have evidence that he has followed this standard. In case the auditor express a modified opinion or withdraw from the engagement, he should document the reasons forming the basis of such decision.

10. **Report on Examination of PFI:** The report should contain the following:
    - Title
    - Addressee
    - Identification of the PFI
    - Reference to this standard
    - Statement that management is responsible for the preparation of PFI.
    - When applicable, a reference to the purpose and for restricted distribution of PFI.
    - Statement that examination procedure included examination, on a test basis of evidences supporting the assumptions, amounts and other disclosures in the forecast or projection.
    - Statement of negative assurance as to whether the assumptions provide a reasonable basis for the PFI.
    - Opinion as to whether the PFI is properly prepared on the basis of assumptions and presented as per relevant financial reporting framework.
    - Appropriate caveats concerning the achievability of results indicated by PFI.
    - Date of report.
    - Place of Signature; and
    - Signature

11. **Qualified, Adverse Opinion in the Report:**
    - When the auditor believes that presentation and disclosures of the PFI are not adequate, the auditor should either resign or provide Qualified/Adverse report.
    - When the auditor believes, that one or more significant assumptions don't provide reasonable basis for the PFI, the auditor should either resign or provide Qualified/Adverse report.
    - When, the examination is affected by conditions that he can't perform necessary procedures, the auditor should either resign or disclaim the opinion.

12. **Example of Report on Examination of Prospective Financial Information:** Refer Chapter 24

No.	Question Bank	Exam	Marks	Refer Point/ Ans.
1	T & Co. wants to issue a prospectus, to provide potential investors with information about future expectations of the Company. You are hired by T & Co. to examine the projected financial statements and give report thereon. What things you will consider before accepting the audit engagement and what audit evidence will be obtained for reporting on projected financial statements?	M14 PM	5	Ans - 1

Answer

Ans – 1:

Projected Financial Statements: As per SAE 3400, "The Examination of Prospective Financial Information", the answer is divided into two parts i.e.
- The things to be considered before accepting the engagement and
- Audit evidence to be obtained for reporting on projected financial statements.
- **Acceptance of Engagement:** As per SAE 3400, before accepting an engagement, the auditor would consider, amongst other things
  - ◊ The intended use of the information;
  - ◊ The elements to be included in the information;
  - ◊ Whether the information will be for general or limited distribution;

◊ The period covered by the information.
◊ The nature of the assumptions used, whether they are best-estimates or hypothetical assumptions;

Further, the auditor should not accept, or should withdraw from, an engagement when the assumptions are clearly unrealistic or when the auditor believes that the prospective financial information will be inappropriate for its intended use.

In accordance with SA 210, "Terms of Audit Engagement", it is necessary that the auditor and the client should agree on the terms of the engagement.

- **Audit evidence to be obtained for Reporting on Projected Financial Statements:** The auditor should document matters, which are important in providing evidence to support his report on examination of prospective financial information, and evidence that such examination was carried out.
- **The audit evidence in form of working papers will include:**
  ◊ The sources of information.
  ◊ Basis of forecasts and the assumptions made in arriving the forecasts.
  ◊ Hypothetical assumptions, evidence supporting the assumptions.
  ◊ Management representations regarding the intended use and distribution of the information, completeness of material assumptions.
  ◊ Management's acceptance of its responsibility for the information.
  ◊ Audit plan.
  ◊ The NTE of examination procedures performed.
  ◊ In case the auditor expresses a modified opinion or withdraws from the engagement, the reasons forming the basis of such decision.

SAE 3402	ASSURANCE REPORTS ON CONTROLS AT A SERVICE ORGANISATION (W.E.F. 1ST APRIL' 2011)

1. Scope of this SAE:

- This SA deals with assurance engagements undertaken by a professional accountant in public practice, to provide a report for use of by user entities and their auditors on the controls at a service organization, that provides a service to user entities Assurance reports prepared in accordance with this SAE are capable of providing appropriate evidence under SA 402.
- This SAE only deals with assertion-based engagements that convey reasonable assurance.
- This SAE applies only, when the service organization is responsible for, or otherwise able to make an assertion about, the suitable design of controls.
- In addition to issuing an assurance report on controls, a service auditor may also be engaged to provide reports such as the following, which are not dealt with in this SAE:
  ◊ A report on a user entity's transactions or balances maintained by a service organization; or
  ◊ An agreed-upon procedures report on controls at a service organization.

2. Objective: The objectives of the service auditor are to obtain reasonable assurance about whether:

- The service organization's description of its system fairly presented.
- The controls are suitable designed.
- Where included in the scope of the engagement, the controls operated effectively.

3. Definition:

3.1 Carve-out Method: Method of dealing with the services, provided by a subservice organization, whereby the service organization's description of its system includes the nature of the services provided by a subservice organization, but that subservice organization's relevant control objectives and related controls are excluded from the service organization's description of its system and from the scope of the service auditor's engagement.

3.2 Inclusive Method: Method of dealing with the services, provided by a subservice organization, whereby the service organization's description of its system includes the nature of the services provided by a subservice organization, but that subservice organization's relevant control objectives and related controls are ***included***

in the service organization's description of its system and from the scope of the service auditor's engagement.

3.3 **Service Auditor:** A professional accountant in public interest who, at the request of the service organization, provides an assurance report on controls at a service organization.

3.4 **Service Organization:** A third party organization that provides services to user entities that are likely to be relevant to user entities internal control as it relates to financial reporting.

3.5 **Sub-service organization:** A service organization used by another service organization to perform of the services provided to user's entities that are likely to be relevant to user entities internal control, as it relates to financial reporting.

3.6 **User Auditor:** An auditor who audits and reports on the financial statements of a user entity.

3.7 **User Entity:** An entity that uses a service organization.

4. **Ethical requirements:** The service auditor shall comply with relevant ethical requirement , including those pertaining to independence, relating to assurance engagements .

5. **Acceptance and Continuance:** Before agreeing to accept, or continue, an engagement the service auditor should:

- Determine whether:
  - ◊ The service auditor has the capabilities and competence.
  - ◊ The scope of the engagement and the service organization's description of its system will not be so limited that they are unlikely to be useful to user entities and their auditors.
  - ◊ The criteria to be applied by the service organization to prepare the description of its system will be suitable and available to user entities and their auditors.
- Obtain the agreement of the service organization that it acknowledges and understands its responsibility:
  - ◊ For the preparation of the description of its system, and accompanying service organization's assertion, including the completeness, accuracy and method presentation of that description and assertion.
  - ◊ To have a reasonable basis for the service organization's assertion accompanying the description of its system.
  - ◊ For stating in the service organization's assertion the criteria it used to prepare the description of its system.
  - ◊ For identifying the risks that threaten achievement of the control objectives and designing and implementing controls to provide reasonable assurance that those risks will not prevent achievement of the control objectives stated in the description of its system, and therefore that the stated control objectives will be achieved; and
  - ◊ To provide the service auditor with (a) Access to all information (b) Additional information (c) Unrestricted access to persons.

6. **Acceptance of a Change in the Terms of the Engagement:** If the service organization requests a change in the scope of the engagement, before the completion of the engagement, the service auditor should be satisfied that there is a reasonable justification for the change.

7. **Assessing the Suitability of the Criteria:** In assessing the suitability of the criteria to evaluate the service organizations description of its system, the service auditor should determine whether the description presents how the service organization s system was designed and implemented, including, as appropriate:

- The types of services provided.
- The procedures, by which services are provided.
- The related records and supporting information.
- How the service organization's system deals with significant events and conditions.
- The process used to prepare reports and other information for user entities.
- The specified control objectives and controls designed to achieve those objectives.
- Complementary user entity controls contemplated in the design of the controls; and
- Other aspects of the service organization's control environment, risk assessment process, that are relevant to the services provided.

8. **Obtaining Evidence regarding the Description:** The service auditor shall obtain and read the service organization's description of its system, and shall evaluate whether those aspects of the description included in the scope of the engagement are fairly presented, including whether:

- Control objectives stated in the service organization's description of its system are reasonable in the circumstances.
- Controls identified in that description were implemented.
- Complementary user entity controls, if any, are adequately described; and
- Services performed by a subservice organization, if any, are adequately described, including whether the inclusive method or the carve-out method has been used in relation them.

9. **Obtaining Evidence Regarding Design of Controls:** The service auditor shall determine which of the controls at the service organization are necessary to achieve the control objectives stated in the service organization's description of its system, and shall assess whether those controls were suitably designed.

10. **Obtaining Evidence Regarding Operating Effectiveness of Controls:** When providing type 2 reports, the service auditor shall test those controls that the service auditor has determined are necessary to achieve the control objectives. When designing and performing tests of controls, the service auditor shall:
    - Perform other procedures in combination with inquiry to obtain evidence about.
    - How the control was applied.
    - The consistency with which the control was applied; and
    - By whom or by what means the control was applied.
    - Determine whether controls to be tested depend upon other controls.
    - Determine means of selecting items for testing that are effective in meeting the objectives of the procedure.

11. **The Work of an Internal Audit Function:**
    - **Obtaining an Understanding of the Internal Audit Function:** If the service organization has an internal audit function, the service auditor should obtain an understanding of the nature of the responsibilities of the internal audit function.
    - **Determining Whether and to What Extent to Use the Work of the Internal Auditors:** The service auditor shall determine:
    - Whether the work of the internal auditors is likely to be adequate for purposes of the engagement; and
    - If so, the planned effect of the work of the internal auditors on the nature, timing or extent of the service auditor's procedures
    - **Using the Work of the Internal Audit Function:** In order for the service auditor to use specific work of the internal auditors, the service auditor should evaluate and perform procedures on that work to determine its adequacy for the service auditor's purposes.
    - **Effect on the Service Auditor's Assurance Report:**
        - ◊ If the work of the internal audit function has been used, the service auditor should make no reference to that work in the section of the service auditor's assurance report that contains the service auditor's opinion.
        - ◊ In the case of a type 2 report, if the work of the internal audit function has been used in performing tests of controls, that part of the service auditor's assurance report that describes the service auditor's tests of controls and the results thereof shall include a description of the internal auditor's work and of the service auditors procedures with respect to that work.

12. **Written Representations:** The service auditor shall request the service organization to provide written representations:
    - That reaffirms the assertion.
    - That it has provided the service auditor with all relevant information; and
    - That it has disclosed to the service auditor any Non-compliance or Design deficiencies in controls, etc.

13. **Content of the Service Auditor's Assurance Report:**
    - A title that clearly indicates the report is an independent service auditor's assurance report.
    - An addressee.
    - Identification of the service organization's description of its system.
    - Identification of the criteria, and the party specifying the control objectives.
    - A statement that the report is intended only for user entity.
    - Management responsibility for the description of the system and design, control of the system.
    - Service auditor's responsibility.

- A statement that the engagement was performed in accordance with SAE 3402.
- A summary of the service auditor's procedures to obtain reasonable assurance.
- Limitations of controls in the case of a type 2 report.
- The service auditor's opinion.
- The date of the service auditor's assurance report.
- Practitioner's Signature.
- The place of signature.

14. **Modified Opinions:** If the service auditor concludes that:
    - The service organization's description does not fairly present, in all material respects, the system as designed and implemented;
    - The controls related to the control objectives stated in the description were not suitably designed, in all material respects;
    - In the case of a type 2 report, the controls tested, which were those necessary to provide reasonable assurance that the control objectives stated in the service organization's description of its system were achieved, did not operate effectively, in all material respects; or
    - The service auditor is unable to obtain sufficient appropriate evidence.

    In above cases, the service auditor's opinion shall be modified, and the service auditor's assurance report shall contain a clear description of all the reasons for the modification.

SRE 4400	ENGAGEMENTS TO PERFORM AGREED-UPON PROCEDURES REGARDING FINANCIAL INFORMATION (W.E.F. IST APRIL' 2004)

1. **Introduction:** In an engagement to perform agreed upon procedures, the auditor is engaged by the client to issue a report of factual findings, based on specified procedures performed on specified subject matter of specified elements, accounts or items of a financial statement.

    For example, an engagement to perform agreed-upon procedures may require the auditor to perform certain procedures concerning individual items of financial data such as accounts payable, accounts receivable, purchases from related parties, sale purchase and profits of a segment of an entity or even a complete set of financial statements.

2. **Objective:** The objective of an agreed upon procedures engagement is for the auditor to carry out procedure of audit nature, to which the auditor and the entity and any appropriate third parties have agreed and to report on factual finding thereon.

    The auditor simply provides a report of the factual findings of agreed upon procedures, ***no assurance is expressed by him in his report.*** The report is restricted to those parties that have agreed to the procedures to be performed since others, unaware of the reasons for the procedures, may misinterpret the result.

3. **General Principles of an Agreed Upon Procedure Engagement:** The auditors should comply with Code of Ethics issued by ICAI. Ethical principles are:
    - Integrity;
    - Objectivity;
    - Professional competence and due care;
    - Confidentiality;
    - Professional conduct; and
    - Technical standard;

    Independence is not a requirement for agreed upon procedures. However, when the auditor is not independent, a statement to that effect should be made in the report of factual findings.

4. **Defining the terms of the Engagement:** There should be clear understanding regarding the agreed procedures and the conditions of the engagement which includes the followings:
    - Nature of engagement.
    - Purpose for the engagement.

- Identification of the financial information to which the agreed upon procedures will be applied.
- Nature, timing and extent of the specific procedures.
- Limitation on distribution of the report of factual findings. If such limitation would be in conflict with the legal requirements, if any, the auditor would not accept the engagement.

5. **Planning & Documentation:** The auditor should plan the work, so that effective engagement will be performed. The auditor should document matters which are important in providing evidence to support the report of factual findings, and evidence that the engagement was carried out in accordance with this SRS and the terms of the engagement.

6. **Procedures & Evidence:** The auditors should carry out necessary procedures (including inquiry and analysis, computation, comparison, observation and inspection and obtaining confirmations) and use the evidence obtained as the basis for the report of factual findings.

7. **Reporting:** The report of factual findings should contain:
   - Title
   - Addressee
   - Identification of specific financial or non-financial information to which the agreed-upon procedures have been applied.
   - A Statement that the procedures performed was those agreed-upon with the recipient.
   - A statement that the engagement was performed in accordance with this standard and terms of engagement.
   - Identification of the purpose for which the agreed-upon procedures were performed.
   - A listing of the specific procedures performed.
   - A description of the auditor's factual findings including sufficient details of errors and exceptions found.
   - A Statement that the procedures performed does not constitute either an audit or a review and, as such, no assurance is expressed.
   - A statement that the report is restricted to those parties that have agreed to the procedures to be performed.
   - A statement (when applicable) that the report relates only to the elements specified and that it does not extend to the entity's financial statements taken as a whole.
   - Date of the report.
   - Place of signature.
   - Auditor's signature.

   Report should be signed by the auditor in his personal name. Where the firm is appointed, the report should be signed in the personal name of the auditor and in the name of the firm. Auditor should also mention the membership number assigned by the ICAI.

8. **Example of an Engagement Letter for an Agreed-upon Procedures Engagement:** Refer Chapter 24

9. **Example of a Report of Factual Findings in Connection with Accounts Receivable:** Refer Chapter 24

SRS 4410	ENGAGEMENTS TO COMPILE FINANCIAL INFORMATION (W.E.F. IST APRIL' 2004)

1. **Introduction:** The purpose of this SRS is to establish standards on professional responsibilities of an accountant when an engagement to compile financial statements or other financial information is undertaken and the form and content of the report to be issued in connection with such a compilation so that the association of the name of the accountant with such financial statements or financial information is not misconstrued by a user of those statements or information as having been audited by him.

2. **Objective:** The objective of a compilation engagement is for an accountant to use accounting expertise, as opposed to auditing expertise, to collect, classify and summarise financial information. This requires reducing detailed data to a manageable and understandable form without the requirement to test assertions underlying that information.

A compliance engagement would also include preparation of quarterly financial results, restatement of financial statements in accordance with financial reporting framework other than in accordance with which the financial statements to be restated are already prepared and presented.

3. **General Principles of Compliance Engagement:** The auditors should comply with Code of Ethics issued by ICAI. Ethical principles are:
   - Integrity;
   - Objectivity
   - Professional competence and due care;
   - Confidentiality
   - Professional conduct; and
   - Technical standard

   Independence is not a requirement for agreed upon procedures. However, when the auditor is not independent, a statement to that effect should be made in the accountant's report.

4. **Management's Responsibility:** The management is responsible for preparation and presentation of financial statements or other financial information in accordance with the applicable laws and regulations, if any, and for taking reasonable steps to prevent and detect errors, fraud or other irregularities. This includes:
   - Ensuring that the financial information generated in the entity is correct, complete and reliable.
   - Maintaining adequate Accounting and other Records and Internal Controls.
   - Selecting and applying appropriate accounting policies.
   - Establishing controls for safeguarding the assets and detecting frauds.
   - Ensuring compliance with laws and regulation.
   - Complete disclosure of all material and relevant information to the accountant.

5. **Defining terms of Engagement:** The accountant should ensure that there is a clear understanding of the terms of the engagement by means of an engagement letter. It helps to avoid misunderstanding regarding matters, such as the objective and scope of the engagement and the extent of the auditor's responsibilities. The engagement letter would include the following:
   - Nature of engagement including the fact that neither an audit nor a review will be carried out and that accordingly no assurance will be expressed.
   - Fact that engagement can't be relied upon to disclose fraud, etc. but if accountant comes across any such matter, he'll inform the management about same.
   - Nature of the information to be supplied by client.
   - Fact that management is responsible for:
     - ◊ Ensuring correctness, completeness and reliability of financial information generated in the entity.
     - ◊ Maintaining adequate accounting and other records and Internal Controls
     - ◊ Selecting and applying appropriate accounting policies.
     - ◊ Establishing controls for safeguarding the assets and detecting frauds.
     - ◊ Ensuring compliance with applicable laws and regulation
   - Complete disclosure of all material and relevant information to the accountant
   - Intended use and distribution of the compiled information.
   - Basis for fee computation and billing arrangements.
   - Basis of accounting on which financial information is to be compiled.
   - Unrestricted access to documents records, etc.
   - Fact, that management is responsible to the users for the compiled information.
   - Request for client to confirm the terms of engagement b acknowledging receipt of engagement letter.

6. **Planning & Documentation:** The auditor should plan the work so that effective engagement will be performed. The auditor should document matters which are important in providing evidence to support that the engagement was carried out in accordance with this Auditing and Assurance Standards and the terms of the engagement.

7. **Procedures and Evidences**:

   The accountant should obtain the general knowledge of business and operations of the entity and should be familiar with accounting principles and practices of industry in which entity operates and with the form and content of financial statements / information which is appropriate in the circumstances.

- The accountant should request management representation letter on significant information or explanation given orally on which he considers representations are required.
- If the accountant becomes aware that the information supplied by management is incorrect, incomplete, or otherwise unsatisfactory, the accountant should consider performing additional procedures (such as making inquiries, assessing internal controls, etc) and request management to provide additional information. If management refuses to provide additional information, the accountant should withdraw from the engagement, informing the entity of the reasons for the withdrawal.
- He should also read the compiled information and consider whether it appears to be appropriate in form and free from obvious material misstatement.

8. Special Consideration:

8.1 Clients having an Identified Reporting Framework: The accountant should ensure that the financial statements or other financial information compiled must comply with the requirements of the identified FRF. In case of any material departure, the fact should be stated in the notes to accounts or other compiled financial information as well as in the accountant's report.

8.2 Clients having no Identified Reporting Framework: In that case accounts are normally assumed to comply with the generally accepted accounting practices, including the accounting standards issued by the ICAI. In case of different basis of compilation, this fact should be stated in the notes to accounts or other compiled financial information as well as in the accountant's report.

8.3 Non-Compliance with the Accounting Standards: If the accountant becomes aware of material non-compliance with the relevant Accounting Standards, the same should be brought to the notice of the management. If the same is not rectified by the management, it should be included in the notes to the accounts and the compilation report of the accountant.

8.4 Accounting Estimates made by Clients: If it appears that certain estimates (e.g. work in progress) made by the client are unreasonable, the accountant should brought to the notice of the management for consideration.

Financial information compiled should be approved by client, before signing the compilation report by accountant. The word 'audit" should not be used anywhere. He should not prepare financial statements etc on his letter head or his other stationary as it may mislead the user.

9. Reporting [N03 N06]: The report should contain:

- Title: the title of the report should be "Accountant's Report on Compilation of Unaudited Financial Statement's
- Address: addressed to the appointing authority
- Identification of the financial information.
- When relevant, a statement that the accountant is not independent of the entity.
- A statement that the management is responsible for:
- Ensuring correctness, completeness and reliability of financial information generated in the entity.
- Maintaining adequate accounting and other records and Internal Controls and selecting and applying appropriate accounting policies.
- Establishing controls for safeguarding the assets and detecting frauds.
- Ensuring compliance with applicable laws and regulation.
- Complete disclosure of all material and relevant information to the accountant.
- A statement that the engagement was performed in accordance with this standard.
- A statement that neither an audit nor a review has been carried out and that accordingly no assurance is expressed on the financial information.
- A paragraph, when considered necessary, drawing attention to the disclosure of material departures from the identified FRF.
- Date of report.
- Place of Signature.
- Accountant's signature: The report should be signed by the accountant in his personal name and in the name of the firm. Also mention the membership number.

Financial statements complied by the accountant should also contain a reference such as "Unaudited", "Complied without Audit or Review" and also "Refer to Compilation Report" on each page or on the front of financial statements.

10. Example of an Engagement Letter for a Compilation Engagement [M07]: Refer Chapter 24

11. Example of an Accountant's Report on Compilation of unaudited Financial Statements *(when such FS Comply with the Generally Accepted Accounting Practices in India):* Refer Chapter 24

No.	Question Bank	Exam	Marks	Refer Point/ Ans.
1	Write a short note on - Reporting on the compilation engagement.	N03 N06 PM	4	9
2	As a chartered accountants firm draft an engagement letter to the Board of Directors for the compilation of financial statements of XYZ Ltd. as at 31.3.2007	M07 PM	16	10
3	While compiling the financial statements of a concern you observed that the input information supplied by the concern is incomplete, incorrect and few of the Accounting Standards have not been followed. Describe, in brief, the procedure you will follow in the above.	M05 PM	5	Ans - 1
4	You are appointed to compile financial statements of Y & Co. for tax purposes. During the course of work, you learn that the inventory is grossly understated. On pointing the same, the partners of Y & Co. tell you that since you are not conducting an audit, the said figures duly certified by the firm should be accepted.	J09 PM	5	Ans - 2
5	C & Co., hired Mr. a, Chartered Accountant, to compile its financial Statements for the interim period ending on 31st December 2012. Kindly assist Mr. A in drafting scope of engagement letter with specific focus on C & Co's responsibility.	N13 PM	4	Ans - 3

Answer

Ans – 1: Compilation of Financial Information:

According to SRS 4410 "Engagements to Compile Financial Information", an accountant would normally have to rely upon the management for information to compile the financial statements in a compilation engagement. If in the course of compilation of financial statements, it is observed that the information supplied by the entity is incorrect, incomplete or otherwise unsatisfactory, the accountant should perform following procedures:

- Make any enquiries of management to assess the reliability and completeness of the information provided;
- Assess internal controls prevailing in the entity; and
- Verify any matters or explanations.

The accountant may also request the management to provide additional information. If the management refuses to provide additional information, the accountant should withdraw from the engagement, informing the entity of the reasons for such withdrawal. If one or more accounting standards are not complied with, the same should be brought to the notice of the management and if the same is not rectified by the management, the accountant should include the same in notes to the accounts and the compilation report to the management

Ans – 2:

As per "SRS 4410 Engagements to Compile Financial Information", If the accountant becomes aware of material misstatements, the accountant should persuade the management to carry out necessary amendments in the financial statements or other complied financial information. If such amendments are not made and the financial statements are still considered to be misleading, the accountant should withdraw from the engagement.

As per guidance note on Tax Audit u/s 44AB of the Income Tax Act, 1961, the stock auditor should study the procedure followed by the assesses in taking the inventory of closing stock at the end of the year and the valuation thereof. The tax auditor should also examine the basis adopted for ascertaining the cost and this basis should be consistently followed. It is very necessary for an auditor to ensure that the method followed for valuation of stock results in disclosure of correct profit and gains.

In the instant case, appointment was made to compile financial statements for tax audit purpose of Y & Co., a firm. It is our duty of to ensure that method followed for valuation of stock results in disclosure of correct profit and gains.

In this case the stock valuation was grossly understated. Consequently, disclosure of profit is also not correct. Hence, contention of the Y & Co., that you are not the conducting an audit, the said figures duly certified by the firm should be accepted is not correct.

Ans – 3:

The engagement letter to be issued by Mr. A should state the following as management's responsibility:

- The accuracy and completeness of the information supplied to us, including maintenance for adequate accounting records and internal controls and selection and application of appropriate accounting policies.
- Preparation and presentation of the financial statements of the entity, in accordance with the applicable laws and regulations, if any.
- Safeguarding the assets of the entity and also establishing appropriate controls designed to prevent and detect fraud and other irregularities.
- Ensuring that the activities of the entity are carried in accordance with applicable laws and regulations and that it institutes appropriate controls to prevent and detect any non-compliance.
- Ensuring complete disclosure of all material and relevant information to the accountant.

1B GUIDANCE NOTE

GN-1 GUIDANCE NOTE ON INDEPENDENCE OF AUDITORS

1. **Introduction:** This guidance note aims to clarify the meaning of independence while performing their duties as auditors. Independence implies that the judgement of a person is not subordinate to the wishes or direction of another person who might have engaged him, or to his own self-interest. This Guidance Note provides guidance to members about the specific circumstances and relationships that may create threats to independence. This Guidance Note also provides safeguards that should be employed by the auditors to mitigate the risks arising from such circumstances and relationship leading to the threats to independence.

2. **Independence Perspectives:** There are two interlinked perspectives of independence of auditors viz (a)

independence of mind and (b) independence in appearance. The Code of Ethics for Professional Accountants, issued by International Federation of Accountants (IFAC) defines the term 'Independence' as follows:

Independence is:

- **Independence of Mind:** the state of mind that permits the provision of an opinion without being affected by influences that compromise professional judgment, allowing an individual to act with integrity, and exercise objectivity and professional skepticism: and
- **Independence in Appearance:** the avoidance of facts and circumstances that are so significant a reasonable and informed third party, having knowledge of all relevant information, including any safeguards applied, would reasonably conclude a firms, or a member of the assurance team's, integrity, objectivity or professional skepticism had been compromised. "

3. **Threat to Independence**: The Code of Ethics for Professional Accountants, prepared by the (IFAC) identifies five types of threats. These are:
   - **Self-interest Threats:** These threats occur when an auditing firm, its partner or associate could benefit from a financial interest in an audit client. For example, loan or guarantee to or from the concerned client, undue dependence on a client's fees and, hence, concerns about losing the engagement, close business relationship with an audit client, potential employment with the client etc.
   - **Self-review Threats:** These threats occur when during a review of any judgment or conclusion reached in a previous audit or non-audit engagement, or when a member of the audit team was previously a director or senior employee of the client. Intsances where such threats come into play are "when an auditor having recently been a director or senior officer of the company.
   - **Advocacy Threats:** These threats occur when the auditor promotes, or is perceived to promote, a client's opinion to a point where people may believe that objectivity is getting compromised, e.g. when an auditor deals with shares or securities of the audited company or becomes the client's advocate in litigation and third party disputes.
   - **Familiarity Threats:** These threats occur when auditors form relationships with the client where they end up being too sympathetic to the client's interests. This can occur in many ways such as: (a) a close relative of the audit team working in a senior position in the client company; (b) former partner of the audit firm being a director or senior employee of the client; and (c) acceptance of significant gifts or hospitality from the client.
   - **Intimidation Threats:** These threats occur when auditors are deterred from acting objectively with an adequate degree of professional skepticism. Basically these could happen because of threat of replacement over disagreements with the application of accounting principles, or pressure to disproportionately reduce work in response to reduced audit fees.
4. **Safeguards to Independence**: The CA has a responsibility to be independent by taking into account the context in which they practice, the threats to independence and the safeguards available to eliminate the threats. To address these issues, members should follow the following guiding principles:
   - The auditors should always be and appear to be independent of the entities that they are auditing.
   - The auditor should necessarily follow the key fundamental principles of audit such as integrity, objectivity and professional skepticism.
   - Before taking on any work, an auditor must conscientiously consider whether it involves threats to his independence. If threats exist, the auditor should either desist from the task or, at the very least, put in place safeguards that eliminate them.
   - If the auditor is unable to fully implement credible and adequate safeguards, then he must not accept the work.

GN-2 GUIDANCE NOTE ON AUDIT OF MISCELLANEOUS EXPENDITURE SHOWN IN BALANCE SHEET

1. **Introduction:** The Guidance Note deal with audit consideration related to following BS items that constitute Miscellaneous expenditure:
   - Preliminary expenses.

- Research & Development expenditure.
- Discount allowed on the issue of shares or debentures.
- Expenses including commission or brokerage on underwriting or subscription of shares or debentures.

The student should also keep in mind the accounting treatment as defined in AS 26 "Intangible Assets".

2. Features of Miscellaneous Expenditure: The following features of miscellaneous expenditure have an impact on the related audit procedures:

- It does not represent any tangible asset.
- The expenditure incurred on these items is usually a non-recurring in nature.
- The balance shown of this expenditure in BS reduces each year by the amount written off each year in P&L A/c, unless there is some fresh expenditure is incurred.

3. Audit Objective:

- Whether, it is proper to defer the expenditure.
- Whether, the period of amortisation of the expenditure is reasonable.
- Whether, the criteria justified previously for the deferral of the expenditure continue to be met and the expected future revenue/benefit related to the expenditure continues to exceed the amount of unamortized expenditure.

4. Audit Procedure:

4.1 Internal Control Evaluation: The auditor should review the following aspects of internal control relating to audit of miscellaneous expenditure:

- Proper authorization of the expenditure being incurred;
- Proper budgeting;
- Accountability for each items of such expenditure.
- Availability of reliable information (report of expert etc) for assessing the results achieved against the objectives and estimates of the expenditure determined originally.

4.2 Verification: The auditor should satisfy himself about the following:

- Whether it is proper to defer the expenditure.
- Reasonableness of the amortization period.
- There is proper authority for incurring such expenditure and its deferral.
- Whether, the criteria for deferral of expenditure continue to be met, if not the auditor should examine whether the unamortized balance has been charged as expense immediately.
- Whether, the expected future benefits related to the expenditure continue to exceed the amount of unamortized expenditure. If not, the auditor should examine whether such excess expenses has been charged as an expense immediately.

5. Preliminary Expenses: Preliminary expenses are the expenses relating to the formation of an enterprise. For example in the case of company it includes: registration fees, legal cost of drafting MOA/AOA etc. The auditor should verify these expenses with reference to supporting documents such as invoices and contracts relating to these expenses. In case of company the auditor should examine that reimbursement of these expenses to promoters is in accordance with the disclosures made in the prospectus.

6. Expenses including Commission or Brokerage on Underwriting or Subscription of Shares or Debentures: The auditor should:

- Examine, whether payment of brokerage, commission etc. authorised by AOA, rules or regulations and relevant statute.
- Examine, whether the rates of commission are in accordance with the disclosures made in the prospectus.
- Verify commission with reference to the agreements with brokers and underwriters.
- Ensure that payments made to underwriters are in accordance with certificate issued by the merchant bankers.
- others expenses such as fees of managers to the issue and registrars to the issue, advertisement expenses, application form, printing of prospectus, share/debenture certificates etc should be verified with reference to supporting documents.
- The limits on the expenses laid down in the applicable statute should also be complied with.

- examine that the discount allowed on the issue of share or debenture is in accordance with relevant statute;
- Also examine that discount allowed is in conformity to the disclosures made in prospectus, returns and other documents.

7. **Research & Development Expenditure:**
   - Verify with the supporting documents such as purchase invoices, agreements with third parties etc;
   - Also check, whether the recognized accounting policies and practices are followed for deferral.
   - Where research programmed is approved by specific authorities, the auditor should also review their report.
   - Examine that the deferred expenditure is systematically allocated to future accounting periods;

8. **Disclosure:** The auditor should examine whether the financial statements contains adequate disclosures such as
   - The nature and amount of miscellaneous expenditure.
   - Amortized portion of deferred expenditure charged to income for the year.
   - Significant accounting policy followed by the entity for deferral and write off.

GN-3	Guidance Note on Audit Reports and Certificates for Special Purposes

1. **Introduction [Also refer SA 800 & SA 805]:** Government authorities may, under various statutes or notifications, require reports or certificates from auditors in support of statements or other information prepared by an enterprise. Reports or certificates on specific matters may also be required from auditors by an enterprise, for its own special purposes. An audit report or certificate for special purpose is one to which the format of general purpose audit report is not applicable. Reports on profit and/or financial forecasts and on tax audit do not fall within the scope of this guidance note.

2. **Scope of Special Purpose Audit Reports and Certificates:**
   - Audit reports or certificates for special purposes may be issued in connection with:
     - ◊ FS which are prepared in addition to general purpose financial statements.
     - ◊ Specified elements, accounts or items of a financial statement.
     - ◊ Financial information given in special purpose formats or schedules.
     - ◊ Compliance with requirements of any agreement or statute or regulation.
     - ◊ Compilation of statistics or ascertainment of basic figures e.g., for the purpose of fixing quotas or levies.

3. **Difference between "Certificate" and "Report" [N02 N04]:**

3.1 **Meaning of Certificate:**
   - A certificate is a written confirmation of the accuracy of the facts stated therein and does not involve any estimate or opinion.
   - Such certificates are often required by govt. authorities in support of statements or other information prepared by an enterprise.
   - While issuing a certificate, auditor is responsible for the factual accuracy of what is stated therein.

3.2 **Meaning of Audit Report:**
   - A audit report is a formal statement, usually made after an enquiry, examination or review of specified matters under report and includes the reporting auditor's opinion thereon.
   - While issuing an audit report, auditor is responsible for ensuring that the report is based on factual data, that his opinion is in due accordance with facts, and that it is arrived at by the application of due care and skill.

4. **Responsibility for Preparation of Special Purpose Statements:** The primary responsibility for the contents of a special purpose statement rests with the enterprise and this would be evidenced by a suitable declaration or authentication by the management on the face of the statement.

5. **Scope of a Reporting Auditor's Function:**

- A reporting auditor should have a clear understanding of the scope and nature of the terms of his assignment. It is desirable for him to obtain the terms in writing to avoid any misunderstanding.
- A reporting auditor is not an expert on purely technical matters and as such, when he is required to report on or certify such matters (e.g., composition or quality of a product), he should state his limitations clearly in the report or certificate. At the same time he should indicate the extent to which he has been able to exercise his own professional skill and judgment with regard to the matter being reported upon. For instance, he may state that, for the purpose of forming his opinion, he has relied upon a certificate from technical experts.

6. **Contents of Reports and Certificates for Special Purposes [N04]:** In many cases, a reporting auditor can choose the form and contents of his report or certificate. In other cases the form and contents of the report or certificate are specified by statute or notification and cannot be changed. Where a reporting auditor is free to draft his report or certificate, he should consider the following:
   - Specific elements, accounts or items covered by the report or certificate should be clearly identified and indicated.
   - The report or certificate should indicate the manner in which the audit was conducted, e.g., by the application of generally accepted auditing practices, or any other specific tests.
   - If the report or certificate is subject to any limitations in scope, such limitations should be clearly mentioned.
   - Assumptions on which the special purpose statement is based should be clearly indicated if they are fundamental to the appreciation of the statement.
   - Reference to the information and explanations obtained should be included in the report or certificate. In certain cases, apart from a general reference to information and explanations obtained, a reporting auditor may also find it necessary to refer in his report or certificate to specific information or explanations on which he has relied.
   - The title of the report or certificate should clearly indicate its nature, i.e., whether it is a report or a certificate. Similarly, the language should be unambiguous, i.e., it should clearly bring out whether the reporting auditor is expressing an opinion (as in the case of a report) or whether he is only confirming the accuracy of certain facts (as in the case of a certificate). For this, the choice of appropriate words and phrases is important.
   - If the special purposes statement is based on general purpose FS, the report or certificate should contain a reference to such statements. However, the report or certificate should not contain a reference to any other statement unless the same is attached herewith.
   - It should be clearly indicated whether or not the statutory audit of the general purposes FS has been completed and also, whether such audit has been conducted by the reporting auditor or by another auditor. In case the general purposes FS have been audited by another auditor, the reporting auditor should specify the extent to which he has relied on them. He may communicate with the statutory auditor for securing his co-operation and in appropriate circumstances, discuss relevant matters with him, if possible.
   - Where a report requires the interpretation of statute, the reporting auditor should clearly indicate the fact that he is merely expressing his opinion in the matter. He should take sufficient care to ensure that in respect of matters which are capable of more than one interpretation, his report is not misconstrued as representing a settled legal position;
   - An audit report or certificate should ordinarily be a self- contained document. It should not confine itself to a mere reference to another report or certificate issued by the reporting auditor but should include all relevant information contained in such report or certificate.
   - The reporting auditor should clearly indicate in his report or certificate, the extent of responsibility which he assumes. Where the statement on which he is required to give his report or certificate, includes some information which has not been audited, he should clearly indicate in his report or certificate the particulars of such information.

   In certain cases, the form and/or contents of the report or certificate, as prescribed by a statute or a notification, may not be appropriate or adequate. In such situations, the reporting auditor may consider modifying the report or certificate on the basis of the suggestion made in above para to the extent applicable. In case this is not possible, he should clearly indicate the limitations in his report or certificate itself.

7. **Extent of Reliance on General Purpose Audit Report:**

- Where a special purpose engagement is undertaken after the statutory audit has been completed, a reporting auditor should invariably review the statutory audit report to ascertain whether there are any matters which have a bearing on his report/certificate.
- In cases, where a reporting auditor is required to report/certify certain specific matters arising from the financial statements taken as a whole, he should not normally issue his report or certificate until the statutory audit has been completed.
- For instance, a reporting auditor may be required to state whether, in the case of an Indian branch of a foreign company, the profit shown in the accounts represents the remittable surplus of the branch, or he may be asked to report on the computation of, gross profit for the purpose of bonus under the Payment of Bonus Act. In such cases, it would normally not be proper to give his report/certificate until the statutory audit has been completed.
- Where an audit report or certificate is required before the statutory audit is completed, a reporting auditor should clearly state in his audit report or certificate that he is reporting on/ certifying specific matters arising out of the FS of the enterprise, the statutory audit of which has not been completed.
- Where the reporting auditor prepares his report/certificate on the basis of duly audited general purpose FS, he may take the following precautions:
  - ◊ He may clearly state in his report/certificate that the figures from the audited general purpose FS, have been used and relied upon.
  - ◊ He may include in his report/certificate a statement showing the reconciliation between the figures of the general purpose FS and the figures appearing in his report/certificate.

8. Limited Review Report:

In certain circumstances, a reporting auditor may be called upon to give a special report based on a limited review of the accounts rather than on a complete audit, e.g., review of interim financial information for the purpose of ascertaining their compliance with the generally accepted accounting principles or a quick review of the accounts to help an intending buyer of a business in taking a final decision in this regard.

- The scope of a limited review is substantially narrower as compared to an examination in accordance with the generally accepted AS for the expression of an opinion on the FS.
- Limited review primarily consists of the following steps:
  - ◊ Obtaining an understanding of the system of preparation of the information contained in the special purpose statement on which the reporting auditor is required to give his report
  - ◊ Applying analytical review procedures to data under examination; and
  - ◊ Making such enquiries and obtaining such information as is considered necessary.
- In addition to the reporting requirements discussed in para 5 above, the limited review report should also contain:
  - ◊ A description of the procedures used for the review.
  - ◊ A statement that the scope of the review was substantially narrower as compared to an examination made in accordance with the generally accepted auditing practices for expressing an opinion whether the FS show a true and fair view.
  - ◊ An opinion that the statements give the information in accordance with the books of account, records and other statements produced and that they have been drawn up, in accordance with the applicable and generally accepted accounting principles; and
  - ◊ In appropriate circumstances, a qualification or disclaimer so as to dispel any doubt about the conclusions which may he arrived at on the basis of the report.

9. Reports and Certificates on Specified Accounts or Items of Financial Statements:

- The test of materiality which a reporting auditor uses in connection with special purpose reports may be different, depending upon the circumstances, from the test he would use in connection with a general purpose report. For example, where he is required to express an opinion on specified accounts or items of FS, he may judge the materiality of an item solely in relation to such individual accounts of items rather than to the aggregate thereof or to the FS as a whole.
- A reporting auditor's examination of certain records 'for an audit report or certificate for special purpose may also be more intensive than the examination of the same records by the statutory auditor for the purpose of expressing an opinion on the general purpose FS as a whole.

- Certain accounts or items of FS are inter-related, e.g., sales and debtors, purchases and creditors, fixed assets and depreciation, etc. Therefore, where reporting auditor is required to examine and report upon or certify a specified account or items of FS, he may also need to examine the related accounts or items to discover the inconsistencies, if any, between these inter-related accounts or items.

10. Other Engagements: In some cases, a member may be required merely to compile FS or to report whether the FS are in conformity with the books of account. The association of the name of a member with the statements may be misconstrued by a user of the statements. Therefore, it is essential, that the member clearly brings out the nature of his association with the FS. The following precautions are suggested In this regard:

- The title of the report should be 'Chartered Accountant's Report' rather than 'Auditor's Report'.
- In describing the engagement, ambiguous terms such as 'review', 'general review', 'check,
- etc., should be avoided.
- The report should clearly state that the statements were not audited.
- The client should be requested not to use the word 'audit' in describing the nature of services of the members. Similarly, his fee should not be described as 'audit fee' in the accounts, correspondence, or any other document.

11. Communication of Report or Certificate

- The reporting auditor may address his report/certificate to client or to the public authority or person requiring it, as me may be. In appropriate circumstances, a certificate may also be issued without reference to any particular person or by using the words, ***"To whomsoever it may concern".***
- The report or certificate should normally be issued to the client who should be responsible for forwarding the same to the concerned authority, where so required.

12. Communication with the Previous Reporting Auditor: It, would be a healthy tradition if the practice of communicating with the member who had done the work previously is followed in every case where a member is required to give a report/certificate for a special purpose.

13. Illustrations of Statutory Audit Reports and Certificates for Special Purposes

Chartered Accountant's Certificate Regarding Certain Matters in the Application for Grant of Export Performance Certificate under lmport-Export Policy 1983-84.

"I/We do hereby certify that the information given in this statement has been verified from the books maintained by M/s .... and found the same as correct. I/We have also put my/our office seal and signature on the books from which the information has been verified.

I/We am/are neither a partner, a Director nor an employee of the applicant or its associates."

Place: For ABC & Company

Date: Chartered Accountants

Chartered Accountant certificate regarding employers' bonus computation Under the Payment of Bonus Act, 1965 [M15]

"We have reviewed the figure in the above computation, in comparison with the books and records of X Company Limited, produced to us, the audit of which has already been completed by us or another firm of chartered accountants and report that, subject to the notes given on the face of computation, in our opinion, and to the best of our knowledge and belief and according to the information and explanations given to us, the above computation is in due accordance therewith and has been made on a basis reasonably consistent with the provisions of the Payment of Bonus Act, 1965."

Place: For ABC & Company

Date: Chartered Accountants

Certificate under Rule 37BB of Income Tax Act, 1961 (Form No. 15 CB)

Tax Audit Report u/s 44AB of Income Tax Act, 1961(Form 3CA, 3CB & 3CD)

No.	Question Bank	Exam	Marks	Refer Point/ Ans.
1	Mention the difference between "report" and certificate".	N02	4	Refer G.N -3
2	Write short not on: "Certificate for Special Purpose vs. Audit Report".	N04 PM	4	
3	What are the contents of reports and certificate for special purpose.	N04	6	
4	As a Statutory Auditor how would you deal with the following cases? "National Tourism Ltd., a wholly owned Government Company approaches you to give a revised report on the revised accounts, as the original account has undergone changes consequent to the audit of Comptroller and Auditor General of India".	M04	4	Ans - 1
5	Comment on the following: The statutory audit of Fortune Limited for the year ended on 31-3-2009 was completed and auditor also submitted his report with the audited Financial Statements to the management of the company. Therefore; the management of the company approached the auditor to revise certain items in the Financial Statements.	N09	5	Ans - 2
6	A company wants to amend its accounts after the completion of the audit and adoption of the Accounts by the Board, but before circulation to the Shareholders. It requires its statutory auditor to report on the amended accounts. State the steps the statutory audit should adopt in such a situation.	M07	8	
7	Write short notes on "Guidance note on Audit of Miscellaneous Expenditure".	N10	4	Ans - 3
8	Comment on the following: "For Excise Duty on finished goods in stock as at the end of the year, there is an option available to provide for the same or to show the same as a Contingent liability".			Ans - 4
9	A limited has paid minimum alternate tax u/s 115JB of the Income Tax Act, 1961, for the year ended 31st March, 2009. The company wants to disclose the same as an "Asset" since the company is eligible to claim credit for the same.	N09 PM	5	Ans - 5
10	As a Statutory auditor, how would you deal with following: While finalizing its accounts; a company does not provide for Income-tax-payable under the provisions of the Income-tax act, 1961. A not is however given that since adequate tax has been deducted at source, no additional tax is payable.	N08	5	Ans - 6
11	As an auditor, how would you deal with the following: XY Ltd. Had entered into derivative transactions in the foreign currency, which were based on probable export orders. As at the year end on 31st March, 2011, the mark-to-market (MTM) loss on the said derivatives was Rs. 250 lakhs. The company contends that since the MTM loss is notional and likely to be recouped in the next year, the same need not be provided for.	N09	5	Ans - 7
12	M Ltd. intends to intensify its advertisement strategy of hoarding advertisements to increase its sale during the impending festival season. You have been appointed as the special auditor to examine the expenditure under this head. What will be usual evidence you will look for in this case to justify the expenditure?	N13 PM	4	Ans - 8

Answers

Ans -1:

The guidance note on auditor's report on revised accounts of companies before circulation to shareholders deals with those situations wherein the statutory auditor is required to give report on the revised accounts. The guidance notes requires that the statutory auditor must observe the following steps while issuing the revised audit report:-

- All, copies of the original accounts and audit reports thereon are returned to the auditor. '
- The adequate disclosure has to be made that the accounts which were earlier approved by the BOD and reported by the auditors have been revised and re-approved by the BOD as a specific note on the amended accounts.
- In case the notes to accounts do not contain any note on revision or such a note is considered adequate or comprehensive, the statutory auditor shall have to indicate that accounts that have been revised are based on the audit report of C&AG.
- Therefore, the auditor at the time of issue of revised reports has to bring these facts in his report if not included as a note in revised accounts and finally, the auditor's report (revised) should clearly draw the attention to their earlier audit report.

Ans -2:

Amendment of accounts after the completion of the audit and adoption of the accounts by the Board before circulation to the shareholders: This pertains to the manner in which the statutory auditor should report upon amended accounts. The Companies Act does not contemplate the revision of accounts and a further report by the statutory auditor on the amended accounts. At the same time, it is entirely within the competence of the 'Board of Directors to amend the accounts and resubmit the same to statutory auditors for report before the accounts are placed before the annual General Meeting. The report issued by the statutory auditor on such amended accounts will be in substitution of the report issued before the amendment. Unless all copies of the original accounts and reports are returned to the auditor, such substitution is not possible.

The guidance on Auditor's report on revised accounts of companies before circulation to shareholders recommends that members, when called upon to issue a report on amended accounts for the same period due to amendments to the accounts, should ensure all copies of the original accounts and reports are returned to him, adequate disclosure about the revision of accounts already reported, appears as a specific note on the amended accounts. If the Statutory auditor is satisfied about the adequacy of disclosure, there may not be any need for him to refer to the revision of balance sheet and or the profit and loss account in his report otherwise he has to refer to the revision in his report.

Ans -3: Guidance note on Audit of Miscellaneous Expenditure:

This Guidance Note provides guidance on audit procedures to be applied while auditing miscellaneous expenditure.

'Miscellaneous expenditure' shown in the balance sheet of companies (or shown under this or some other appropriate heading in the balance sheet of other enterprises) embraces within its fold a variety of items of expenditure which are not entirely charged to income in the year in which they are incurred, but are carried forward in the balance sheet to be written-off in subsequent periods. Unless some benefit from the expenditure can reasonably be expected to be received in future and unless the amount of such benefit is reasonably determinable, there is no justification for carrying forward the expenditure for being written-off in subsequent periods. Also, the amount of expenditure to be carried forward should not exceed the expected future revenue/other benefits related to the expenditure.

The Guidance Note deals with the audit considerations related to the following items that normally constitute 'miscellaneous expenditure':

- Preliminary expenses.
- Expenses including commission or brokerage on underwriting or subscription of shares or debentures including discount allowed on the issue of shares or debentures.
- Research and development expenditure, etc.

Since AS 26, applies to different entity from different dates, it may happen that certain enterprises, till the date the standard becomes mandatory for them may continue to defer the expenditure incurred on items that normally constitute "miscellaneous expenditure". Once an entity applies AS 26 to account for intangible assets, the expenditure incurred on items that normally constitute miscellaneous expenditure shall be governed by the Standard, except in the case of already appearing miscellaneous expenditure in the balance sheet which is to be accounted for using AS 26.

As per Guidance note on Audit of Miscellaneous Expenditure (Revised), the auditor should examine whether the financial statements contain adequate disclosures as required by AS 26. The auditor should also examine that the financial statements disclose the accounting policy with regard to miscellaneous expenditure. On the first occasion when AS 26 is applied by an enterprise for accounting for items of miscellaneous expenditure, the financial statements should also disclose the change in accounting policy with regard to miscellaneous expenditure in accordance with the requirements of Accounting Standard (AS) 5, “Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies”.

Ans -4 :

- The AS 2 (Revised) on, "Valuation of Inventories" states that finished goods are to be valued by taking into account the costs of purchase, costs of conversion and other costs incurred in bringing the inventories to the present location and condition. The costs of conversion to be included would be all direct factory overheads related to the said finished goods.
- Excise duty is a duty which is payable on the manufacture of the finished goods inside a factory. Though the collection of the same is deferred till the goods leave the factory, the liability for the same arises when the manufacture takes place. Therefore, it is mandatory for an entity to provide for liability for excise duty on finished goods lying in stock at the end of the year and add the same to the value of closing stock.
- According to Guidance Note on "Accounting Treatment of Excise Duty", excise duty should be considered as a manufacturing expense and like other manufacturing expenses be considered as an element of cost for inventory valuation. Where excise duty is paid on excisable goods and such goods are subsequently utilised in the manufacturing process, the duty paid on such goods, if the same is not recoverable from taxing authorities, becomes a manufacturing cost and must be included in the valuation of WIP or finished goods arising from the subsequent processing of such goods. Further, where the liability for excise duty has been incurred but its collection is deferred, provision for the unpaid liability should be made. Excise duty cannot be treated as a period cost. Accordingly excise duty now cannot be shown as a contingent liability.
- Thus, in view of the above, now it is mandatory for an entity to prov-4ide for liability for excise duty on finished goods lying in stock at the end of the year and add the same to the value of closing stock. If the said provision is not made, the revised Guidance Note on Accounting Treatment for Excise duty says that the auditor should qualify his report and, if possible, also mention the quantum of the duty not so provided.

Ans - 5:

- AS per Guidance Note issued by ICAI on “Accounting for credit available in respect of MAT under the IT Act 1961”, MAT credit is not a deferred tax assets under AS22, and yet it gives rise to expected future economic benefit in the form of adjustments of future income tax liability arising within the specific period.
- The framework for the preparation and presentation of the FS, issued by the ICAI, defines the term “Asset”, which is a resource, controlled by the enterprise as a result of past events from which future economic benefits are expected to follow to the enterprises. According to the framework, once an item meets the definition of the term ‘Asset” it has to meet the criteria for recognition of an asset, so that it may be recognized as assets in the FS. As per paragraph 88 of the framework, an asset is recognized in the balance sheet, when it is probable that the future economic benefits associated with it will flow to the enterprise and the asset has a cost of value that can be measured reliably.
- The MAT credit fulfills the above criteria. Thus, if the auditor is satisfied that the probability of the company to claim the said credit is high, it could recognize the same as an asset. In the balance sheet, it could be shown under the head “Loan and Advances” as the MAT credit entitlement.

Ans - 6:

- As per Guidance Note on provision for liability for taxation, the provision for anticipated tax liability in respect of profits of the company has to be made while finalizing its accounts.
- Accordingly, non-provision for taxation would amount to contravention of the provisions of section 128, 129 and 133 of Company Act, 2013 i.e. maintenance of proper books for account and disclosures of true and fair view of the state of affairs of the company.
- Conclusion: Based on the above, the auditor is required to qualify his report and such qualification should bring out in what manner the accounts do not disclose “True and Fair” view of the state of affairs of the Company and its Profit or loss. However, the qualification should also mention clearly that TDS is in excess of the estimated tax liability for the year.

Ans - 7:

As per ICAI announcement on "Accounting for Derivatives" the entity is required to provide for losses in respect of all outstanding derivative contracts at the BS date by marking them to market, keeping in view the principle of prudence as enunciated in AS 1 "Disclosure of Accounting Policies"

Conclusions: In the instant case, XY Ltd should provide for MTM losses for Rs. 250 lakhs. Auditor, should consider for making appropriate disclosures in their reports if the aforesaid accounting treatment and disclosures are not made by the company.

Ans - 8:

Hoarding Advertisement Expenses: The following would be the usual evidence to justify advertisement expenditure-

- Copy of Resolution passed by the Company to authorize expenditure.
- Examination of Quotations received from various advertising agencies.
- Permission letter from the Municipal authorities.
- Copies of contracts with advertising agencies.
- Bill/Invoice from advertising agency to ensure that rates charged for different types of advertisement are as per contract.
- Receipts issued by the advertising agencies.

A COMPLETE GUIDE FOR
ADVANCED AUDITING

(CA FINAL)

Salient Features

- Presentation of whole Syllabus in an easy language to understand the complex subject matter.
- Tabular and graphic presentation to facilitate easy understanding and learning.
- Inclusion of flowcharts on various topics, including Standards on Auditing.
- Presentation of maximum topics in point-wise manner.
- Upto date Amendments Including CARO 2015 & Format of New Audit Report Under Companies Act, 2013.
- Illustration of all "Audit Report" as per SA 700, SA 705 & SA 706 at one place (See Chapter 24) for quick understanding of "Audit Report" in different situations with minimum time frame & fast understandability.
- All Example of Engagement Letter as per SA 210, SA 2400, SRE 2410, SRS 4400, SRS 4410 at one place (See Chapter - 24) for quick understanding of Engagement Letter in different situations with minimum time frame & fast understandability.
- All Illustration of Audit Report, Review Report & Certificate as per SA 800, SA 805, SRE 810, SRE 2400, SRE 2410, SAE 3400, SRS 4400, SRS 4410 at one place (See: Chapter - 24) for quick understanding of Audit Report, Review Report in different situations & their comparison with minimum time frame & fast understandability.
- Full coverage of Questions appeared in past 35 exams & Practice Manual has been arranged in following manners:
  - « Chapter wise/topic wise
  - « Standard of Auditing wise
  - « Accounting Standard wise
  - « Clause wise & Schedule wise (Chapter – Professional Ethics)
  - « Clause wise (Chapter – Audit under Fiscal Law (Form 3CD)
- Graphs at the beginning of every chapter, showing marks allotment in last twenty examinations.
- List of questions including case study's appeared in past 34 examinations given at the end of each chapter. Suggested answer given after Questions, so that student could first try to recall the Law/ points/SA/Section/Act related to that case study and try to solved out the case study before seeing the suggested answer. It will enhance their irretrievability power. It will also help students to have an idea of paper style.
- Short Notes of all Chapters given at the end of the book (See Chapter – 26) for Quick revision.
- Table Showing Importance of Chapter on the Basis of Marks Allotment in Past Examinations.
- 100 + practical Question on New Companies Act, 2013 & CARO 2015.

ISBN 819305800-3

Available at Leading Bookshops all over India, or write to:

Spiraa™ Publishing Inc.

Phone: 011-45553634 Email: info.spiraa@gmail.com

Also Available on amazon.in and flipkart.com

9 788193 058008