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Important abbreviations used in notes :

FRF-Financial Reporting Framework

WR-Written Representation

ROMM-Risk of Material Misstatement

NTE-Nature, time and extent

SAAE-Sufficient and Appropriate Audit Evidence

TCWG-Those Charged with Governance

EOM-Emphasis of Matter Para

OM-Other Matters Para

SQC-Standards on Quality Control

SA 200

OVERALL OBJECTIVES OF THE INDEPENDENT AUDITOR AND THE CONDUCT OF AN AUDIT IN ACCORDANCE WITH STANDARDS OF AUDITING

SA 200 states that the auditor shall ensure that his opinion on financial statement are reflecting True and Fair view. Section 143(2) also requires the auditor to state in his report whether accounts examined by him and financial statement give True and Fair view.(True and Fair view means financial information should be truthfully recorded and fairly presented).

Auditor is required to obtain reasonable assurance that financial statement are free from material misstatement.

Auditor is required to report on financial statements, and communicate as required by the SA's. Section 143(2) also requires the auditor to report to the members of the company on the accounts examined by him and financial statement which are to be laid down in AGM.

As per SA 200, he should obtain SAAE to reduce Audit Risk to an acceptable low level i.e. the auditor should consider SA 500 as per SA 200.

According to SA 200,if the auditor is unable to obtain SAAE to support his conclusions or unable to draw reasonable assurance ,he should either give a disclaimer of opinion or should withdraw from engagement if permitted by law.

Auditor cannot obtain absolute assurance i.e. he 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.

Inherent Limitations of an Audit	
Nature of Financial Reporting	• Preparation of Financial Statement is the responsibility of management. • However, preparation of financial statement involves judgement by management. • There are range of issues involving different interpretation and judgement. • Hence preparation of financial statement involve subjective decision making. • This gives rise to inherent risk which cannot be eliminated by performing it.
Nature of audit procedure	• There are **practical and legal limitation on auditor's ability to obtain Audit Evidence.** • There is a possibility that Management may not provide complete information intentionally or unintentionally. • Internal control systems may be planned & framed by management so that they can manipulate and override them. • Frauds may involve sophisticated & carefully organised

	schemes. • Audit is not an official investigation- No power of search & seizure. • Hence, the nature of audit procedures is such that audit evidences obtained are persuasive rather than **conclusive.**
Timeliness & Cost-Benefit Analysis	• **The matter of difficulty, time , or cost involved is not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative or to be satisfied with audit evidence that is less than persuasive.** • There is always a pressure to finish audit quickly, in least possible time. • Further because of limited audit fees there is budget & cost constraint.
Other limitations	• Frauds, particularly involving senior management or collusion. • Non-disclosure of related parties. • Non compliance with laws and regulation. • Information not provided by management.

Requirement of SA 200	
Ethical Requirements	• Integrity • **Objectivity** • **Confidentiality** • **Professional behaviour** • **Professional competence and due care-Example-Auditor said that i was unaware of SA 505 issued by ICAI. Hence he is lacking professional competence. As per Kingston Cotton Mills "The auditor is justified in relying upon the management if due care is exercised.**
Professional skepticism	Professional skepticism is nothing but altitude of the auditor which requires alertness towards information provided to him by the auditee. Auditor should remain alert to conditions which may indicate possible misstatement due to error or fraud, and a critical or fraud, and a critical assessment of audit evidence. He should maintain professional scepticism throughout the audit to identify fraud risk factors, evaluate related party transactions etc.
Professional Judgement	Professional Judgement- is necessary in particular regarding decisions about • Nature, time and extent of audit procedures • Materiality of Audit Risk • Evaluation whether Sufficient and Appropriate Audit Evidence has been obtained. • Drawing conclusion based on audit evidence obtained.
Obtain Sufficient and Appropriate Audit Evidence	• The auditor should obtain sufficient and appropriate audit evidence as per AS 500. • The sufficiency and appropriateness of audit evidence are interrelated.

	• **Sufficiency is the measure of quantity of audit evidence.** • **Appropriateness is the measure of the quality of audit evidence; that is, its relevance and reliability in providing support for the conclusions on which the auditor's opinion is based.** • If the Auditor fails to obtain sufficient and appropriate audit evidence, he will be giving a disclaimer.
Compliance with Standards of Auditing	• Compliance with SA's-Section 143(9) of Companies Act 2013 also states that auditor should comply with standards of auditing. • **If he fails to comply with Standards of Auditing and fails to depart his attention to the departure, he will be guilty of professional misconduct.**

SA 200 also states that the management cannot restrict the scope of auditor's audit function.

Scope of Auditor is determined in accordance with

- ✓ Terms of Engagement
- ✓ Requirement of legislation
- ✓ SA, Guidance notes.

If scope is restricted or there is a threat to auditor's independence, communicate to TCWG as per SA 260.

<u>Questions on SA 200</u>

1. Mr. X a practicing CA accepted audit of PQR Ltd where his wife is a MD. Comment.

Sol-Mr X shall not be eligible for appointment in PQR Ltd as per:

- **Section 141(3) of Co's Act 2013.**
- **SA 200-Ethical Requirements.**
- **General Council Guidelines issued by ICAI that states that a member of Institute should not express his opinion on Financial Statements of any business or enterprise in which his relative (within meaning of AS-18) have either themselves or in conjunction with a member in business of enterprise.**
- **Guidance Note on Auditor's Independence.**

2.The auditor's need not review accounting policies unless there is a change in basis of Accounting.

- **He should critically examine Accounting policies adopted by client and test for conformity with Accounting Standards And Recommendations of the Institute.**
- **As 1-Consistency of accounting policies**
- **SA 200-True and Fair View.**

3. The directors asked the auditor to accept reduced fees and asked the auditor not to carry out full audit as he had done in the past.

- **The terms of engagement cannot, however, restrict the scope of an audit. In the given question, terms of engagement on reduced fee are limiting the scope of audit as determined by pronouncements of the institute and section 143 of Co's Act 2013.**

4. Comment on the following: M/s XYZ & Co., auditors of Goodwill Education Foundation, a recognised non profit organisation feels that the standards on auditing need not be applied as Goodwill Education Foundation is a non-profit making concern.(May 2010)

Answer-

(a) The Preface to Standards on Auditing gives the scope of the Standards on Auditing.
(b) As per the Preface, the SAs will apply whenever an independent audit is carried out; that is, in the independent examination of financial statements/information of any entity; whether profit- oriented or not and irrespective of its size, or legal form (unless specified otherwise) when such an examination is conducted with a view to expressing an opinion thereon.
(c) Further on discharging their attest function; it is the duty of the Chartered Accountant to ensure that SAs are followed in the audit of financial information covered by their audit reports.
(d) In the given case, even though the client is a non-profit oriented entity the SAs shall apply and the auditor shall be guilty of professional misconduct.

SA 210
AGREEING THE TERMS OF AUDIT ENGAGEMENT

Pre conditions for audit

- Determine whether applied Financial Reporting Framework (FRF) is acceptable.
- Obtain management representation regarding.

Premise of an audit-pt 2,3

1. **Acceptable financial reporting framework is used in preparation of financial statement.**
2. **Necessary internal controls are implemented to ensure that financial statements are free from fraud or error.**
3. **Providing the auditor**
   - **Access to all records and information.**
   - **Additional information requested by the auditor**
   - **Unrestricted access to persons within entity to enable him to get audit evidence.**

- **<u>Contents of Engagement Letter-</u> The agreed terms of the audit engagement shall be recorded in an audit engagement letter or other suitable form of written agreement and includes:**
  1. **The objective and scope of the audit of the financial statements;**
  2. **The responsibilities of the auditor;**
  3. **The responsibilities of the management;**
  4. **Identification of the applicable FRF for the preparation of the financial statements; and**
  5. **Reference to the expected form and content of any reports to be issued by the auditor.**

- **<u>Limitation imposed before accepting assignment</u>- If the auditor believes the limitations will result in the auditor disclaiming an opinion on the financial statement, the auditor should not accept such an assignment unless required by law.**

- **<u>Change in terms of audit engagement</u>**
  1. **When a client requests the auditor to change the terms of engagement auditor should consider whether proposed changed terms of engagement will provide lower level of assurance.**
  2. **If the proposed terms do not convey a lower level of assurance, the auditor should not agree unless reasonable justification given by management.**
  3. **If reasonable justification not given by management- Withdraw if legally permissible and also consider the need/ obligation to report the circumstances , which compelled him to withdraw , to board of directors or shareholders or related regulatory authority.**

- **Circumstances that may warrant revision in terms of audit engagement(may 2013)**
  1. **Change in-senior management**
  2. **Change in Financial Reporting Framework.**
  3. **Change in reporting requirement.**
  4. **Significant change in ownership.**
  5. **Significant change in nature and size of entity.**
  6. **Revised terms of audit engagement.**
  7. **Misunderstanding of scope and objective.**

- **FRF v/s Law-conflict-Discuss conflict with management. If additional requirement can't be met even by additional disclosure, modify audit report as per SA 705.**

Questions from SA 210

1. Comment on the following; "It is not mandatory to send new engagement letter in recurring audit, but sometimes it becomes mandatory to send new letter." Explain those situations where new engagement letter is to be sent.

OR

R & C0., a firm of Chartered Accountants have not revised the terms of engagements and obtained confirmation from the clients , for last 5 years despite change in business and professional development. Please elucidate the circumstances that may warrant the revision in terms of engagement.

2. X, a CA was engaged by a PQR Ltd for auditing their accounts. He sent his letter of engagement to the BOD , which is accepted by the company. In the course of audit of the company, the auditor was unable to obtain SAAE regarding receivables. The client requested for a change in terms of engagement. Offer your comments in this regard.

SA-220
QUALITY CONTROL FOR AN AUDIT OF FINANCIAL STATEMENTS

Factors should be considered for incorporating quality control in audit work:

a) **Leadership responsibility –The engagement partner should be appointed and he should take up the responsibility of overall quality control and to direct, review and supervise the work of his engagement team.**
b) Skills and competence-Audit personnel should have required skill and competence.
c) Assignment-Audit work should be assigned only to competent personnel.
d) Delegation-There should be sufficient direction ,supervision and review of work at all levels.
e) Consultation-Whenever necessary ,consultation within and outside the firm with experts.
f) Acceptance and Retention of clients-Evaluation of prospective client and review of existing client should be done on ongoing basis.
g) Monitoring-Adequacy and operating effectiveness of quality control policies and procedures should be monitored.

These quality control policies must be present at both the levels of audit:

- ✓ Firm level audits
- ✓ Individual level audits

Audit work should be delegated to assistance with professional competence and should be appropriately directed and supervised. The work of assistants should be reviewed.

There should be an engagement partner appointed to each audit engagement undertaken by firm to take responsibility for engagement on firm's behalf. As per SQC 1, for listed entity, engagement partner should be rotated every 7 years.

<u>Questions on SA 220</u>

1.You are an audit senior working for the firm Kala & Company. You are currently carrying out the audit of W Ltd., a manufacturer of waste paper bins. You are unhappy with W Ltd.'s inventory valuation policy and have raised the issue several times with the audit manager. He has dealt with the client for a number of years and does not see what you are making a fuss about. He has refused to meet you on site to discuss these issues. The former engagement partner to W Ltd. retired two months ago. As the audit manager had dealt with W Ltd. for so many years, the other partners have decided to leave the audit of W Ltd. in his capable hands. Comment on the situation outlines above. (RTP)

Several quality control issues are raised in the scenario:

- **Engagement Partner: An engagement partner is usually appointed to each audit engagement undertaken by the firm, to take responsibility for the engagement on behalf of the firm. Assigning the audit to an experienced audit manager is not sufficient.**
- **The lack of an audit engagement partner also means that several of the requirements of SA 220 directing, supervising and reviewing the audit are not in place.**
- **In this scenario the audit manager and senior have conflicting views about the valuation of inventory. This does not appear to have been handled well, with the manager refusing to discuss the issue with the senior.**
- **SA 220, requires that the audit engagement partner takes responsibility for setting disputes in accordance with the firm's policy in respect of resolution of difference of opinion**

required by SQC 1" Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements".

- **In this case, the lack of engagement partner may have contributed to this failure to resolve the disputes. In any event, at best, the failure to resolve the difference of opinion is a breach of the firm's policy under SQC 1. At worst, it indicates that the firm does not have a suitable policy concerning such disputes required by SQC1.**

2. ***M/s Sureshchandra & Co. has been appointed as an auditor of SC Ltd. for the financial year 2015-16. CA. Suresh, one of the partners of M/s Sureshchandra & Co., completed entire routine audit work by 29th May, 2016. Unfortunately, on the very next morning, while roving towards office of SC Ltd. to sign final audit report, he met with a road accident and died. CA. Chandra, another partner of M/s Sureshchandra & Co., therefore, signed the accounts of SC Ltd., without reviewing the work performed by CA. Suresh. State with reasons whether CA. Chandra is right in expressing an opinion on financial statements the audit of which is performed by another auditor.***
   - As per SA 220 "Quality Control for an audit of Financial Statements", an engagement partner taking over an audit during the engagement may apply the review procedures such as the work has been performed in accordance with professional standards and regulatory and legal requirements; significant matters have been raised for further consideration; whether appropriate consultations have taken place and the resulting conclusions have been documented.
   - One of the basic principles, which govern the auditor's professional responsibilities and which should be complied with wherever an audit is carried, is that when the auditor delegates work to assistants or uses work performed by other auditor and experts, he will continue to be responsible for forming and expressing his opinion on the financial information. However, he will be entitled to rely on work performed by others, provided he exercises adequate skill and care. However, the auditor should carefully direct, supervise and review work delegated.
   - To conclude, CA. Chandra is allowed to sign the audit report, though will be responsible for expressing the opinion.

ASSEMBLY OF AUDIT FILE AS PER SQC 1

- The auditor shall assemble the audit documentation in an audit file within 60 days of completion of audit.
- The auditor shall retain the Audit file for a period of 7 years from the date of Audit Report.
- As per SA 230 read with SQC 1 ,Audit documentation is the property of the auditor. He may at his discretion, make portions or extracts of audit documentation available to the clients, provided such disclosure does not undermine validity of work performed , or in case of assurance engagements, the independence of auditor and his personnel.
- It is also clarified by the ICAI, that an auditor is not required to provide the client or the other auditor's of the same enterprise or its related enterprise such as a parent or subsidiary, access to his audit working papers.

SA 230
AUDIT DOCUMENTATION

Audit Documentation is the record of audit procedures performanced, (Test of Controls/Substantive Procedures), Relevant Audit Evidence obtained(Oral/Visual/Documentary) and Conclusions the auditor reached (Modified or Unmodified)

As per SA 230 read with SQC 1,working papers should be preserved for a minimum period of 7 years. i.e No working paper can be deleted or discarded upto 7 years from Audit Report.

Purposes of Audit Documentation

- ✓ Assisting Engagement Team to plan and perform audit.
- ✓ Assisting members of engagement team responsible for supervision of audit work.
- ✓ Enabling engagement team to be accountable for users.
- ✓ Records for future audit.
- ✓ Enable conduct of quality control reviews as per SQC 1.
- ✓ Enabling conduct of external inspections in accordance with legal , regulatory framework.

Which matters are to be documented?

- ✓ NTE of Audit Procedures to comply with laws.
- ✓ Results of Audit Procedures.
- ✓ Significant matters arising during audit.
- ✓ Discussion of matters with TCWG.
- ✓ Reasons for discarding/modifying/deleting working papers after 7 years.
- ✓ Sometimes some SA's require mandatory documentation.

Matters arising after the date of auditor's report.

As per SA 560"Subsequent Events" issued by ICAI, if the auditor is aware of any of the matter after the date of audit report and the auditor is of the opinion that, if the matter had been known to him at the date of auditor's report it may have caused the auditor to amend his report, the auditor shall perform additional procedures.

DOCUMENTATION

Then the auditor shall document:

- ✓ The circumstances encountered;
- ✓ Additional procedures performed;
- ✓ Audit evidences obtained; and
- ✓ Conclusions reached thereon and their affect on audit report.

What are the factors affecting form, contents and extent of audit?

- ✓ **Size and Complexity of Entity.**
- ✓ **Nature of Audit Procedures to be performed.**
- ✓ **Identified risks of material misstatements.**
- ✓ **Significance of Audit Evidence obtained.**
- ✓ **Nature and extent of exceptions identified.**

- ✓ **Need to document a conclusion.**
- ✓ **Audit methodology and tools used.**

Does the statuary auditor have the right to access working papers of branch auditor?

- ✓ **The principal auditor of an enterprise do not have the right to access to the audit working papers of the branch auditor's.**
- ✓ **In case of a company, the statuary auditor has to consider the report of the branch auditor as per Section 143 and has a right to seek clarifications or to visit the branch if he deems necessary.**
- ✓ **As per SA 600,an auditor can rely on the work of another auditor ,without having right of access to the working papers.**

Can the auditor provide the access of his working papers to any 3rd party?

- ✓ **Working papers may contain some vital information of the client.**
- ✓ **As per SA 200, one of the ethical requirement that the auditor has to follow is confidentiality.**
- ✓ **Also clause 1 of part 1 of 2 nd Schedule provides that a CA in practice is deemed to be guilty of professional misconduct if he discloses information of the client, without his consent.**
- ✓ **Hence, Auditor cannot share the working papers to any 3rd party, unless it is a requirement of law.**

SA 240

AUDITOR'S RESPONSIBILTY IN RELATION TO FRAUD IN AN AUDIT OF FINANCIAL STATEMENT

Fraud **means an intentional act by one or more individual among management , those charged with governance, employees, or third parties, to deceive, to mislead or atleast to conceal the truth to obtain an unjust or illegal advantage.**

In accordance with SA 315,auditor should identify and assess risks of material misstatement due to fraud at the financial statement level, and at assertion level for classes of transactions, account balances and disclosures.

In accordance with SA 330,the auditor should determine overall responses to address the assessed risk of material misstatement due to fraud at financial statement level.

Perform Risk Assessment Procedures,& General understanding of its entity ,its environment and Internal Control System as per SA 315.

Auditor's Responsibilities relating to fraud in an audit of Financial Statement.

- ✓ Obtaining Reasonable Assurance that financial statements taken as a whole are free from material misstatement, whether due to fraud or error.
- ✓ Maintain Professional Scepticism throughout the audit.
- ✓ Obtain Written Representation.
- ✓ As per SA 200, due to inherent limitations of an audit, there is an unavoidable risk that some material misstatement of Financial statement will not be detected ,even though the auditor is properly planned and performed in accordance with SA's.
- ✓ Risk of not detecting a material misstatement resulting Management fraud is greater than Employee fraud, because management can easily manipulate accounting records because management is in a unique position to penetrate fraud because of Management's ability to manipulate accounting records & prepare financial statements by overriding controls.
- ✓ <u>Perform Risk Assessment Procedures</u>
    - Enquiry of Management.
    - Enquiry of Those Charged With Governance.
    - Evaluation of fraud risk factor.
    - Evaluation of identified unusual & unexpected relationship.
- ✓ Consider impact of fraud on financial statement.
- ✓ Consider reliability of WR if management fraud found.
- ✓ Communicate to chairman, Board of Directors.

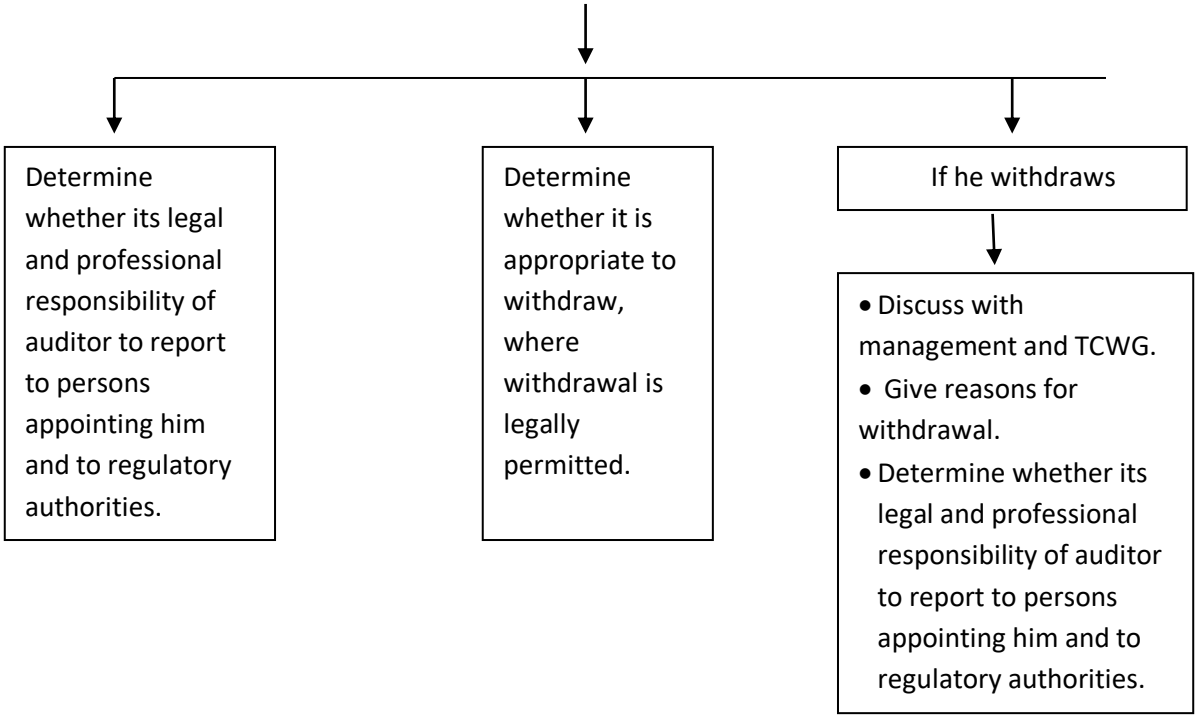
Possible sources of Fraudulent Financial Reporting(FRAUD)

- ✓ F-Recording fictitious journal entries, particularly at the end of Accounting Year to manipulate operating results.
- ✓ R-Receipts ka Embezzlement.
- ✓ A-Assets ka misappropriation.
  Stealing physical Assets/IPR
  Adjusting Assumptions inappropriately and changing judgements
- ✓ U-Using Entity's assets for personal use.
- ✓ D- Delaying, advancing or omitting recognition in financial statement of events and transactions that have occurred during reporting period.

Whenever any fraud is discovered by the auditor ,report under Section 143(12) to Central Government.
Additional reporting responsibility under CARO as per Section 143(11) issued by Central Government.
The person committing the fraud shall be liable under Section 447.

Fraud has been defined in paragraph 11 (a) of SA 240, "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial statements" as an intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage.'

If Auditor is unable to continue the Engagement



Questions of SA 240

1) **While conducting statuary audit of ABC Ltd, you came across IOU's amounting to 2 cr. as against cash balance of 2.10 cr. You also observed that despite similar balances throughout the year, small amounts of Rs.50000 are withdrawn from bank to meet day to day expenses.(June 2009/RTP May 2013)**

ANSWER:

- Obtain SAAE regarding existence of fraud(SA 240)
- If fraud, reporting to CG under 143(12)
- Reporting under CARO under clause 3(x),Section 143(11).
- Guidance Note on Audit of Cash and Bank Balance-If unduly large balance of cash ,carry surprise physical verification. If cash in hand does not meet with book balance ,seek explanation ,state fact in report.

2**) Management has committed a Teeming and Lading Fraud. What are auditor's responsibilities relating to fraud in an audit of financial statement. (May 2005/RTP Nov 2010)**
[Refer the heading- Auditors Reporting Responsibility in an Audit of Financial Statement]

3) **You notice a misstatement resulting from fraud or suspected fraud during the audit and conclude that it is not possible to continue the performance of audit.(Nov 2006)**
[Refer the heading-If Auditor is unable to continue the engagement}]

4) **In the course of audit of A Ltd you suspect the management has indulged in fraudulent financial reporting. State the possible source of such fraudulent reporting. (May 2012)**

5) **While auditing accounts of public ltd co. for the year ended 31st March 2014,auditor found errors in valuation of inventory which effects the materiality of financial statements.(Nov 2003/ RTP Nov 2013)**
   - Hints-AS 2,SA 320,error if intentional SA 240,143(12),143(11),communicate to TCWG as per SA 260,Ask management to correct such errors .If management refuses to correct, modify as per SA 705.

6) **Auditor observed that there was a specific audit done, suspicious of fraud, requested copy of report to enable him to report on fraud. The same was not provided .The auditor then requested for WR Management remained silent. Guide the auditor.(May 2014)**

- Obtain reasonable assurance that financial statements are free of fraud. If fraud found consider SA 240.

- Frauds may be sophiscated and carefully designed.
- As per SA 580 if WR not provided , revaluate integrity of management, effect on reliability of Written Representation, disclaimer also possible.

SA 250
CONSIDERATION OF LAWS AND REGULATIONS IN AN AUDIT OF FINANCIAL STATEMENTS

Responsibilities of Auditor.

- ✓ Auditor is not responsible for prevention/detection of non compliances. **Management, with the oversight of those charged with governance, is responsible for ensuring that the entity's operations are conducted in accordance with laws and regulations.**
- ✓ The auditor should obtain general understanding of regulatory framework and how entity complies with it.
- ✓ The auditor should obtain Sufficient and appropriate audit evidence w.r.t. laws directly effecting determination of amount and disclosure in Financial statement.
- ✓ He is not required to obtain expert understanding of other laws that do not have a direct bearing on Financial statement such as compliance with environmental regulations.
- ✓ Non compliance with other laws may result in litigations , fines and other consequences .The auditor will disclose whether co. has made provisions for such fines ,litigations.
- ✓ Obtain written representation that all instances of non- compliances or suspected non-compliances with laws and regulations have been disclosed to the auditors.
- ✓ Obtain Sufficient and appropriate audit evidence that all instances of non-compliances or suspected non-compliances with laws and regulations have been disclosed to the auditors.
- ✓ Obtain Sufficient and appropriate audit evidence that whether the misstatements found is due to fraud or error. If it is done fraudulently , the auditor shall consider SA 240.

Whenever,any violations is being noticed, the Statuary Auditor's must report the same to

- ✓ Management
- ✓ Stakeholders
- ✓ Those Charged with Governance
- ✓ If Management/TCWG is involved, communicate to the next level-Supervisory Board or Audit Committee.
- ✓ If next level is not there, obtain legal advice.

If non compliances has material effect on Financial Statements, it means Financial statement is not reflecting True and fair view(Required under SA 200 and Section 143(2).Hence the auditor is required to give qualified/adverse report.

Reporting to Regulatory and Enforcement Authorities

The auditor's duty of confidentiality would preclude reporting to a 3rd party. However ,in certain circumstances duty of confidentiality is overridden by statute, law or by courts of law.

Indicators of Non -Compliance(Pimple)

- ✓ P-Payments made without proper authorisation/Payment of fines or penalties/Purchasing at price significantly above or below market price.
- ✓ I-Investigations made by Government department.
- ✓ M-Adverse Media Comment.
- ✓ P-Payments made to Related Parties, Loans to Consultants etc.
- ✓ L-Lax i.e weak accounting system.
- ✓ E-Extra ordinary and unauthorised transactions.

Some special points

- ✓ **The DRS shall disclose as to whether the directors had devised proper system to ensure compliance with all the provisions of all applicable laws and regulations and whether such system were adequate and operating effectively.**

Questions for SA 250

1.A company is not registered with Provident fund Act and not remitted Management dues. Management says in absence of registration ,there is no default.

- **Auditor is required to report under Section 143(11) i.e. CARO issued by Central Government.**
- **SA 250**
- **Modify as per SA 705.**

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. (Nov 2012, RTP May 2016)

- **If there is no direct effect on determination of amount and other disclosures ,but compliance is fundamental to operational aspects of company, then to continue as going concern ,to avoid fines and penalties ,auditor's responsibility to identify such non compliance.**
- **If non compliance has a material effect and not adequately reflected in Financial statements, express Qualified/Adverse.**

SA 260
COMMUNICATING WITH THOSE CHARGED WITH GOVERNANCE

Key Definitions:

1. **Management:** Such personnel who are responsible to perform day to day functions of the business and are also responsible for making financial statements.

For example: Executive members of Governance Board .i.e. Executive Board.

2. **Those charged with governance(TCWG):** Such personnel having 2 responsibilities:

- ✓ For overseeing the strategic directions of the entity; and
- ✓ Obligations related to the accountability of the entity.

In short, TCWG means such personnel who will supervise the performance of the Management and are responsible for approving financial statements.

For example: Audit Committee

Point to be noted:
In this SA, the Auditor is required to communicate certain matters to TCWG. However, it may happen that due to low size or structure , the entity may not have a separate committee for the approval of F/S and Management will be responsible for the same. So in these circumstances the auditor shall communicate to Management.

Matters to be communicated to TCWG	
Auditor's Responsibility	The auditor is responsible for forming and expressing an opinion on Financial Statements.
Significant Findings of the Audit	(a) Significant findings w.r.t accounting policy, accounting estimate and financial statement disclosures. (b) **Significant difficulties, if any, encountered during the audit such as;** ✓ Delay by the management in providing information. ✓ Unavailability of information. ✓ Extensive unexpected efforts required to obtain SAAE. ✓ Restrictions impose on auditor by the management. ✓ Management's unwillingness to make or extend its assessment of the entity's ability to continue as a going concern when requested.
Independence	**In the case of listed entities, the auditor shall communicate with TCWG:** ✓ Statement that the engagement team and the network firms have complied with relevant ethical requirements regarding independence. ✓ Threats to auditor's independence and the measures taken by the auditor to overcome those threats.
Scope	**Planned scope and timings of the audit shall be communicated to TCWG.**

Factors affecting the form of communication:
The form of communication may be orally or in writing ,detailed or summarized , structured or non structured. The various factors governing mode of communication are: ✓ Whether a discussion of the matter will be included in the **Key Audit Matters Paragraph.** ✓ Whether the matter has been satisfactorily resolved. ✓ Whether management has previously communicated the matter. ✓ The size, operating structure, control environment and legal structure of the entity. ✓ Legal requirements. ✓ The expectations of TCWG. ✓ The amount of ongoing contact and dialogue the auditor has with TCWG. ✓ Whether there have been significant changes in the membership of a governing body.

Mode of communication

- All significant matters should be communicated in writing at reasonable time depending upon the nature of the matter.
- Timing of Communication should be appropriate. Any planning matters should be communicated at the time of Audit Engagement Letter

New principles w.e.f .1.4.2017

1. Key audit matters as given in SA 701 are selected from matters communicated with those charged with governance.
2. The auditor may communicate preliminary views about key audit matters while discussing the planned scope and timings of the audit.

SA 265
COMMUNICATING DEFICIENCIES IN INTERNAL CONTROL TO THOSE CHARGED WITH GOVERNANCE

What is deficiency in internal control?

- ✓ when control is designed, implemented or operated in such a way that it is either unable to prevent, detect or correct **material misstatements** on timely basis or when internal control system does not exists.
- ✓ If individually or in combination, deficiencies are significant as per professional judgement of the auditor communicate to TCWG. Give description of deficiencies and its potential effects to facilate understanding of TCWG.
- ✓ The letter describing such weakness in internal control to be communicated in writing to management and TCWG is also known as **letter of weakness.**

PTR: Letter of weakness not only contains the lapses in the internal control system but also remedial actions suggested by the auditor to overcome those weakness.

Examples of material misstatement

- ✓ Non disclosure of Related Party Transactions
- ✓ Contingent Liabilities not shown
- ✓ Assets are overstated;
- ✓ Liabilities are understated;

Indicators of significant deficiencies in internal control

- ✓ Evidence of ineffective control environment.
- ✓ Absence of risk assessment process within the entity.
- ✓ Evidence of an ineffective risk assessment process within the entity.
- ✓ Evidence of an ineffective response to identified risk.
- ✓ Misstatements detected by the auditor that were not prevented, detected and corrected by the entity's internal control.
- ✓ Evidence of managements inability to oversee the preparation of financial statements.
- ✓ Disclosure of material misstatement due to error or fraud as prior period items in the current years Statement of Profit and Loss.

Question - Indicate the precise nature of auditor's liability in the following situations and support your views with authority, if any: Certain weaknesses in the internal control procedure in the payment of wages in a large construction company were noticed by the statutory auditor who in turn brought the same to the knowledge of the Managing Director of the company. In the subsequent year huge defalcation came to the notice of the management. The origin of the same was traced to the earlier year. The management wants to sue the auditor for negligence and also plans to file a complaint with the Institute In the given case, certain weaknesses in the internal control procedure in the payment of wages in a large construction company were noticed by the statutory auditor and brought the same to the knowledge of the Managing Director of the company. In the subsequent year, a huge defalcation took place, the ramification of which stretched to the earlier year. The management of the company wants to sue the statutory auditor for negligence. The precise nature of auditor's liability in the case can be ascertained on the basis of the under noted considerations: (a) Whether the/ defalcation emanated from the weaknesses noticed by the statutory auditor, the information regarding which was passed on to the management; and (b) Whether the statutory auditor properly and adequately extended the audit programme of the previous year having regard to the weaknesses noticed. (RTP Nov 2014)

- **SA 265**
- **clause 7,schedule 2,ca act**
- **Auditor's defence-Kingston cotton mills.- If the auditor took care while discharging his duties, he is not guilty.**

SA 299
RESPONSIBILITY OF JOINT AUDITORS

SA 299 is applicable when more than one auditor are appointed to conduct the audit of large entity.

Advantages of joint audit:

- ✓ **Pooling and sharing of resources.**
- ✓ **Everyone has expertise in different area.**
- ✓ **Advantage of mutual discussion.**
- ✓ **Better quality of work performance.**
- ✓ **Improved services to client company.**
- ✓ **Lower costs to carry out the audit work.**

Disadvantages of joint audit:

- ✓ **Sharing of fees.**
- ✓ **Lack of clear definition in case of joint responsibility.**
- ✓ **Co-ordination problems in conduct of work.**
- ✓ **Areas of common concern being neglected.**
- ✓ **Problems when firms of different standing are associated.**

Where joint auditors are appointed, they should , by mutual discussion , divide the audit work among themselves. The division of work is on the basis of components of financial statement , period of time , specified areas etc.

Jointly and severally responsible for

- ✓ Work not divided and to be carried out together
- ✓ Statute requirement in relation to disclosure requirement of financial statement
- ✓ Ensure compliance of Audit Report
- ✓ Matter which is brought to notice of joint auditors
- ✓ Decisions taken by all the auditor's in relation to nature, time and extent of Audit Procedures

INDIVIDUAL RESPONSIBILITIES

- ✓ For work divided, in nature, time ,extend of audit procedure ,
- ✓ professional judgement,
- ✓ reviewing internal control,
- ✓ reviewing audit reports of work allocated to him,
- ✓ obtaining information and explanation.

Rights of joint auditor's

- ✓ to assume that other joint auditors have carried out work in accordance with generally accepted auditing procedures.

Other Issues

1. Is it necessary for a joint auditor to review work of others?
   No. can assume that worked in accordance with generally accepted auditing procedure since other joint auditor is also a member of ICAI.
2. Is view of majority bound on the joint auditor?
   No. each one of them has right to express his own opinion through a separate report. Diverge views are to be reported in case of disagreement. However efforts must be made to arrive at an agreed report so that users of financial statement don't get confused.

♣ **Non Applicability**- Relationship between Principal Auditor & Branch Auditor.

Question -1

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.

- **Refer point 1,2,3**
- **Since division of work not documented as per SA 299 guilty of negligence.**
- **Also guilty of pm under CA ACT.**

SA 300
AUDIT PLANNING

Need of Audit Plan

- ✓ It is essential to plan in advance to complete audit in timely and efficient.

Who should be involved in Audit Planning ?

- ✓ Along with senior partner ,the engagement team leader of Audit Engagement Team with his key members.

Preliminary Engagement Activities(ETC)

- ✓ E-Evaluating **compliance with ethical requirements, including independence, as required by SA 220;**
- ✓ T-Understanding of **Terms of the Engagements as required by SA 210;**
- ✓ C-Perform procedures required by SA 220, "Quality Control for an Audit of Financial Statements" **regarding the continuance of the client relationship and the specific audit engagement;**

What should be considered in Planning/Audit Strategy?(STD and additional points)

- ✓ S-Scope
- ✓ T-Timing
- ✓ D-Directors required for engagement team
- ✓ Characteristics of Engagement
- ✓ Reporting objectives
- ✓ Consider the results of preliminary engagement
- ✓ Nature ,Time, Extent of resources.

Development of Audit Plan

- ✓ While developing audit plan, the auditor shall give description of SA 315(NTE of RAP),330(NTE of further audit procedures) and other planned audit procedures as per audit standards.

Can the Audit Plan or strategy be changed during the audit engagement?

- ✓ Audit planning is a continuous process , the auditor may change the audit plan or strategy during the performance of an audit engagement as a result of
  - Unexpected events;
  - Change in conditions; or
  - The audit evidence obtained from the result of audit procedures.

Relationship between the Overall Audit Strategy and the Audit Plan:

a. The audit strategy provides the guidelines for developing the audit plan. It establishes the scope and conduct of the audit procedures and thereby works as basis for developing a detailed audit plan.

b. Detailed audit plan would include the nature, timing and extent of the audit procedures to obtain sufficient appropriate audit evidence.

c. The audit strategy is prepared before the audit plan.

d. The audit plan contains more details than the overall audit strategy.

e. Audit strategy and audit plan are inter-related because change in one would result into change in the other.

SA 315
IDENTIFYING AND ASSESSING THE RISK OF MATERIAL MISSTATEMENT THROUGH UNDERSTANDING THE ENTITY AND ITS ENVIRONMENT

How will auditor will understand entity and its environment?

1. Understanding the legal structure of the entity.
2. Nature of business.
3. Laws and Regulations Applicable.
4. How is it financed
5. Management structure-TCWG,BOD
6. FRF applicable
7. Accounting policies
8. Accounting Estimates
9. Integrated or Non Integral
10. List of Related parties.

Understanding of entities Internal control system

A. Internal control is a process designed ,implemented and maintained by management and TCWG to ensure

- ✓ Reliability of financial reporting.
- ✓ Effectiveness & Efficiency of operation.
- ✓ Safeguarding of Assets.
- ✓ Compliance with laws and regulation.

B. Components of Internal Control System(ICRAM)

- ✓ Information System-There are two types of information system, manual and automated.(CIS)
- ✓ Control Environment-Understanding the control environment, whether management, with TCWG has created and maintained a culture of honesty and ethical behaviour.
- ✓ Risk Assessment Procedures
- ✓ Activities-The auditor shall obtain understanding of control activities relevant to an audit. **For example; Authorization , Segregation of duties, Safeguarding, Asset accountability**
- ✓ Monitoring(SA-220)-Monitoring of controls is a process to assess the quality of internal control performance over time.

Identifying and assess the Risk of Material Misstatement

- ✓ The auditor shall perform risk assessment procedures to provide a basis for identification and assessment of risk of material statement at the financial statement level and assertion level.
- ✓ Risk Assessment Procedures by themselves do not provide sufficient and audit evidence on which to base the audit opinion.

Risk Assessment Procedures.

- ✓ Risk is of 3 types-Inherent risk ,control risk and detection risk.
- ✓ Risk Assessment Procedures included the following
  1. Enquiries of management and others (TCWG) who can assist in identifying risk of material misstatement.
  2. Observation and Inspection.
  3. Enquiry of others.
  4. Analytical Procedures(SA-520).

Audit Risk.(Inherent Risk vs. Control Risk vs. Detection Risk).

- ✓ Audit Risk is the risk that an auditor may issue an inappropriate opinion when there is material misstatement in financial statement**(Defined in SA 200)**
- ✓ There are two components of Audit Risk
  - a.) Risk of material misstatement-Risk that financial statement may contain material misstatement assessed by the auditor prior to audit.
    There are 2 components-Inherent Risk and Control Risk.
  - b) .Detection Risk.
- ✓ As per SA 315 read with SA 330,auditor exercises his professional judgement to assess audit risk and to design audit procedures to ensure that it is reduces to an acceptable low level.
- ✓ Detection Risk is the risk that even auditor's substantive procedure will fail to detect risk of material misstatement although risk existing in account balance or class of transaction could be material.
- ✓ Higher, the Inherent Risk and Control Risk, the more substantive procedures the auditor will perform, obtain more audit evidence ,and reduce his detection risk so as to reduce audit risk to an acceptable low level.
- ✓ Inherent Risk- There will always be risk of material misstatement existing in account balance or class of transaction or disclosure presuming that there is no internal Control. **Therefore, such risk of material misstatement due to non-existence of internal controls is known as an inherent risk.**
- ✓ Control Risk-The risk of material misstatement existing in account balance or class of transaction or disclosure will not be prevented, detected and timely corrected by system of internal control.

Audit Risk = Risk of Material Misstatement × Detection Risk
Risk of Material Misstatement = Inherent Risk × Control Risk
Therefore, Audit Risk = IR × CR × DR

IT systems also pose specific risks to an entity's internal control? What are those risks?

- ✓ Reliance on inaccurate input, processing and output.
- ✓ Possibility of IT personnel gaining access beyond those necessary to perform their assigned duties thereby breaking down segregation of duties.
- ✓ In appropriate manual intervention.
- ✓ Unauthorised access to data that may result in destruction of data or improper changes to data.(U)
- ✓ Unauthorised changes to data in Master files.
- ✓ Unauthorised changes to systems or programs.
- ✓ Failure to make necessary changes to systems or programs.

Risks that require special consideration:

- ✓ Risk of fraud;
- ✓ Risk related to recent significant, economic , accounting or other developments lie changes in regulatory environment etc.
- ✓ Risk involved in compex transactions.
- ✓ Significant transactions with related parties.
- ✓ Risk involved in significant unusual transactions.

Conditions and indications that may indicate Risk of Material Misstatements (Give few examples)

- ✓ Significant transactions with related parties.
- ✓ Weakness in internal control.
- ✓ Changes in IT environment.
- ✓ Launch of new products or services.
- ✓ Going concern and liquidity issues.
- ✓ Significant amount of unusual transactions.
- ✓ Pending litigation and contingent liabilities.

SA 330
AUDITOR'S PROCEDURES RESPONSIVE TO RISK ASSESSED AT ASSERTION LEVEL

Auditor's Procedures responsive to risk Assessed at assertion level

Test of Controls	Substantive Procedures
✓ Perform test of controls to ensure that internal control is designed and effectively operating throughout the period. ✓ If control risk is high, perform more test of controls. ✓ Communicate material weakness in internal control to Those Charged with Governance.	✓ It is an audit procedure designed to detect material misstatement at assertion level. Substantive Procedures comprise: (a)Tests of details(of classes of transactions, account balances and disclosures). (b)Substantive analytical Procedures. ✓ Irrespective of the assessed risk of material misstatement, the auditor shall perform substantive procedures for each material class of transactions, account balances and disclosure. ✓ The auditor's substantive procedures shall include (a)Agreeing or reconciling the financial statement with the underlying accounting records; and (b)Examine material journal entries and other adjustments made during the course of preparing the financial statements.

NATURE, TIME AND EXTENT OF AUDIT PROCEDURES	
NATURE	The nature of further audit procedures refers to their purpose (tests of controls or substantive procedures) and their type , that is **inspection, observation, inquiry , confirmation, recalculation, re-performance or analytical procedures.**
TIME	**Timing refers to when audit procedures are performed.** For example, the auditor may perform test of controls or substantive procedures at an interim date or at period date.
EXTENT	**Extent refers to the quantity of a specific audit procedure to be performed.** For example- sample size.

Questions on SA 330

1. "Surprise Checks" help the auditors to ascertain whether the internal control system is operating effectively in a Company or not". Discuss.

Answer- SA 315 & SA 330 prescribes that the auditor should obtain an understanding of the accounting and internal control systems sufficient to plan the audit and develop an effective audit approach, in this context, surprise checks intend to ascertain whether the system of internal control is operating effectively and whether the accounting and other records are prepared concurrently and kept up-to-date. Surprise checks are a useful method of determining whether or not errors exist and where they exist, of bringing the matter promptly to the attention of the management so that corrective action is taken immediately. Consequently, surprise visits by the auditor can exercise a good moral check on the client's staff. Therefore Surprise Checks help the auditors to ascertain whether the internal control system is operating effectively in a Company or not.

2. 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.

- **Factors that may rewarrant test of controls.**
  - **a.)Deficient Control environment.**
  - **b)Deficient monitoring of control.**
  - **c.)Deficient general IT controls.**
  - **d.)Changing circumstances that indicate the need for change in controls.**
  - **e.)Personnel changes**

3.Procedure in case detection risk cannot be reduced to acceptance level OR "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." (RTP)

- **As per SA 315 read with SA 330,auditor exercises his professional judgement to assess audit risk and to design audit procedures to ensure that it is reduces to an acceptable low level.**
- **Detection Risk is the risk that even auditor's substantive procedure will fail to detect risk of material misstatement although risk existing in account balance or class of transaction could be material.**
- **Higher, the Inherent Risk and Control Risk, the more substantive procedures the auditor will perform, obtain more audit evidence ,and reduce his detection risk so as to reduce audit risk to an acceptable low level.**
- **If it cannot be reduced to an acceptable level, the auditor should express a qualified opinion or disclaimer of opinion as may be appropriate.**

SA 320
MATERIALITY IN PLANNING AND PERFORMING THE AUDIT

Material items are those which may influence the decision of uses of financial misstatement .Example .If one student scores 50% and other student scores 52%,it might not be material for the interviewer. On the other hand if other students scores rank, it might influence the decision.

Whether item is material or not, it depends on professional judgement of the auditor.

Materiality is judged at time of

- ✓ Planning
- ✓ Evaluation of audit evidence
- ✓ Conclusion of reporting.

What do you mean by Performance Materiality?

- ✓ Amount set by the auditor at less than materiality level for the financial statement as a whole. Why?
- ✓ To ensure that aggregate **of uncorrected and undetected misstatements** is less than materiality for the financial statement as a whole.
- ✓ To reduce risk to an appropriately low level.
- ✓ Example- materiality level of rs.5lakh decided. lets say,40% of materiality level=rs.2 lakh decided as performance materiality. Agar 3 Galatia 2 lakh ki nikal gai,toh aggregate basis main materiality level exceed hojayga.

The auditor can revise materiality level based on progress of audit. If he finds material misstatement, then reduce materiality level to cover more items. Consider whether Nature, Time and extent of further Audit Procedures will remain appropriate. If the auditor gets additional information then he should revise materiality. For example, if there is new requirement of law/ regulation/FRF, entity has made a major decision to dispose of a major part of the entity's business, the auditor should revise the materiality level. If materiality is more, the auditor will perform more audit procedures and reduce the overall audit risk.

The auditor may decide to evaluate misstatements even if it is less than materiality level set by him.

Use of Benchmark in determining Materiality- A percentage is often applied to a chosen benchmark as a starting point in determining materiality for the F/S as a whole**.**

Factors that may effect the identification of an appropriate benchmark include the following(Nov 2013)

- ✓ The elements of the F/S(for example, assets, liabilities, equity, revenue, expenses)
- ✓ Items where attention of users of F/s may be focused.
- ✓ Nature of entity.
- ✓ Ownership structure of entity and way of financing(for example, if entity is financed solely by assets , users may put more focus on assets, rather than earnings)
- ✓ The relative volatility of the benchmark.

May 2015
Q.As an auditor of RST Ltd. Mr P applied the concept of materiality for the financial statement as a whole. On the basis of obtaining information of significant contractual arrangements that draw attention to a particular aspect of a company's business ,he wants to revaluate the materiality concept. Please, guide him.

- **As per SA 320,set benchmark on the basis of which audit procedures will be performed.**
- **point no 5**
- **Can revaluate after considering necessity of such revision.**

SA 402
AUDIT CONSIDERATIONS RELATING TO AN ENTITY USING SERVICE ORGANISATIONS

Meaning of terms used in SA	
Service Auditor	An Auditor who at the request of the service organization, provides an assurance report on the controls of a service organization.
Service Organisation	A third party organization that provides services to user entities that are part of those entities that are part of those entities information system relevant to financial reporting.
User Auditor	An Auditor who audits and reports on the financial statements of a user entity.
User Entity	An entity that uses a service organization and whose financial statements are being audited.

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 organisation in the user's entity operations , including

- ✓ Nature of services provided by service organisation to user entity and the significance of those services to the user entity.
- ✓ Nature of materiality of transactions processed by the service organisation.
- ✓ Contractual terms for the activities undertaken by the service organisation.
- ✓ Degree of interaction between activities of service organisation and user entity.
- ✓ Design and implementation of controls at user's entity relating to service organisation.
- ✓ General controls and computer systems controls.

If the auditor of user organisation is not able to obtain all information at user entity he shall

- ✓ Contact service organisation through user entity to obtain information.
- ✓ Visit service organisation and perform procedures therein.
- ✓ Using another auditor for same.
- ✓ Obtain type 1 or type 2 report from auditor of service organisation.

Type 1 Report is the report on description and design of controls designed and implemented at a service organisation. It is a report by the service auditor that comprises of service organisation's system, control objectives and related controls that have been designed and implemented at a particular date.

Type 2 Report is more comprehensive. It includes Type 1 and additionally it also includes the description of test of controls performed to arrive at the above opinion.

In determining the **sufficiency and appropriateness** of the audit evidence provided by a Type 1 or Type 2 report, the user auditor shall be satisfied as to:

- ✓ Service auditor's professional competence
- ✓ Adequacy of the standards under which Type 1 or Type 2 report was issued. i.e. whether the same was prepared as per SAE 3402.

If the auditor of user organisation is not able to obtain information , give qualified or disclaimer.

Reporting

- ✓ Unmodified-Don't refers to service auditor's report.
- ✓ Modified- May refer to service auditor's report.

Note-SA 3402 applies to auditor of service organisation whose duty is to report in type 1 or type 2 to the auditor of user's entity.He shall perform test of controls while providing type 2 report.If controls are not fairly designed and implemented or he is unable to obtain SAAE, modify the opinion.

Questions on SA 402

1. 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?

- **Refer point no 1**
- **consider the nature and extent of activities undertaken by service organisations so as to determine whether those activities are relevant to the audit.**
- **Obtain Type 1/2 report.**

2. In the course of the audit of R Ltd., the audit manager of ABC & Co. observed that R Ltd. has outsourced certain activities to an outsourcing agency. As the engagement partner guide the audit manager in the assessment of services provided by the outsourcing agency in relation to the audit. (RTP, May 2010, 2011).

Refer point no 1

3. G Ltd. is a mobile phone operating company. Barring the marketing function it had outsourced the entire operations 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 -ions. Nov 2013, RTP Nov 2014

- **Refer point no 1**

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SA 450
EVALUATION OF MISSTATEMENT IDENTIFIED DURING AUDIT

What is misstatement?

An item is said to be misstated when it is reported in financial statements in a way which is different from that prescribed in FRF, may be due to error and fraud.

If misstatement is immaterial

- ✓ Document all misstatement which is treated as material.
- ✓ Obtain Written Representation that uncorrected misstatement are immaterial .

If misstatement is material or aggregate of uncorrected misstatement becomes material,

↓

Consider adjustment of nature ,time and extend of audit procedures.

↓

Communicate them to appropriate level of management and request them to correct it.

↓

If management:

Refuses to correct	Corrects them
• Consider their reasons and effect on audit report.	• Perform additional procedures to determine whether some other misstatement remain.

<u>Questions from SA 450</u>

1. 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.

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

2. While auditing accounts of a public limited company for the year ended 31st March 2014, an auditor found an error in the valuation of inventory, which affects the F/S materially- Comment as per standards on auditing.(AS 2, SA 320, SA 450, SA 260, SA 240, consider implication on true and fair view).

SA 500
AUDIT EVIDENCE

What is Audit Evidence?

- ✓ **Information used by the auditor in arriving at the conclusions on which auditor's opinion is based.**

The auditor should obtain sufficient and appropriate audit evidence as per SA 200 read with SA 500. Audit procedures prescribed under SA 500 read with SA 315 and SA 330-Risk Assessment procedures, Test of controls(compliance procedures) and Substantive procedures.

Substantive procedures further compromises of Test of details and substantive analytical procedures.

Meanings

- ✓ Test of controls-Designed to check whether internal control system is designed and operating effectively throughout the period(Auditor evaluates operating effectiveness of internal controls at assertion level).The auditor performs such audit procedures so that he can obtain audit evidence regarding adequacy of internal controls in an enterprise. After performing test of controls , if auditor finds that controls are inadequate or absent he shall communicate the same to TCWG as per SA-265.

- ✓ Substantive Procedures-These are designed to detect material misstatements at the assertion level. compromise test of details and substantive analytical procedures.(SA-520).Substantive tests are conducted in areas which are not subject to internal controls and are hence judgemental in nature.

Methods of obtaining audit evidence-

- ✓ **Inspection**-examination of records documents and tangible assets. Technique in which auditor obtains audit evidence with respect to existence of tangible assets and not wrt ownership or value.
- ✓ **Observation**-witnessing a process or procedure being performed by others. Technique in which evidence is obtained regarding existence, physical condition and control.
- ✓ **Inquiry and confirmation**-consists of seeking information of knowledgeable persons ,both financial and non financial, within the entity or outside the entity. Inquiries may be oral as well as written. In respect of certain matters , auditor my consider it appropriate to obtain written representation from management. Hence Written Representation obtained under sa-580 is also an audit evidence but cannot be solely relied upon. **The auditor also has to enquire about certain matters as per Section 143(1) of Companies Act, 2013.**

- ✓ **External comfirmation**-sa-505
- ✓ **Recalculation-**checking mathematical accuracy of documents or records.eg-calculating depreciation.
- ✓ **Reperformance-**Auditor independently executes the procedures again or controls again.eg-recounting of inventory.

- ✓ **Analytical procedures**-studying significant ratios, trends ,unusual fluctuation.(sa-520)

Reliability of Audit Evidence

- ✓ Original documents are more reliable than mere photocopies.
- ✓ Evidences obtained outside the entity are more reliable than evidences obtained within the entity.
- ✓ Evidences are more reliable when internal control system is sound.
- ✓ Evidences obtained directly by auditor are more reliable than obtained indirectly.

Reference to Management Expert

When auditor wants to use any information as audit evidence prepared by managements expert,

Auditor is first required to evaluate competence, capability and objectivity of expert before using such information. Also he should obtain understanding and evaluate appropriateness of experts work.

The auditor may also consider the following while evaluating the appropriateness of the managements expert 's work as audit evidence for the relevant assertion:

- ✓ **The relevance and reasonableness of the expert's finding or conclusions, their consistency with other audit evidence, and whether they have been appropriately reflected in the financial statements.**
- ✓ **If that expert's work involves use of significant assumptions and methods, the relevance and reasonableness of those assumptions and methods;**
- ✓ **If that expert's work involves significant use of source data , the relevance, completeness, and accuracy of that source**

Point to Remember:
The auditor/ auditor's will be held responsible for grossly negligence if faulty expert's work is used without examining the adequacy of expert's work.

Inconsistency between audit evidences obtained from 2 sources or audit evidence obtained is not reliable

- **Consider Modifying appropriately the audit report as per SA 705.**
- **Consider effect of matter on other aspects of audit**

Questions from SA 500

1. Write short note on : Inquiry.

2. Write short note on : Assessing the reliability of audit evidence.

3.The auditor accepted gratuity liability valuation based on certificate issued by qualified actuary. However, the auditor noticed that the retirement age adopted is 65 years as against retirement age of 60 years. The company is considering a proposal to increase the retirement age.

OR

M/s LNK's gratuity scheme's valuation by actuary shows wide variation compared to previous year's figures. As a statuary auditor, how will you deal with situation.

- **Refer the topic "Reference to Mgt Expert'**

SA 501
AUDIT EVIDENCE-SPECIFIC CONSIDERATION FOR SPECIFIC ITEMS

⇩

Part A-Inventory

- Mandatory to attend physical inventory counting unless impracticable, to **evaluate management's procedure for inventory counting; inspect the inventory; and perform test counts.**
- **SITUATION 1**
  If impracticable ,perform alternative audit procedures to obtain SAAE regarding existence and condition of inventory. If not possible to perform alternate procedures ,modify audit report as per Sa 705.
- **SITUATION 2**
  If unable to attend inventory counting due to unforeseen circumstances, Then perform physical counts on alternative date, and perform audit procedures on intervening transaction.
  Alternate audit procedures include
  1.Reconcile the changes in inventory between date of physical count and period end date.
  2.Observe treatment given for discrepancies observed.
  3.Ensure appropriate cut off procedures followed or not.
  4.Obtain Written Representation..

⇩

Part B-Litigations

- Perform audit procedures to obtain SAAE about existence of litigations and claims. How-Inquiry from management, Review minutes of meeting of TCWG and correspondence between entity and its external council, review legal expense account.
- Obtain WR that all litigations and claims have been presented in financial statement and disclosed to the auditor.
- If audit procedures indicate other litigations or claims, seek communication with entity's external legal counsel.
- If management refuses to give permission to auditor to communicate with external legal counsel and unable to obtain audit evidence, Modify the report.

1 .Comment on the following: You are the auditor of Easy Communications Ltd. for the year 2013–14. The inventory as at the end of the year i.e. 31.3.14 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?(Refer situation 2 in inventory)

2. **LMN Ltd. supplies navy uniforms across the country. The company has 4 warehouses at different locations throughout the India and 5 warehouses at the borders. The major stocks are generally supplied from the borders. LMN Ltd. appointed M/s OPQ & Co. to conduct its audit for the financial year 2015-16. Mr. O, partner of M/s OPQ & Co., attended all the physical inventory counting conducted throughout the India but could not attend the same at borders due to some unavoidable reason. You are required to advise M/s OPQ & Co.,**

   (i) How sufficient appropriate audit evidence regarding the existence and condition of inventory may be obtained? **(By conducting test count, observing management procedure etc)**

   (ii) How an auditor is supposed to deal when attendance at physical inventory counting is impracticable? **(Refer situation 1 in inventory)**

SA 505
EXTERNAL CONFIRMATIONS

- ✓ This is one of the methods of obtaining audit evidence as enumerated under sa-500.
- ✓ External confirmation is the process of obtaining and evaluating audit evidence through a direct communication from a third party w.r.t. certain assertions made by management in financial statements.
- ✓ Process of external confirmation, ordinarily, consists of the following:
  - Selecting the items for which confirmations are needed.
  - Designing form of confirmation request.
  - Communicating confirmation request to appropriate third party.
  - obtaining response from third party.
  - evaluating information.
- ✓ Give examples of areas in which external confirmation is required.
  - Bank Balance.
  - Accounts receivable balance.
  - Stocks held by third parties.
  - Accounts payable balances.
  - Loans from lenders.

- ✓ Types of confirmation request:

  a.) Positive confirmation-Response mandatory in case of agreement or disagreement. If response is not received in reasonable time, send additional confirmation request. Regarded as a better mode of confirmation request. Where risk or materiality level is high , internal control system is not so sound and exception rate is high, it is advisable to send positive confirmation request.

  b.) Negative confirmation-Response from the external party is required only in case of disagreement. It is to be used when risk of material misstatement or the materiality level is low , internal control is effective and exception rate is low.

- ✓ What are the various factors to be considered while designing confirmation request?

  As per SA 505, "External Confirmation", factors to be considered when designing confirmation requests include:

  (i) The assertions being addressed.

  (ii) Specific identified risks of material misstatement, including fraud risks.

  (iii) The layout and presentation of the confirmation request.

  (iv) Prior experience on the audit or similar engagements.

  (v) The method of communication (for example, in paper form, or by electronic or other medium).

  (vi) Management's authorisation or encouragement to the confirming parties to respond to the auditor. Confirming parties may only be willing to respond to

a confirmation request containing management's authorisation.

(vii) The ability of the intended confirming party to confirm or provide the requested information (for example, individual invoice amount versus total balance).

Questions from SA 505

1. Audit response/procedures when management refuses to seek external confirmation.

- **Consider validity of grounds for such a request- example. If Due to a dispute with creditors, management has refused as it might adversely affect the negotiations between entity and creditor. In such a situation auditor should pay heed to management request.**
- **Obtain evidence to support the same.**
- **The auditor should ask the management to submit its request in written form giving in details the reason for such request.**
- **If the auditor agrees to management request, document the reasons for acceding to management request.**
- **Apply alternative procedures to obtain sufficient appropriate evidence regarding that matter.**

2. During the course of audit of Star Limited the auditor received some of the confirmation of the balances of trade payables outstanding in the balance sheet through external confirmation by negative confirmation request. In the list of trade payables, there are number of trade payables of small balances except one, old outstanding of ` 15 Lacs, of whom, no confirmation on the credit balance received. Comment with respect to Standard of Auditing.

- **Meaning of negative confirmation.**
- **less persuasive.**
- **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.**
- **Conclusion- 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.**

3. Moon Ltd replaced its statuary auditors for the Financial Year 2015-16. 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 payment nor he is traceable. Under the circumstances, no confirmation of credit balance is available.

- **Examine the validity of credit balance.**
- **Obtain Sufficient and Appropriate Audit Evidence.**
- **Apply alternative procedures and not rely solely on Written Representation.**
- **Finally, he should include the matter by way of a qualification in his audit report to the members.**

4. As an auditor how will you deal with the following; when the audit team visited the client to perform substantive audit of debtor, the client produced ledger account of customers and confirmations for the top 10 customers. One of the debtors was more than 5 years old, but he had confirmed his balance.

- **Enquire reason of non payment and his financial abilities. If found adverse, advice client to provide provision for bad debts and WR that it is not a forged transaction.**

SA 510
INITIAL AUDIT ENGAGEMENTS-OPENING BALANCES

Applicability of SA 510(imp for case study)

- ✓ Opening Balance Present
- ✓ Previous year audit not done or done by another auditor

Objective of SA 510 is for the auditor to obtain evidences whether(MP)

M-Opening balance contain material misstatement(Prior period adjustment entry made)
P- Accounting Policies used in preceding year are consistent with that of current year .Any change will be appropriately disclosed.

If previous year financial year were audited by another auditor CA in practise ,then in the current year, the new auditor is not required to reaudit the previous financial statement. But obtain sufficient and appropriate audit evidence regarding MP plus read most recent financial statements.
If previous year financial year were unaudited then in the current year, the new auditor is not required to reaudit the previous financial statement .However ,he need to disclose this fact in his audit report in the other matters para plus read most recent financial statements.

Reporting requirements under SA 510

Audit Evidence Regarding opening balance	Reporting Responsibility
Available and material misstatement can be corrected	Issue unqualified report.
Available and material misstatement cannot be corrected/accounting policies not consistent or not properly disclosed	Issue qualify or adverse report.
Not Available and material misstatement cannot be corrected	Issue qualified or disclaimer report.

Questions from SA 510

1.You have been appointed as the auditor of Good Health Ltd for 2007-2008 which was audited by CA Trustworthy in 2006-2007.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 2007-2008 as Opening Balance and the opening Balance do not contain misstatements. Refer point 3.

2. In an initial audit engagement the auditor will have to satisfy about the sufficiency and appropriateness of 'Opening Balance ' to ensure that they are free from misstatements , which materially affect the current financial statements. Lay down the audit procedure, you will follow when financial statements are audited for the first time. If, after performing the procedure, you are not satisfied about the correctness of 'Opening Balances', what approach will you adopt in drafting your audit report?(Refer point 5)

SA 520
ANALYTICAL PROCEDURES

What are analytical procedures. For what purposes they can be used?

- ✓ **"Analytical procedures"** means evaluation of financial information through analysis of plausible relationships among financial and non- financial data.
- ✓ It refers to comparisons and ratio analysis(i.e analysis of significant ratios and trends.
- ✓ Comparison with-Prior period , budgets, similar industry information.
- ✓ Purposes of analytical procedures
  a)to assist auditor in planning NTE of other audit procedures.
  b)Investigating unusual fluctuations.
  c)analysis of significant ratios and trends.
  d)to be used as substantive procedures when there use can be more effective than test of details in reducing detection risk.

Auditor's objective w.r.t SA 520

- ✓ To obtain relevant and reliable audit evidence when using substantive audit procedure.
- ✓ To design and perform SAP near the end of audit.
- ✓ If there is unusual fluctuations, then make enquiry of the management and perform extended procedures(further investigation, obtain more explanations, more evidence.

Reliance on Analytical procedures.

- ✓ Depending upon materiality of items involved-if more materiality level, perform analytical procedure plus other substantive procedures ,if less material ,may rely solely on analytical procedures.
- ✓ Depending upon other inherent risk and control risk-more risk ,more reliance on comprehensive test of details and not solely on analytical procedures.
- ✓ Accuracy of results of analytical procedures.

Factors to be considered while performing Analytical Procedures:

- ✓ Suitability-Determine the suitability of particular substantive Analytical Review Procedure for a given assertion. **For example-in case of predictable relationships, analytical procedures is more suitable.**
- ✓ Reliability- **Reliability of data; source of information ,relevance of information, comparability of information.(Nov 2015)**
- ✓ Expectations-To develop an expectation of recorded amount and evaluate whether expectation is sufficiently precise to identify misstatement.
- ✓ Difference-Difference of recorded amounts from expected values i.e. acceptable without further investigation.

Questions on SA 520

1. What are the considerations to be kept in mind while performing analytical procedures?

2.In the audit of Hotel Great Hay Limited its Auditor wants to use the the analytical procedure as substantive procedure in respect of room rental income as well as payroll cost, guide him as to how it can be done.

Sol: 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, there by providing audit evidence for a significant item in the financial statements and reducing the need to perform test of details on the payroll.

In case of Room Rental Income of Hotel- Different types of AP provides different level of assurance. AP involves the prediction of total rental income in case of hotel taking the room tariff rates, the number of rooms and vacancy rates into consideration, can provide persuasive evidence and may eliminate the need of further verification by means of Test of Details, provided the elements are appropriately verified.

SA 530
AUDIT SAMPLING

MEANING

Audit sampling refers to application of Audit Procedures to less than 100% of the financial statements.

What is sampling risk? What are the types of sampling risk?/Risk factors to be kept in mind while applying sampling technique(May 2010)

Sampling risk-Risk that auditor's conclusion based on a sample is different from conclusion if entire population were subjected to same audit procedure .In other words,

Sampling Risk=Opinion based upon selected sample size-Opinion based on cent-percent financial statement/larger sample size.

Types of Sampling Risk

Arises in Test of Controls	Risk of over reliance and under reliance
Arises in Test of Details	Risk of incorrect rejection and incorrect acceptance

Risk	**Impact on opinion**
Under reliance and incorrect rejection	More audit work. Report not erroneous.
over reliance and incorrect acceptance	Erroneous report by the auditor

Methods of selection of sample size:

- ✓ Random selection/Non statistical-In this method, the sample size is selected on the professional judgement of auditor whereby every item would have equal chances of selection or deselect ion.
- ✓ Systematic selection/Statistical- In this method, the sample size is selected on the basis of various mathematical models. Example-Permutations and Combinations, Simulation model etc.
- ✓ **Haphazard Selection**
  - It is one which is adopted by the auditor in the cases where the sample does not follow a structured sampling.
  - Haphazard selection is not appropriate when using statistical sampling.
  - All items in a population should get a chance of being selected.

Some special points

- ✓ Tolerable error is the amount of error that is acceptable to the auditor in making a sample choice.
- ✓ Anomaly is the exceptional deviation or deviation that may be presented in the sample size selected for each audit.

- ✓ Perform audit procedures on each item selected. If the auditor is unable to do so, treat item as a deviation or misstatement in case of test of details. Investigate the nature and cause of deviation.

SA 540
AUDITING ACCOUNTING ESTIMATES , INCLUDING FAIR VALUE ACCOUNTING ESTIMATES AND RELATED DISCLOSURES

Types of Accounting Estimates

- ✓ Fair Value Accounting Estimates-Estimates where current transaction cost basis is used or Based on condition prevailing in market. **Examples -ESOP, Options, Futures, Financial Instruments.**
- ✓ Other Accounting Estimates-Every estimate other than Fair Value Accounting Estimate. **Example-Provision for Doubtful Debts, Warranty Obligations, Depreciation Method or Estimating Asset useful life, Expected life of Intangible Assets, Outcome of Long term Contracts, Provision for Contingent Liability.**

Duties of Auditor:

Auditor should obtain sufficient and appropriate accounting estimate that all estimates by management used in preparation and presentation of financial statements are

- ✓ Reasonable
- ✓ Disclosed properly as per FRF.

PTR: Inappropriate accounting estimate is a misstatement . Hence ,requirements of SA 450 will also apply.

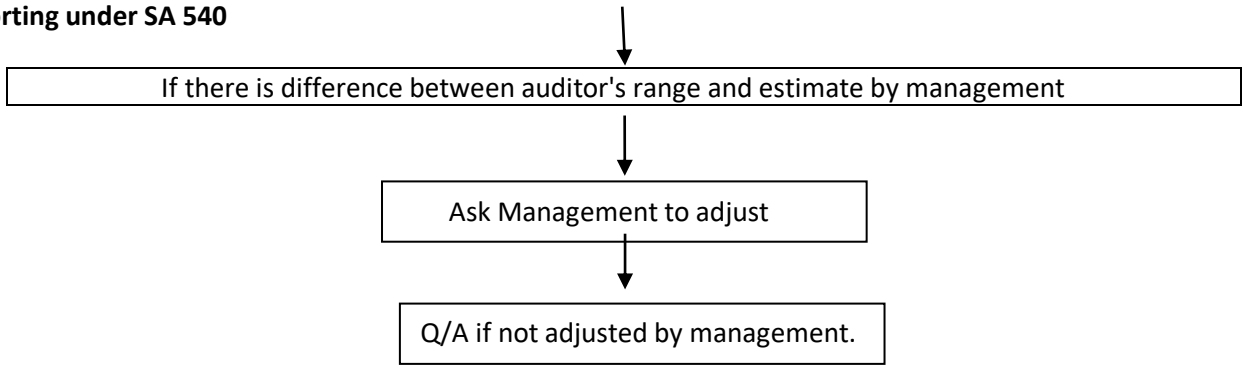
Procedures to be followed:

Risk Assessment Procedures	Further Audit Procedures
Understand the nature of entity business and the significance of use of estimate.	Auditor may apply his own audit procedures to get his point estimate and should compare with Management Point Estimate.
How Management identifies those transactions, events and conditions that may give rise to the need for accounting estimates to be disclosed .Make enquiry of management for the same.	Evaluate whether management has used an management expert under SA 500. The auditor may also use an expert under SA 620.
Evaluate process used by the management in making estimates(Assumptions used)	Consider consistency of estimation procedures applied by management. If changed , whether change is justified.
Auditor should confirm from management, how they ensure reliability of data used in estimates and methods and methods and assumptions used.	Evaluate reasonableness of accounting estimates, disclosures, obtain written representation.

Examples of indicators of possible management bias with respect to accounting estimates:

- ✓ **Changes in accounting estimate or the method for making it.**
- ✓ **Use of entity's own assumptions for fair value accounting estimates which is inconsistent with market assumptions.**
- ✓ **Selection of significant assumptions that yield a point estimate favourable for management objectives.**
- ✓ **Selection of a point estimate that may indicate a pattern of optimism or pessimism.**

Reporting under SA 540



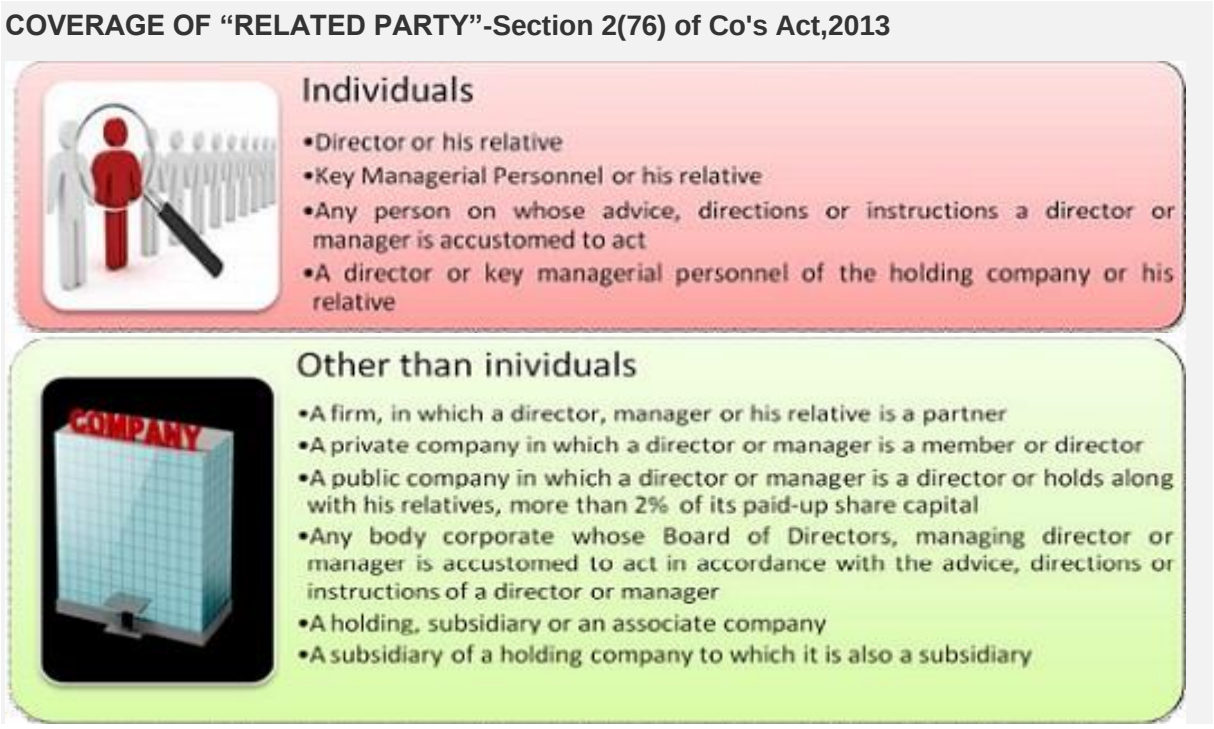
<u>Questions on SA 540</u>

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 will you minimize the risk of material misstatements.(May 2011/RTP Nov 2012)

- Duties of an auditor & Procedures to be followed.

2. With reference to the Standards of Auditing, state the examples of accounting estimates that may have a high estimation uncertainity.

SA 550
RELATED PARTIES



Related parties as per AS 18

a) Holding, subsidiary and co-subsidiary

b) Associates, joint ventures and co-venturers.

c) Individuals having control or significant influence over entity.

d)Key management personnel and their relatives.

e)Enterprises over which c & d have significant influence.

Elaborate how the Statutory Auditor can verify the existence of related parties for the purpose of reporting under Accounting Standard 18.

Verification of Existence of Related Parties:

As per 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.

Examples-

(i) Entity Income Tax Returns.

(ii) Information supplied by the entity to regulatory authorities.

(iii) Shareholder registers to identify the entity's principal shareholders.

(iv) Statements of conflicts of interest from management and those charged with governance.

(v) Records of the entity's investments and those of its pension plans.

(vi) Contracts and agreements with key management or those charged with governance. (vii) Significant contracts and agreements not in the entity's ordinary course of business.

(viii) Specific invoices and correspondence from the entity's professional advisors.

(ix) Life insurance policies acquired by the entity.

(x) Significant contracts re-negotiated by the entity during the period.

(xi) Internal Auditor's Report.

(xii)Documents associated with the entity's filings with a securities regulator (e.g., prospectuses)

(xiii) Minutes of meetings of shareholders and of those charged with governance.

(xiv) Such other records or documents as the auditor considers necessary in the circumstances of the entity.(MOA, AOA, Section 189 register, Annual Returns etc.

Identification of possible sources for Related Parties' information:

- ✓ 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.
- ✓ However, it is the management, which is primarily responsible for identification of related parties.
- ✓ The duties of an auditor with regard to reporting of related party transaction as required by Accounting Standard 18 "Related Party Disclosures" is given in SA 550.

Auditor Work/Responsibilities/Audit Procedures

- ✓ **To ensure compliance of Financial Reporting Framework and Co's Act as far as related to related parties.**
- ✓ **To obtain understanding of entity's Related Party's Transaction.**
- ✓ **Perform audit procedures to identify , assess & respond to Risk of material misstatement.**
- ✓ **To evaluate fraud risk factors in relation to related parties.**
- ✓ **To have an attitude of professional skepticism.**
- ✓ **Obtain Written Representation regarding all RPT's.**

- ✓ **Communicate to Those Charged With Governance all significant matters arising during the audit in relation to RPT's.**

Risk Assessment procedures and related activities

- ✓ **Obtain understanding of Entity's RPT and inquire from Management regarding : Changes in RP's from prior period, nature of relationship between entity and RP, Type of transaction entered.**
- ✓ **Enquire about internal controls adopted by the management for the identification, accounting and discloser of RPT's.**
- ✓ **During the audit, the auditor shall maintain professional scepticism that whether any instances are there showing the existence of RPT's or relationships that management has not previously identified or disclosed to the auditor.(How to identify discussed)**
- ✓ **The auditor shall share relevant information obtained about the entity's related parties with the other members of the engagement team.**
- ✓ **After applying all the above procedures if the auditor identifies fraud risk factors then the auditor designs and performs further Audit Procedures to obtain Sufficient and Appropriate Audit Evidence about assessed Risk of material misstatement associated with RPT's.**

AUDITOR'S REPORTING/RESPONSE TO ASSESSED RISKS

CASES	AUDITOR'S DUTY
1.When auditor identifies previously unidentified or undisclosed RPT's	✓ Communicate the same to Management and Those Charged With Governance. ✓ Request the management to disclose the same. If Management agrees to disclose: Unqualified Report If Management refuses to disclose: Modify the report and document reasons for refusal.
2.Where the contract is of abnormally high amount with related party/outside entity's normal course of business	✓ The auditor shall apply additional audit procedures in regards to contract terms, pricing, RPT, transaction, approval, authentication and disclosure. ✓ Inspect contracts/ agreements and evaluate transactions consistency with management explanation and disclosure as per FRF. ✓ Inspect fraud risk factors. ✓ IF found unreasonable, the auditor shall modify his audit report in accordance with SA 705.

<u>Questions from SA 550</u>

1. A Ltd .holds the ownership of 10% of voting power and control over the composition of BOD of B Ltd. While planning the statuary audit of A Ltd. what factors will be considered by you for audit of financial statements.(May 2015 exam)

- Holding subsidiary relation exists as A Ltd controls composition of BOD of B Ltd.
- Section 129-Consolidated financial statement must be prepared as per AS and Sch3.
- SA 550

- AS 18
- Section 188 if any transaction between them.
- Section 189.

2. JY & Co. is appointed as auditor of Breeze Ltd. JY & Co. seeks your guidance for reviewing the records and documentation of the company regarding 'related party transactions in the normal course of business'. Describe the steps to be followed.
Hint: Maintain alertness, Apply professional skepticism when reviewing records/documents**.**

3. Elaborate how the statuary auditor can verify the existence of related parties for the purpose of reporting under AS 18.

OR

In the course of audit of Q Ltd., its statuary auditor wants to be sure of adequacy of RPT's. Kindly guide the auditor in identifying the possible sources of RP information.

4. 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 it?(SA Background plus case no 2)

SA 560
SUBSEQUENT EVENTS

Briefly describe the auditor's responsibility regarding subsequent events.

- ✓ 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 realised.
- ✓ 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 favourable and unfavourable, that occur between the balance sheet date and the date on which the financial statements are approved.
- ✓ As per AS 4 only those events the contingency of which existed at the Balance Sheet Date can be adjusted. However the exceptions being
  - a)When the Going Concern is Effected
  - b)Proposed dividend.(The key point to remember is that proposed dividend do not require any adjustment under Revised Schedule 3).
- ✓ 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.

Audit procedures on subsequent events.

- ✓ The auditor shall 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 of, or disclosure in, the financial statements have been identified.
- ✓ Auditor's risk assessment in determining the nature and extent of such audit procedures, which shall include the following:
  - Obtaining an understanding of any procedures management has established to ensure that subsequent events are identified.
  - Inquiring of management and, where appropriate, those charged with governance as to whether any subsequent events have occurred which might affect the financial statements.
  - Reading minutes, if any, of the meetings, of the entity's owners, management and those charged with governance, that have been held after the date of the financial statements and inquiring about matters discussed at any such meetings for which minutes are not yet available.
  - Reading the entity's latest subsequent interim financial statements, if any.

Finally, When the auditor identifies events that require adjustment of, or disclosure in, the financial statements, the auditor shall determine whether each such event is appropriately reflected in those financial statements.

QUESTIONS:

1. As a statutory auditor of a company, comment on the following:

(a) A fire broke out on15th May, 2013, in which material worth ` 50 lakhs which was lying in inventory since 1st March, 2013 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, 2013-14, no provision for the loss needs to be made in the financial statements for 2012-13.

- 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 only those events the contingency of which existed at the Balance Sheet Date can be adjusted. However the exceptions being
  a)When the Going Concern is Effected
  b)Proposed dividend.
- As per SA 560 "Subsequent Events", the auditor should assure that all events occurring subsequent to the date of the financial statements and for which the applicable financial reporting framework 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 balance sheet date because as per AS 4.
- 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.(Because if it effects materially the going concern, adjustment is required.
- Thus, assuming that going concern concept is not violated, the company has correctly accounted by not providing provision. However, the auditor is required to ensure the proper disclosure of abovementioned event.

(iii) A Co. Ltd. has not included in the Balance Sheet as on 31-03-2014 a sum of ` 1.50 crores being amount in the arrears of salaries and wages payable to the staff for the last 2 years as a result of successful negotiations which were going on during the last 18 months and concluded on 30-04-2014. The auditor wants to sign the said Balance Sheet and give the audit report on 31-05- 2014. The auditor came to know the result of the negotiations on 15-05-2014. Comment

- Subsequent Events: This case requires attention to SA 560 "Subsequent Events", AS 4 "Contingencies and Events occurring after the Balance Sheet Date" and AS 29 "Provisions, Contingent liabilities and Contingent Assets".
- Condition existing on balance sheet date. Hence adjusting event as per As 4.
- However its a contingent liability. Hence provision to be made as per Para 68 of AS 29.
- Perform procedures prescribed under SA 560.

SA 570

GOING CONCERN

Important indicators which should be considered for evaluating the assumption of going concern.

Financial Indications ✓ Net liability or net current liability position. ✓ Fixed-term borrowings approaching maturity without realistic prospects of renewal or repayment; or excessive reliance on short-term borrowings to finance long-term assets. ✓ Indications of withdrawal of financial support by trade payables. ✓ Negative operating cash flows indicated by historical or prospective financial statements. ✓ Adverse key financial ratios. ✓ Substantial operating losses or significant deterioration in the value of assets used to generate cash flows.
Operating Indications ✓ Management intentions to liquidate the entity or to cease operations. ✓ Loss of key management without replacement. ✓ Loss of a major market, key customer(s), franchise, license, or principal supplier(s). ✓ Labour difficulties. ✓ Shortages of important supplies. ✓ Emergence of a highly successful competitor.
Other Indicators ✓ Change in government policies. ✓ Change in laws.

Responsibilities of Auditor under SA 570

- ✓ Consider events, conditions that may cast significant doubt on going concern. Also determine whether Management has performed assessment of entity available to consider as Going Concern.
- ✓ Maintain Professional Skepticism.
- ✓ Obtain Sufficient And Appropriate Audit Evidence-Review latest interim financial statement, Subsequent Events after Balance Sheet Date, Review BOD minutes, Budgeted Cash flow statement.
- ✓ Communicate to TCWG events/conditions that may cast significant doubt on entity's ability on Going Concern.
- ✓ Mitigatory Factors if present, auditor may include the matter in Emphasis Of Matter's Para.

Additional Audit Procedures when events or conditions are identified:

- ✓ When management has not yet performed an assessment of the entity's to continue as going concern, requesting management to make its assessment.
- ✓ Evaluating management's plans for future actions in relation to its going concern assessment, whether the outcome of these plans is likely to improve the situation and whether management's plans are feasible in the circumstances.
- ✓ When the entity has prepared a cash flow forecast, and analysis of the forecast is a significant factor in considering the future outcome of events or conditions in the evaluation of management's plans for future action:
  - Evaluating the reliability of the underlying data generated to prepare the forecast; and
  - Determining whether there is adequate support for the assumptions underlying the forecast.
- ✓ **Considering whether any additional facts or information have become available since the date on which management made its assessment.**

Reporting Responsibility as per SA 570

Going Concern Assumption	Auditor's Opinion
Appropriate	Unmodified Opinion
Questionable & Resolved by Management Explanation	Unmodified Opinion but disclose in EOM Para.
Questionable & Not Resolved by Management Explanation	Qualified Opinion
Inappropriate	Adverse Opinion.

PTR: (w.e.f. 1.4. 2017)

Material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern is itself a key audit matter but to be reported as per SA 570.

Questions on SA 570

1.ABC Company files a law suit against Unlucky Company for ` 5 crores. The Attorney of Unlucky Company feels that the suit is without merit, so Unlucky Company merely discloses the existence of the law suit in the notes accompanying its financial statements. As an auditor of Unlucky Company, how will you deal with the situation?

- **AS 29-Contingent Liability as per Para 68 since possible obligation not in control of enterprise.**
- **As per SA 570 "Going Concern", there are certain examples of events or conditions that, individually or collectively, may cast significant doubt about the going concern assumption. 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 is one of the example of such event.**
- **If the auditor finds the uncertainty, he may request the management to adjust the sum of 5 crore by making provision for expenses as per AS 29. If the management does not accept the request the auditor should qualify the audit report.**
- **Mention in Audit report since pending litigation as per Rule 11 of Company(Audit and Auditor) rules.**

2. R & Co. is the statutory auditor of S Ltd. For the financial year ended on 31st March 2014, 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.?

- **SA 200, Section 143(9)-Compliance with all SAs.**
- **Para 10 of AS 1-Going concern is a fundamental accounting assumption.**
- **SA 570 reporting responsibility .**
- **SA 600 since audit of branch. Section 143(8)**
- **SA 620 (May use work of auditor's expert.**

3.M/s TK Projects Ltd , a manufacturing company in the Steel industry was allegedly involved in some irregularity relating to allotment of coal blocks for which a complaint was lodged against the company by the government. The financial institution stopped additional working capital finance which caused a financial crisis resulting in stoppage of production. The company incurred a massive loss during the year 2014-2015 . There were delays in salary and other payments. Certain KMP including GM finance and certain other employees left the Company. The company has no sound action plan to mitigate these situations. Guide the statuary auditor on how he should deal with this situation.

- **Give adverse opinion as there are several indicators effecting going concern and there are no mitigatory factors present**

SA 580
WRITTEN REPRESENTATION

What is written representation?

A written statement by management provided to the auditor to confirm certain matters or to support other audit evidence. Financial statements, supporting books records, assertions do not constitute written representation.

Imp point-Written representation provide necessary audit evidence for the purpose of SA 500.However they do not provide sufficient and appropriate audit evidence .Auditor cannot form his opinion solely on written representation.

Some important points-

- ✓ As per Section 143 of Co. Act 2013,Audiors are required to report as to whether they have obtained information and explanation as may be necessary for purpose of audit evidence. WR is one of the ways of obtaining such information.
- ✓ Written Representation does not relieve the auditor of reporting responsibility .The auditor will have to perform Substantive Procedures irrespective of the fact that Written Representation has been received.
- ✓ If management does not provide WR, the responsibilities of auditor are as under
  - Discuss the matter with management.
  - Re-evaluate the integrity of the management and evaluate its potential effect.(If doubt about managements integrity or WR not provided, give disclaimer.)
  - Take possible actions. Also consider the effect on auditors opinion in audit report.(Disclaimer since WR not provided.)
  - Additionally not providing of WR will be regarded as limitations on auditors scope .The auditor shall communicate the same to TCWG as per SA 260.

- ✓ If Written Representation is inconsistent with other audit evidences obtained ,the auditor shall perform additional audit procedures to resolve the matter. If the matter remains unsolved , reconsider the reliability of WR. Example. Management provides Written Representation, that there are no frauds in organisation. Other evidences indicate existence of fraud.
- ✓ Its professional judgement of auditor to obtain WR. Some standards where WR to be obtained mandatorily in writing.
  (SA -250,SA-501,SA-505,SA-540,SA-550,SA-560,SA-570).

Basic elements of a Management Representation Letter

- ✓ It is a written statement provided to the auditor to confirm certain matter or to support other audit evidence.
- ✓ It does not include Financial Statements , assertions, or supporting books and records.
- ✓ The auditor should request Management to provide a Written Representation that it has fulfilled its responsibility for preparation of Financial Statement in accordance with applicable Financial Reporting Framework.
- ✓ Written Representation shall be for all Financial statements and periods referred to in Audit Report.
- ✓

Questions from SA 580

1. **Explain what is meant by WR and indicate to what extent an an auditor can place reliance on such representation.**
2. **State briefly the basic elements of Management Representation Letter.**
3. **In the course of audit of ABC Ltd, its management refuses to provide WR. As an auditor what is your duty?**
4. **An auditor of Mohan 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 machinery as appearing in the books of accounts. The auditor accepted the same without any further procedure and signed the audit report. Is he right in his approach?**
   - The auditor is not right in his approach. He is guilty of professional misconduct.
5. **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 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 atleast WR in respect of fraud by the company. For this request also, the management remained silent. Please guide Mr N.**
   - Applying SA 240 and SA 580, auditor is required to state the facts in his report and he should also disclaim an opinion on the financial statements.

SA 600
USING THE WORK OF ANOTHER AUDITOR

Another auditor is the person other than principal auditor of company. **example.** branch auditor, auditor of subsidiary.

Considerations by Principal Auditor.

- ✓ Before using the work of another auditor ,principal auditor should evaluate the competence of another auditor if he is not member of ICAI. However the principal auditor is not required to evaluate professional competence if that another auditor happens to be member of ICAI.
- ✓ Advice/May give directions in writing to other auditor regarding specific procedures/observations to be done.
- ✓ Obtain Sufficient And Appropriate Audit Evidence regarding the fact whether the work of the other auditor is sufficient for his purpose.
- ✓ May require him to furnish questionnaire and perform supplementary test.
- ✓ If there is modification in another auditor's report then, principal auditor should consider whether modification in his report is required.
- ✓ Obtain representation from the other auditor that significant accounting, auditing and reporting requirements have been complied.

The principal auditor should properly co-ordinate with another auditor i.e **there should be a sufficient liaison between the principal auditor and other auditor.** For this purpose, the principal auditor may find it necessary to issue written communication to the other auditor.

The other auditor should coordinate in the following manner:

- ✓ Adhering to time table.
- ✓ Bringing to the attention of principal auditor any significant finding.
- ✓ Compliance with relevant statuary requirements.
- ✓ Respond to detailed questionare.

Role of Principal Auditor (ABC & Associates- Auditor of Parent Company):

(i) It is necessary to issue written communication(s) as a principal auditor to the other auditor.

(ii) 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.

(iii) 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.

Role of Other Auditor (XYZ & Associates- Auditor of Subsidiary Company):

(i) 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.

(ii) He should ensure compliance with the relevant statutory requirements.

(iii) The other auditor should respond to the questionnaire on a timely basis sent by Principal Auditor.

There should be statement of division of responsibility showing to what extend to which financial statement of component audited by another auditor has been included in financial statement of entity.

As per **SA-705**,Principal auditor should modify his audit report if he can't use the work of another auditor or perform sufficient additional procedures.

Questions from SA 600

1.The statuary auditor of Holding company demands for working papers of auditors of subsidiary company of which you are auditor?

- **SA 230-working paper is property of auditor.**
- **SA 600-can use work of other auditor if due diligence exercises.**
- **clause 1 of part 1 of Second Schedule and SA 200-confidentiality requirement.**
- **ICAI clarification-auditor is not required to provide to client or other auditor access to working papers.**
- **Conclusion-The statuary auditor of holding cannot have access to working papers of auditor of subsidiary company. However he can ask certain questions about manner in which audit is conducted and other clarification.**

2. "There should be sufficient liaison between a principal auditor and other auditor's."Discuss the above statement and state in this context the reporting considerations, when the auditor uses the work performed by the other auditor's.

3. Describe the relevance of SA 600 while auditing consolidation of financial statements.(Responsibilities given in SA 600)

SA 610(Revised)
USING THE WORK OF INTERNAL AUDITOR

Scope :

SA 610 (Revised) does not apply if the entity does not have an internal audit function. Activities similar to those performed by an internal audit function may be conducted by functions with other titles within an entity. Some or all of the activities of an internal audit function may also be outsourced to a third-party service provider. Neither the title of the function, nor whether it is performed by the entity or a third-party service provider, are sole determinants of whether or not the external auditor can use the work of the function. Rather, it is the nature of the activities; the extent to which the internal audit function's organizational status and relevant policies and procedures support the objectivity of the internal auditors; competence; and systematic and disciplined approach of the function that are relevant. References in this SA to the work of the internal audit function include relevant activities of other functions or third-party providers that have these characteristics.

- ✓ ***Internal audit function*** – A function of an entity that performs assurance and consulting activities designed to evaluate and improve the effectiveness of the entity's governance, risk management and internal control processes;
- ✓ ***Direct assistance*** – The use of internal auditors to perform audit procedures under **the direction, supervision and review of the external auditor**. The external auditor may be prohibited by law or regulation from obtaining direct assistance from internal auditors;
- ✓ ***Relationship between SA 315 and SA 610 (Revised)*** – Many entities establish internal audit functions as part of their internal control and governance structures. Depending upon the factors discussed in point (e) below, the external auditor should also apply principles of SA 315 and SA 330 so that he would be able to use the work of the internal audit function in a constructive and complementary manner;

Factors that external auditor will consider before using the work of internal auditor: (Amended)*

- ✓ Extend to which internal auditor function's organisational status & relevant policies and procedures support objectivity of internal auditor.
- ✓ Level of competence of internal audit function.
- ✓ Whether the Internal Audit function applies a systematic & disciplined approach including quality control.

Further, the external auditor shall not use the work of the internal audit function if the external auditor determines that:

- ✓ *The function's organizational status and relevant policies and procedures do not adequately support the objectivity of internal auditors;*
- ✓ *The function lacks sufficient competence; or*
- ✓ *The function does not apply a systematic and disciplined approach, including quality control.*

Further the auditor will determine in what areas & to what extend work of internal auditor can be used (Depending on his judgement & assessed risk of

material misstatement , significance of threats, and the objectivity and independence of internal auditor.)

Before using the specific work of the internal Auditor, The external auditor shall ensure the following:

- ✓ Whether work was performed by internal auditors having adequate technical training and proficiency;
- ✓ Whether the work was properly supervised, reviewed and documented;
- ✓ Whether the internal auditor has obtained adequate audit evidence to draw reasonable conclusions;
- ✓ Whether the conclusions reached are appropriate in the circumstances and the reports prepared by the internal auditors are consistent with the results of the work performed;
- ✓ Whether the exceptions or unusual matters , if any, disclosed by the internal auditors are properly resolved.

Concept of Direct Assistance:

The statuary auditor has to determine whether direct assistance can be used i.e. to use work of the internal auditor under his direction, supervision and review. It is allowed when

- ✓ It is not prohibition by law or regulation
- ✓ There should be no significant threats to objectivity of Internal Auditor
- ✓ Internal auditor should be competent and capable

Further, he will determine the Nature, Time and Extent on which direct assistance can be taken.

Direct assistance is not advisable on the following:

- ✓ Matters involving Significant Judgements in Audit.
- ✓ Matters on which Risk of Material Misstatement is high.
- ✓ Matters in which Internal Auditor is already involved.
- ✓ When internal auditor is not objective, competent and capable**.**

Point to be noted- These SA does not deal with instances when individual internal auditors provide direct assistance to the external auditor in carrying out audit procedures.

<u>Questions from SA 610</u>

1.CA. Amboj , a practicing chartered accountant has been appointed as an internal auditor of Textile ltd. He conducted the physical verification of the inventory at the year end and handed over the report of such verification to CA. Kishore, the statuary auditor of the Company, for his view and reporting. Can CA. Kishore rely on such report?

- Refer factors that the external auditor will consider before using the work of internal auditor.
- Finally if the *auditor is satisfied about the appropriateness of the verification, he can rely on the report but if he finds that the verification is not in order, he has to decide otherwise. The final responsibility to express opinion on the financial statement remains with the statutory auditor.*

SA 620
USING THE WORK OF AUDITOR'S EXPERT

Auditor's Expert-An individual or organisation possessing expertise in a field other than accounting or auditing, whose work in that field is used by auditor to assist the auditor in obtaining SAAE. Auditors expert may be internal auditors expert or external auditors expert.

Evaluation of experts work-(ask u cid)

A-Assumptions to be used by the expert and their consistence with previous year.
S-Scope of experts work
K-Knowledge of expert in the particular field.
U-Understanding of experts work
C-Competence, Capability and Objectivity of expert.
C-Contents of expert's report and usefulness to the auditor.
I-Independence of expert and his relationship with client.
D-Data to be used by expert and its reliability.
Before using experts work auditor should also apply professional scepticism as per SA-200.

Can Experts name be included in auditor's report.
Yes , but only after prior consent of expert. However, auditor should indicate in audit report that such reference would not reduce auditors responsibility.

The following factors may suggest the need for more a detailed agreement than would otherwise be the case, or for the agreement to be set out in writing:

- ✓ The auditor's expert will have access to sensitive or confidential entity information.
- ✓ The respective roles or responsibilities of the auditor and the auditor's expert are different from those normally expected.
- ✓ Multi-jurisdictional legal or regulatory requirements apply.
- ✓ The matter to which the auditor's expert's work relates is highly complex.
- ✓ The auditor has not previously used work performed by that expert.
- ✓ The greater the extent of the auditor's expert's work, and its significance in the context of the audit.

Examples of matters for expert work (imp for case study)

OR

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?

- Valuation of complex financial instruments ,land and building, plant and machinery, jewellery, works of art, antiques, intangible assets, impaired assets and liabilities.
- Actuarial calculation of liabilities associated with insurance contracts or employee benifit plans.
- Estimation of oil and gas reserves.
- Valuation of environmental liabilities and site clean up costs

SA 700
FORMING AN OPINION AND REPORTING ON FINANCIAL STATEMENTS

SA-700 mainly deals with unmodified opinion and form and content of Independent Auditor's Report.

Unmodified opinion means that the entire financial statement has been prepared in accordance with applicable FRF.

SA 700 is in context of general purpose financial statements only. F/S under special purpose framework are dealt by SA 800 and 805.Also it does not deals with audit of particular financial statement out of complete set or any particular component of financial statement.

SA 700 requires that auditor shall form an opinion on whether the Financial Statements are prepared in all material respects as per applicable FRF. To form this opinion , auditor needs to conclude as to whether he has obtained **reasonable assurance** the financial statements as a whole are free from material misstatements, whether due to fraud or error. **As per SA 700, to conclude that reasonable assurance has been obtained , auditor shall consider**

a) If sufficient appropriate audit evidence has been obtained.
b) Whether uncorrected misstatements are material, individually or in aggregate and appropriate steps have been taken.
c) The results of evaluation in which auditor is required to evaluate **whether financial statements are prepared in accordance with applicable FRF by evaluating:**
- Significant policies selected and applied are adequately disclosed.
- Accounting policies so selected and applied are consistent with framework requirements.
- Management's estimates are reasonable.
- Financial statements fulfil qualitative requirements i.e. relevance, reliability, understand ability, comparability etc.
- Adequate disclosures has been made.
- Terminology used , including the title of financial statements is appropriate.

Contents of Audit Report

Title	For example; Independent Auditor's Report".
Addressee	Audience for whom addressed.
Auditor's Opinion	***The first section of the auditor's report shall include the auditor's opinion, and shall have the heading "Opinion."*** ***The Opinion section of the auditor's report shall also:*** - Identify the entity whose financial statements are audited - State that financial statements have been audited

	- Identify the title of financial statements that comprise complete set of F/S - Refer to the summary of important policies and other explanatory information - Specify the time period covered by audited F/S
Basis for Opinion:	***The auditor's report shall include a section, directly following the Opinion section, with the heading "Basis for Opinion", that:*** ***(a) States that the audit was conducted in accordance with Standards on Auditing;*** ***(b) Refers to the section of the auditor's report that describes the auditor's responsibilities under the SAs;*** ***(c) Includes a statement that the auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit, and has fulfilled the auditor's other ethical responsibilities in accordance with these requirements. The statement shall refer to the Code of Ethics issued by ICAI;*** ***(d) States whether the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's opinion.***
Going Concern	***Where applicable, the auditor shall report in accordance with SA 570.***
Key Audit Matters	***For audits of complete sets of general purpose financial statements of listed entities, the auditor shall communicate key audit matters in the auditor's report in accordance with SA 701.*** ***When the auditor is otherwise required by law or regulation or decides to communicate key audit matters in the auditor's report, the auditor shall do so in accordance with SA 701.***
Management's Responsibility	- Preparation of F/S as per FRF - Giving WR that Mgt is responsible for same - Designing and Implementation of internal control
Auditor's Responsibility	- Express opinion on F/S - Compliance with SA
Location of the description of the auditor's responsibilities for the audit of the financial statements.	
Other reporting responsibilities	
Signature of the Auditor	

SA 701
COMMUNICATING KEY MATTERS IN THE INDEPENDENT AUDTOR'S REPORT

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

The purpose of communicating key audit matters is to enhance the communicative value of the auditor's report by providing greater transparency about the audit that was performed.

Communicating key audit matters is not a substitute for modified opinion or substitute for reporting in accordance with SA 570 .

The auditor should take into account the following factors while determining key audit matters

- ✓ Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with SA 315.
- ✓ Highly uncertain management estimates.
- ✓ The effect of the audit of significant events or transactions that occurred during the period.

The auditor shall not communicate a matter in the Key Audit Matters section of the auditor's report when the auditor would be required to modify the opinion in accordance with SA 705(Revised) as a result of the matter.

Examples of Key audit matters but not to be reported as key audit matters-A matter giving rise to modified opinion in accordance with SA 705 (Revised), or a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with SA 570.

SA 705
MODIFICATIONS TO THE OPINION IN THE INDEPENDENT AUDITOR'S REPORT

Nature of matter giving rise to modification	Auditor's Judgement 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
Inability to obtain sufficient and appropriate audit evidence	Qualified opinion	Disclaimer of opinion

Note- Most of the time auditor is not able to obtain SAAE due to :

- ✓ **Limitations imposed by circumstances**
- ✓ **Limitations imposed by management**

Drafting of Qualified Opinion

"In our opinion and to the best of information and explanation given to us, except for the matter described in Basis of Qualified Opinion paragraph, the financial statement reflect a true and fair view.

Drafting of Disclaimer of Opinion Para

"Because of the significance of 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 financial statements.

OR

In our opinion, because of significance of matter discusses in the Basis for Adverse Opinion paragraph, the consolidated F/S do not give a true and fair view in conformity with the accounting principles generally accepted in India.

Note- Before drafting the qualified/disclaimer para , the auditor must prepare a Basis for Qualified/Disclaimer opinion drawing the intention of users of F/S towards the reason of giving Q/D.

New principles w.e.f. 1.4.2017

Unless required by law or regulation, when the auditor disclaims an opinion on the financial statements, the auditor's report shall not include a Key Audit Matters section in accordance with SA 701.

<u>Questions from SA 705</u>

1. Discuss the various aspects to be considered by the statuary auditor before qualifying the report.

Or

What are the features of a qualified audit report.

Or

When should an auditor make a disclaimer opinion in his Audit Report?

Or

Under the applicable Standards on Auditing, in what circumstances does the report of statuary auditor require modifications? What are the types of modification possible to the said report?

SA 706
EMPHASIS OF MATTER PARAGRAPHS AND OTHER PARAGRAPHS IN THE INDEPENDENT AUDITOR'S REPORT

Emphasis of Matter paragraph: If the auditor considers it necessary to draw user's attention to matter presented or disclosed in the financial statements that in the auditor's judgment, is of such matter that it is fundamental to user's understanding of the F/S, the auditor shall include an EOM para provided that Auditor is not required to modify the opinion and the matter has not been determined as a key audit matter.

Examples of emphasis of matter which may have an adverse effect on the functioning of the company :

- Factors leading to material uncertainty that may cast a significant doubt the company's ability to continue as going concern;
- Material uncertainty regarding the outcome of a litigation;

Examples of emphasis of matter which may not have an adverse effect on the functioning of the company

- Excess managerial remuneration paid;
- Accrual of a contractually receivable claim based on management estimate where the ultimate realisation could be different from the amount accrued;
- On frauds that have been dealt with in the financial statements of the company and would not have any continuing effect on the financial statements.

Drafting of Emphasis of matter Para
"Without qualifying our opinion we draw attention to Note x of Schedule.....to the financial statement. The entity is
.....

Other matters Para- If the auditor considers it necessary to draw user's attention to matter other than those presented or disclosed in the financial statements that in the auditor's judgment, is of such matter that it is fundamental to user's understanding of the F/S, the auditor shall include an OM para provided: this is not prohibited by law and the matter has not been determined as a key audit matter

If the auditor expects to include an EOM or an Other Matter paragraph in the auditor's report, the auditor shall communicate with TCWG regarding this expectation and the proposed wording of this paragraph.

SA 710
COMPARATIVE INFORMATION-CORRESPONDING FIGURES AND COMPARATIVE FINANCIAL STATEMENTS

Differentiate between comparative financial statements and corresponding figures.

Comparative financial statements	Corresponding figures
1.Amounts and other disclosures for prior period are not integral part of current period financial statement. 2.The information included is merely comparable with financial statement of current period.	1.Amounts and other disclosures for prior period are integral part of current period financial statement. 2.The information included is to be read with the financial statement of current period.

Reporting Requirement-Corresponding figures

Previous Auditor's Report	Current Year Report	Auditor's Responsibility
Unmodified	Unmodified	Don't refer to corresponding figures
Modified	Unresolved	Modify. If modified but resolved auditor can include it in EOM Para.
Existence of material misstatement	Finds SAAE regarding same	Modify.
Unaudited/Audited by another Auditor		State In Other Matter Para

Auditor's responsibilities/ duties for reporting of comparatives under SA-710.(May 2010)

A. Obtain SAAE whether corresponding figures meet requirement of FRF .This involves assessing whether
   - Accounting policies are consistent
   - Whether corresponding figures agree with prior period figures.

- Appropriate adjustments/disclosures has been made.

B .If there is doubt of Material Misstatement in comparative information

- Apply Professional scepticism as per Sa 200
- Obtain SAAE regarding existence of material misstatement as per SA-500.

C .If prior period financial statement has been audited by another auditor/unaudited

- Apply SA 510 to audit of opening balances.
- State in Other Matters PARA .

If prior period financial statement has been audited by the auditor himself, apply SA-560"Subsequent Events also".

Questions from SA 710

1. Write short note on: Corresponding Figures.

2. What are the auditor's responsibilities in respect of corresponding figures?

3. The audit report of P Ltd. for the year 2014-15 contained a qualification regarding non-provision of doubtful debts. As the statuary auditor of the company for the year 2014-15 , how will you report, if:

a) The company does not make provision for doubtful debts in 2015-16?

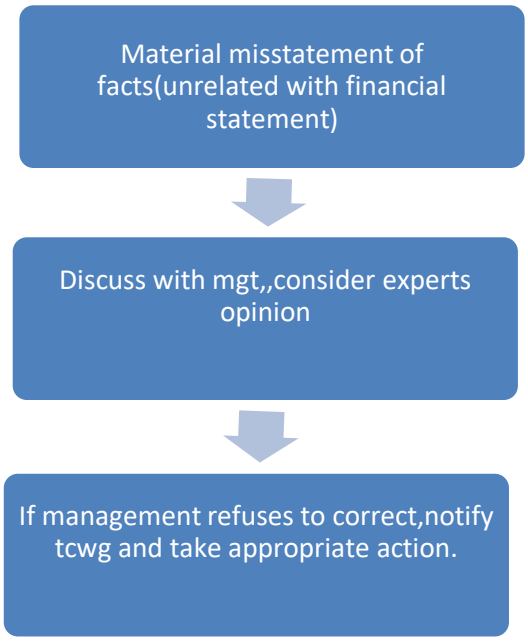
b) The company makes adequate provision for doubtful debts in 2015-15?

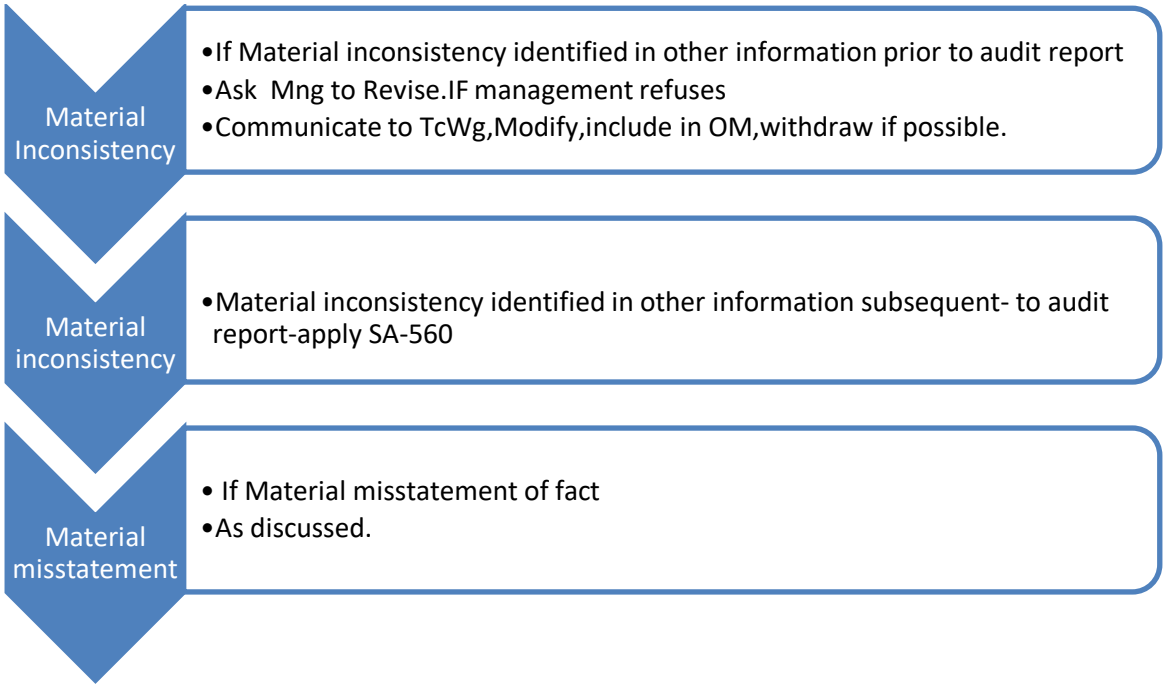
HINT:

a) If P Ltd. does not make PDD the auditor will have to modify his report .

b) The auditor need not refer to earlier year's modification.

SA 720
THE AUDITOR'S RESPONSIBILITY IN RELATION TO OTHER INFORMATION IN DOCUMENTS CONTAINING AUDITED FINANCIAL STATEMENTS





SA 800
SPECIAL CONSIDERATIONS- AUDIT OF F.S. PREPARED IN ACCORDANCE WITH SPECIAL PURPOSE FRAMEWORKS

SA 800 deals with audit condiderations for a particular purpose . example-loan agreement/projectreport.

Before accepting such engagement, assure(PIA):

- ✓ Purpose for which financial statement is prepared
- ✓ Intended user
- ✓ Acceptance of FRF(SA-210)

Form and Content of Audit Report.

- ✓ SA-700
- ✓ Purpose for which financial statement is prepared
- ✓ Intended user
- ✓ Acceptance of FRF(SA-210)
- ✓ Alert users -Include in Emphasis of Matter Para alerting users of audit report that financial statement are prepared in accordance with special purpose framework.

Audit Procedures to be followed while planning and performing an audit.

- ✓ Obtain understanding of entity's selection and application of accounting policies.
- ✓ Compliance with SA's relevant for audit.
- ✓ Alert users -Include in Emphasis of Matter Para alerting users of audit report that

financial statement are prepared in accordance with special purpose framework.

May 2015 Exam
Q. The financial statements of TC & Co. have been prepared by Management of an Entity in accordance with Financial Reporting Provisions of a Contract (that is, a Special Purpose Framework) to comply with the provisions of the contract. Based on the contact, the Management does not have a choice of FRF.As an Auditor what considerations would be taken while planning and performing audit.?

SA 805
SPECIFIC CONSIDERATIONS-AUDIT OF SINGLE PURPOSE FINANCIAL STATEMENT AND SPECIFIC ELEMENTS, ACCOUNTS OR ITEMS OF FINANCIAL STATEMENT

Single financial element means specific element of a financial statement .example cash flow, profit and loss account.

Before accepting assignment assure

- ✓ Purpose for which financial statement is prepared
- ✓ Intended user
- ✓ Acceptance of FRF(SA-210)

If the auditor is unable to comply with the standards of auditing relevant for his audit purpose, he shall not accept engagement.

The auditor should Include in Emphasis of Matters Para alerting users that it is the audit of single purpose financial statement/specific item and not the audit of entire financial statements.

SA- 810
ENGAGEMENT TO REPORT ON SUMMARY FINANCIAL STATEMENT

Summary financial statement-It is the historical financial information derived from the financial statement but contains less details than financial statement.

Before accepting assignment/audit procedures

- ✓ Purpose for which financial statement is prepared
- ✓ Intended user
- ✓ Acceptance of FRF(SA-210)
- ✓ Whether applied criteria is acceptable and properly disclosed.

Ensure that available financial statements are available to intended users without undue difficulty.

This assignment may be accepted only by the auditor who conducted a audit of Annual financial statement.

SRS 4400-Engagement to perform agreed upon procedures	SRS 4410-Engagement to compile financial information	SRE 2400-REview of financial statements.
Auditor carries out agree upon procedures to report on factual findings.	The accountant issues a compilation report.	The practitioner(CA other than CA of the client) reviews the financial statements.
Procedures- • Inquiry • Recomputation, • Analysis • Observation • Confirmation. • Report on agreed upon procedures must describe the purpose and agreed upon procedures in sufficient details to enable the reader to understand the nature and extend of work performed.	• Obtain WR from Management (mgt responsibility accuracy of accounting data and disclosure) • Non compliance with AS-Tell Management-If not rectified-Include in notes to accounts and compilation report. • However in case of misstatement ,if management refuses to amend financial information/compiled information and f/s are misleading-Withdraw. • If information supplied is incomplete ,incorrect then- a)enquire from management b)assess internal control c)verify explanation	• Obtain evidence by 2 ways-Enquiry and ARP. • Follow SQC. • Ethical norms(Objectivity, Independence, Confidentiality and Professional care) • Planning and knowledge of entity's business. • Documentation-To support review report &To comply Professional Standards. • While giving assurance ,the word negative/moderate assurance will be used(Nothing has come in the practitioner

	d)obtain WR.	knowledge which states that f/s is not true and fair.)
Common for all 3 Contents of Audit Report • Title • Addressee • Management Responsibility • Relevant Auditing Standards have been followed. • Audit is not carried out. • Departures from FRF • Date of Report • Place • Signature • If not independent, disclose the fact. • Without reference-do not refer it as audit report. • Fees-Fees not to be described as Audit Fees.		SRE 2410-Review of Interim Financial Information • Negative assurance. • Follow SQC. • Enquiry, Analytical Review Procedure. • Ethical norms • Key point-to be done by the independent auditor of client.

Questions from SRE 2400

1. You are required to review the system and the information generated from the financial statements. Discuss the detailed procedures(general points only) that may be performed by you as a company auditor for review of financial statements.

- ✓ **Discuss terms of engagement with client and engagement team.**
- ✓ **Prepare an engagement letter deciding scope of engagement.**
- ✓ **Understanding of entity's business and system for recording financial information.**
- ✓ **Obtain Written Representation from Management.**
- ✓ **Perform Analytical Procedures.**
- ✓ **Reading minutes of Shareholders, Board of Directors.**
- ✓ **Obtain financial statements and discuss them with management.**
- ✓ **Inquire about- RPT's, Contingencies and Commitments, Plans to dispose off major segments/assets.**

Questions from SRS 4410

1. 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.

- ✓ **Persuade mgt to carry out amendment and if amendments not made and F/S are misleading, accountant should withdraw from engagement.**
- ✓ **Guidance note on tax audit-Stock Auditor should study procedure of taking closing stock and valuation, and tax auditor should examine basis adopted for ascertaining the cost and whether its consistently followed.**
- ✓ **In this Q, appointment was made to compile financial statements for tax audit . Its the duty to ensure method followed for valuation of stock results in disclosure of correct profit and gains. Therefore, contention of Y & Co. is not correct.**

2. Write a short note on Reporting on a compilation engagement.

- ✓ **Contents of Audit Report.**

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.

- ✓ **Make enquiries of Mgt, Assess Internal Control, Verify matters or explanations.**
- ✓ **Obtain additional information , may be by Written Representation.**
- ✓ **If Mgt refuses to give additional information, withdraw from engagement , stating entity reasons for withdrawal.**
- ✓ **If one or more accounting standards are not complied with, same should be brought to notice of the management and if same is not rectified, accountant should include the same in notes to accounts and the compilation report to the management.**

SAE 3400
THE EXAMINATION OF PROSPECTIVE FINANCIAL INFORMATION

Factors to be considered before accepting the audit engagement and what audit evidence will be obtained for reporting on projected financial statements?

Projected Financial Statements:
As per SAE 3400, "The Examination of Prospective Financial Information", the answer is divided into two parts i.e.
(i) the things to be considered before accepting the engagement and
(ii) audit evidence to be obtained for reporting on projected financial statements.

Acceptance of Engagement: As per SAE 3400, "The Examination of Prospective Financial Information", before accepting an engagement to examine prospective financial information, the auditor would consider, amongst other things:

- ✓ the intended use of the information;
- ✓ whether the information will be for general or limited distribution;
- ✓ the nature of the assumptions, that is, whether they are best-estimates or hypothetical assumptions;
- ✓ the elements to be included in the information; and
- ✓ the period covered by the information.

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 nature, timing and extent** of examination procedures performed, and,

In case the auditor **expresses a modified** opinion or withdraws from the engagement, the reasons forming the basis of such decision.

Contents of Report on examination of Prospective Financial Information

- ✓ Title.
- ✓ Addressee
- ✓ Identification of PFI
- ✓ Reference to this standard
- ✓ Statement that management is responsible for its preparation.
- ✓ When applicable, a reference to the purpose and for restricted distribution of PFI.
- ✓ Statement supporting assumptions, amounts and other disclosures in PFI
- ✓ Statement of negative assurance as to whether assumptions provide a reasonable basis for PFI.
- ✓ Opinion as to whether PFI is properly prepared on the basis of assumptions and presented as per relevant FRF.

SAE 3420

ASSURANCE ENGAGEMENTS TO REPORT ON THE COMPILATION OF PRO FORMA FINANCIAL INF0RMATION INCLUDED IN A PROSPECTUS

- **Scope:** This SAE applies when:
  - (i). Such reporting is required by securities law or the regulation of the securities exchange ("relevant law or regulation") in the jurisdiction in which the prospectus is to be issued; or
  - (ii). This reporting is generally accepted practice in such jurisdiction.
- **Non applicability:**
  - (i). This standard does not deal with circumstances where pro forma financial information is provided as part of the entity's financial statements pursuant to the requirements of an applicable financial reporting framework.
  - (ii). This SAE does not deal with non-assurance engagements in which the practitioner is engaged by the entity to compile its historical financial statements.
- **Definitions:**
  1. *Applicable criteria* – The criteria used by the responsible party when compiling the pro forma financial information. Criteria may be established by an authorized or recognized standard-setting organization or by law or regulation. Where established criteria do not exist, they will be developed by the responsible party.
  2. *Pro forma adjustments* – In relation to unadjusted financial information, these include:
     - (i). Adjustments to unadjusted financial information that illustrate the impact of a significant event or transaction if the event had occurred or the transaction had been undertaken at an earlier date selected for purposes of the illustration; and
     - (ii). Adjustments to unadjusted financial information that are necessary for the pro forma financial information to be compiled on a basis consistent with the applicable financial reporting framework of the reporting entity and its accounting policies under that framework.
  3. *Pro forma financial information* – Financial information shown together with adjustments to illustrate the impact of an event or transaction on unadjusted financial information as if the event had occurred or the transaction had been undertaken at an earlier date selected for purposes of the illustration. In this SAE, it is presumed that pro forma financial information is presented in columnar format consisting of:
     - a. the unadjusted financial information;
     - b. the pro forma adjustments; and
     - c. the resulting pro forma column.
  4. *Prospectus* – A document issued pursuant to legal or regulatory requirements relating to the entity's securities on which it is intended that a third party should make an investment decision.
  5. *Published financial information* – Financial information of the entity or of an acquiree or a divestee that is made available publicly.

6. *Unadjusted financial information* – Financial information of the entity to which pro forma adjustments are applied by the responsible party.

- **Nature of the Practitioner's Responsibility:** In an engagement performed under this SAE, the practitioner has no responsibility to compile the pro forma financial information for the entity; such responsibility rests with the responsible party. The practitioner's sole responsibility is to report on whether the pro forma financial information has been compiled, in all material respects, by the responsible party on the basis of the applicable criteria.
- **Assessment of unadjusted financial information and pro forma financial information:** The practioner should assess the appropriateness of these information on the basis of following factors:
  (a) Source of such information - the extent to which it can be relied upon;
  (b) Whether such financial information is factually supportable;
  (c) Consistency with the entity's applicable financial reporting framework and its accounting policies under that framework;
  (d) Determine whether the calculations within the pro forma financial information are arithmetically accurate.
- **Purpose of Pro Forma Financial Information Included in a Prospectus:** The purpose of pro forma financial information included in a prospectus is solely to illustrate the impact of a significant event or transaction on unadjusted financial information of the entity as if the event had occurred or the transaction had been undertaken at an earlier date selected for purposes of the illustration. This is achieved by applying pro forma adjustments to the unadjusted financial information. Pro forma financial information does not represent the entity's actual financial position, financial performance, or cash flows.

  For example, the entity may acquire a number of businesses prior to an initial public offering. In such circumstances, the responsible party may choose to present a pro forma net asset statement to illustrate the impact of the acquisitions on the entity's financial position and key ratios such as debt to equity as if the acquired businesses had been combined with the entity at an earlier date. The responsible party may also choose to present a pro forma income statement to illustrate what the results of operations might have been for the period ended on that date. In such cases, the nature of the pro forma financial information may be described by titles such as "Pro Forma Balance Sheet as at March 31, 20X1" and "Pro Forma Statement of profit and loss for the Year Ended March 31, 20X1."
- **Compilation of Pro Forma Financial Information:** The compilation of pro forma financial information involves the responsible party gathering, classifying, summarizing and presenting financial information that illustrates the impact of a significant event or transaction on unadjusted financial information of the entity as if the event had occurred or the transaction had been undertaken at the selected date. Steps involved in this process include:
  (a) Identifying the source of the unadjusted financial information to be used in compiling the pro forma financial information, and extracting the unadjusted financial information from that source;
  (b) Making pro forma adjustments to the unadjusted financial information for the purpose for which the pro forma financial information is presented; and
  (c) Presenting the resulting pro forma financial information with accompanying disclosures
- **Nature of Reasonable Assurance Engagement:** A reasonable assurance engagement to report on the compilation of pro forma financial information involves performing the procedures set out in this SAE to assess whether the "applicable criteria" used by the responsible party in the compilation of the pro forma financial information provide a reasonable basis for presenting the significant effects directly attributable to the event or transaction, and to obtain sufficient appropriate evidence about whether:
  (a) The related pro forma adjustments give appropriate effect to those criteria; and
  (b) The resulting pro forma column reflects the proper application of those adjustments to the unadjusted financial information.

It also involves evaluating the overall presentation of the pro forma financial information. The engagement, however, does not involve the practitioner updating or reissuing any reports or opinions on any historical financial information used in compiling the pro forma financial information, or performing an audit or review of the financial information used in compiling the pro forma financial information.

- **Relationship with Other Professional Pronouncements:** During the course of this engagement, the practitioner should:
  (a) Comply with the independence and other requirements of the Code of Ethics, issued by the Institute of Chartered Accountants of India; and
  (b) Implement quality control procedures that are applicable to the individual engagement.
- **Presentation of pro forma financial information:** The practitioner shall evaluate the presentation of the pro forma financial information. This shall include consideration of:
  (a) The overall presentation and structure of the pro forma financial information, including whether it is clearly labeled to distinguish it from historical or other financial information;
  (b) Whether the pro forma financial information and related explanatory notes illustrate the impact of the event or transaction in a manner that is not misleading;
  (c) Whether appropriate disclosures are provided with the pro forma financial information to enable the intended users to understand the information conveyed; and
  (d) Whether the practitioner has become aware of any significant events subsequent to the date of the source from which the unadjusted financial information has been extracted that may require reference to, or disclosure in, the pro forma financial information.
- **Written Representations:** The practitioner shall request written representations from the responsible party that:
  (a) In compiling the pro forma financial information, the responsible party has identified all appropriate pro forma adjustments necessary to illustrate the impact of the event or transaction at the date or for the period of the illustration; and
  (b) The pro forma financial information has been compiled, in all material respects, on the basis of the applicable criteria.
- **Forming the Opinion:** The practitioner shall form an opinion on whether the pro forma financial information has been compiled, in all material respects, by the responsible party on the basis of the applicable criteria. In order to form that opinion, the practitioner shall conclude whether the practitioner has obtained sufficient appropriate evidence about whether the compilation of the pro forma financial information is free from material omissions, or inappropriate use or application of a pro forma adjustment. That conclusion shall include an evaluation of whether the responsible party has adequately disclosed and described the applicable criteria to the extent that these are not publicly available.
  (a) *Unmodified Opinion:* If pro forma financial information has been compiled, in all material respects, by the responsible party on the basis of the applicable criteria.
  (b) *Modified Opinion – Qualified/ Adverse/ Disclaimer/ EOM, as the case may be:* If pro forma financial information has not been compiled, in all material respects, by the responsible party on the basis of the applicable criteria.

  But where the relevant law or regulation precludes (i.e. does not permit) publication of a prospectus that contains a modified opinion with regard to whether the pro forma financial information has been compiled, in all material respects, on the basis of the applicable criteria and the practitioner concludes that a modified opinion is nevertheless appropriate in accordance with the Framework for Assurance Engagements, the practitioner shall discuss the matter with the responsible party. If the responsible party does not agree to make the necessary changes, the practitioner shall:

  (i). Withdraw from the engagement; or

(ii). Consider seeking legal advice.

- **Factors to be considered before accepting such assurance engagement:**
  - (a) His capabilities and competence;
  - (b) Determine that the applicable criteria are suitable and that it is unlikely that the pro forma financial information will be misleading for the purpose for which it is intended;
  - (c) Where the sources from which the unadjusted financial information and any acquiree or divestee financial information have been extracted have been audited or reviewed;
  - (d) If the entity's historical financial information has never been audited or reviewed, consider whether the practitioner can obtain a sufficient understanding of the entity and its accounting and financial reporting practices to perform the engagement;
- **Basic Elements of such assurance report:**
  - (a) Title;
  - (b) Addressee;
  - (c) Introductory Paragraph identifying the pro forma financial information, nature of the unadjusted financial information, and applicable criteria on the basis of which the responsible party has performed the compilation of the pro forma financial information;
  - (d) A statement that the responsible party is responsible for compiling the pro forma financial information on the basis of the applicable criteria;
  - (e) Description of the practitioner's responsibilities clearly specifying that the practitioner does not provide any assurance that the actual outcome of the event or transaction at that date would have been as presented;
  - (f) A statement that the engagement was performed in accordance with SAE 3420, '*Assurance Engagements to Report on the Compilation of Pro Forma Financial Information Included in a Prospectus'*,
  - (g) Statements that:
    - (i). the applicable criteria used by the responsible party in the compilation of the pro forma financial information provide a reasonable basis for presenting the significant effects directly attributable to the event or transaction,
    - (ii). the procedures selected depend on the practitioner's judgment, having regard to the practitioner's understanding of the nature of the entity, the event or transaction in respect of which the pro forma financial information has been compiled, and other relevant engagement circumstances; and
    - (iii). The engagement also involves evaluating the overall presentation of the pro forma financial information
  - (h) *Opinion paragraph:* Unless otherwise required by law or regulation, the practitioner's opinion using one of the following phrases, which are regarded as being equivalent:
    - (a) The pro forma financial information has been compiled, in all material respects, on the basis of the [applicable criteria]; or
    - (b) The pro forma financial information has been properly compiled on the basis stated;

    The relevant law or regulation in some jurisdictions may prescribe the wording of the practitioner's opinion in terms other than those specified above
  - (i) Signature;
  - (j) Date and Place