

10+ years of experience! Unbeatable Passion for Audit Subject!!! That's CA Pragnesh Kanabar Sir!

Brahmastra Revision CA Inter Audit- New Syllabus- ALL SAs

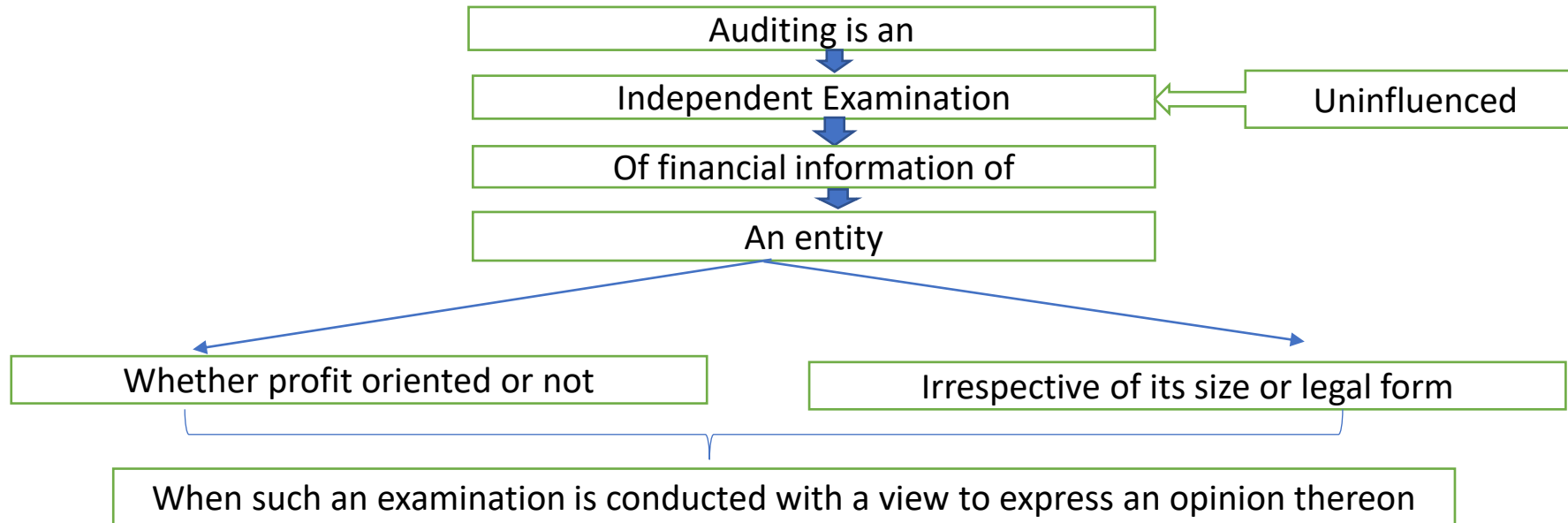
Chapter 1, 2, 3, 4, 6, 7, 8, 11 of CA Inter Audit New Syllabus

**(My sequence of teaching is different but by the end of all slides all chapters
as per module will be covered)**

**Watch Revision Videos on our Youtube Channel- The Audit Academy
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Definition of Audit



Person Conducting audit is expected to: (4 marks)

BOA's TACOS

- BOA- Check Entries in the Books of Accounts
- T- FS Show a True and Fair View of P/L and Assets & Liabilities
- A- AS have been followed
- C- Clear information Conveyed
- O- none of the entries have been Omitted
- S- Supported by sufficient and appropriate audit evidence



Preparation and Presentation of Financial Statements is the responsibility of management including those charged with governance (tcwg)

Prevention and detection of fraud and error is the primary responsibility of management including tcwg

Auditor's primary duty is to form and express an opinion on the financial statements being audited

Auditor needs to maintain an attitude of professional skepticism (questioning mind/maintaining alertness) while planning and performing an audit.

After reasonable verification auditor may consider the documents and records of the auditee as genuine unless there are reasons to believe the contrary.

Auditor can be held liable for fraud in the financial statements only if it is proved that he was grossly negligent in the conduct of his duties

As per SA 200- 'Overall Objectives of Independent auditor and conduct of audit in accordance with SAs

The overall objectives of the auditor are

To obtain **Reasonable assurance**

To report on the financial statements as required by SAs

Whether FS as a whole are **free from material misstatements**

Whether FS are in accordance with **Applicable Financial Reporting Framework**

in accordance with auditor's findings

Reasonable Assurance means auditor is providing a high level of trust (assurance) through his opinion but his opinion is not a guarantee (absolute assurance). Auditor cannot provide guarantee because audit suffers from some unavoidable (inherent) limitations. (MODULE TYU- 1)

Free from material misstatement- means FS should be free from significant/large errors

Applicable Financial reporting Framework- means the set of guidelines based upon which entity has to prepare their FS

Professional Skepticism Examples- 4 marks- Ch 11 Concept from module

It means **maintaining alertness** and a **questioning mind**.

Auditor shall **consider the documents as genuine UNLESS there are reasons/evidence to believe otherwise**

Auditor shall **maintain such attitude throughout the audit**

Examples of maintaining an attitude of professional skepticism- (**Contradict FAR**)

Contradict- Audit evidence that **contradicts** other evidence

R- Information that creates doubt over **reliability** of documents

F- Conditions that indicate possible **fraud**

A- Additional procedures to be performed in case of doubt

It means **coverage** of audit- how many areas auditor needs to cover in order to achieve his objective?

Scope of audit of FS is governed by **applicable laws, SAs** issued by the ICAI and the **terms of engagement** as agreed with the client.

Scope includes the following:

CSD

C- Coverage of all aspects of the entity relevant to the FS being audited

S- Sufficiency and reliability of the information

D- Disclosures- whether proper disclosures have been made as per Accounting Standards and applicable law. (MODULE TYU 2)

Scope excludes: Do not DIE

a) not expected to perform duties which fall outside domain of his competence.

b) not an expert in authentication of documents

c) not an official investigation into alleged wrong doing (MODULE TYU 3)

(Investigation is a critical examination of the accounts with a special purpose)

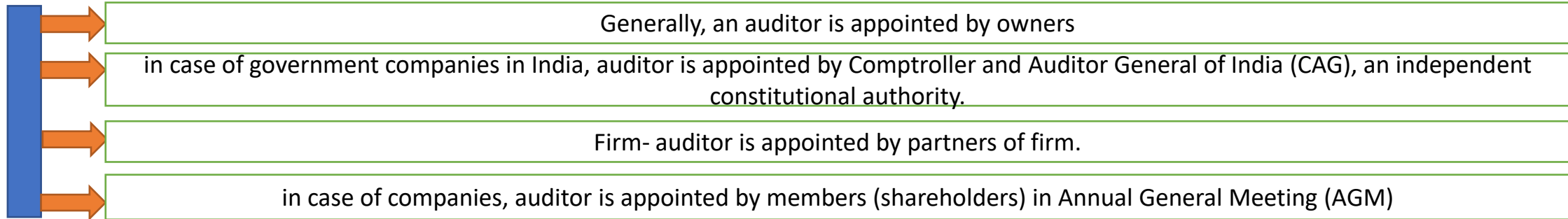
Types of Audit of FS

Statutory Audit:

Audit of FS Required by Law (Companies Act, 2013; Banking Regulation Act, 1949; Insurance Act, 1938)

Voluntary Audit:

Audit of FS not required by Law. (Audit of FS by proprietor, partnership firm, HUF)



The Audit report is submitted to person making the appointment. In case of companies, these are shareholders- in case of a firm, to partners who have engaged him.

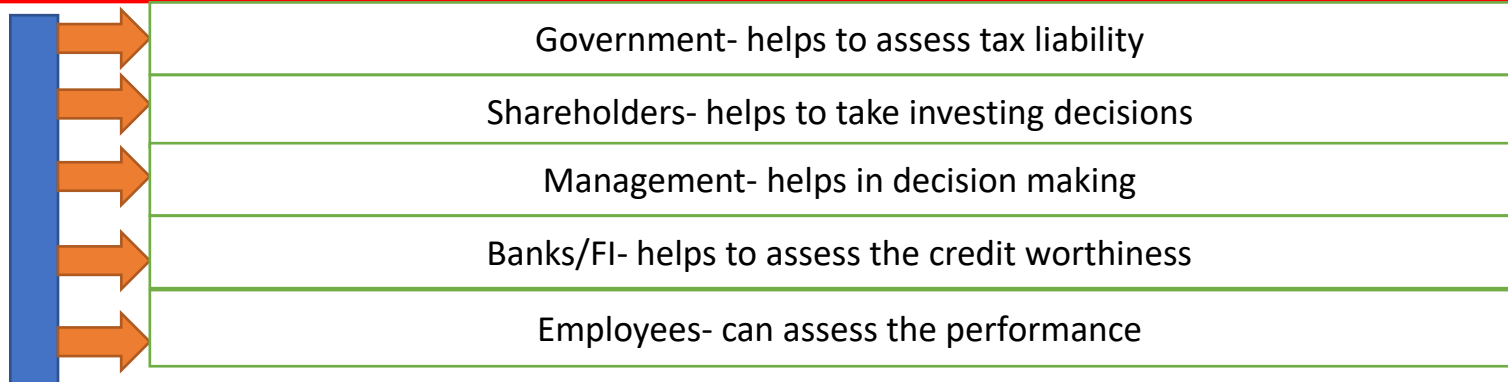
Advantages of Audit: (4 marks)**I M Detective Safe**

I- Helps in improving **Internal Control**

M- Acts as a **moral check** on the employees

Detective- Helps in **detection** of wastages/losses

Safe- **Safeguards** the financial interest of the **stakeholders**



Inherent Limitations of Audit

FACTO

Why auditor cannot reduce audit risk to zero and cannot provide absolute assurance?

F- Nature of **Financial Reporting**

Preparation of FS involves estimates which further involve uncertainty as there could be multiple judgments

A- Nature of **Audit Procedures**

Auditor may not obtain the required audit evidence due to practical and legal limitations. Example- Mgmt may not provide complete data, **audit is not investigation** and hence there are no specific powers of search and seizure

C- **Cost- Benefit Balance*****

There is a balance to be struck between the value of the information and cost to be incurred for obtaining such information.

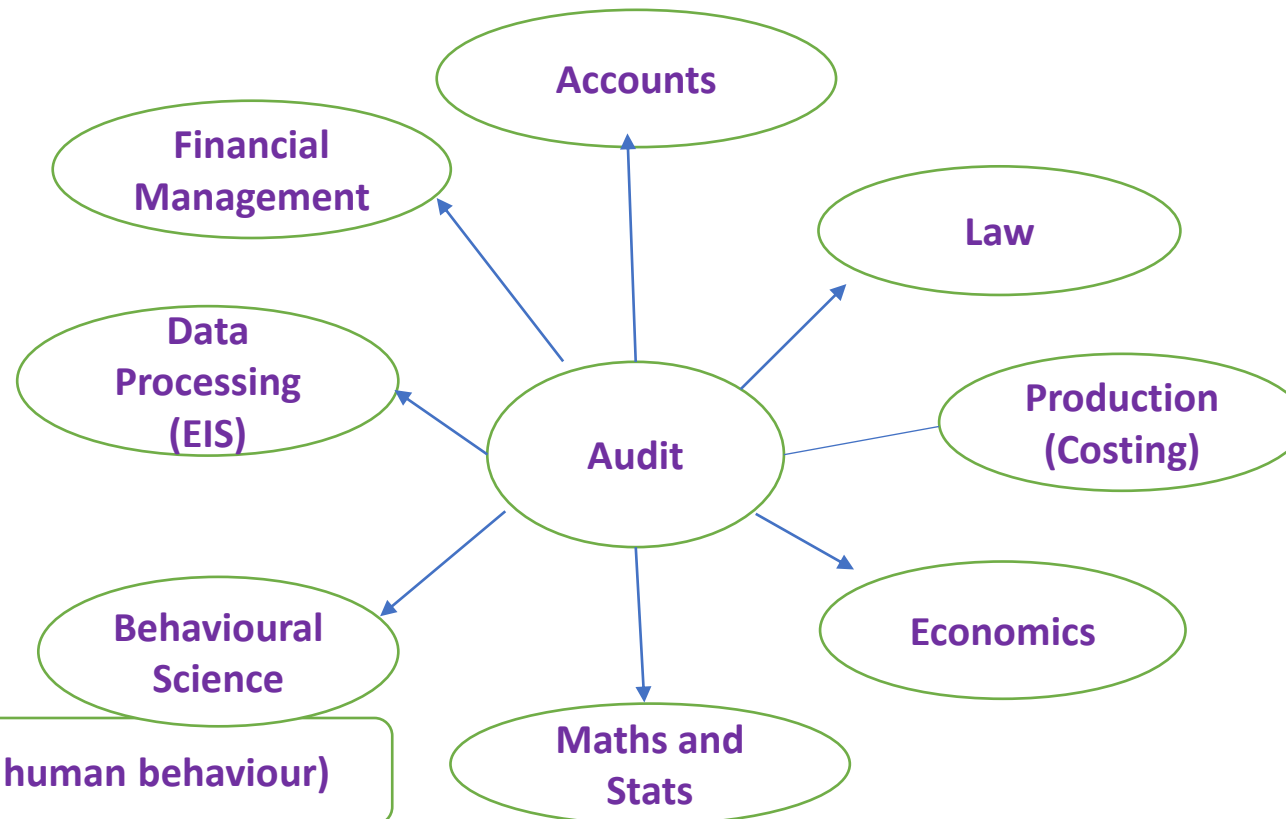
T- **Timeliness of Financial Reporting*****

There is an expectation that audit report should be made available within a specified time-frame. Due to this auditor adopts sampling technique.

*****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.**

O- **Other Matters**

In some matters, auditor's ability to detect misstatements greatly reduces. e.g- Fraud, related party transactions etc.

Relationship of auditing with other disciplines (3-4 marks)

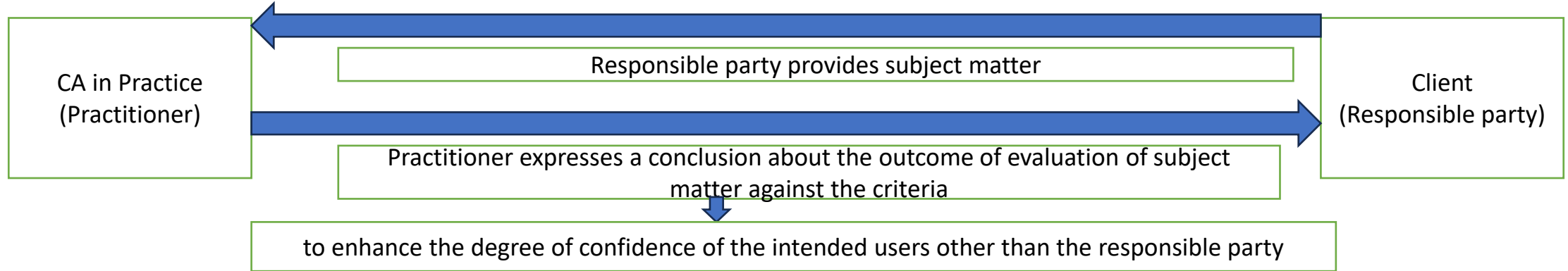
(Art of dealing with human behaviour)

Connect every subject with audit and explain why it is important to have knowledge of that subject.
2-3 lines per point.

Concept of Engagement

Engagement means an arrangement to do something.

Assurance Engagement means (as given below)



Elements of assurance engagement- 5 elements

- A three party relationship involving a practitioner, a responsible party, and intended users
- An appropriate subject matter
- Suitable criteria
- Sufficient appropriate evidence
- A written assurance report in appropriate form

Introduction to Engagement and Quality Control Standards

Following Engagement and Quality Control Standards have been issued by AASB → Auditing and Assurance Standard Board

SQC- Standards on Quality Control

Quality Control measures to be implemented by members

Slots allotted:
1-99
Standards issued:
1

SA- Standards on Auditing

Audit of Financial Statements

Slots allotted:
100-900
Standards issued:
38

SRE- Standards on Review Engagement

Review of Financial Statements

Slots allotted:
2000-2699
Standards issued:
2

SAE- Standards on Assurance Engagement

Other Assurance Engagements (Examination of information other than FS)

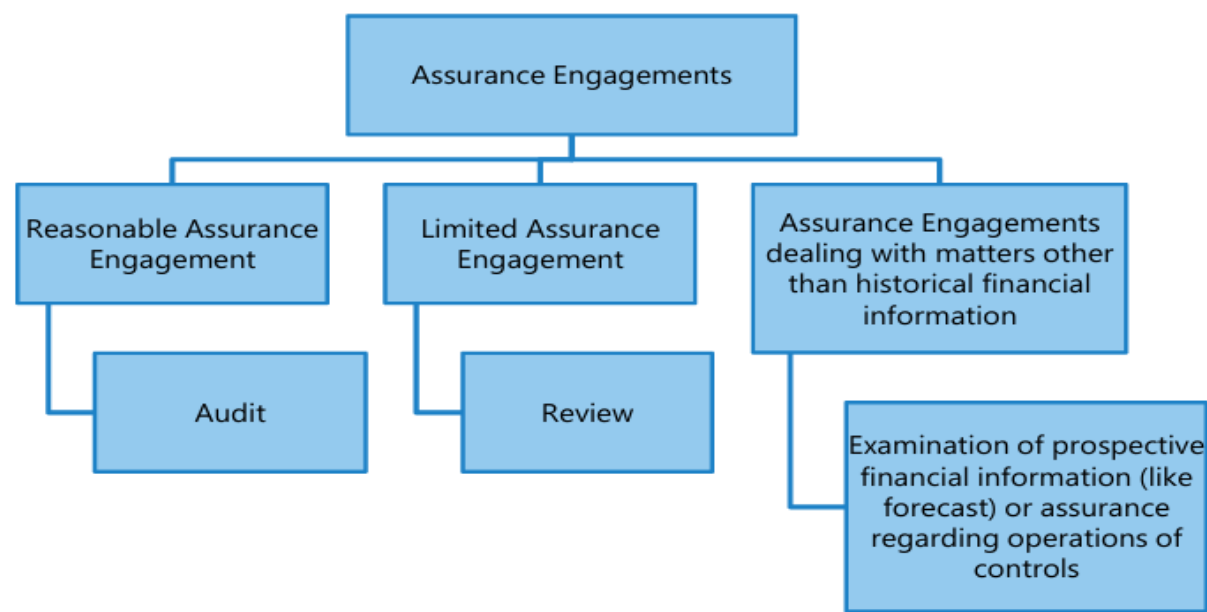
Slots allotted:
3000-3699
Standards issued:
3

SRS- Standards on Related Services

Performing procedures as agreed with the client. No Assurance activity involved (E.g- Compiling FS)

Slots allotted:
4000-4699
Standards issued:
2

Inter-CA Syllabus deals only with SAs i.e. standards on auditing issued by AASB for bringing uniformity in auditing practices while auditing FS of any entity irrespective of its size and nature. **As per Preface to Auditing Pronouncements (SAs) → It is mandatory to follow SAs while auditing FS irrespective of the entity being audited**



<i>Reasonable assurance engagement</i>	<i>Limited assurance engagement</i>
Reasonable assurance engagement provides high level of assurance.	Limited assurance engagement provides lower level of assurance than reasonable assurance engagement.
It performs elaborate and extensive procedures to obtain sufficient appropriate evidence.	It performs fewer procedures as compared to reasonable assurance engagement.
It draws reasonable conclusions on the basis of sufficient appropriate evidence.	It involves obtaining sufficient appropriate evidence to draw limited conclusions.
Example of reasonable assurance engagement is an audit engagement.	Example of limited assurance engagement is review engagement.

Framework behind Engagement and Quality Control Standards

Indian Scenario

The ICAI

Has established AASB- Auditing and Assurance standard Board

AASB has issued engagement and quality control standards

Global Scenario

IFAC (International Federation of Accountants)- 1977

IFAC established IAASB- International Auditing and Assurance Standard board

IAASB issued IAAS- International Auditing and Assurance Standards

Authority Attached to the Documents issued by the ICAI

Statements issued by the Council of the ICAI are mandatory.

- A) Statements on Accounting matters, if not followed by the client then auditor must mention it in his report.
- B) Statements on auditing matters must be followed by the auditor

Guidance notes issued by the ICAI are recommendatory unless otherwise stated by the ICAI. It means, exceptionally we can follow our own judgment only if we have valid reasons to do so.

SA Series	Deals with	Currently How many SAs issued by AASB?	How many NOT in Inter CA syllabus?
SA 100-199	Introductory Matters	None	-
SA 200- 299	General Principles and Responsibilities	9 SAs → SA 200, SA 210, SA 220, SA 230, SA 240, SA 250, SA 260, SA 265, SA 299	SA 240 and SA 250
SA 300- 499	Risk assessment and Responses to the assessed Risk	6 SAs → SA 300, SA 315, SA 320, SA 330, SA 402, SA 450	SA 402 and half part of SA 330
SA 500- 599	Audit Evidence	11 SAs → SA 500, SA 501, SA 505, SA 510, SA 520, SA 530, SA 540, SA 550, SA 560, SA 570, SA 580	1 SA → SA 540
SA 600-699	Using the work of Others	3 SAs → SA 600, SA 610, SA 620	SA 620 and Half SA 600
SA 700- 799	Audi Conclusions and Reporting	6 SAs → SA 700, SA 701, SA 705, SA 706, SA 710, SA 720	1 SA → SA 720
SA 800- 899	Specialised Areas	3 SAs → SA 800, SA 805, SA 810	3 SAs → SA 800, SA 805, SA 810

1. Difference between the word management and those charged with governance-

- A) Those Charged With Governance-** Persons providing strategic direction to the entity and responsible for oversight of the management when they are preparing and presenting financial statements. E.g Audit Committee, BOD etc...
- B) Management-** Persons responsible for executing the directions and preparation and presentation of financial statements. E.g. CEO, CFO, KMP etc..
- C) In small entities-** Management and TCWG could be the same persons.

2. Applicable Financial Reporting Framework-

The Financial Reporting Framework adopted by management and where appropriate, TCWG in the preparation and presentation of financial statements that is

- A) acceptable in view of the nature of the entity and objective of FS or**
 - B) that is required by law or regulation**
- E.g. Schedule III + AS in case of Companies.**

3. Materiality in the context of audit.

- A) Material items are such items which can impact the economic decisions of the users of FS.
- B) Materiality is a relative term i.e. it depends upon facts and circumstances of each case. There is no single standard rule determining materiality across all circumstances. It depends upon various factors

4. Sufficient and Appropriate Audit Evidence (SAAE)

Sufficiency means **quantity** of the information.

Appropriateness means **quality** of the information.
Quality means **relevance (logical connection)** and **reliability (complete and accurate)**.

- Audit evidence is cumulative in nature.
- Auditor needs to obtain at-least persuasive audit evidence.
- In any auditing situation, if intended evidence is not available then auditor shall perform alternate audit procedures to obtain SAAE.

Evidence can be obtained from

Accounting Records:

- BOA
- Ledger
- Invoices
- Bank Statements etc.

Other Information Supporting Accounting Records:

- Minutes of Meeting
- Confirmation from third party
- MOA/AOA

Type of Evidence

Based upon Source of Information:

- A) Internal Evidence: Originates from the entity being audited
- B) External evidence: Originates from sources outside the entity.

Based upon nature of Information:

- A) Written
- B) Oral
- C) Visual

5. Concept of Assertions

Assertions are representations made by management in the FS either directly or indirectly about the TBDs → Transactions, balances and disclosure

Assertions about transactions

O → Occurrence → transactions/ events recorded in FS have actually occurred.

C → Completeness → no omission

A → Accuracy → amount and other data is appropriate

C → Cut-off → correct accounting period

C → Classification → recorded in proper accounts

Assertions about balances

E → Existence → assets/liab actually exists.

V → Valuation → appropriate amounts and adjustments done.

R → Rights and Obligation → holds/ controls the asset and liab are actual obligations of the entity.

C → Completeness → no omission

Assertions about Presentation and Disclosures:

(i) Occurrence and Rights and obligations

(ii) Accuracy and valuation

(iii) Classification and understandability

(iv) Completeness.

Working Space:

6. Audit Procedures

In order to conduct audit of FS and obtain SAAE (Sufficient and Appropriate Audit Evidence), auditor needs to perform the following procedures:

Understand the entity and its environment (obtain knowledge of client's business to IDENTIFY what can go wrong (risk of fraud and error) in FS).....

Evaluate entity's accounting system and Internal Controls relevant to preparation of FS (to ASSESS the chances of error and fraud in FS).....

It helps auditor in IDENTIFYING and ASSESSING the **Risk of Material Misstatement** (whether due to fraud or error)

At Assertion level → chances of error and fraud in individual TBDs

At overall FS level → what can go wrong in the overall FS

It helps auditor in determining the NTE → Nature, timing and Extent of Further Audit Procedure (**responses to the assessed Risks of Material Misstatement**)

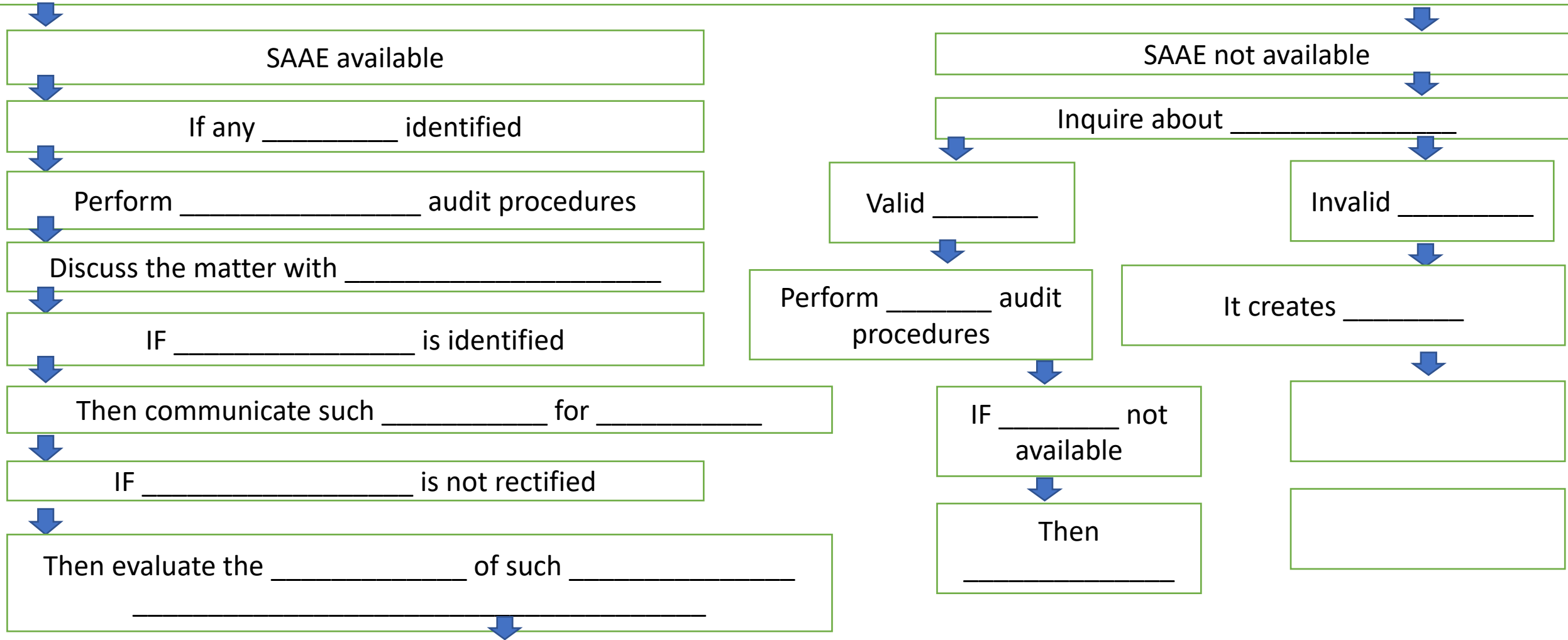
Compliance Procedure (Test of Controls):
Verify operating effectiveness of the controls and detect deviations, if any from the prescribed procedure.

Substantive Procedure:
A) Test of Details
To verify ACPD → Amount Classification Presentation and Disclosure and identify misstatements, if any by vouching and verification.
B) Analytical Procedure: Ratios, comparisons and trend analysis etc.

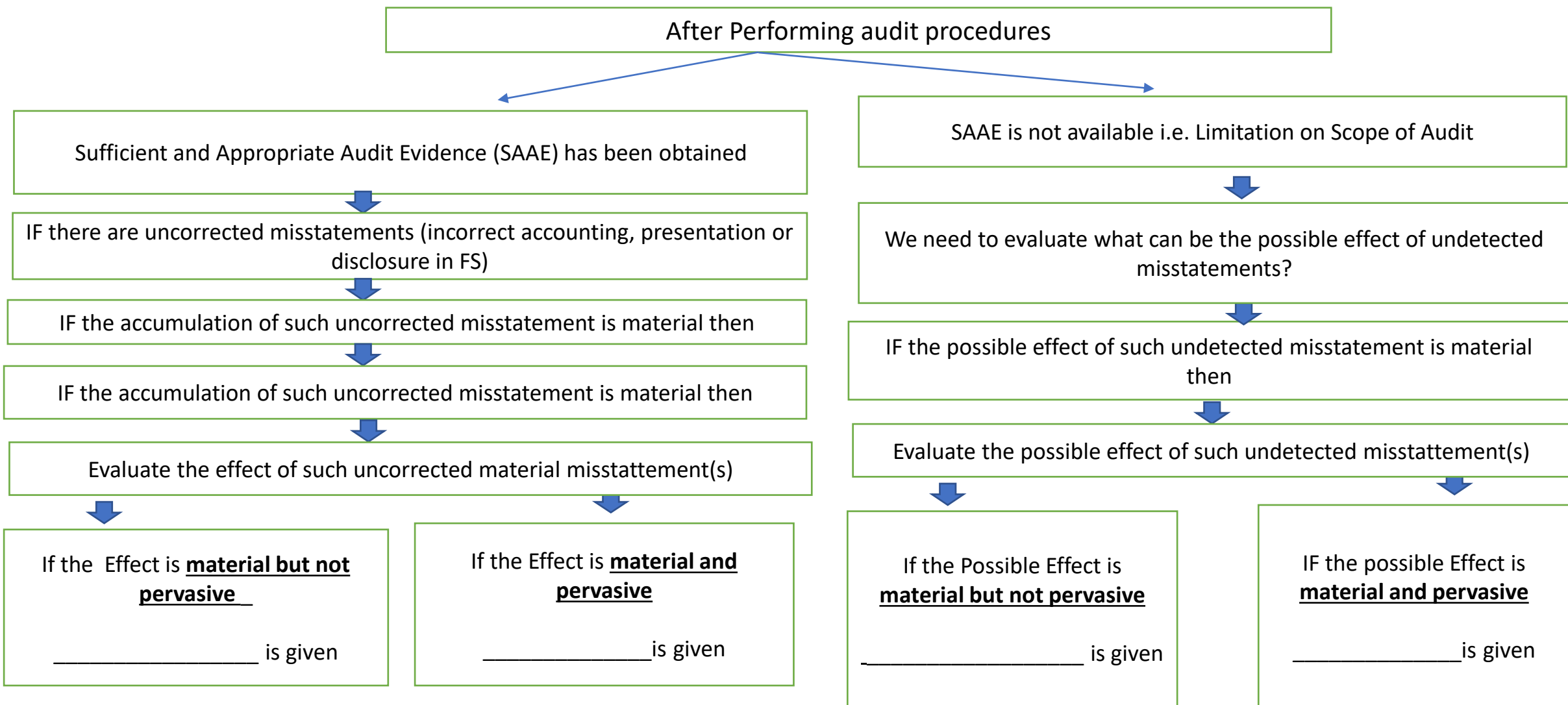
Auditor also applies Analytical procedures (ratios and comparisons) while performing risk assessment Procedure (concept discussed in Chapter 8)

7. Summary Chart of overall Auditor's approach

Auditor performs audit procedures to obtain SAAE in order to verify management's assertions



8. Audit Opinion (SA 705)- Chapter 8 Concept



8. Audit Opinion (SA 705)- Chapter 8 Concept

Examples (read the question and apply the chart)

Sr.No	Situation	<u>Answer</u>
1	While auditing a company running coaching classes, you observed that admissions of the students and payment done to professors were wrongly recorded in FS	
2	While auditing a company running coaching classes, you observed that there is insufficient evidence to verify admissions of the students and payment done to professors	
3	While auditing a company running coaching classes, you observed that rent payments (5% of total expenses) have not been properly recorded in FS	
4	While auditing a company running coaching classes, you observed that there is insufficient evidence to verify rent payments (5% of total expenses) recorded in FS.	
5	You observe that there are material misstatements in opening balances which have not been rectified by the management	
6	You observe that there is insufficient evidence to verify opening balances recorded in FS	

8. Audit Opinion (SA 705)- Chapter 8 Concept

Pervasive means, as per auditor's judgment, the effect is such that it covers a major portion of the financial statements and it is not limited to some specific items. **For example**, while auditing a coaching class, if you find

A) Admissions of students and payments done to professors are wrongly recorded

Or

B) You were not given the data related to admissions of students and payments done to professor

Material but not pervasive means, as per auditor's judgment, the effect is significant but it is limited to specific items of financial statements (FS) and does not cover substantially overall FS. **For example**, while auditing a coaching class you find

A) Printing and stationery expenses are incorrectly recorded.

Or

B) You were not given sufficient data to verify printing and stationery expenses

How to write/draft a Qualified opinion?

To the best of our knowledge and information available with us, in our opinion, FS of the entity show a true and fair view of the state of affairs as on year end and profit or loss account and cash flows for the year ended 31st March XXXX, except for the matters explained in Basis for Qualified opinion Para (a separata para for explaining the reasons)

8. Audit Opinion (SA 705)- Chapter 8 Concept

How to write/draft an Adverse opinion?

To the best of our knowledge and information available with us, in our opinion, FS of the entity do not show a true and fair view of the state of affairs as on year end and profit or loss account and cash flows for the year ended 31st March XXXX, due to the matters explained in Basis for Adverse opinion Para (a separata para for explaining the reasons)

How to write/draft a Disclaimer of an opinion?

We are unable to form and express an opinion whether FS of the entity show a true and fair view of the state of affairs as on year end and profit or loss account and cash flows for the year ended 31st March XXXX, due to the limitation on scope of audit as explained in Basis for Disclaimer of an opinion Para (a separata para for explaining the reasons)

9. Key Audit Matters (SA 701)- Chapter 8 Concept

It is an additional paragraph inserted by the ICAI in the audit report from FY 18-19 onwards.

KAM is mandatory for audit of listed entities.

Auditor can voluntarily apply the concept of KAM in audit of other unlisted entities which are of public interest as per his judgment

What is a Key audit Matter?

KAM is selected from matters communicated with Those Charged with Governance (read with SA 260)

KAMs are those matters that, in auditor's professional judgment

were of _____ in the audit of financial statements of the _____

Important points of SA 701

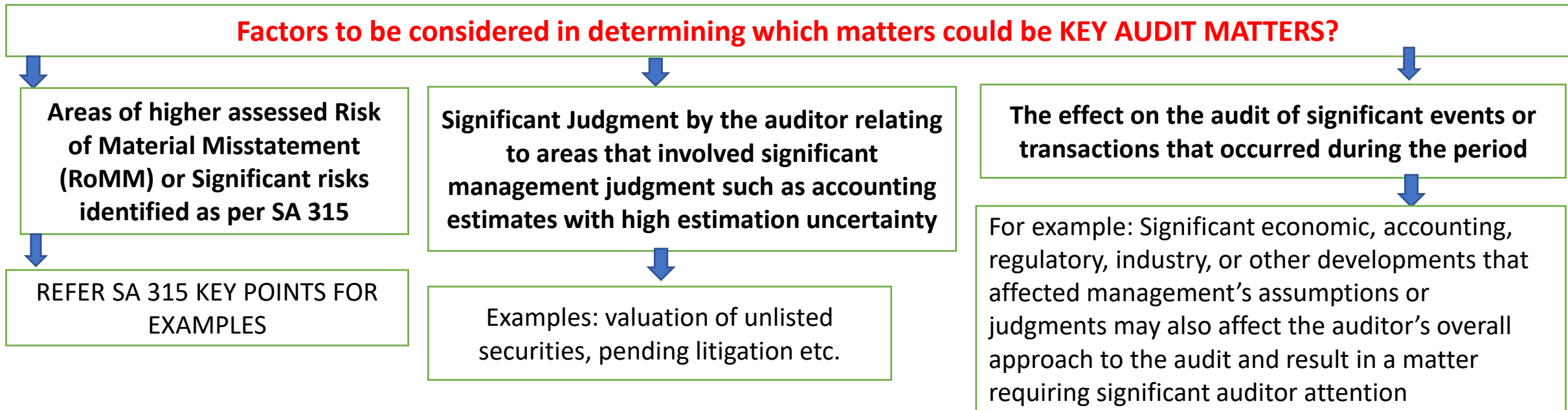
Factors to be considered for determining Key Audit Matters (to be read after all SAs are over)

How to Communicate Key Audit Matters in Audit Report

Important Principles while Communicating Key Audit Matters

9. Key Audit Matters (SA 701)- Chapter 8 Concept

Factors to be considered in determining which matters could be KEY AUDIT MATTERS?



How to communicate Key Audit Matters in Audit Report?

The introductory language under KAM shall state the following:

- A) Key audit matters are those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements [of the current period] and
- B) These matters were addressed in the context of the audit of the financial statements as a whole, and in forming the auditor's opinion thereon, and the auditor does not provide a separate opinion on these matters.

9. Key Audit Matters (SA 701)- Chapter 8 Concept

Describe Each Key Audit Matter under an appropriate Sub-heading.

For each Key Audit Matter auditor shall:

- A) Give reference to the related disclosure, if any, in the financial statements.
- B) Explain why the matter was considered to one of the most significant matter
- C) Explain how the matter was addressed (resolved) in the audit

Note:

- A) If SA 701 is applicable and there are NO Key audit matters in the current period then auditor should mention this fact in the audit report under the heading KAM
- B) IF SA 701 is applicable and KAMs have been already covered by other paragraphs then auditor should mention such fact in the audit report under the heading KAM

Important principles for Communicating KAM in audit report

KAM is not a substitute for:

- A) disclosures required in the financial statements
- B) Expressing modified opinion as per SA 705
- C) Describing material uncertainty related to Going Concern as per SA 570

KAMs are additional important facts which auditor intends to highlight and **it is not to be taken as auditor's opinion on such matters.**

If auditor has expressed disclaimer of opinion as per SA 705 then in such audit report he shall not insert KAM (This is a SPECIFIC RESTRICTION BY THE ICAI)

IF SA 701 is applicable and auditor has determined a matter as KAM, he **MAY NOT** communicate such matter in audit report **if:**

- A) **Law or regulation precludes (prohibits)** public disclosure about the matter (for example matters under judicial investigation) **OR**
- B) In extremely rare circumstances, the **auditor determines** that the matter should not be communicated in the auditor's report because **the adverse consequences of doing so would be more than the public interest benefits of such communication.**

10. EOM and OM Para (SA 706)- Chapter 8 Concept

Other Matter Para

This para is used as an additional disclosure in the audit report in order to highlight

Condition 1: A matter other than the matter presented or disclosed in financial statements

Condition 2: IF such matter is significant in order to explain auditor's report, scope of audit etc.. to bring more clarity about the audit that has been performed

Condition 3: Only if such disclosure in audit report is not prohibited by laws and regulation

Condition 4: _____

If all of the above conditions are satisfied

Then auditor should highlight such matter under Other Matter Para in Audit Report

Example: In an audit of a private limited company, branches were audited by a person other than company's auditor. Hence, the company's auditor wants to highlight such fact in his audit report for the clarity of readers of audit report.

Drafting OM PARA in Audit report: While Drafting OM Para in Audit report, auditor has to ensure that: 'he uses the heading Other Matter or Any other appropriate heading that best describes the matter'.

10. EOM and OM Para (SA 706)- Chapter 8 Concept

Emphasis of Matter Para

This para is used as an additional disclosure in the audit report in order to highlight

Condition 1: A matter presented or disclosed in financial statements

Condition 2: For which auditor does not have a modified opinion as per SA 705

Condition 3: But as per auditor's judgment, matter is fundamental to the users understanding of FS

Condition 4: _____

If all of the above conditions are satisfied

Then auditor should highlight such matter under Emphasis of Matter Para in Audit Report

Example: During the audit of a private limited company, auditor has observed that there were changes in some accounting policies, which have been properly recorded in the Financial Statements but auditor wants to highlight it separately in audit report.

Drafting EOM PARA in Audit report: While Drafting EOM Para in Audit report, auditor has to ensure that

A) He states clearly that his opinion is not modified with respect to such matter

And

B) He must provide reference to the relevant notes to accounts which have been discussed in EOM Para

11. Material Uncertainty Related to Going Concern Para (SA 570)- Chapter 4 and 8 Concept

IF auditor has concluded after performing procedures as per SA 570 that

Going concern basis of accounting is appropriate

Mgmt provides adequate disclosures in the FS

Going concern basis of accounting is appropriate but material uncertainty exists about entity's ability to continue as going concern. Management is expected to provide adequate disclosures in the FS explaining such material uncertainty and plans to overcome it.

Mgmt does not provide adequate disclosures in the FS

Going Concern basis of accounting is inappropriate. Mgmt should adjust the FS accordingly and show balances at NRV and adopt receipt basis of accounting.

Mgmt adjusts the FS accordingly.

Mgmt does not adjust the FS accordingly.

12. Form and Content of Auditor's Report → SA 700- Chapter 8 Concept

Title → auditor's report shall have a title that clearly indicates that it is the report of an independent auditor

Addressee → The auditor's report shall be addressed, as appropriate, based on the circumstances of the engagement.

Opinion → It shall include:

- A) Identify _____ whose financial statements have been audited
- B) State that the _____;
- C) Identify the title of each statement comprising the financial statements;
- D) Refer to the notes, including the summary of significant accounting policies and
- E) Specify the date of, or period covered by, each financial statement comprising the financial statements.

Basis for Opinion → It shall include:

- (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 → As per SA 570

Key Audit Matters → As per SA 701

Emphasis of Matter Para → As per SA 706

Other Matter Para → As per SA 706

Responsibilities of Management for the Financial Statements (read this after SA 210 is over): Describe management's responsibility for:

- A)** Preparing the financial statements in accordance with the applicable financial reporting framework, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error
- B)** Assessing the entity's ability to continue as a going concern¹⁴ and whether the use of the going concern basis of accounting is appropriate as well as disclosing, if applicable, matters relating to going concern.

Auditor's Responsibilities for the Audit of the Financial Statements (read this after all SAs are over): It shall:

- A)** State that the objectives of the auditor are to:
 - (i) Obtain reasonable assurance about whether FS are free from material misstatement, whether due to fraud or error and
 - (ii) Issue an auditor's report that includes the auditor's opinion
- B)** State that reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with SAs will always detect a material misstatement when it exists.
- C)** State that misstatements can arise from fraud or error, and provide a description of materiality or explain when they are considered as material
- D)** Describe that auditor exercise professional judgment in planning and performing audit as per SAs.

Auditor's Responsibilities for the Audit of the Financial Statements: (continued)**E) Auditor needs to describe an audit by explaining auditor's responsibilities:**

- (i) To identify and assess RoMM whether due to fraud or error in FS.
- (ii) To obtain understanding of internal control
- (iii) To evaluate appropriateness of accounting policies
- (iv) To conclude on appropriateness of mgmt.'s use of going concern basis of accounting.

F) Also explain that auditor communicates with TCWG matters describes as per SA 260.

“Report on Other Legal and Regulatory Requirements” (read this with Section 143 of Companies Act, 2013):

If the auditor addresses other reporting responsibilities in the auditor's report on the financial statements that are in addition to the auditor's responsibilities under the SAs, these other reporting responsibilities shall be addressed in a separate section in the auditor's report.

Signature:

The report is signed by the auditor (i.e. the engagement partner) in his personal name. Where the firm is appointed as the auditor, the report is signed in the personal name of the auditor and in the name of the audit firm. The partner/proprietor signing the audit report also needs to mention the membership number assigned by the Institute of Chartered Accountants of India. They also include the registration number of the firm, wherever applicable, as allotted by ICAI, in the audit reports signed by them.

Place:

The auditor's report shall name specific location, which is ordinarily the city where the audit report is signed.

Date:

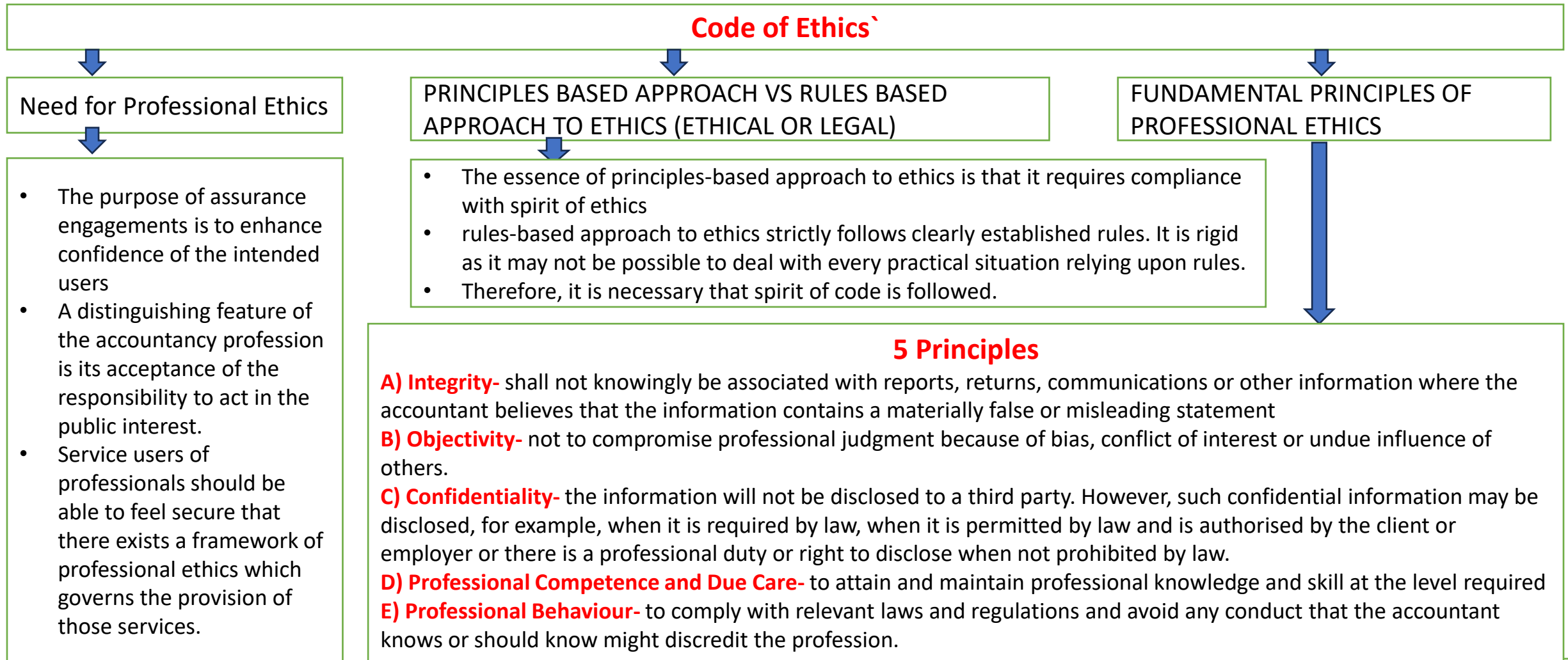
The auditor's report shall be dated no earlier than the date on which Those with the recognized authority have asserted that they have taken responsibility for those financial statements and auditor has obtained sufficient appropriate audit evidence.

Annexures →

Now Basic Concepts are over and we will start chapter wise discussion of SAs.

First we will finish SAs given in the ICAI module- Chapter 11

It covers Concept of ethics, SA 210 and Quality Control Standards SQC-1 and SA 220



Concept of Independence`

Independence is not accurately defined because it is a state of mind.

It means maintaining an uninfluenced state of mind

As per the IFAC (International Federation of Accountants)

Explains Independence as

Independence of
Mind

+

Independence
of Appearance

Independence of Mind: Auditor's own evaluation whether he can form an opinion without being influenced by the auditee (client)

Independence of Appearance: Whether there are facts/ circumstances which can make a third party conclude that auditor's independence has been compromised

Threats to Independence

Sacred SAIF

Sacred- Self Review threat

S- Self Interest Threat

A- Advocacy Threat

I- Intimidation Threat

F- Familiarity Threat

Threats to independence

Self-interest threat: auditing firm, its partner or associate could benefit from a financial interest in an audit client.

Self- Review threats:
(fear of exposing own errors)

- i) a review of any judgement or conclusion reached in a previous audit or non-audit engagement.
- ii) when a member of the audit team was previously a director or senior employee of the client.

Advocacy threat: when the auditor promotes, or is perceived (as seen by third party) to promote, a client's opinion to a point where people may believe that objectivity (impartial attitude) is getting compromised. E.g- auditor giving legal advice to same client

Intimidation threats: when auditors are stopped from acting objectively with professional skepticism. It could be due to threat of replacement as a result of arguments with clients

Familiarity threat: when auditors form relationships with the client where they end up being too sympathetic to the client's interests.

Safeguards to independence

There are safeguards in the form of statutory provisions mentioned in **Companies Act, 2013** and **Chartered Accountants Act, 1949** which help auditor in maintaining its independence.

It means how auditor can protect its independence against the threats explained earlier

Apart from the statutory provisions, **auditor should follow the following guiding principles in this regard:**

1. Auditor should always **be and appear to be independent.**
2. The key fundamental principles of **integrity, objectivity and professional skepticism can be fulfilled only if auditor remains independent.**
3. Before accepting audit, he must **consider whether there is any threat to his independence.**
4. If such threat exists then he must apply safeguards **and eliminate such threat.**
5. If the threat cannot be eliminated and **auditor believes that he may not be able to maintain his independence, then he shall not accept such audit.**

Objective (Purpose) of SA 210

To ACCEPT or CONTINUE an audit engagement only when

The basis upon which it is to be performed has been agreed through

Establishing **whether pre-conditions** for an audit are present or not

Confirming that there is a **common understanding** between the auditor and the management and where appropriate, those charged with Governance (TCWG)

Pre-Conditions**

Determine whether financial reporting framework is acceptable or not

It means the basis upon which management prepares FS is acceptable or not

Obtain the agreement of management that it acknowledges and understands the Premise based upon which audit is conducted (REFER SA BASICs)

Preparation and presentation of FS as per AFRF

Internal control as management considers necessary

Providing Access and information to the auditor required for the purpose of his audit

****If the pre-conditions do not exist then auditor cannot accept the audit unless otherwise required by law and regulation.**

Letter of Engagement

To,
The management/TCWG

OSAMA Report

1. Objectives and Scope of audit with reference to the applicable law governing the audit (E.g. Companies Act, 2013)
2. Auditor's Responsibilities
3. Management's responsibilities
4. Applicable Financial Reporting Framework (AFRF)
5. Expected form and content of Audit Report to be issued (and a statement that _____)

From,
Auditor

Recurring Audit (2nd year onwards with the same client)

Auditor need not revise the terms of engagement unless

A) circumstances require him to do so**

B) there is a need to remind the entity of existing terms (to clear misunderstanding)

** example- significant change in LMNO.....- Law, Management, Nature of business, Ownership, Reporting Requirements etc

Changes in the terms of engagement (4-5 marks)

Before Acceptance of Audit

IF suggested changes may lead to LOSA (Limitation on Scope of Audit)

IF Such LOSA may lead to _____
_____ in future

Then auditor must not accept such audit unless required by Law and regulation to do so

** it means auditor wont be able to form an opinion on FS due to lack of evidence

After Acceptance of Audit***

Is there a reasonable justification?

Valid Reasons for changes

Accept the change (in writing)###

Invalid reasons for changes

Do not accept such change

IF management and TCWG do not allow auditor to continue with original terms

Then withdraw from the engagement if it is legally permissible to do so

*** Why mgmt requests to change the terms?

CMR

- A) C _____
- B) M _____
- C) R _____

###In order to avoid confusion, the audit report would not include reference to:
(a) the original engagement; or
(b) any procedures that may have been performed in the original engagement.

Quality Control

SQC-1

Responsibilities of CEO/MP (Managing partner) to design and implement quality control policies and procedures related to following Elements of Quality Control
LE AHEM

L- Leadership Responsibilities for quality within the audit

E- Ethical requirements

A- Acceptance and continuance of client relationship and engagement

H- Human Resource policies and procedures

E- Engagement performance

M- Monitoring

SQC is applicable in SA, SRE, SAE and SRS (all engagements covered under such standards)

SA 220

Responsibilities of Engagement partner to implement quality control policies and procedures of the firm in each audit engagement to which that partner is assigned.

Objective- To obtain reasonable assurance whether

- a) the audit engagement is complying with professional and legal standards
- b) the audit report issued is appropriate or not.

1) Leadership Responsibilities

SQC-1- for quality within the firm

CEO/MP shall assume ultimate leadership responsibilities for quality within the firm. All policies and procedures shall be designed keeping in view the following considerations:

CORD

- C**- Commercial considerations < Quality
- O**- Operational leaders shall have appropriate competence and capabilities
- R**- Resources should be devoted to quality control
- D**- Demonstrate commitment to quality while implementing all policies and procedures.

SA 220- for quality within the audit

Engagement partner shall be responsible for quality of each audit engagement assigned to him. Actions and messages of EP shall emphasize upon

IQ

a) Importance of CAT

- C- Compliance with professional and legal standards
- C- Compliance with firm's quality control policies and procedures
- A- Appropriateness of Audit Report
- T- Team's ability to raise concerns without fear.

b) Quality is essential in audit engagement

2- Ethical requirements

SQC-1

SA 220

Firms' CEO/MP shall establish policies and procedures to ensure firm's personnel comply with relevant ethical requirements

Responsibilities of Engagement partner to monitor compliance with ethical requirements in each audit engagement to which that partner is assigned.

- a) Identify threats to compliance with ethical requirements
- b) Report to the appropriate persons within the firm to determine appropriate action.

Compliance towards fundamental principles should be emphasized by SPAM

- S- Spread awareness
- P- Process for dealing with non-compliance
- A- Actions of firm's leadership
- M- Monitoring

Independence policies and procedures

Design policies and procedures to comply with independence requirements in all assurance engagements

- communicate such policies to firm's personnel
- Identify threats to independence
- Develop a mechanism to report such threats to independence

Obtain annual confirmation from all assurance teams that they are complying with firm's policies and procedures on independence

Familiarity threat in case of listed entities
Eng. Partner shall be rotated at-least once in 7 years.

3- Acceptance and continuance of client relationship and engagements

SQC-1

SA 220

Firm shall establish policies and procedures to determine

Client/Engagement Acceptance.

Factors to be considered:

- a) Evaluate Integrity of client → analyse nature of business, reputation, past history etc.
- b) Evaluate firm's resources and capabilities → knowledge, experience, skill and ability etc.
- c) Evaluate compliance with ethical requirements → no conflict of interest, independence etc.

Client/Engagement continuance.

Re-evaluate

- a) 3 points as discussed in acceptance
- b) LOSA, if any imposed by management and TCWG

Firm shall also establish withdrawal policies and procedures that are to be followed in case of withdrawal from the engagement/client.

- EP shall review the information of client/engagement obtained from firm's policies and procedures.
- EP shall determine whether conclusions reached regarding acceptance/continuance are appropriate or not.
- In case of any adverse findings, EP shall report to appropriate person within the firm to determine appropriate action.

Withdrawal policies and procedures:

- a) Discussing the matter with appropriate level of management and TCWG
- b) Consider and fulfill professional and legal responsibilities for informing stakeholders about withdrawal from the engagement.
- c) Documenting significant discussions during the withdrawal stage,

Human Resource

Firm should establish policies and procedures for its human resource management

These policies and procedures should address the following issues:

C4 P2 RE

- C4-** Competence, Capabilities, Career development, Compensation
- P2-** Performance evaluation and Promotion
- R-** Recruitment
- E-** Estimation of personal needs

5- Engagement performance

SQC-1

- a) Policies and procedures to brief engagement teams
- b) Policies and procedures to undertake appropriate consultation on difficult matters whether within or outside the firm.
- c) Engagement documentation
- d) Differences of opinion- resolve as per firm's policies and procedures
- e) EQCR- next page

SA 220

- a) EP shall DSR the work performed by audit team members (DSR- Direction Supervision and Review)
- b) Consultation- EP shall determine whether there is a need to obtain consultation
- c) EQCR- SP shall determine whether EQCR has been appointed. EP shall not date the auditor's report till the completion of EQCR.

Monitoring**SQC-1**

- CEO/MP shall ensure that firm's policies and procedures are RAO- relevant, adequate and operating effectively
- Factors to be considered in determining monitoring policy
 - Incorporation of new developments
 - Dealing with complaints and allegations
 - Appropriate remedial action to be taken.

SA 220

EP shall evaluate results of firm's monitoring process and take necessary corrective action. E.g. updating audit procedures

Engagement Quality Control Review (EQCR)

What? → Additional Review (i.e. in addition to the review done by engagement partner) of the significant judgments made and conclusions reached by audit team

Applicable to?

Mandatory for _____.

_____ conduct it for audit of unlisted entities.

Who can conduct EQCR?

- A CA Partner of the firm (other than engagement partner)
- Any other suitably experienced person (CA) of the firm
- A suitably qualified external person (CA in Practice)
- Team of individuals of the firm headed by CA

Role of Engagement Quality Control Reviewer:

- Review of draft audit report
- Review of significant judgments and conclusions
- Review of selected documentation which is significant
- Discussions with engagement partner on critical areas.
- Whether appropriate consultation was taken on critical areas
- Evaluation of independence of the audit team

EQCR _____ **AUDIT REPORT IS SIGNED.**

An engagement partner taking over an audit during the engagement should apply the review procedures in order to review the work performed to the date of a change in order to assume the responsibilities of an engagement partner.



M/s Sureshchandra & Co. has been appointed as an auditor of SC Ltd. for the financial year 2014-15. CA. Suresh, one of the partners of M/s Sureshchandra & Co., completed entire routine audit work by 29th May, 2015. Unfortunately, on the very next morning, while going 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.



Two main points:

- A) **Basic principle of Audit** → 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 and is not aware of any reason to believe that he should not have so relied
- B) **Concept of SA 220** as discussed above.

Chapter 4, 7 & 6 SAs → Audit Evidence, Completion and review and Audit Documentation

1. [SA 500- Audit Evidence](#)
2. [SA 505- External Confirmation](#)
3. [SA 580- Written Representation](#)
4. [SA 501- Audit Evidence- Specific Considerations for selected items](#)
5. [SA 510- Initial Audit Engagement- Verification of Opening Balances](#)
6. [SA 550- Related Party](#)
7. [SA 560- Subsequent Events](#)
8. [SA 570- Going Concern](#)
9. [SA 230- Audit Documentation](#)
10. [SA 610- Using the work of Internal Auditor](#)
11. [SA 520- Analytical procedures](#)
12. [SA 530- Audit Sampling](#)
13. [SA 450- Evaluation of misstatements identified during the audit](#)
14. [SA 260- Overview of communication with TCWG](#)
15. [SA 265- Communicating deficiencies in internal control with management and TCWG](#)

Auditor needs to obtain Sufficient and appropriate audit evidence by performing audit procedures → Discussed in Basic concepts of SAs

When information to be used as audit evidence has been prepared using the work of a management's expert, the auditor shall:

- Evaluate the competence, capabilities and objectivity of that expert;
- Obtain an understanding of the work of that expert
- Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion

When using information produced by the entity, the auditor shall:

- Obtaining audit evidence about the accuracy and completeness of the information
- Evaluating whether the information is sufficiently precise and detailed for the auditor's purposes

Inconsistency in or Doubts over Reliability of Audit Evidence

→ audit evidence obtained from one source is inconsistent with that obtained from another

Or

→ the auditor has doubts over the reliability of information to be used as audit evidence

Then

the auditor shall determine what modifications or additions to audit procedures are necessary to resolve the matter, and shall consider the effect of the matter, if any, on other aspects of the audit.

Auditor's judgment as to sufficiency may be affected by the factors such as

- Materiality
- RoMM
- Size and characteristics of the population

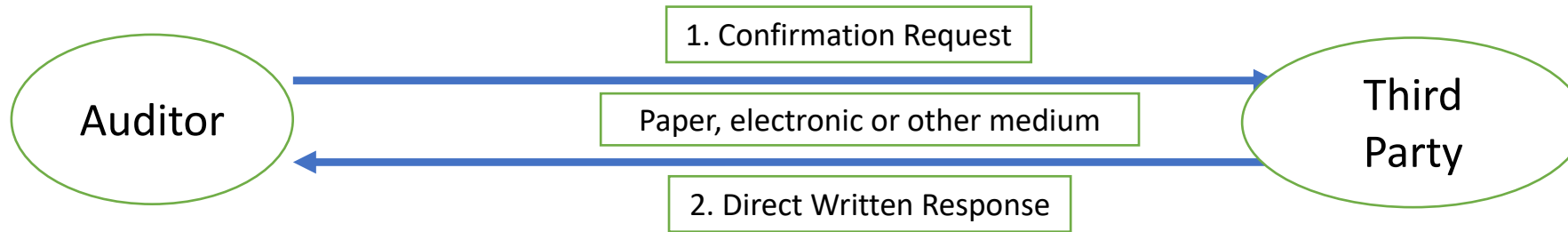
Audit procedures to obtain audit evidence can include- RIO's Ex is RIA

- Recalculation
- Inspection
- Observation
- External Confirmation
- Reperformance
- Inquiry
- Analytical Procedures

Principles determining reliability of audit evidence

- Written vs _____
- Direct vs _____
- External vs _____
- Original vs _____
- If the controls are operating effectively then

Definition



Definition as per Bare SA 505:

“Audit evidence obtained as a direct written response to the auditor from a third party (the confirming party), in paper form, or by electronic or other medium.”

Types of Confirmation Request

Positive Confirmation Request:

A request that the confirming party respond directly to the auditor indicating whether the confirming party agrees or disagrees with the information in the request, or providing the requested information.

Negative Confirmation Request:

A request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request.

4 conditions (Code word: RAID):

- 1) R- **Risk** of Material Misstatement is low
- 2) A- Too many similar items with lower **AMOUNTS**
- 3) I- Chances of **Ignorance** by third party are less i.e. 3rd party will not disregard such request.
- 4) D- Chances of **Disagreement** are less i.e. Low rate of Exception

It provides less persuasive (convincing) evidence than Positive confirmation request

Therefore it should be used less frequently and only if all of these conditions are satisfied:

Factors that may assist the auditor in determining whether external confirmation procedures are to be performed as substantive audit procedures include

KAWO of Third Party

- A) The confirming party's **knowledge** of the subject matter
- B) The **ability** or **willingness** of the intended confirming party to respond. For example:
 - (i) May not accept responsibility for responding to a confirmation request;
 - (ii) May consider responding too costly or time consuming
 - (iii) May have concerns about the potential legal liability resulting from responding
 - (iv) May account for transactions in different currencies
 - (v) May operate in an environment where responding to confirmation requests is not a significant aspect of day-to-day operations.
- C) The **objectivity** of the intended confirming party → if it's a related party then the response could be biased

Examples of situation where external confirmation procedures may provide relevant evidence. (read once)

- A) Bank balances and other information relevant to banking relationships.
- B) Accounts receivable balances and terms.
- C) Inventories held by third parties at bonded warehouses for processing or on consignment.
- D) Property title deeds held by lawyers or financiers for safe custody or as security
- E) Investments held for safekeeping by third parties, or purchased from stockbrokers but not delivered at the balance sheet date.
- F) Amounts due to lenders, including relevant terms of repayment and restrictive covenants.
- G) Accounts payable balances and terms.

External Confirmation Procedure

Determining the information to be confirmed or requested

Selecting the appropriate confirming party

Designing the confirmation requests

Sending the requests to the confirming party, including follow-up requests (additional request)

Example:

- A) Confirming account balances
- B) confirm terms of agreement
- C) confirm terms of transaction
- D) Confirm absence of certain conditions

Factors to be considered for designing a confirmation request:

Code: PM CALRA

- P- Past experience of the auditor while dealing with third parties.
- M- Management's authorization of the request (so that third parties reply faster)**
- C- Communication method
- A- Assertions being addressed (i.e. the nature of matter required)
- L- Layout and presentation method
- R- Risk of material misstatement involved in the matter
- A- Ability of third party to provide the requested information

****What if Management refuses to authorize a confirmation request?**

Inquire whether there is a reasonable justification for such refusal?

Valid Reasons

Perform Alternate Audit procedure

IF SAAE still not available

Then modify opinion as per SA 705

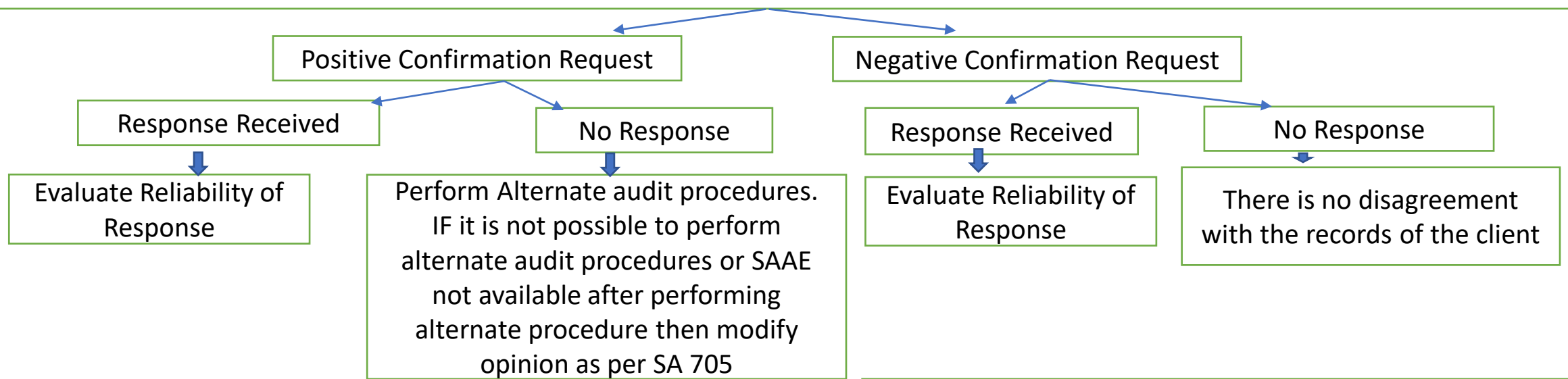
Consider
Risk of fraud

Invalid Reasons

Discuss the matter with TCWG

IF TCWG also refuses to allow the auditor to send the request

Results of External Confirmation Procedure



Reliability of the response:

→ Factors that may create doubt over reliability of response:

- A) Was received by the auditor indirectly
- B) Appeared not to come from the originally intended confirming party.

IF the response to a request is unreliable then re-assess romm and consider risk of fraud and the implications on other audit procedures.

Following Categories of results possible (summarising previous chart)

- A) A response by the appropriate confirming party indicating agreement with the information provided in the confirmation request, or providing requested information without exception.
- B) A response deemed unreliable.
- C) A non-response.
- D) A response indicating an exception.

Definition- Analysis

A written statement by management provided to the auditor to confirm certain matters or to support other audit evidence.

Written representations in this context do not include financial statements, the assertions therein, or supporting books and records.

Basic Points**Reliability of Written Representation**

- A) Although WR is a necessary evidence but it is not considered as a SAAE.
- B) WR is considered as a supporting evidence.
- C) The fact that mgmt is going to provide WR should not stop auditor from performing his planned audit procedures to verify whether mgmt has fulfilled its responsibilities.

Form of Written Representation

- A) representation letter addressed to the auditor.
- B) date → as near as practicable to, but not after, the date of the auditor's report on the FS.
- C) period → The written representations shall be for all financial FS referred to in the auditor's report.

Content of Written Representation

- A) Fulfillment of Management's responsibilities:
 - i) It has fulfilled its responsibility for preparation and presentation of FS as per AFRF as agreed in the terms of engagement.
 - ii) It has provided the auditor with all relevant information and access as agreed in the terms of the audit engagement.
 - iii) All transactions have been recorded and are reflected in the financial statements
- D) [For matters as required by other SAs.]
- E) [Any other matter as required by the auditor.]

- In some cases, it may be appropriate for the auditor to obtain a WR about a specific assertion in the financial statements **during the course of the audit.**
- The auditor and mgmt may agree to a form of WR that **updates written representations relating to the prior periods** by addressing whether there are any changes to such written representations and, if so, what they are.
- Situations may arise **where current management were not present during** all periods referred to in the auditor's report. This fact, however, does not reduce such persons' responsibilities for the FS as a whole. The requirement for the auditor to request from them WR that cover the whole of the relevant period(s) still applies.
- In some cases, mgmt may include in the **WR qualifying language to the effect that representations are made to the best of its knowledge and belief** → Auditor can accept such wording if the auditor is satisfied that the WRs are being made by those with appropriate responsibilities and knowledge of the matters included in the representations

If law or regulation requires management to make written public statements about its responsibilities, and the auditor determines that such statements provide some or all of the representations required by SA 580, the relevant matters covered by such statements need not be included in the representation letter.

Generally WR are taken as an acknowledgement from the management that they have FULFILLED their responsibilities as agreed in the terms of engagement. However, in certain circumstances the auditor may also ask management to reconfirm its acknowledgement and understanding of management's responsibilities as agreed in letter of engagement. Explain such circumstances.

- Those who signed the terms of the audit engagement on behalf of the entity no longer have the relevant responsibilities
- The terms of the audit engagement were prepared in a previous year
- There is any indication that management misunderstands those responsibilities;
- Changes in circumstances make it appropriate to do so.

Auditor has requested management to provide written representations

Management provides the requested WRs

IF auditor develops doubt over the reliability of WRs

Then auditor shall _____

If auditor concludes that WRs are _____

Then auditor shall _____

Management refuses to provide the requested WRs

Then auditor shall _____

IF WRs are still not provided to the auditor

Then auditor shall _____

In the above situations, auditor should

- A) Re-assess the Reliability, integrity and ethical values of the management
- B) Consider possibility of fraud in the FS
- C) Determine the effect on other evidences obtained till date from the management

SA 501 deals with auditor's responsibility to obtain

Sufficient and Appropriate Audit Evidence (SAAE) for verifying

Existence and Condition of

Completeness of

Presentation and disclosure of

Inventory

Litigation and Claims

Segment information

Main procedure:- Attend the physical counting of inventory being done by the management

Main procedure:- Perform Procedures to identify litigation and claims involving the entity

Main procedure:- Verify the presentation and disclosure as per Applicable Financial Reporting Framework (AS 17 and IND AS 108)

Part I- Part I- SAAE for verifying Existence and Condition of Inventory (when inventory is material to the FS)

Auditor needs to attend the physical counting of inventory by the management

Such procedure should be performed as on the year end date (date of FS)

Audit procedure by the auditor while attending such physical counting of inventory

Main procedure:- E-TOPIC

E-TOPIC

E- Evaluating Management's instructions and procedures (*e.g. controls implemented over movement of inventory, accurate identification of WIP, procedures used to estimate physical quantities etc.*) for recording and controlling the results of the entity's physical inventory counting

T- Test Counts (sample verification)

O- Observation of management's count procedures

P- Perform checks → Final inventory records vs Actual inventory count results

I- Inspect the inventory (to test its condition)

C- Confirmation with third parties (or inspection or both based upon the materiality of inventory held with third parties). Auditor also use the report of another auditor.

Part I- SAAE for verifying Existence and Condition of Inventory (when inventory is material to the FS)... **Various possibilities**

If physical inventory counting is conducted at a date

For e.g: 31st March is not possible and verification is scheduled as on 25th March

Procedures: Perform E-TOPIC + Reconciliation for changes between count date and the date of FS (adjustments made, differences, if any)

If the auditor is _____ physical inventory counting due to unforeseen circumstances

For e.g: Mgmt is ready but Audit team was not able to visit as on the planned date due to some unexpected situation.

Procedures: some physical counts on an alternative date + perform audit procedures on intervening transactions (recon) + Obtain a WR from mgmt that all standard procedures were followed for counting and they have informed auditor about differences, if any

If attendance at physical inventory counting is _____

For e.g: Location is near border areas and currently there are disturbances making it impossible to conduct inventory count

Procedures: Perform alternate audit procedure (e.g. verify previous records, ledger scrutiny and conduct recon till the count date, read internal auditor or other auditor reports etc.). If it does not provide SAAE then modify opinion as per SA 705

Part I- Existence and Condition of Inventory → Matters relevant in Planning attendance at physical inventory counting

WIN LATER

- W- Work in progress (determining completion)
- I- Internal control for maintenance of inventory
- N- Nature of Inventory
- L- Location at which inventory is held
- A- Adequate procedures established by the management? (arrangements made by them for inventory count)
- T- Timing of the count
- E- Expert's assistance required?
- R- Risk of Material Misstatement involved.

Part II-SAAE for verifying COMPLETENESS OF Litigation and Claims → I M CREW

- I- Inquiring the entity's In-house legal Counsel about the litigation and claims involving the entity
- M**- Inquiring the Management about the litigation and claims involving the entity
- C**- Communication between entity and its external legal counsel should be verified
- R**- Reviewing legal expense accounts of the entity to identify litigation and claims
- E**- External confirmation from the entity's external legal counsel → Mgmt should be asked to allow external legal counsel to communicate with the auditor. Two possibilities
 - A) If mgmt refuses then consider impact on opinion as per SA 705
 - B) If mgmt allows but lawyer does not respond then perform alternate audit procedures. IF SAAE still not available then consider impact on opinion as per SA 705
- W**- Written representation from mgmt as per SA 580 regarding
 - a) Completeness (no omission) of litigation and claims involving the entity
 - b) Presentation and disclosure in FS about litigation and claims involving the entity as per AFRF

Part II-SAAE for verifying **COMPLETENESS OF Litigation and Claims****Examples of circumstances when auditor may seek a meeting with entity's external legal counsel:**

- A) The auditor determines that the matter is a significant risk.
- B) The matter is complex.
- C) There is disagreement between management and the entity's external legal counsel.

Ordinarily, such meetings require management's permission and are held with a representative of management in attendance.

Part III-SAAE for verifying **Presentation and Disclosure OF Segment Information- **2 Points****

- A) Obtaining an **understanding of the methods used by mgmt in determining segment** information → whether such methods provide fair presentation as per AFRR and test the application of such methods. For example:
 - (i) Sales, transfers and charges between segments, and elimination of inter-segment amounts
 - (ii) Comparisons with budgets and other expected results, for example, operating profits as a percentage of sales.
 - (iii) The allocation of assets and costs among segments.
 - (iv) Consistency with prior periods, and the adequacy of the disclosures with respect to inconsistencies.
- B) Perform **analytical procedures** (ratios and comparisons) as per SA 520

Initial Audit Engagement (IAE): An engagement in which either...

The financial statements for the prior period were not audited

OR

The financial statements for the prior period were audited by a predecessor (previous) auditor

Opening balances

Account balances that exist at the beginning of the period i.e. prior period closing balances

+

matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments of the prior period

Objective of SA 510

To obtain sufficient and appropriate audit evidence (SAAE) about whether:

Opening balances contain misstatements that materially affect the current period's financial statements

Accounting policies reflected in the opening balances are:

- A) Appropriate as per AFRF
- B) Consistently applied
- C) Changes, if any, are properly accounted presented and disclosed as per AFRF

Audit Procedures for verifying opening balances → Read Forward Adjustment Policy

Read the most recent financial statements, if any and predecessor auditor's report, if any

Whether prior period balances have been correctly brought **forward**

Any **adjustment** to opening balances disclosed as prior period items in the current year's P&L

Verify whether accounting **policies** are ACC

→ Appropriate as per AFRF,

→ Consistently applied and

→ changes, if any have been properly APD → accounted, presented and disclosed in the FS as per AFRF.

Use of Predecessor Auditor's report

While performing Risk Assessment Procedure

While forming audit conclusions

If predecessor auditor has expressed modified opinion on prior period FS then it helps the auditor to understand RoMM in the current period FS

Modified opinion expressed by the predecessor auditor on prior period FS

Matter has been resolved in CYFS

Matter remains unresolved in CYFS

Matter remains relevant and material in CYFS

Modify opinion on CYFS

Various possible audit conclusions

S.N	Situation	Conclusion
1	the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances	Qualified or Disclaimer
2	the auditor concludes that the opening balances contain a misstatement that materially affects the current period's financial statements, and the effect of the misstatement is not properly accounted for or not adequately presented or disclosed	Qualified or Adverse
3	the current period's accounting policies are not consistently applied in relation to opening balances in accordance with the applicable financial reporting framework	Qualified or Adverse
4	a change in accounting policies is not properly accounted for or not adequately presented or disclosed in accordance with the applicable financial reporting framework	Qualified or Adverse

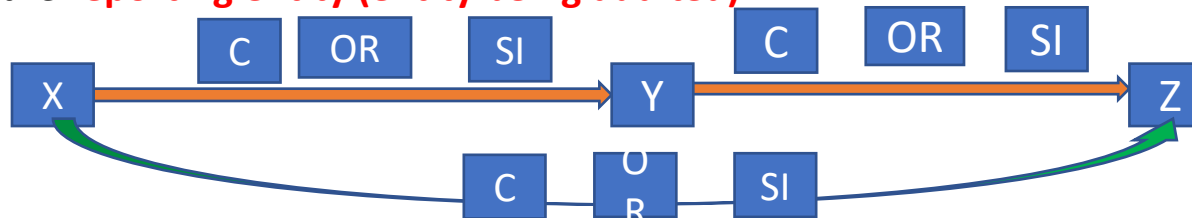
Definition

As defined in the applicable financial reporting framework (AFRF) → AS 18/ IND AS 24

If AFRF is silent

Then following relationships will be considered as Related Parties

A) A person or other entity that has **control (C)** or **significant influence (SI)**, directly or indirectly through one or more intermediaries, over the **reporting entity (entity being audited)**



X → A Person or other entity

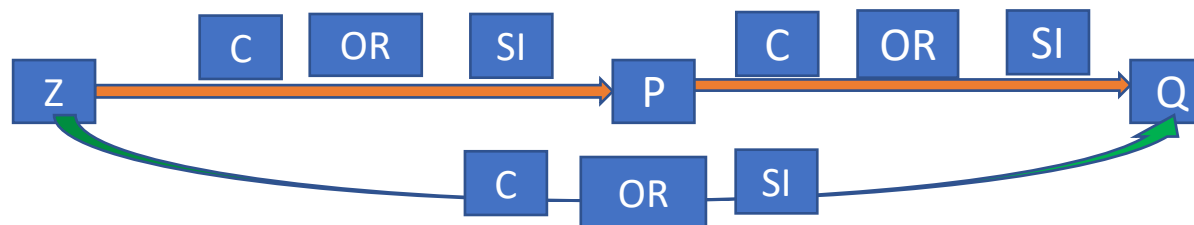
Y → Intermediary

Z → Reporting entity (entity being audited)

In the above diagram → X, Y and Z are related Parties

For definition of Control/Significant influence → Refer AS-18 (inter-ca), IND AS 24 (final ca)

B) Another entity over which **the reporting entity has control or significant influence**, directly or indirectly through one or more intermediaries



Q → A Person or other entity

P → Intermediary

Z → Reporting entity (entity being audited)

In the above diagram → Z, P and Q are related Parties

For definition of Control/Significant influence → Refer AS-18 (inter-ca), IND AS 24 (final ca)

C) Another entity that is under common control with the reporting entity through having:

- i. Common controlling ownership;
- ii. Owners who are close family members or
- iii. Common key management.



R → A Person or other entity

Z → Reporting entity (entity being audited)

Z and R being commonly controlled in any of the above mentioned ways.

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

Objectives of the auditor are

Perform risk assessment procedure for identifying RoMM due to fraud (what can go wrong in FS due to RPR and RPT)

Perform further audit procedures to obtain SAAE whether RPR and RPT have been appropriately IAD → identified, accounted and disclosed in FS as per AFRF

To conclude whether RPR and RPT in FS achieve a true and fair view and not misleading

RPR → Related Party Relationships, RPT → Related Party Transactions, RoMM → Risk of Material Misstatement

RPR and RPT can lead to High RoMM than other transactions. Explain with Examples → COMPLEX ABNORMAL SYSTEM

- i) Related parties may operate through an **extensive and COMPLEX range of relationships** and structures, with a corresponding increase in the complexity of related party transactions.
- ii) RPT **may not be conducted under normal market terms (ABNORMAL)** and conditions; for example, some related party transactions may be conducted with no exchange of consideration.
- iii) **Information SYSTEMS may be ineffective** at identifying or summarising transactions and outstanding balances between an entity and its related parties.

Risk Assessment Procedure- Obtaining an understanding wrt RPR and RPT

Understanding the entity's RPR and RPT:

Conduct Inquiry of the management regarding

- i) RPR → Identity of entity's related parties, changes from prior period, nature of entity's related party relationship
- ii) RPT → type and purpose of transactions

Evaluating internal controls over entity's RPR and RPT:

- i) How entity IAD → Identifies, Accounts for and Discloses RPR and RPT in FS
- ii) Who authorizes and approves significant arrangements with related parties
- iii) Who authorizes and approves significant transactions with related parties including transactions outside the normal course of business.

Identifying the related parties

Where the applicable financial reporting framework establishes related party requirements

information regarding the identity of the entity's related parties is likely to be readily available to mgmt because the entity's information systems will need to record, process and summarise RPR and RPT

Where the applicable financial reporting framework does not establish related party requirements

Auditor should still conduct following inquiries:

- A) The entity's ownership and governance structures
- B) The types of investments that the entity is making and plans to make;
- C) The way the entity is structured and how it is financed

IDENTIFICATION of previously unidentified or undisclosed Related Parties or Significant Related Party Transactions

Examples of records/documents which can show the existence of RPR and RPT which may not have been previously identified.

IAS2

- A) I → Income tax returns
- B) I → Internal auditors' reports.
- C) I → Records of the entity's INVESTMENTS
- D) I → INFORMATION supplied by the entity to regulatory authorities
- E) S → Significant contracts and agreements not in the entity's ordinary course of business.
- F) S → Shareholder registers etc..

Definition of Subsequent Events

Events occurring between the date of the financial statements and the date of the auditor's report

facts that become known to the auditor after the date of the auditor's report.

**Objectives of Auditor**

Obtain SAAE about whether 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 FS are appropriately reflected in those financial FS as per AFRF

Respond appropriately to facts that become known to the auditor after the date of the auditor's report, that, **had they been known to the auditor at that date, may have caused the auditor to amend the auditor's report..**

Events occurring between the date of the financial statements and the date of the auditor's report- **Category 1**

- 1) Obtain SAAE about whether 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 FS are appropriately reflected in those financial FS as per AFRF
- 2) Procedures- **SUMI's Adjustment in writing**
 - S- Subsequent interim FS to be read
 - U- Understand procedures established by mgmt. to identify SE
 - M- Minutes of meeting held after the date of FS
 - I- Inquire- Inquiries of mgmt. whether SE have occurred that require adjustment or disclosure in the FS.
 - Adjustment- Whether SE that require adjustment/disclosure have been adjusted/disclosed in FS accordingly.
 - Writing- WR by the mgmt. that all SEs that require adjustment or disclosure have been actually adjusted or disclosed in FS.

facts that become known to the auditor after the date of the auditor's report.

Before issuing FS- **Category 2**

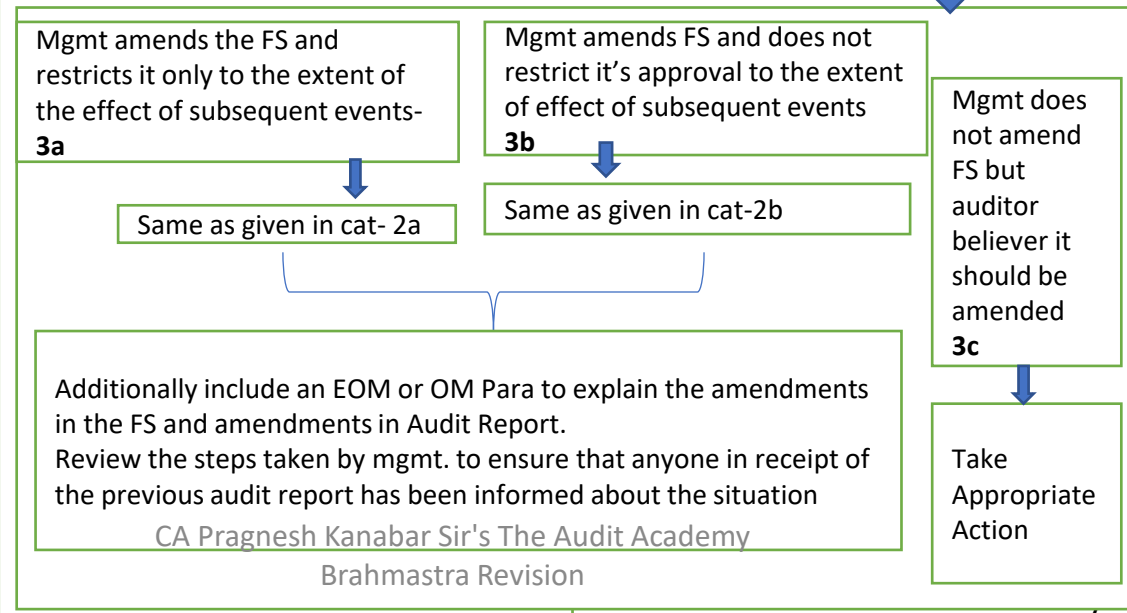
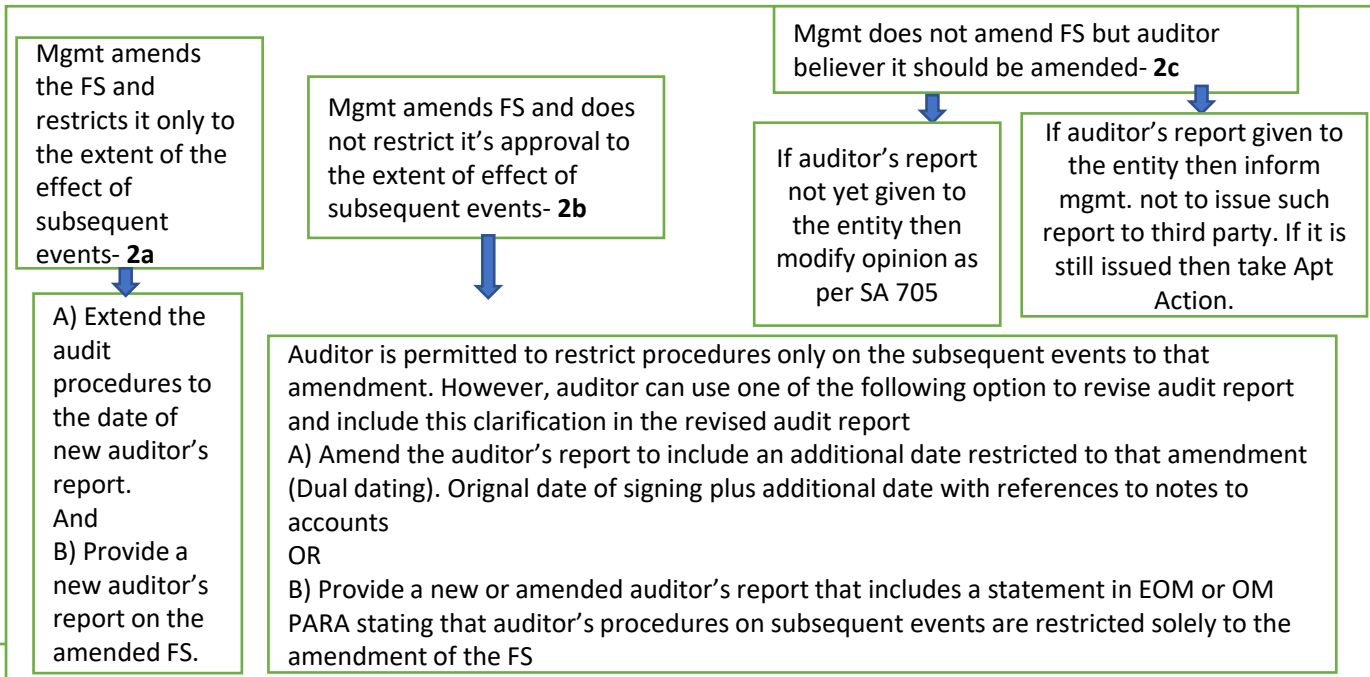
After Issuing FS- **Category 3**

Common theory for CAT-2 and CAT-3 SEs

A) the auditor has no obligation to perform any audit procedures regarding such FS

B) However, if a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report, the auditor shall

- A) Discuss the matter with management and, where appropriate, TCWG.
- B) Determine whether the financial statements need amendment and, if so,
- C) Inquire how management intends to address the matter in the financial statements



Auditor shall obtain SAAE whether a material uncertainty exists in relation to events or conditions that cast significant doubt over entity's ability to continue as going concern

Risk Assessment Procedure

consider whether events or conditions exist that may cast significant doubt on the entity's ability to continue as a going concern

determine whether management has already **performed a preliminary assessment** of the entity's ability to continue as a going concern

If such an assessment has been performed then

Inquire whether mgmt has identified events or conditions that can cast significant doubt over entity's ability to continue as going concern.

If such an assessment has not been performed then

Inquiring on what basis mgmt. is applying going concern basis of accounting

Further Audit Procedures

The auditor shall evaluate management's assessment of the entity's ability to continue as a going concern.

Following matters should be considered: **Complete Period Beyond Future Forecasts Facts to be Written**

A) Period Covered: cover the same period as that used by management to make its assessment as required by AFRF (not less than 12 months from the balance sheet date)

B) Completeness: Whether it includes all relevant information known to the auditor

C) Period beyond management's assessment: whether there are events or conditions beyond the period of management's assessment that can create material uncertainty over going concern.

D) Management's plans for future action: Whether the outcome of these plans can improve the situation

E) Evaluation of Cash flow Forecast: Evaluating the reliability of the supporting data and whether assumptions are reasonable

F) Additional facts post assessment: whether there is any need to re-assess entity's ability to continue as going concern.

G) Written Representation: Requesting WR from mgmt. and where appropriate, TCWG regarding their plans for future actions and feasibility of these plans.

Indicators of Material Uncertainty

Financial Indicator

- A) Net liability or net current liability position.
- B) Fixed-term borrowings approaching maturity without realistic prospects of renewal or repayment; or excessive reliance on short-term borrowings to finance long-term assets
- C) Indications of withdrawal of financial support by creditors
- D) Negative operating cash flows indicated by historical or prospective financial statements
- E) Adverse key financial ratios.
- F) Substantial operating losses or significant deterioration in the value of assets used to generate cash flows.
- G) Arrears or discontinuance of dividends.
- H) Inability to pay creditors on due dates.
- I) Inability to comply with the terms of loan agreements.
- J) Change from credit to cash-on-delivery transactions with suppliers.
- K) Inability to obtain financing for essential new product development or other essential investments.

Operating Indicator

- A) Management intentions to liquidate the entity or to cease operations.
- B) Loss of key management without replacement.
- C) Loss of a major market, key customer(s), franchise, license, or principal supplier(s)
- D) Labor difficulties.
- E) Shortages of important supplies.
- F) Emergence of a highly successful competitor.

Other Indicator

- A) Non-compliance with capital or other statutory or regulatory requirements, such as solvency or liquidity requirements for financial institutions.
- B) Pending legal or regulatory proceedings against the entity that may, if successful, result in claims that the entity is unlikely to be able to satisfy.
- C) Changes in law or regulation or government policy expected to adversely affect the entity.
- D) Uninsured or underinsured catastrophes when they occur.

Conclusion

Use of Going Concern Basis of Accounting Is appropriate but material uncertainty exists
Management needs to provide adequate disclosures in the FS

Use of Going Concern Basis of Accounting Is Inappropriate

Management needs to prepare liquidation accounts

Adequate Disclosure of a Material Uncertainty Is Not Made in the FS

Adequate Disclosure of a Material Uncertainty Is Made in the FS

A) Express a qualified opinion or adverse opinion, as appropriate, in accordance with SA 705
And
B) In the Basis for Qualified (Adverse) Opinion section of the auditor's report, state that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the financial statements do not adequately disclose this matter

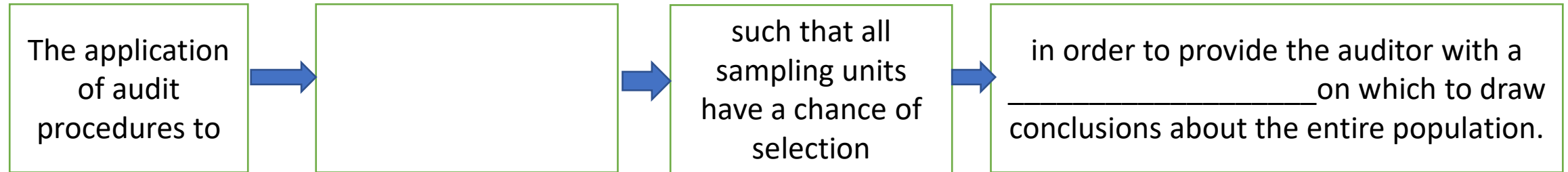
The auditor shall express an unmodified opinion and the auditor's report shall include a separate section under the heading "Material Uncertainty Related to Going Concern" to:
A) Draw attention to the note in the financial statements that discloses such matters and
B) State that these events or conditions indicate that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the auditor's opinion is not modified in respect of the matter

If the financial statements have been prepared using the going concern basis of accounting but, in the auditor's judgment, management's use of the going concern basis of accounting in the preparation of the financial statements is inappropriate, the auditor shall express an adverse opinion

IF the FS are prepared on acceptable basis (liquidation accounts) then auditor may be able to express an unmodified opinion but may consider it appropriate or necessary to include an Emphasis of Matter paragraph in accordance with SA 706

Disclosures to be given when auditor concludes that that management's use of the going concern basis of accounting is appropriate in the circumstances but a material uncertainty exists:
A) Adequately disclose the principal events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and management's plans to deal with these events or conditions and
B) Disclose clearly that there is a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and, therefore, that it may be unable to realize its assets and discharge its liabilities in the normal course of business.

Sampling Definition



It is in the interest of the auditor that if he decides to form his opinion on the basis of a part checking (i.e sampling). Elaborate

A) With the shift in favour of formal internal controls (automated), the possibilities of routine errors and frauds have greatly diminished and hence the auditors often find extensive routine checking as less productive.

B) **There is Nothing** statutorily stated anywhere which specifies what work is to be done, how it is to be done and to what extent it has to be done and hence it is matter of professional judgment

C) **Since** statistical theory of sampling is based on a scientific law, it can be relied upon to a greater extent.

Population

→ Population refers to the entire set of data from which a sample is selected and about which the auditor wishes to draw conclusions.

→ auditor should select sample items in such a way that the sample can be expected to be representative of the population

→ **Characteristics of Population** → **CAR**

A) C → Completeness: it needs to include all relevant items i.e all the activities, throughout the entire period

B) A → Appropriateness: Whether population is appropriate for the specific audit objective.

C) R → Reliable: sufficiently complete and accurate.

Sampling Risk

Audit Procedures	Sampling Result	Actual Scenario	It impacts
Test of Controls			Audit Efficiency/ Effectiveness
			Audit Efficiency/ Effectiveness
Test of Details			Audit Efficiency/ Effectiveness
			Audit Efficiency/ Effectiveness

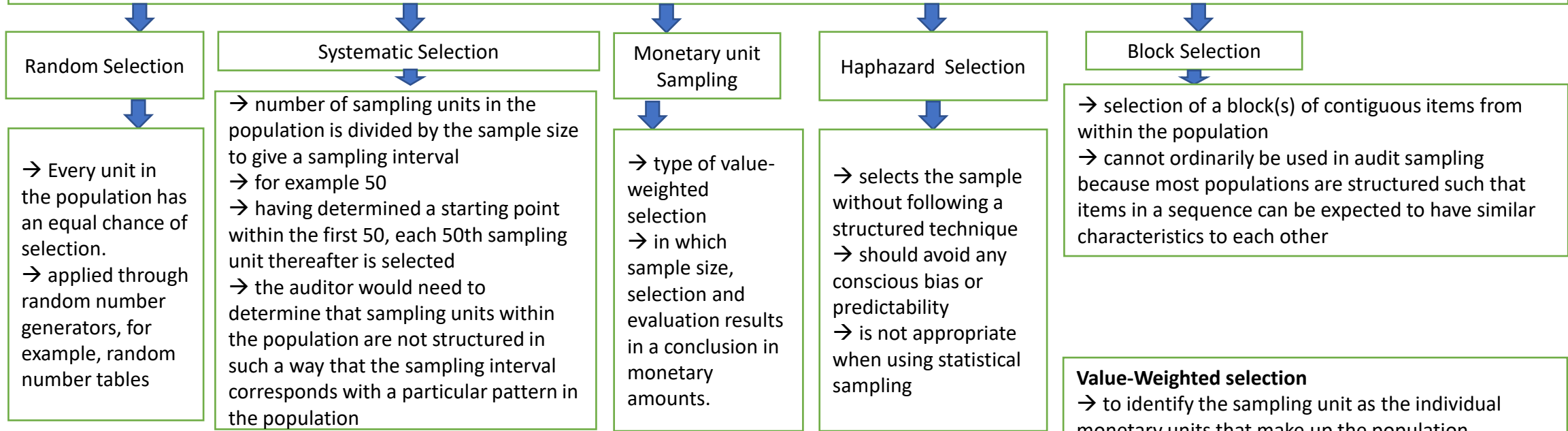
Sampling Risk → As per Bare SA:

The risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure

Type 1 → In the case of a test of controls, that controls are more effective than they actually are, or in the case of a test of details, that a material misstatement does not exist when in fact it does

Type 2 → In the case of a test of controls, that controls are less effective than they actually are, or in the case of a test of details, that a material misstatement exists when in fact it does not.

Sampling Techniques



Factors influencing sample size for TOC

- An increase in the extent to which the auditor's risk assessment takes into account relevant controls → Sample Size _____
- An increase in the tolerable rate of deviation → Sample Size _____
- An increase in the expected rate of deviation of the population to be tested → Sample Size _____
- An increase in the auditor's desired level of assurance → Sample Size _____
- Increase in number of sampling units in the population → _____

Factors influencing Sample Size for TOD

- An increase in the auditor's assessment of the risk of material misstatement → Sample Size _____
- An increase in the use of other substantive procedures directed at the same assertion → Sample Size _____
- An increase in the auditor's desired level of assurance → Sample Size _____
- An increase in tolerable misstatement → Sample Size _____
- An increase in the amount of expected misstatement → Sample Size → _____

Value-Weighted selection

- to identify the sampling unit as the individual monetary units that make up the population
- Having selected specific monetary units from within the population, for example, the accounts receivable balance, the auditor may then examine the particular items, for example, individual balances, that contain those monetary units.

Stratification

- Dividing population into discrete (separate) sub-population.
- Objective → allow sample size to reduce without increasing sampling risk.
- Stratification by monetary value or a particular characteristic
- results of audit procedures applied to a sample of items within a stratum can only be projected to the items that make up that stratum

Approaches to Sampling

statistical sampling approaches:

- has the random selection of the sample units; and
- the use of probability theory to evaluate sample results, including measurement of sampling risk characteristics
- Sample is selected by applying certain mathematical and statistical methods.

non-statistical

- A sampling approach which does not have features of statistical approach is called as non-statistical approach.
- the sample size and its composition are determined on the basis of the personal experience and knowledge of the auditor.
- This approach has been in common application for many years because of its simplicity in operation

Statistical vs Non- Statistical approach.:

(Main differences: Scientific/non-scientific, Unbiased/Biased, Accurate/Judgmental)

- 1) Audit testing done through Statistical approach is more scientific than testing based entirely on the auditor's own judgment because it involves use of mathematical laws of probability.
- 2) Statistical sampling has reasonably wide application where a population to be tested consists of a large number of similar items e.g payroll checking, vouching of invoices and petty cash vouchers
- 3) There is no personal bias of the auditor in case of statistical sampling.
- 4) The non-statistical sampling is criticized on the grounds that it is neither objective nor scientific.
- 5) In case of non-statistical sampling- the sample may not be a true representative of the total population
- 6) Under some audit circumstances, statistical sampling methods may not be appropriate. E.g when exact accuracy is required or in case of legal requirements etc.
- 7) The decision whether to use a statistical or non-statistical sampling approach is a matter for the auditor's judgement**
- 8) However, sample size is not a valid criterion to distinguish between statistical and non-statistical approaches**

Performing Audit Procedures on the Sample Selected



→ auditor shall perform audit procedures, appropriate to the purpose, on each item selected

→ If the audit procedure is not applicable to the selected item then the auditor shall perform the procedure on a replacement item.

E.g. An example of when it is necessary to perform the procedure on a replacement item is when a voided check (Cancelled cheque) is selected while testing for evidence of payment authorization. If the auditor is satisfied that the check has been properly cancelled such that it does not constitute a deviation, an appropriately chosen replacement is examined. A replacement would then mean a proper and valid cheque through which payment has been made

→ If the auditor is unable to apply the designed audit procedures, or suitable alternative procedures, to a selected item, the auditor shall treat that item as a

→ deviation from the prescribed control, in the case of tests of controls, or

→ a misstatement, in the case of tests of details

E.g. An example of a suitable alternative procedure might be the examination of subsequent cash receipts together with evidence of their source and the items they are intended to settle when no reply has been received in response to a positive confirmation request.

Sampling Result → Statements from Bare SA

The auditor shall evaluate:

- A) The results of the sample
- B) Whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested.

Projecting Misstatements:

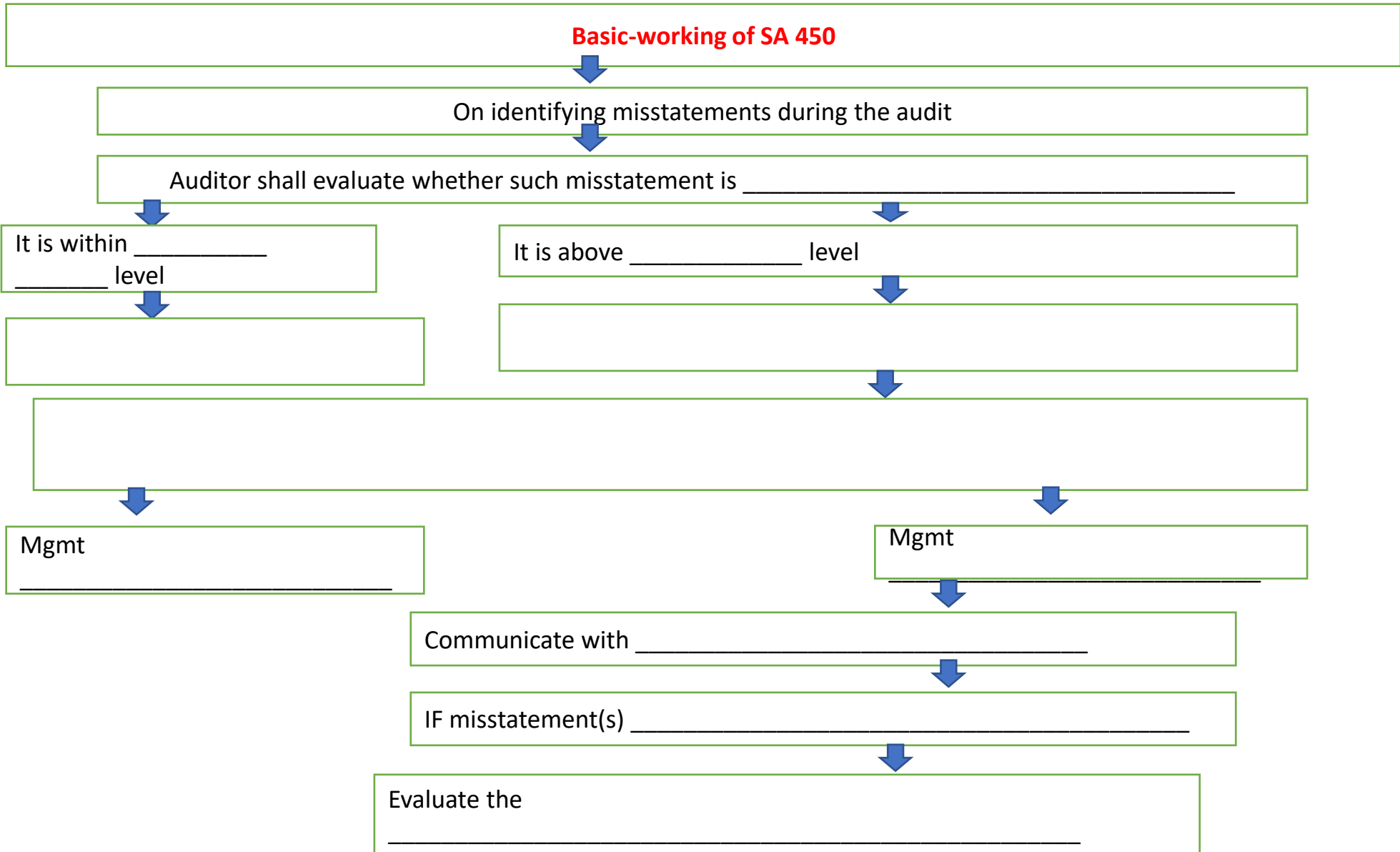
- The auditor is required to project misstatements for the population to obtain a broad view of the scale of misstatement but this projection may not be sufficient to determine an amount to be recorded.
- When a misstatement has been **established as an anomaly**, it may be excluded when projecting misstatements to the population. However, the effect of any such misstatement, if uncorrected, still needs to be considered in addition to the projection of the non-anomalous misstatements.
- In the case of tests of details, **the projected misstatement plus anomalous misstatement, if any, is the auditor's best estimate of misstatement in the population.**

→ **For tests of controls, no explicit projection of deviations** is necessary since the sample deviation rate is also the projected deviation rate for the population as a whole

→ **If the auditor concludes that audit sampling has not provided a reasonable basis for conclusions about the population that has been tested, the auditor may** → Request mgmt to investigate misstatements that have been identified or modify the NTE of further audit procedures.

Advantages of Statistical Sampling (to be discussed after finishing all concepts of Sampling)


- A) The amount of testing (sample size) does not increase in proportion to the increase in the size of the area (universe) tested.
- B) The sample selection is more objective and thereby more defensible.
- C) The method provides a means of estimating the minimum sample size associated with a specified risk and precision.
- D) It may provide a better description of a large mass of data than a complete examination of all the data, since non-sampling errors such as processing and clerical mistakes are not as large



Communication and correction of Misstatements

- The auditor shall communicate on a timely basis all misstatements accumulated during the audit with the appropriate level of management, unless prohibited by law or regulation. The auditor shall request management to correct those misstatements
- If management refuses to correct some or all of the misstatements communicated by the auditor, the auditor shall obtain an understanding of management's reasons for not making the corrections.
- The auditor shall communicate with TCWG uncorrected misstatements and the effect that they, individually or in aggregate, may have on the opinion in the auditor's report, unless prohibited by law or regulation. Auditor shall request that such misstatements should be corrected

Written Representation

The auditor shall request a written representation from management and, where appropriate, those charged with governance whether they believe the effects of uncorrected misstatements are immaterial, individually and in aggregate, to the financial statements as a whole. A summary of such items shall be included in or attached to the written representation

Evaluating materiality of uncorrected misstatements

Prior to evaluating the effect of uncorrected misstatements, the auditor shall reassess materiality determined in accordance with SA 320 to confirm whether it remains appropriate in the context of the entity's actual financial results

**Auditor shall consider:**

- A) The size and nature of the misstatements,
- B) the particular circumstances of their occurrence
- C) The effect of uncorrected misstatements related to prior periods

Definition of Analytical Procedures

evaluations of financial information through

analysis of plausible relationships among both financial and non-financial data

AP also cover such investigations as is necessary of

Identified fluctuations or relationships that are
→ inconsistent with other relevant information or
→ differ from expected values by a significant amount.

Objective as per SA 520

To obtain relevant and reliable audit evidence when using SAP

To design and perform analytical procedures near the end of the audit

that assist the auditor when forming an overall conclusion

whether the FS are consistent with the auditor's understanding of the entity.

Examples of Analytical Procedures

consideration of comparisons of the entity's financial information are:

- Comparable information for prior periods
- Anticipated results of the entity, such as budgets or forecasts, or expectations of the auditor, such as an estimation of depreciation.
- Similar industry information, such as a comparison of the entity's ratio of sales to accounts receivable with industry averages or with other entities of comparable size in the same industry.

consideration of relationships are:

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

Thus, we can say that Analytical Procedures may be segregated into the following major types:

- as comparison of client and industry data
- comparison of client data with similar prior period data
- comparison of client data with client-determined expected results,
- comparison of client data with auditor-determined expected results
- comparison of client data with expected results, using non financial data

The overall tests can be extended for making inter-firm and intra-firm comparison of trading results.

When designing and performing SAP, auditor shall consider following:

Determine the suitability of particular SAP for a given assertion

It depends upon:

- A) influenced by the nature of the assertion
- B) how effective it will be in detecting a misstatement
- C) Different types of analytical procedures provide different levels of assurance

Evaluate the reliability of data from which the auditor's expectation of recorded amounts or ratios is developed

It depends upon:

- SNC2
- A) Source of the information.
- B) Comparability of the information.
- C) Nature and relevance of the information.
- D) Controls over the information

Develop an expectation of recorded amounts or ratios and evaluate whether the expectation is sufficiently precise

It depends upon:

- Accurate Degree Available
- A) The accuracy with which the expected results of SAP can be predicted.
- B) The degree to which information can be disaggregated.
- C) The availability of the information, both financial and non-financial.

Determine the amount of any difference of recorded amounts from expected values that is acceptable without further investigation (It is influenced by materiality)

Factors to be considered for Substantive Analytical Procedures: Source of Distilled PAANI

- A) Source of data:
- B) Disaggregation
- C) Predictability
- D) Account type
- E) Availability of Data
- F) Nature of Assertion
- G) Inherent Risk → What can go wrong in the FS.

Techniques Available as SAP

Trend analysis

- is a commonly used technique
- analysing account fluctuations by comparing current year to prior year/ several years information
- It is the comparison of current data with the prior period balance or with a trend in two or more prior period balances
- The auditor evaluates whether the current balance of an account moves in line with the trend established with previous balances for that account, or based on an understanding of factors that may cause the account to change.

Ratio analysis

- useful for analysing asset and liability accounts as well as revenue and expense accounts
- An individual balance sheet account is difficult to predict on its own but its relationship to another account is often more predictable
- Ratios can also be compared
 - A) Over time
 - B) with entities in the same group
 - C) with other companies in the same industry.

Reasonableness tests

- this analytical procedure does not rely on events of prior periods, but upon non-financial data for the audit period under consideration
- These tests are generally more applicable to income statement accounts and certain accrual or prepayment accounts
- these tests are made by reviewing the relationship of certain account balances to other balances for reasonableness of amounts

Structural modelling

A modelling tool constructs a statistical model from financial and/or non-financial data of prior accounting periods to predict current account balances
E.g. Linear Regression

Timing of Analytical Procedures



Experienced auditors use analytical procedures in all stages of the audit:

A) Planning Phase

B) Testing Phase:

C) Completion Phase:

Investigating results of SAP



If analytical procedures performed in accordance with this SA identify fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount



the auditor shall investigate such differences by



Inquiring of management and obtaining appropriate audit evidence relevant to management's responses reliability of data from which the auditor's expectation of recorded amounts or ratios is developed



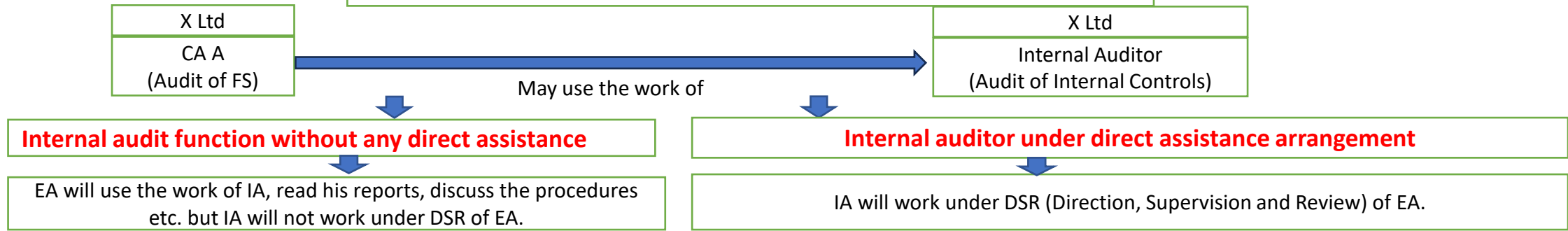
IF management is unable to provide an explanation



Perform other audit procedures as considered necessary in the circumstances.

Consideration → Public Sector Entities.

The relationships between individual financial statement items traditionally considered in the audit of business entities may not always be relevant in the audit of governments or other non-business public sector entities



Key Questions	Approach 1- Using the work of IA function (No direct assistance)	Approach 2- Using IA to provide Direct assistance to the EA.
Determining whether to use his work or not. (Evaluating IA)	<p>Evaluate OCA of IA</p> <p>O- Objectivity- Organisational status should support objectivity</p> <p>C- Competence- sufficient competence to perform IA</p> <p>A- Approach- systematic and disciplined approach while performing IA</p> <p>If there is sufficient doubt over O/C/A then don't use the work of IA or use less of his work.</p>	<p>Evaluate LOC</p> <p>L- Legal prohibition in using IA for direct assistance (DA)</p> <p>O- Objectivity</p> <p>C- Competence</p> <p>If there is a legal prohibition or sufficient doubt over O/C then don't use IA to provide DA to the EA.</p>
Determining in which areas and to what extent EA can use IA's work	<p>A) Evaluate the scope of work of IA as agreed with the management to understand whether it is relevant or not for EA.</p> <p>B) Areas in which using IA's work is allowed- Note 1 after this table</p> <p>C) Areas in which EA should less of IA's work or avoid using it and perform more of the work directly- Note 2 after this table</p> <p>D) Co-ordinate with IA (Discuss the NTE of procedures, sample size etc.)</p>	<p>A) Prior written agreement with management and IA agreeing for direct assistance arrangement</p> <p>B) Areas in which EA can use IA to provide Direct Assistance- Note 1 after this table</p> <p>C) Areas in which EA should not use IA to provide Direct Assistance- Note 3 after this table</p>
Evaluating the Adequacy of the work performed	<p>EA shall perform following procedures to determine whether the work of IA is adequate for the purposes of audit:</p> <p>A) Inquiry,</p> <p>B) Observation</p> <p>C) Reperform some of the work done by IA</p> <p>D) Reviewing IA's working papers, if necessary.</p>	<p>A) DSR the IA in accordance with SA 220</p> <p>B) EA should reperform some of the work done by IA.</p> <p>C) EA should be satisfied that IA has obtained SAAE in relation to the work allocated to him.</p> <p>D) Working papers of IA under DA arrangement will be the property of EA.</p>

Note 1: Work of the internal audit function that can be used by the external auditor include the following:

- A) Testing of the operating effectiveness of controls.
- B) Substantive procedures involving limited judgment.
- C) Observations of inventory counts.
- D) Tracing transactions through the information system relevant to financial reporting.
- E) Testing of compliance with regulatory requirements.
- F) In some circumstances, audits or reviews of the financial information of subsidiaries that are not significant components to the group (where this does not conflict with the requirements of SA 600).

Note 2: The external auditor shall make all significant judgments in the audit engagement and, to prevent undue use of the work of the internal audit function, shall plan to use less of the work of the function and perform more of the work directly in case of following circumstances:

- (a) More judgment is involved in:
 - (i) Planning and performing relevant audit procedures; and
 - (ii) Evaluating the audit evidence gathered;
- (b) The higher the assessed risk of material misstatement at the assertion level, with special consideration given to risks identified as significant;
- (c) The less the internal audit function's organizational status and relevant policies and procedures adequately support the objectivity of the internal auditors; and
- (d) The lower the level of competence of the internal audit function.

Note 3: The E.A. shall not use internal auditors to provide direct assistance to perform procedures :

- A) Making significant judgements in the audit
- B) Relate to higher assessed risks of material misstatement where the judgement required is more than limited.
- C) Relate to work which is reported to management or TCWG by Internal audit function
- D) Relate to decisions the E.A. makes in accordance with SA

SA 260- Communication with Those Charged With Governance (TCWG)- Chapter 7

1. Who is TCWG?

It depends upon size/ ownership of the entity. For Example:

- A) Supervisory board (non-executive) that is legally separate from executive management (two-tier)
- B) Supervisory and executive functions of single board (one-tier)
- C) Government entities- TCWG may not be a part of the entity i.e it could be an external party

Auditor's **Responsibilities** in relation to audit of FS.
If LOE as per SA 210 has been discussed and agreed with TCWG then no separate communication required as per SA 260.
If LOE has been agreed with management then forward copy of such letter to TCWG

2. Matters to be communicated (PLAN AND FIND RESPONSIBLE INDEPENDENCE)

Planned scope and timing of audit.
Communicate MIKER- (materiality, Internal control relevant to audit, preliminary views about Key Audit Matter, Expert's involvement, Risk areas of significant risk)

Significant findings from audit: WO MARD

- A- Accounting practices- qualitative aspects- discussion of PED- Policy estimates and disclosures
- D- Difficulties encountered during the course of audit- E.g. Delay, denial, short-time, refusal to provide information etc.
- R- Report modifications- Q,A,D opinion, EOM, OM, KAM etc.
- M- Matters subject to discussion with management- significant events/transactions in current period; Appointment and fees related; Matters on which there is a disagreement between auditor and mgmt.
- W- WRs that auditor is requesting
- O- Other matters relevant to financial reporting that require attention of TCWG

Written declaration regarding compliance with **independence**.
Mandatory in case of **listed entities**.
Content of such communication:
(a) team and firm has complied with independence
(b) All relationships and other matters between the firm, network firms, and the entity that, in the auditor's professional judgment, may reasonably be thought to bear on independence. This shall include total fees charged during the period covered by the financial statements for audit and non-audit services and
(c) The related safeguards that have been applied to eliminate identified threats to independence or reduce them to an acceptable level.

3. Manner of communication (next page)

3. Manner of communication

- A) The auditor shall communicate with those charged with governance the form, timing and expected general content of communications.
- B) The auditor shall communicate in writing with those charged with governance regarding significant findings from the audit if, in the auditor's professional judgment, oral communication would not be adequate. Written communications need not include all matters that arose during the course of the audit.
- C) The auditor shall communicate in writing with those charged with governance regarding auditor independence when required in case of listed entities. The auditor shall communicate with those charged with governance on a timely basis.
- D) The auditor shall evaluate whether the two-way communication between the auditor and those charged with governance has been adequate for the purpose of the audit. If it has not, the auditor shall evaluate the effect, if any, on the auditor's assessment of the risks of material misstatement and ability to obtain sufficient appropriate audit evidence, and shall take appropriate action.

4. Significance of Communication with Those charged with governance

An effective two-way communication is important in assisting:

- A) understanding matters related to the audit in context, and in developing a constructive working relationship.
- B) auditor in obtaining from those charged with governance information relevant to the audit.
- C) Those charged with governance in fulfilling their responsibility to oversee the financial reporting process

1. Deficiency in Internal Control

Internal control is DIO (designed implemented or operated) in such a way that is unable to prevent or detect and correct misstatements in the FS

A control necessary to prevent, or detect and correct, misstatements in the FS on a timely basis is missing

2. During the Course of audit, if auditor identifies any deficiency in internal control

He should evaluate whether it is a significant deficiency in internal control

2.1 IF it is a significant deficiency in internal control then auditor should

2.2 IF it is not a significant deficiency in internal control then auditor should

3. Examples of significant deficiency in internal control:**Like Volume and Amount of SU SU**

- A) Likelihood of deficiency leading to Material Misstatement
- B) Volume of activity in the area to which deficiency relates
- C) Amounts exposed to deficiency
- D) Susceptibility to loss or fraud
- E) Subjectivity/complexity of the estimates exposed to deficiency.

4. Indicators of significant deficiencies in internal control include:

- A) Ineffective control environment
- B) Misstatements detected by the auditor which were not detected by entity's internal control.
- C) Disclosure of previous year's material misstatement due to error or fraud as 'Prior Period item' in the Current year FS

5 Communicating Significant deficiencies identified- Letter of Weakness

- A) A description (exact quantification not required) of the deficiencies and an explanation of their potential effects
- B) Sufficient information to enable TCWG and mgmt to understand the **context of the communication:**
 - (i) **Purpose of audit** → **express an opinion on FS.**
 - (ii) **Audit includes consideration of internal controls relevant to preparation of FS.**
 - (iii) **Only those deficiencies have been communicated which were identified during the audit and auditor does not provide a separate assurance on the entity's internal control.**
- C) May include Suggestions for remedial action.
- D) Mgmt's responses on the deficiencies

Note:

- a) **Timing of Communication** → in case of **listed entities** → **before the date of approval of the financial statements**
- b) **Timing of Communication** → in case of **other entities** → not more than 60 days after the date of the auditor's report (before completing assembly of audit file)

Objective of the auditor is to prepare documentation that provides

A sufficient and appropriate record of the basis for the auditor's report

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

Audit Documentation refers to the record of

procedures performed

relevant audit evidence obtained,

conclusions the auditor reached

Purpose of Documentation- 6 points

Assisting audit team to PAD, Retaining Records, Enabling Reviews (internal and external)

- A) Assisting the engagement team to plan and perform audit
- B) Enabling the engagement team to be accountable for its work.
- C) Assisting the engagement team to DSR as per SA 220 (Direct, Supervise and Review)
- D) Retaining a record of matters of continuing significance to future audits.
- E) Enabling the conduct of EQCR as per SA 220
- F) Enabling the conduct of external inspection (e.g. peer review, quality review)

Form, Content and Extent of Documentation

→ The nature, timing, and extent of the audit procedures performed to comply with the SAs and applicable legal and regulatory requirements. **Example**

- i) Identifying characteristics of each item tested
- ii) Who performed the work and date of completion
- (iii) Who reviewed the work performed.

→ The results of the audit procedures performed, and the audit evidence obtained;

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

→ Document Discussions of significant matters with management and where appropriate TCWG (matter discussed, when and with whom discussions took place).

→ How the auditor addressed the inconsistency identified during the audit.

Factors determining Form, Content and Extent of Audit Documentation

MR. SPEED

M- The audit _____ and tools used.

R- The identified _____.

S- The _____ of the entity.

P- The nature of the audit _____ to be performed.

E- The significance of the audit _____ obtained.

E- The nature and extent of _____ identified.

D- The need to _____ or the basis for a conclusion not readily determinable from the documentation of the work performed or audit evidence obtained.

Examples of Audit Documentation (Read once)

- A) Audit programmes.
- B) Analyses.
- C) Issues memoranda.
- D) Summaries of significant matters.
- E) Letters of confirmation and representation.
- F) Checklists.
- G) Correspondence (including e-mail) concerning significant matters.

Auditor needs to maintain adequate documentation of Significant Matters.

Judging the significance of a matter requires an objective analysis of the facts and circumstances. Explain with examples.

- A) Matters that give rise to significant risks (examples of significant risks are given in SA 315)
- B) Results of audit procedures indicating possible material misstatement or need to perform additional procedures.
- C) Circumstances that cause the auditor significant difficulty in applying necessary audit procedures
- D) Summaries of significant matters.
- D) Findings that could result in a modification to the audit opinion.

Examples of circumstances in which it is appropriate to prepare audit documentation relating to the use of professional judgment

- A) The rationale for auditor's conclusion where auditor needs to consider various factors.
- B) The Basis of auditor's conclusion in verifying estimates with high subjectivity.
- C) The basis for auditor's conclusion about the authenticity of a document.

Ownership of Working Papers (SQC-1)



- A) SQC-1 provides that, _____, audit documentation is the property of the auditor.
- B) He may at his discretion, make portions of, or extracts from, audit documentation available to clients, provided such **disclosure does not undermine the validity of the work performed, or, in the case of assurance engagements, the independence of the auditor or of his personnel.**

Assembly of Audit File (SQC-1)



- Audit file may be defined as
- one or more folders or other storage media,
 - in physical or electronic form,
 - containing the records that comprise the audit documentation for a specific engagement.
- SQC 1 requires firms to establish policies and procedures for the timely completion of the assembly of audit files. An appropriate time limit within which to complete the assembly of the final audit file is ordinarily not more than _____ days after the date of _____.
- It is an administrative process which does not involve new procedures.
- Administrative changes can be made while assembly of audit file e.g. cross referencing working papers, signing completion checklist etc.

Retention of Working Papers



SQC 1 requires firms to establish policies and procedures for the retention of engagement documentation. The retention period for audit engagements ordinarily is no shorter than seven years from the date of the _____, or, if later, the date of the _____.

Completion memorandum



- The auditor may consider it helpful to prepare and retain as part of the audit documentation
- a summary (sometimes known as a completion memorandum) that describes:
 - a) a summary (sometimes known as a completion memorandum) that describes
 - b) how they were addressed.
- Such a summary may
 - a) facilitate effective and efficient review and inspection of the audit documentation, particularly for large and complex audits.
 - b) assist auditor's consideration of the significant matters.
 - c) the auditor in analysing whether the overall objectives of the auditor have been achieved or not.

Access to Working Papers (working note during lecture)

Chapter 8- Audit Report- Balance Discussions (SA 700 to SA 706 discussed earlier)

SA 710 Comparative Information—Corresponding Figures and Comparative Financial Statements

Comparative Information → The amounts and disclosures included in the FS in respect of **one or more prior periods** as per AFRF

Corresponding Figures

Comparative information where amounts and other disclosures for the prior period are included as an integral part of the current period FS and are intended to be read only in relation to the amounts and other disclosures relating to the current period

The level of detail presented in the corresponding amounts and disclosures is dictated primarily by its relevance to the current period figures.

the auditor's opinion on the financial statements refers to the current period only. Corresponding figures are discussed in audit report only if the need arises.

Comparative Financial Statements

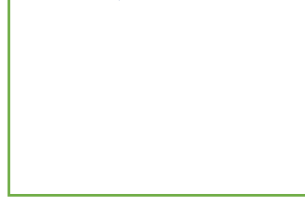
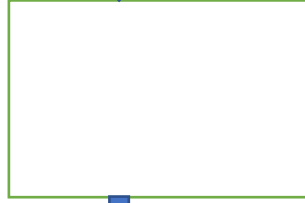
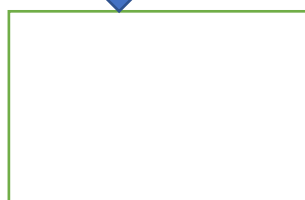
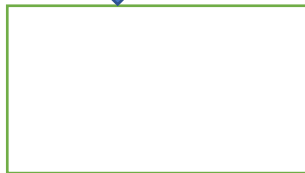
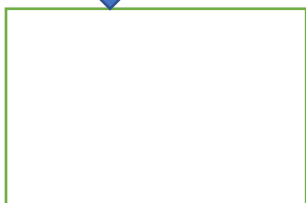
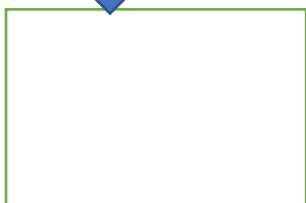
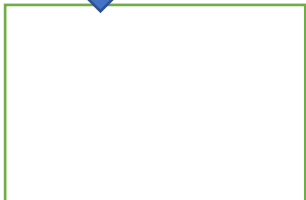
Comparative information where amounts and other disclosures for the prior period are included for comparison with the FS of the current period but, if audited, are referred to in the auditor's opinion.

The level of information included in those comparative FS is comparable with that of the FS of the current period.

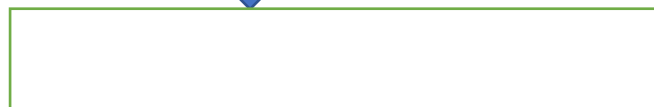
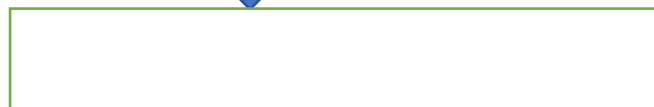
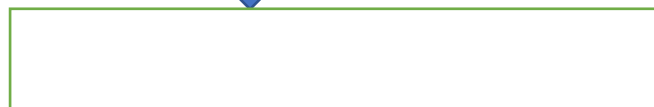
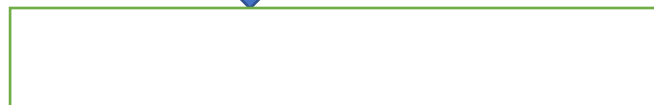
the auditor's opinion refers to each period for which financial statements are presented.

Corresponding Figures → Reporting Considerations →

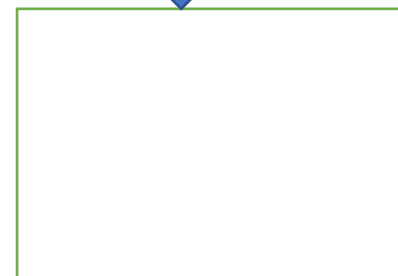
Prior Period FS audited by existing auditor



Prior Period FS audited by predecessor auditor



Prior Period FS unaudited



Comparative FS → Reporting Considerations →

Prior Period FS audited by existing auditor

if the auditor's opinion on such prior period financial statements

differs from the opinion the auditor previously expressed,

the auditor shall disclose the detailed reasons for the different opinion in an Other Matter paragraph in accordance with SA 706

Working Space :-

Prior Period FS audited by predecessor auditor

predecessor auditor had previously reported without modification

If the auditor concludes that a material misstatement exists that affects the prior period FS

communicate the misstatement with the appropriate level of mgmt and TCWG

request that the predecessor auditor be informed

If the prior period FS are amended and the predecessor auditor agrees*** to issue a new auditor's report on such amended prior period FS

the auditor shall report only on the _____

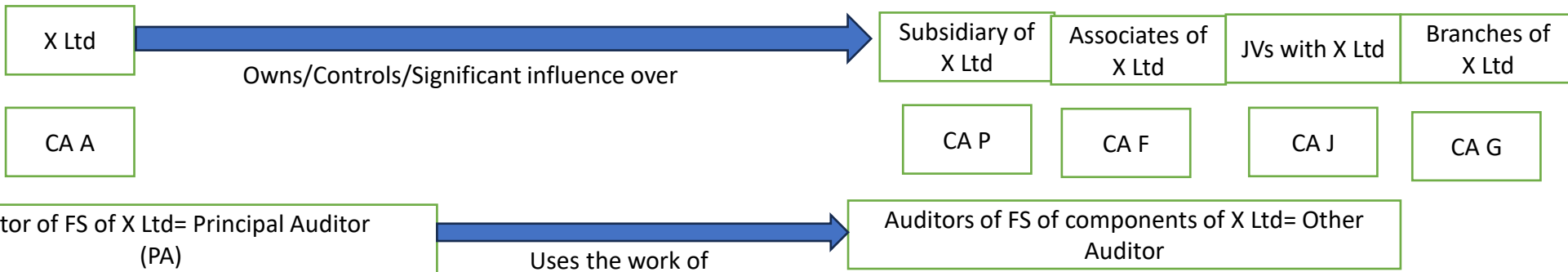
*** If he is unwilling/unable to revise the report then current auditor should include in OM Para the predecessor auditor reported on the FS of the prior period before amendment.

Prior Period FS unaudited

Audit procedures for Comparative Information



- Whether the financial statements include the comparative information required by the AFRF
- Whether comparative information is appropriately classified.
- Whether comparative information agrees with the amounts and other disclosures presented in the prior period.
- Whether the accounting policies reflected in the comparative information are consistent with those applied in the current period or changes, if any have been properly APD → accounted presented and disclosed in FS.
- If the auditor had audited the prior period's financial statements, the auditor shall also follow the relevant requirements of SA 560.
- If the auditor becomes aware of a possible material misstatement in the comparative information while performing the current period audit, the auditor shall perform such additional audit procedures as are necessary
- As per SA 580 → Written Representation for:
 - A) all periods referred to in the auditor's opinion.
 - B) any prior period item that is separately disclosed in the current year's statement of profit and loss.
- Initial Audit Engagements → Also apply requirements of SA 510.



SA 600- Key points

Acceptance as Principal Auditor (PA)

For this purpose the auditor would consider:

MR. Business Performs

- A) materiality of the portion of the financial information which the principal auditor audits
- B) the principal auditor's degree of knowledge regarding the **business** of the components
- C) the **RoMM** in the financial information of the components audited by the other auditor
- D) the **performance** of additional procedures as set out in this SA

PA's Audit Procedures

A Written Special Advise → Plan and Arrange Time-Table for Accounts and Audit

- A) **advise** the other auditor → how his work and report will be used
- B) make sufficient **arrangements** at the planning stage for co-ordination
- C) Inform about matters requiring **special** audit considerations
- D) Advise about significant **accounting, auditing** and reporting requirements.
- E) Obtain representation (**written**) that OA has complied with these requirements.
- F) Discuss **time-table** for Completion of Audit

Co-ordination between Auditors

- A) Sufficient liaison between the principal auditor and the other auditor.
- B) The other auditor should co-ordinate with the principal auditor
- C) The principal auditor should advise the other auditor of any matters having an important bearing on the other auditor's work.
- D) PA may require the other auditor to answer a detailed questionnaire
- E) OA should respond to such questionnaire on a timely basis.

Division of responsibility

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

If the other auditor issues a Modified Report then PA shall consider materiality and decide modification accordingly

IF PA relies upon work of OA then he shall state the extent of financial info audited by OA included in the financial info of the entity. (Other Matter Para)

IF PA cannot rely upon OA and he concluded that it is not possible to perform alternate audit procedures. Principal auditor to express a qualified opinion or disclaimer of opinion in case of a limitation on the scope of audit.

SA 299- Joint Audit of Financial Statements

1. Joint Audit Planning and Risk Assessment

- A) Factors to be considered in development of Joint Audit Plan and strategy
 - I) Identify division of audit areas
 - II) Ascertaining reporting objectives to plan timing of audit
 - III) Team members to be directed depend upon certain factors
 - IV) Results of preliminary engagement activities and knowledge gained on other similar engagements
 - V) Ascertaining the nature, timing and extent of resources
- B. Work allocation document to be signed by all JAs and to be communicated with TCWG
- C. All JA's to obtain common engagement letter and common written representation letter.

2. Responsibility division

Jointly and Severally responsible for:

- A) Audit work which is not divided.
- B) decisions taken by all JAs under audit planning for common audit areas concerning the NTE of procedures to be performed by each JA.
(execution remains individual responsibility)
- C) matters brought to notice by one JA and on which there is an agreement among all JAs.
- D) Examining that FS of the entity comply with relevant law.
- E) P&D of FS as required by AFRF.
- F) Ensuring that audit report complies with Law and SAs

Individually responsible for

- Areas allocated to each Joint auditor.
- Determine the NTE of audit procedures to be applied to the area allocated.
- Study the internal control system of the area allocated.

Each JA is allowed to assume that the other JAs have performed work as per SAs. Not required to review the work performed by other JA.

3. Reporting Considerations

- where the joint auditors are in disagreement with regard to the **opinion or any matters to be covered by the audit report, they shall express their opinion in a separate audit report.**
- A joint auditor is not bound by the views of the majority of the joint auditors regarding the opinion or matters to be covered in the audit report.
- Such Separate audit report shall also make reference to the audit report issued by other joint auditors. Such reference shall be made under the heading "Other Matter Paragraph" as per SA 706.

Sec 143 (1)	Duty to inquire upon certain matters
	amongst other matters inquire into the following matters, namely:—
a)	whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are prejudicial to the interests of the company or its members
b)	whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company
c)	where the company not being an investment company or a banking company, whether so much of the assets of the company as consist of shares, debentures and other securities have been sold at a price less than that at which they were purchased by the company
d)	whether loans and advances made by the company have been shown as deposits
e)	whether personal expenses have been charged to revenue account
f)	where it is stated in the books and documents of the company that any shares have been allotted for cash, whether cash has actually been received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading

The opinion of the Research Committee of the Institute of Chartered Accountants of India on section 143(1) is reproduced below: “The auditor is not required to report on the matters specified in sub-section (1) unless he has any special comments to make on any of the items referred to therein. If he is satisfied as a result of the inquiries, he has no further duty to report that he is so satisfied. In such a case, the content of the Auditor’s Report will remain exactly the same as the auditor has to inquire and apply his mind to the information elicited by the enquiry, in deciding whether or not any reference needs to be made in his report. In our opinion, it is in this light that the auditor has to consider his duties under section 143(1).” Therefore, it could be said that the auditor should make a report to the members in case he finds answer to any of these matters in adverse.

Sec 143(3) Duty to report upon Certain Matters**The auditor's report shall also state—**

- | | |
|----|---|
| a) | whether he has sought and obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of his audit and if not, the details thereof and the effect of such information on the financial statements |
| b) | whether, in his opinion, proper books of account as required by law have been kept by the company so far as appears from his examination of those books and proper returns adequate for the purposes of his audit have been received from branches not visited by him |
| c) | whether the report on the accounts of any branch office of the company audited under sub-section (8) by a person other than the company's auditor has been sent to him under the proviso to that sub-section and the manner in which he has dealt with it in preparing his report |
| d) | whether the company's balance sheet and profit and loss account dealt with in the report are in agreement with the books of account and returns |
| e) | whether, in his opinion, the financial statements comply with the accounting standards |
| f) | the observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company |
| g) | whether any director is disqualified from being appointed as a director under sub-section (2) of section 164 |
| h) | any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith |
| i) | whether the company has adequate internal financial controls with reference to financial statements in place and the operating effectiveness of such controls; |

[In case of Private Company - Clause \(i\) of Sub-Section \(3\) of Section 143 Shall not apply to a private company:-](#)

(i) which is a one person company or a small company;

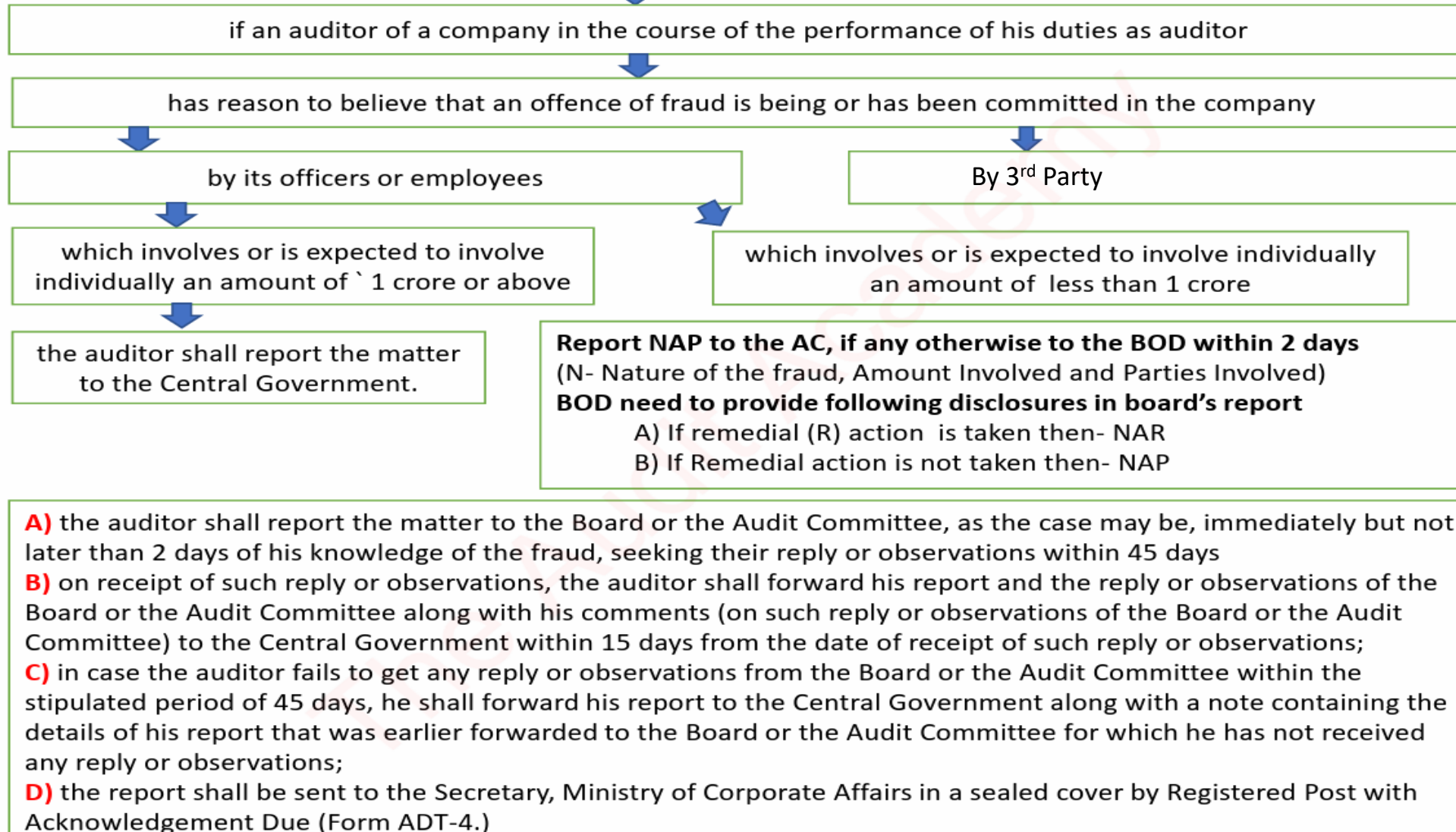
or

(ii) which has turnover less than rupees fifty crores as per latest audited financial statement and which has aggregate borrowings from banks or financial institutions or any body corporate at any point of time during the financial year less than rupees twenty five crorej) such other matters [as may be prescribed](#).

The auditor's report shall also include their views and comments on the following matters, namely:-

- (1) whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statement;
- (2) whether the company has made provision, as required under any law or accounting standards, for material foreseeable losses, if any, on long term contracts including derivative contracts;
- (3) whether there has been any delay in transferring amounts, required to be transferred, to the Investor Education and Protection Fund by the company.
- (4) (i) Whether the management has represented that, to the best of its knowledge and belief, other than as disclosed in the notes to the accounts, no funds have been advanced or loaned or invested (either from borrowed funds or share premium or any other sources or kind of funds) by the company to or in any other person(s) or entity(ies), including foreign entities ("Intermediaries"), with the understanding, whether recorded in writing or otherwise, that the Intermediary shall, whether, directly or indirectly lend or invest in other persons or entities identified in any manner whatsoever by or on behalf of the company ("Ultimate Beneficiaries") or provide any guarantee, security or the like on behalf of the Ultimate Beneficiaries;
- (ii) Whether the management has represented, that, to the best of its knowledge and belief, other than as disclosed in the notes to the accounts, no funds have been received by the company from any person(s) or entity(ies), including foreign entities ("Funding Parties"), with the understanding, whether recorded in writing or otherwise, that the company shall, whether, directly or indirectly, lend or invest in other persons or entities identified in any manner whatsoever by or on behalf of the Funding Party ("Ultimate Beneficiaries") or provide any guarantee, security or the like on behalf of the Ultimate Beneficiaries; and
- (iii) Based on such audit procedures that the auditor has considered reasonable and appropriate in the circumstances, nothing has come to their notice that has caused them to believe that the representations under sub-clause (i) and (ii) contain any material mis-statement.
- (5) Whether the dividend declared or paid during the year by the company is in compliance with section 123 of the Companies Act, 2013.
- (6) Whether the company has used such accounting software for maintaining its books of account which has a feature of recording audit trail (edit log) facility and the same has been operated throughout the year for all transactions recorded in the software and the audit trail feature has not been tampered with and the audit trail has been preserved by the company as per the statutory requirements for record retention.

Audit Trail means, a step-by-step sequential record which provides evidence of the documented history of financial transactions to its source. An auditor can trace every step of, the financial data of a particular transaction right from the general ledger to its source document with the help of the audit trail.

S. 143(12) of Companies Act, 2013- Duty to report fraud to the central government**Fraud Reporting to CG- Sec 143(12) read with Rule 13 of CAAR, 2014**

CARO 2020:

Para 1	This Order may be called the Companies (Auditor's Report) Order, 2020.
Para 2	It shall apply to every company including a foreign company as defined in clause (42) of section 2 of the Companies Act, 2013 (18 of 2013) [hereinafter referred to as the Companies Act], except–
i)	a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949
ii)	an insurance company as defined under the Insurance Act, 1938
iii)	a company licensed to operate under section 8 of the Companies Act
iv)	a One Person Company as defined in clause (62) of section 2 of the Companies Act and a small company as defined in clause (85) of section 2 of the Companies Act
v)	a private limited company, not being a subsidiary or holding company of a public company, having a) a paid up capital and reserves and surplus not more than one crore rupees as on the balance sheet date and b) which does not have total borrowings exceeding one crore rupees from any bank or financial institution at any point of time during the financial year and c) which does not have a total revenue as disclosed in Scheduled III to the Companies Act (including revenue from discontinuing operations) exceeding ten crore rupees during the financial year as per the financial statements.
This Order shall not apply to the auditor's report on consolidated financial statements except clause (xxi) of paragraph 3.	

Para 3	Matters to be included in auditor's report																	
The auditor's report on the accounts of a company to which this Order applies shall include a statement on the following matters, namely:-																		
Clause i)	Property, Plant and Equipment																	
a)	Proper records A) whether the company is maintaining proper records showing full particulars, including quantitative details and situation of Property, Plant and Equipment B) whether the company is maintaining proper records showing full particulars of intangible assets;																	
b)	Physical Verification whether these Property, Plant and Equipment have been physically verified by the management at reasonable intervals; whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of account																	
c)	Ownership of Immovable Properties: whether the title deeds of all the immovable properties (other than properties where the company is the lessee and the lease agreements are duly executed in favour of the lessee) disclosed in the financial statements are held in the name of the company, if not, provide the details thereof in the format below:																	
	<table border="1"> <thead> <tr> <th>Description of property</th> <th>Gross carrying value</th> <th>Held in name of</th> <th>Whether promoter, director or their relative or employee</th> <th>Period held – indicate range, where appropriate</th> <th>Reason for not being held in name of company (is there a dispute?)</th> </tr> </thead> <tbody> <tr> <td> </td> <td> </td> <td> </td> <td> </td> <td> </td> <td> </td> </tr> </tbody> </table>						Description of property	Gross carrying value	Held in name of	Whether promoter, director or their relative or employee	Period held – indicate range, where appropriate	Reason for not being held in name of company (is there a dispute?)						
Description of property	Gross carrying value	Held in name of	Whether promoter, director or their relative or employee	Period held – indicate range, where appropriate	Reason for not being held in name of company (is there a dispute?)													
d)	Revaluation whether the company has revalued its Property, Plant and Equipment (including Right of Use assets) or intangible assets or both during the year and, if so, whether the revaluation is based on the valuation by a Registered Valuer; specify the amount of change, if change is 10% or more in the aggregate of the net carrying value of each class of Property, Plant and Equipment or intangible assets																	
e)	Benami Property? whether any proceedings have been initiated or are pending against the company for holding any benami property under the Benami Transactions (Prohibition) Act, 1988 (45 of 1988) and rules made thereunder, if so, whether the company has appropriately disclosed the details in its financial statements																	

Clause ii)	Inventory
a)	Physical Verification? whether physical verification of inventory has been conducted at reasonable intervals by the management and whether, in the opinion of the auditor, the coverage and procedure of such verification by the management is appropriate; whether any discrepancies of 10% or more in the aggregate for each class of inventory were noticed and if so, whether they have been properly dealt with in the books of account;
b)	Working Capital Loan Sanctioned? whether during any point of time of the year, the company has been sanctioned working capital limits in excess of five crore rupees, in aggregate, from banks or financial institutions on the basis of security of current assets; whether the quarterly returns or statements filed by the company with such banks or financial institutions are in agreement with the books of account of the Company, if not, give details;
iii)	Investments made/loans or Guarantees Given whether during the year the company has made investments in, provided any guarantee or security or granted any loans or advances in the nature of loans, secured or unsecured, to companies, firms, Limited Liability Partnerships or any other parties, if so,-
a)	Break-up of loan given to SJAs and Others whether during the year the company has provided loans or provided advances in the nature of loans, or stood guarantee, or provided security to any other entity [not applicable to companies whose principal business is to give loans], if so, indicate- A) the aggregate amount during the year, and balance outstanding at the balance sheet date with respect to such loans or advances and guarantees or security to subsidiaries, joint ventures and associates B) the aggregate amount during the year, and balance outstanding at the balance sheet date with respect to such loans or advances and guarantees or security to parties other than subsidiaries, joint ventures and associates;
b)	Prejudicial to Company's interest? whether the investments made, guarantees provided, security given and the terms and conditions of the grant of all loans and advances in the nature of loans and guarantees provided are not prejudicial to the company's interest;

c)	<p>Repayment Schedule and Recovery? in respect of loans and advances in the nature of loans, whether the schedule of repayment of principal and payment of interest has been stipulated and whether the repayments or receipts are regular;</p>
d)	<p>Amount overdue for > 90 days if the amount is overdue, state the total amount overdue for more than ninety days, and whether reasonable steps have been taken by the company for recovery of the principal and interest;</p>
e)	<p>Renewal/extension/replacement of loan given? whether any loan or advance in the nature of loan granted which has fallen due during the year, has been renewed or extended or fresh loans granted to settle the overdues of existing loans given to the same parties, if so, specify the aggregate amount of such dues renewed or extended or settled by fresh loans and the percentage of the aggregate to the total loans or advances in the nature of loans granted during the year [not applicable to companies whose principal business is to give loans];</p>
f)	<p>Demand Loans or without defined repayment schedule? whether the company has granted any loans or advances in the nature of loans either repayable on demand or without specifying any terms or period of repayment, if so, specify the aggregate amount, percentage thereof to the total loans granted, aggregate amount of loans granted to Promoters, related parties as defined in clause (76) of section 2 of the Companies Act, 2013;</p>
iv)	<p>Compliance with Sec 185 and 186 in respect of loans, investments, guarantees, and security, whether provisions of sections 185 and 186 of the Companies Act have been complied with, if not, provide the details thereof</p>
v)	<p>Deposits Accepted. in respect of deposits accepted by the company or amounts which are deemed to be deposits, whether the directives issued by the Reserve Bank of India and the provisions of sections 73 to 76 or any other relevant provisions of the Companies Act and the rules made thereunder, where applicable, have been complied with, if not, the nature of such contraventions be stated; if an order has been passed by Company Law Board or National Company Law Tribunal or Reserve Bank of India or any court or any other tribunal, whether the same has been complied with or not;</p>

vi)	Cost Records: whether maintenance of cost records has been specified by the Central Government under subsection (1) of section 148 of the Companies Act and whether such accounts and records have been so made and maintained
vii)	Statutory dues
a)	Arrears exceeding 6 months whether the company is regular in depositing undisputed statutory dues including Goods and Services Tax, provident fund, employees' state insurance, income-tax, sales-tax, service tax, duty of customs, duty of excise, value added tax, cess and any other statutory dues to the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as on the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated;
b)	Details of Legal Dispute where statutory dues referred to in sub-clause (a) have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned. (A mere representation to the concerned Department shall not be treated as a dispute)
viii)	Undisclosed Income Surrendered/Disclosed whether any transactions not recorded in the books of account have been surrendered or disclosed as income during the year in the tax assessments under the Income Tax Act, 1961, if so, whether the previously unrecorded income has been properly recorded in the books of account during the year
ix)	Default in repayment of dues
a)	whether the company has defaulted in repayment of loans or other borrowings or in the payment of interest thereon to any lender, if yes, the period and the amount of default to be reported as per the format below:

Nature of borrowing, including debt securities	Name of lender*	Amount not paid on due date	Whether principal or interest	No. of days delay or unpaid	Remarks, if any
--	-----------------	-----------------------------	-------------------------------	-----------------------------	-----------------

b)	Wilful Defaulter? whether the company is a declared wilful defaulter by any bank or financial institution or other lender;
c)	Utilization for the specified purpose? whether term loans were applied for the purpose for which the loans were obtained; if not, the amount of loan so diverted and the purpose for which it is used may be reported
d)	Utilization of short term for long term purpose? whether funds raised on short term basis have been utilised for long term purposes, if yes, the nature and amount to be indicated
e)	Loans taken to meet obligations of components? whether the company has taken any funds from any entity or person on account of or to meet the obligations of its subsidiaries, associates or joint ventures, if so, details thereof with nature of such transactions and the amount in each case
f)	Securities held in Components Pledged? whether the company has raised loans during the year on the pledge of securities held in its subsidiaries, joint ventures or associate companies, if so, give details thereof and also report if the company has defaulted in repayment of such loans raised

x)	Public Offers and Private Placement
a)	whether moneys raised by way of initial public offer or further public offer (including debt instruments) during the year were applied for the purposes for which those are raised, if not, the details together with delays or default and subsequent rectification, if any, as may be applicable, be reported;
b)	whether the company has made any preferential allotment or private placement of shares or convertible debentures (fully, partially or optionally convertible) during the year and if so, whether the requirements of section 42 and section 62 of the Companies Act, 2013 have been complied with and the funds raised have been used for the purposes for which the funds were raised, if not, provide details in respect of amount involved and nature of non-compliance;

xi)	Fraud Reporting
a)	whether any fraud by the company or any fraud on the company has been noticed or reported during the year, if yes, the nature and the amount involved is to be indicated;
b)	whether any report under sub-section (12) of section 143 of the Companies Act has been filed by the auditors in Form ADT-4 as prescribed under rule 13 of Companies (Audit and Auditors) Rules, 2014 with the Central Government
c)	whether the auditor has considered whistle-blower complaints, if any, received during the year by the company

xii)	Nidhi Company
a)	whether the Nidhi Company has complied with the Net Owned Funds to Deposits in the ratio of 1: 20 to meet out the liability;
b)	whether the Nidhi Company is maintaining ten per cent. unencumbered term deposits as specified in the Nidhi Rules, 2014 to meet out the liability;
c)	whether there has been any default in payment of interest on deposits or repayment thereof for any period and if so, the details thereof;
xiii)	Compliance with Sec 177 and Sec 188 of Companies Act, 2013 whether all transactions with the related parties are in compliance with sections 177 and 188 of Companies Act where applicable and the details have been disclosed in the financial statements, etc., as required by the applicable accounting standards;
xiv)	Internal Audit system
a)	whether the company has an internal audit system commensurate with the size and nature of its business
b)	whether the reports of the Internal Auditors for the period under audit were considered by the statutory auditor
xv)	Compliance with Sec 192 of Companies Act, 2013 whether the company has entered into any non-cash transactions with directors or persons connected with him and if so, whether the provisions of section 192 of Companies Act have been complied with;
xvi)	NBFC Registration
a)	whether the company is required to be registered under section 45-IA of the Reserve Bank of India Act, 1934 (2 of 1934) and if so, whether the registration has been obtained;
b)	whether the company has conducted any Non-Banking Financial or Housing Finance activities without a valid Certificate of Registration (CoR) from the Reserve Bank of India as per the Reserve Bank of India Act, 1934
c)	whether the company is a Core Investment Company (CIC) as defined in the regulations made by the Reserve Bank of India, if so, whether it continues to fulfil the criteria of a CIC, and in case the company is an exempted or unregistered CIC, whether it continues to fulfil such criteria
d)	whether the Group has more than one CIC as part of the Group, if yes, indicate the number of CICs which are part of the Group

xvii)	<p>Cash Loss? whether the company has incurred cash losses in the financial year and in the immediately preceding financial year, if so, state the amount of cash losses;</p>
xviii)	<p>Resignation by Statutory Auditor whether there has been any resignation of the statutory auditors during the year, if so, whether the auditor has taken into consideration the issues, objections or concerns raised by the outgoing auditors;</p>
xix)	<p>Material uncertainty? on the basis of the financial ratios, ageing and expected dates of realisation of financial assets and payment of financial liabilities, other information accompanying the financial statements, the auditor's knowledge of the Board of Directors and management plans, whether the auditor is of the opinion that no material uncertainty exists as on the date of the audit report that company is capable of meeting its liabilities existing at the date of balance sheet as and when they fall due within a period of one year from the balance sheet date</p>
xx)	<p>CSR activities</p>
a)	<p>whether, in respect of other than ongoing projects, the company has transferred unspent amount to a Fund specified in Schedule VII to the Companies Act within a period of six months of the expiry of the financial year in compliance with second proviso to sub-section (5) of section 135 of the said Act</p>
b)	<p>whether any amount remaining unspent under sub-section (5) of section 135 of the Companies Act, pursuant to any ongoing project, has been transferred to special account in compliance with the provision of sub-section (6) of section 135 of the said Act;</p>
xxi)	<p>Negative Remarks in the Component Auditor's CARO? whether there have been any qualifications or adverse remarks by the respective auditors in the Companies (Auditor's Report) Order (CARO) reports of the companies included in the consolidated financial statements, if yes, indicate the details of the companies and the paragraph numbers of the CARO report containing the qualifications or adverse remarks.</p>

Para 4 of CARO 2020- Reasons to be stated for unfavourable or qualified answers.-

(1) Where, in the auditor's report, the answer to any of the questions referred to in paragraph 3 is unfavourable or qualified, the auditor's report shall also state the basis for such unfavourable or qualified answer, as the case may be.

(2) Where the auditor is unable to express any opinion on any specified matter, his report shall indicate such fact together with the reasons as to why it is not possible for him to give his opinion on the same.

10+ years of experience! Unbeatable Passion for Audit Subject!!! That's CA Pragnesh Kanabar Sir!

Brahmastra Revision CA Inter Audit- New Syllabus

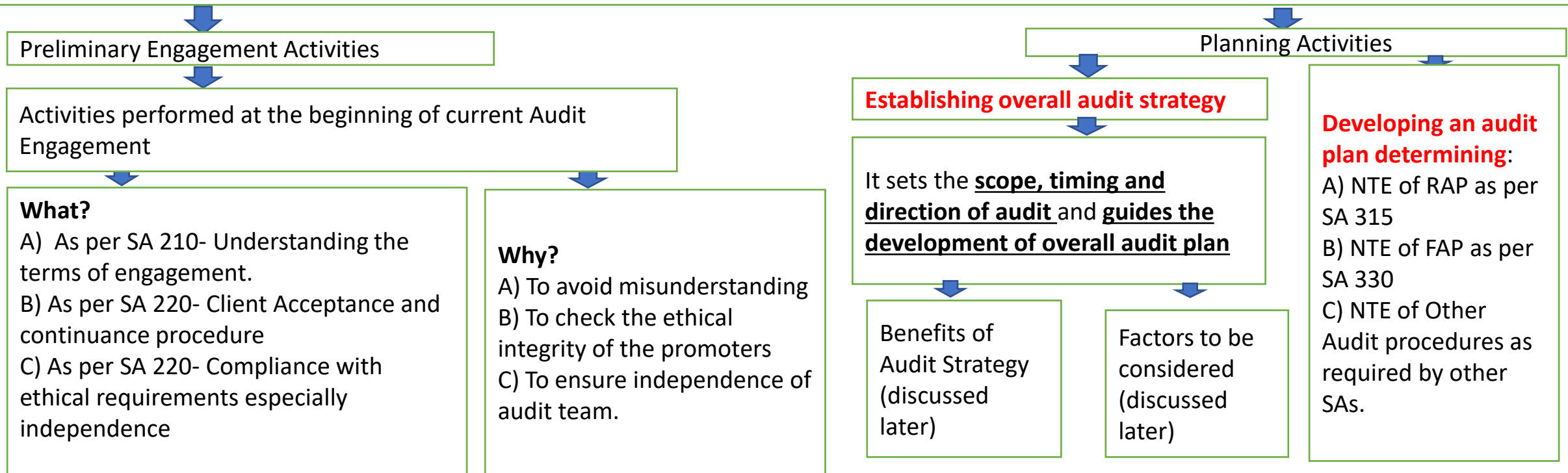
Part II of III- CA Inter Audit Marathon- It covers Chapter 2 & 3 SAs
CA Inter Audit New syllabus

**Watch Revision Videos on our Youtube Channel- The Audit Academy
to get maximum benefit of these notes**

Visit our website- www.theauditacademy.com to join our Youtube channel, telegram channel and to Download our app.

SA 300- Planning an Audit of Financial Statements

This SA deals with following activities to be performed by the auditor



Inter-Relationship between Audit Plan and Audit Strategy (ALL IMPORTANT STATEMENTS).

- Audit Strategy is established before the development of overall audit plan.
- Audit strategy and plan are not necessarily discrete (separate) or sequential processes. They are inter-related. Changes in one may affect the other.
- The audit plan is more detailed than the overall audit strategy that includes the nature, timing and extent of audit procedures to be performed by engagement team member

Benefits of overall audit strategy- 3-4 marks

- Employment of Qualitative Resources (What?) → Audit assistants, experts, technology etc.
- Allocation of Quantity of Resources. (How much?) → Number of team members required?
- Timing of deployment of resources. (When?) → In the interim period or at year-end?
- Management of Resources. (DSR of Resources) → Direction, supervision and Review of Resources? How to manage them?

Factors to be considered while developing audit strategy (*Code: Character of Raman's Team Resulted in Resources*)- 4 marks for each sub-point

Characteristics of Engagement that define the scope.

- a) AFRF
- B) Expected coverage
- C) Use of service organisations
- D) Effect of IT on audit.
- E) Related parties

Raman → ***Reporting***
Objectives, timing of audit and communications required.

- A) Entity's timetable for reporting.
- B) Discussion with mgmt. for type of reports required.
- C) Discussion with Other Auditors for type and timing of report.
- D) Nature and timing of Communications within the audit team

Factors to be considered in directing the engagement ***team's*** efforts.

- (Both of the above points have a common answer)
- A) Determination of materiality.
 - B) Identification of Areas with high RoMM
 - C) Results of previous audit.
 - D) Importance attached to internal control.
 - E) Significant business developments.
 - F) Significant industry specific developments.
 - G) Significant changes in the financial reporting framework.
 - H) The manner in which team members need to maintain professional skepticism

Results of Preliminary engagement activities + Knowledge gained from other engagements (other services provided) performed.

Ascertain the nature, timing and extent of ***resources***.

- A) Selection of engagement team and assigning work to them.
- B) Engagement budgeting (number of hours required)

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

Plans should be made to cover, among other things:

CO-ordinate PIA

- acquiring knowledge of the client’s ACCOUNTING systems, policies and internal control procedures;
- establishing the expected degree of reliance to be placed on INTERNAL control;
- determining and programming the nature, timing, and extent of the audit PROCEDURES to be performed
- COORDINATING the work to be performed.

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

Planning is not a discrete phase of an audit, but rather a continual and iterative process

Planning is not a discrete phase of an audit, but rather a continual and iterative (cyclical/continuous) process that often begins shortly after (or in connection with) the completion of the previous audit and continues until the completion of the current audit engagement. Following activities are to be performed before further audit procedures can be planned:

Law’s MRP Expert

- A) Law → Obtaining a general understanding of LEGAL and regulatory framework applicable to the entity.
- B) M → Determination of MATERIALITY.
- C) R → Performance of other RISK assessment procedures.
- D) P → Development of audit PROGRAMME (audit programme is a set of instructions for the audit team to obtain audit evidence)
- E) Expert → Involvement of EXPERTS.

→The auditor may decide to discuss elements of planning with the entity’s management to facilitate the conduct and management of the audit engagement.

→Although these discussions often occur, the overall audit strategy and the audit plan remain the auditor’s responsibility.

→The involvement of the engagement partner and other key members of the engagement team in planning increases effectiveness and efficiency of audit.

Benefits of Audit Plan- TAPE SD

- A) **Attention** to Important areas
- B) **Timely** resolution of Potential Problems
- C) **Proper** Organisation and Management of Audit Engagement.
- D) Proper **Selection** of Engagement Team
- E) **Direction** and Supervision of Engagement Team
- F) **Easy Coordination** in work done by auditors of components and experts.

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Revision

Considerations in Initial Audit Engagement (first year with the client)

The auditor shall undertake the following activities prior to starting an initial audit:

- A) **Client Acceptance Procedure as per SA 220.**
- B) Communicating with the predecessor (previous) auditor to find out whether there are any reasons for not accepting audit.

Additional matters the auditor may consider in establishing the overall audit strategy and audit plan include the following:

Audit procedures for opening balances (SA 510), request to review working papers of previous auditor, any major issues discussed with management while discussing the terms of engagement etc.

Factors to be considered for planning DSR → Direction Supervision and Review of audit team- SARC or CARS

- The **size** and complexity of the entity
- The **area** of the audit.
- The assessed **risks** of material misstatement
- The **capabilities and competence** of the individual team members

Revising Audit Plan and Strategy

Unexpected Changes in Results:

- A) Result of **UNEXPECTED** events.
- B) **CHANGES** in conditions.
- C) Evidence obtained as a **RESULT** of audit procedures

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Documentation of Audit Plan and Audit Strategy

The auditor shall document:

- A) The overall audit strategy.
- B) **The audit plan**
- C) any significant changes made during the audit engagement to the overall audit strategy or the audit plan, and the reasons for such changes.

More examples of documentation with respect to audit plan and audit strategy and changes in such plan and strategy (remember atleast 3-4):

- A summary of discussions with the entity's key decision makers
- Documentation of audit committee pre-approval of services, where required. (Other services approved by audit committee which can be provided by auditor provided such services are not prohibited u/s 144 of Companies Act, 2013)
- Audit documentation access letters (request by management to access working papers)
- Auditor's report on the entity's financial statements
- Other reports as specified in the engagement agreement
- Other communications or agreements with management or those charged with governance regarding the scope, or changes in scope, of our services

Audit Programme (series of verification procedures to be applied to the financial statements and accounts of a given entity to obtain SAAE and forming an informed opinion on the FS.) CA Pragnesh Kanabar Sir's The Audit Academy Brahmastra

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Advantages of Audit programme

- A) provides the assistant carrying out the audit with total and clear set of instructions
- B) Selection of assistants for the jobs on the basis of capability becomes easier
- C) The assistants, by putting their signature on programme, accept the responsibility for the work carried out by them individually
- D) The principal (partner) can control the progress of the various audits in hand by examination of audit programmes
- E) It serves as a guide for audits to be carried out in the succeeding year.
- F) It serves as evidence in the event of any charge of negligence being brought against the auditor.

Disadvantages of Audit Programme

- A) The work may become mechanical
- B) particular parts of the programme may be carried out without any understanding of the object of such parts in the whole audit scheme
- C) The programme often tends to become rigid and inflexible (the business may change in its operation but the old programme may still be carried on)
- D) Inefficient assistants may take shelter behind the programme when there are no clear instructions.
- E) A hard and fast audit programme may kill the initiative of efficient and enterprising assistants.

Note: We can overcome these disadvantages by regularly updating the programme, rotation of duties of team members etc.

For the purpose of programme construction, the following points should be kept in mind

Stay within LEREC

- A) Stay within the scope and limitation of the assignment.
- B) Determine the evidence reasonably available and identify the best evidence for deriving the necessary satisfaction.
- C) Apply only those steps and procedures which are useful in accomplishing the verification purpose in the specific situation.
- (RELEVANT STEPS ONLY)
- D) Consider all possibilities of error.
- E) Co-ordinate the procedures to be applied to related items.

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Evolving one audit programme applicable to all business under all circumstances is not practicable.

Assistants should be encouraged to keep open mind in order to incorporate areas not covered in the audit programme and remain alert for it..

Audit Programme (series of verification procedures to be applied to the financial statements and accounts of a given entity to obtain SAAE and forming an informed opinion on the FS.)

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An auditor picks up evidence from a variety of fields and it is generally of the following broad types:

- A) Documentary examination
- B) Physical examination
- C) Statements and explanation of management, officials and employees
- D) Statements and explanations of third parties
- E) Arithmetical calculations by the auditor
- F) State of internal controls and internal checks
- G) Inter-relationship of the various accounting data
- H) Subsidiary and memorandum records
- I) Minutes
- J) Subsequent action by the client and by others.

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Auditor should Formulate Audit Programme after understanding Internal Control. Elaborate further. (Chapter 3 concept)

- Auditor should obtain a satisfactory **understanding** of entity's internal control to formulate an audit programme.
- Auditor should also verify **whether system implemented by management is actually in operation.**
- It will enable him to be **more objective** (clear and unbiased) in the framing of the audit programme.
- The extent and the nature of the audit programme is substantially **influenced by the internal control** system in operation
- It also enables an auditor to **decide upon the appropriate audit procedure** to be applied in different areas to be covered in the audit programme.
- In a situation where the internal controls are considered **weak** in some areas, auditor may **perform additional procedures than normally required.**

Chapter 3 of CA –Intermediate- Risk Assessment and Internal Control

- **Audit Risk Concept**
- **SA 315- Identifying and Assessing Risk of Material Misstatement by understanding the entity and its environment.**
- **Concepts of Internal Control- Meaning, objective, limitations, relevance of control to audit, components of internal control, test of controls.**
- **SA 330 concept of test of Controls**
- **SA 320- Materiality**
- **Digital Audit (Automated environment)**
- **IFC as per Companies Act,2013**

Audit Risk → Conceptual interpretation (for technical definition read next page)

Inherent Risk (what can go wrong?)

Control risk (what if control fails?)

RoMM- Risk of Material Misstatement
(Inherent Risk * Control Risk)

Detection Risk (What if Auditor fails?)

Audit Risk- Risk of expressing inappropriate opinion when FS are materially misstated (RoMM * DR)

Inter-Relationship amongst the components of Audit Risk (for working during the lecture)

Audit Risk → All technical terms defined

Inherent Risk: The susceptibility of an assertion about a class of transaction, account balance or disclosure to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls.

Control Risk: The risk that a misstatement that could occur in an assertion about a class of transaction, account balance or disclosure and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity's internal control.

Control risk is a function of the effectiveness of the DIM → design, implementation and maintenance of internal control by management.

Risk of Material Misstatement: - The risk that the financial statements are materially misstated prior to audit. This consists of two components → inherent risk and control risk.

Detection Risk: The risk that the procedures performed by the auditor to reduce audit risk to an acceptably low level will not detect a misstatement that exists and that could be material, either individually or when aggregated with other misstatements.

What is not included in Audit Risk?

- (i) Audit risk does not include the risk that the auditor might express an opinion that the financial statements are materially misstated when they are not. This risk is ordinarily insignificant
- (ii) Further, audit risk is a technical term related to the process of auditing; it does not refer to the auditor's business risks such as loss from litigation, adverse publicity, or other events arising in connection with the audit of financial statements

Audit Risk → Other Points

(i) Inherent risk is higher for some assertions and related classes of transactions, account balances, and disclosures than for others.

For example:

it may be higher for complex calculations, related party transactions, estimates with high uncertainty etc.

(ii) External circumstances giving rise to business risks may also influence inherent risk

For example: technological developments might make a particular product obsolete

(iii) Factors in the entity and its environment may also influence the inherent risk related to a specific assertion

For example:

IF mgmt. and TCWG have a past history of violating laws then it increases the inherent risk of fraud.

(iv) **Inherent risk factors** are considered while designing tests of controls and substantive procedures.

(i) Control Risk is a function of effectiveness of the DIM → design, implementation and maintenance of internal control by management.

(ii) **Auditor has to assess Control risks → whether he wants to 'Rely' or 'Not rely on Controls'.**

(iii) Examples of control risk could include: -

A) A company has devised control that cash and cheque books should be kept in a locked safe and access is granted to authorized personnel only. There is risk that control is not being followed.

B) Similarly, there is a possibility that smoke detectors are not working. A company has devised a control relating to petty cash that items of expenditure of only less than ` 10000 should be routed through imprest system of petty cash. There is a risk that control is not being followed.

(iv) **If auditor is not satisfied with the controls then he shall consider 'NOT RELY ON CONTROL' assessment as appropriate.**

CA Pragnesh Kanabar Sir's The Audit Academy Brahmastra **Risk Assessment Procedure (refer SA Basics)**

Revision

Audit procedures performed to

obtain an understanding of the entity and its environment

including the entity's internal control

to identify and assess the risks of material misstatement, whether due to fraud or error

at the financial statement and assertion levels

For the purpose of Identifying and assessing the risks of material misstatement, the auditor shall:

Identify risks throughout the process of obtaining an understanding of the entity and its environment, including relevant controls that relate to the risks by considering classes of TBDs

Assess the identified risks, and evaluate whether they relate more pervasively to the financial statements as a whole and potentially affect many assertions

Relate the identified risks to what can go wrong at the assertion level, taking account of relevant controls that the auditor intends to test

Consider the likelihood of misstatement, including the possibility of multiple/material misstatements

Note: The auditor also may choose to perform substantive procedures or tests of controls concurrently with risk assessment procedures because it is efficient to do so

Techniques used for performing Risk Assessment Procedure- IAO (3 questions)

Inquiries of management and others within the entity for risk assessment. Examples of others.

- A) Inquiries directed towards TCWG
- B) Inquiries directed toward internal audit personnel
- C) Inquiries of employees involved in initiating, processing or recording complex or unusual transactions
- D) Inquiries directed toward in-house legal counsel
- E) Inquiries directed towards marketing or sales personnel
- F) Inquiries directed to information systems personnel

Analytical Procedures used for Risk Assessment. Explain with Examples

- may help identify the existence of unusual transactions or events, and amounts, ratios, and trends that might indicate matters that have audit implications
- AP performed as risk assessment procedures may include both financial and non-financial information, for example, the relationship between sales and square footage of selling space or volume of goods sold.
- when such AP use data aggregated at a high level, the results of those analytical procedures only provide a broad initial indication about whether a material misstatement may exist.
- APs are useful when co-related with other information available with the auditor.

Observation and inspection may support inquiries of management and others, and may also provide information about the entity and its environment

- Examples of such procedures include observation and inspection of:**
- A) The entity's operations.
 - B) Documents (such as business plans and strategies), records, and internal control manuals
 - C) Reports prepared by management and TCWG (such as minutes of meeting)
 - D) The entity's premises and plant facilities.

- RoMM due to FRAUD
- RoMM due to significant transactions OUTSIDE the normal course of business
- RoMM due to SUBJECTIVITY in accounting estimates (especially estimates with high estimation uncertainty.)
- RoMM due to COMPLEXITY of transactions.
- RoMM due to recent ACCOUNTING DEVELOPMENTS and economic developments.
- RoMM due to significant RELATED party transactions

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Risks of material misstatement may be greater for significant non-routine transactions arising from matters such as foll:

- Greater management intervention to specify the accounting treatment.
- Greater manual intervention for data collection and processing.
- Complex calculations or accounting principles.
- The nature of non-routine transactions, which may make it difficult for the entity to implement effective controls over the risks.

Understanding the entity and its environment

Points to be considered: (Module reference for examples of each point):

LAW NAFO

- A) Law → Relevant industry, regulatory, and other external factors including the applicable financial reporting framework
- B) N → The nature of the entity, including:
 - (i) its operations, (ii) its ownership and governance structure, (iii) types of investments, (iv) how entity is financed
- C) A → The entity's selection and application of accounting policies
- D) O → The entity's objectives and strategies, and those related business risks that may result in RoMM
- E) F → The measurement and review of the entity's financial performance

Why is it important? It helps auditor in:

SAMER

- A) identifying areas where SPECIAL audit consideration is required.
- B) developing expectations for performing ANALYTICAL PROCEDURES.
- C) determining MATERIALITY as per SA 320
- D) EVALUATING sufficiency and appropriateness of audit evidence
- E) assessing ROMM

Revision

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Definition of Internal Control

“the process designed, implemented and maintained by those charged with governance, management and other personnel

to provide reasonable assurance about the achievement of an entity’s objectives with regard to

- FOLA**
- A) F- reliability of _____
 - B) O- efficiency and effectiveness of _____
 - C) L- compliance with _____
 - D) A- safeguarding the _____

Objective of Internal Control- TATA

- Management wants to ensure**
- A) Transaction
 - B) Asset
 - C) Transaction
 - D) Asset

Understanding the entity’s internal control relevant to audit.

All controls are not relevant to audit. Auditor should consider following factors in order to determine the internal controls relevant to audit:

SALIM’s ENTITY

- A) **S-** SIGNIFICANCE of the related Risk.
- B) **A-** Assets safeguarding controls
- C) **L-** Laws and regulations applicable to the entity.
- D) **I-** Internal control → nature (manual or automated) of control, complexity of the systems, component of control (discussed in further slides)
- E) **M-** Materiality of the financial item
- F) **Entity-** Size, nature and complexity of entity’s business.

Limitations of Internal Control

Internal control cannot provide absolute assurance for prevention of fraud and errors because it has following limitations:

High Court Judge Likes Samosa

- A) High →
- B) Court →
- C) Judge →
- D) Likes →
- E) Samosa →

Components of Internal Control- CRIME

Control Environment-
culture set up by mgmt. and tcwg

Entity's **Risk Assessment**
process- How entity identifies and responds to the RoMM

Information system
including FR process-
How transactions/ events are initiated, recorded and reported in FS

Control Activities-
techniques used by mgmt. for implementing internal control

Monitoring
Techniques to check the effectiveness of the controls

Elements of Control Environment: *Human Philosophy* → *Commit Communicate Participate Organise*

- A) Communicating Ethical Values
- B) Commitment to competence- asking employees to be competent in their job
- C) Participation by TCWG
- D) Mgmt's philosophy and operating style
- E) Organisation structure- who reports to whom?
- F) Human Resource Policies

What is included in Control Environment?

- (i)** the governance and management functions
- (ii)** the attitudes, awareness, and actions of those charged with governance and management
- (iii)** the control environment sets the tone of an organization, influencing the control consciousness of its people

Satisfactory Control Environment – not an absolute deterrent to fraud:

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- (a) The existence of a satisfactory control environment can be a positive factor when the auditor assesses the risks of material misstatement.
- (b) it may help reduce the risk of fraud, a satisfactory control environment is not an absolute deterrent to fraud
- (c) However, if there are deficiencies in the control environment then it may undermine the effectiveness of controls, in particular in relation to fraud.
- (d) The control environment in itself does not prevent, or detect and correct, a material misstatement (because it is an indirect control)

Entity's Risk Assessment Process → The auditor shall obtain an understanding of whether the entity has a process for:

- (a) Identifying business risks relevant to financial reporting objectives;
- (b) Estimating the significance of the risks;
- (c) Assessing the likelihood of their occurrence; and
- (d) Deciding about actions to address those risks

Following points to be considered while obtaining an understanding of the information system, relevant to the financial reporting

- A) The classes of transactions in the entity's operations that are material
- B) The procedures by which those transactions are initiated, recorded, processed, corrected as necessary, transferred to the general ledger and reported in the FS
- C) The related accounting records, supporting information and specific accounts in the FS used for recording these transactions
- D) How the information system captures events and conditions that are significant to the FS
- E) The financial reporting process used to prepare the entity's financial statements;
- F) Controls surrounding journal entries.

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The auditor shall obtain an understanding of how the entity communicates financial reporting roles and responsibilities:

- A) Understanding of Roles and Responsibilities:** → Whether mgmt. is providing an understanding of individual roles and responsibilities pertaining to internal control over financial reporting
- B) Understanding regarding Relation of Activities** → Understanding by employees as to how their activities relate to the work of others
- C) Policy Manuals and Financial Reporting Manuals** → Standard operating procedures of the entity.
- D) Open Communication Channels** → help ensure that exceptions are reported and acted on
- E) Less structured and easier for Small Entities** → Communication may be less structured and easier to achieve in a small entity than in a larger entity

Control Activities: Authorize IPS to Perform

- a) Authorization
- b) Information Processing
- c) Physical Controls
- d) Segregation of duties.
- e) Performance Reviews

Note: Control activities that relate to significant risks are relevant for the auditor

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Monitoring of Controls → may include activities such as:

- A) ongoing activities, separate evaluations, or a combination of the two. Ongoing monitoring activities are often built into the normal recurring activities (internal check- discussed later) of an entity and include regular management and supervisory activities.
- B) Internal auditors or personnel performing similar functions may contribute to the monitoring of an entity's controls through separate evaluations
- C) management's review of whether bank reconciliations are being prepared on a timely basis
- D) using information from communications from external parties that may indicate problems or highlight areas in need of improvement.
- E) In case of small entity- the owner-manager can effectively monitor the internal controls.

Benefits of Evaluation of Internal Control



The review of internal controls will enable the auditor to know:

- A) Whether E_____ or F_____ are likely to be located in the operations
- B) Whether the internal records of the entity are r_____
- C) What should be the e_____ and d_____ of the examination?
- D) What should be the appropriate audit t_____?
- E) What are the areas where controls are w_____ and e_____?
- F) Whether an a_____ internal control system is in use?
- G) How far and how adequately the management is d_____ its functions
- H) Whether some worthwhile s_____ can be given to the management?

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Techniques to evaluate and understand Internal Control

N-Narrative Record (NR)

- A) Description of the understanding of Internal Control
- B) Suitable for small entities with unstructured internal control system
- C) Disadvantage- Difficult to understand system by reading NR, difficult to include changes in NR

C- Checklist

- A) series of instructions/questions which audit team should follow/answer while evaluating a system
- B) After following the instruction, ticks/initials are put by the audit team member

Q- Questionnaire- Internal Control Questionnaire

- A) series of questions concerning Internal control
- B) most widely used technique
- C) Questions are framed for each stage of the system
- D) Answer is either 'YES' 'NO' or 'Not Applicable'
- E) It also discloses defects with 'No' answers
- F) It is issued to the client who should get it filled up by their employees which is audited by the auditor.

FlowChart

- A) a graphic presentation of each part of the company's system of internal control
- B) most concise way of recording
- C) minimises the amount of narrative explanation
- D) bird's eye view of the system and the flow of transactions and integration
- E) necessary for the auditor to study the significant features of the business carried on by the concern

Following basic assumptions about elements of good control are taken into account while using standard ICQ:

- A) Certain procedures in general used by most business concerns are essential in achieving reliable internal control. E.g. reconciliations.
- B) Organisations are such that permit an extensive division of duties and responsibilities.
- C) No single person is thrust with the responsibility of completing a transaction all by himself.
- D) There is proper documentation and recording of the transactions.
- E) work performed by each one is expected to come under review of another in the usual course of routine.

Test of Controls → to obtain audit evidence about the effectiveness of the:

Design of the accounting and internal control systems i.e. whether they are suitably designed to prevent or detect and correct material misstatements

Operation of internal control throughout the period.

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Correct or incorrect- 2 marks:

Some of the procedures performed to obtain the understanding of the accounting and internal control systems may not have been specifically planned as tests of control but may provide audit evidence about the effectiveness of the design and operation of internal controls relevant to certain assertions and, consequently, serve as tests of control.

For Example:

in obtaining the understanding of the accounting and internal control systems pertaining to cash, the auditor may have obtained audit evidence about the effectiveness of the bank reconciliation process through inquiry and observation

Test of Controls may include: → CORI

- A) **I** → **Inspection** of documents supporting transactions and other events to gain audit evidence that internal controls have operated properly.
- B) **O** → **Observation** → Inquiries about, and observation of, internal controls which leave no audit trail, for example, determining who actually performs each function and not merely who is supposed to perform it
- C) **R** → **Re-performance** involves the auditor's independent execution of procedures or controls that were originally performed as part of the entity's internal control, for example, reconciliation of bank accounts,
- D) **C** → **Computer** → Testing of internal control operating on specific computerised applications or over the overall information technology function, for example, access or program change controls

While designing and performing test of controls, the auditor shall consider

- A) by whom they were applied.
- B) how they were applied.
- C) the consistency with which they were applied during the period
- D) Whether there is a need to test the effective operation of indirect controls

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Using evidence obtained from previous audits

Whether auditor can use such evidence or not depends upon: **C₂DE₃**

- A) E → Effectiveness of the components of internal control
- B) E → Effectiveness of General IT-Controls
- C) E → Extent of reliance on control
- D) C → Changes in the controls
- E) C → Characteristics of control (manual or automated)
- F) D → Deviations noticed in previous audit
- G) RoMM involved and intended reliance on such controls.

Factors that may decrease the period for retesting a control:

MC₂D₃

- A) A significant **manual** element to the relevant controls.
- B) **Changing** circumstances that indicate the need for changes in the control.
- C) Personnel **changes** that significantly affect the application of the control.
- D) **Deficient** control environment.
- E) **Deficient** monitoring of controls
- F) **Deficient** general IT-controls

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matters the auditor may consider in determining the extent of tests of controls include the following:

- The frequency of the performance of the control by the entity during the period
- How much the auditor is relying on the operating effectiveness of the control.
- The expected rate of deviation from a control.
- The relevance and reliability of the audit evidence to be obtained.
- The extent to which audit evidence is obtained from tests of other controls

When Auditor identifies deviations from the prescribed controls:

Deviations from prescribed controls may be caused by such factors:

- A) changes in key personnel
- B) significant seasonal fluctuations in volume of transactions
- C) human error

The evaluation of deviations may result in the auditor concluding that the assessed level of control risk needs to be revised.

auditor shall make following specific inquiries:

- A) Whether the tests of controls that have been performed provide an appropriate basis for reliance on the controls
- B) Whether additional tests of controls are necessary
- C) Whether the potential risks of misstatement need to be addressed using substantive procedures.

What is an automated environment

An automated environment basically refers to a business environment where the **processes, operations, accounting and decisions (PODA)** are carried out by using computer systems – also known as Information Systems (IS) or Information Technology (IT) systems

Risk arising from use of IT system

FULLY Inaccurate
 F- Failure to make necessary changes
 U- Unauthorized access to data
 L- Loss of data
 L- Lack of adequate SOD- segregation of duties
 Inaccurate- Inaccurate processing of data

Impact of IT related risks

A) Impact on substantive checking- IT risks may lead to non-reliance of data obtained from systems.
 B) Impact on control- It can lead to non-reliance on automated controls
 C) Impact on Reporting- in case of companies, it may lead to modification of auditor's report in some instances

Types of Controls in Automated environment

A) General IT controls- policies and procedures that relate to many applications and support the effective functioning of application controls. It commonly includes PADA
 P- Program change
 A- Access security
 D- Data centre
 A- Application system

B) Application controls- It includes both automated or manual controls that operate at a business process level.

C) IT-dependent controls- manual controls that make use of some form of data or information or report produced from IT systems and applications.

Note- The relationship between the application controls and the General IT Controls is such that General IT Controls are needed to support the functioning of application controls, and both are needed to ensure complete and accurate information processing through IT systems.

Key features of an automated environment**CAFE LISA**

C- Connectivity is better
 A- Accuracy of data processing
 F- Faster Business operation
 E- Errors are less
 L- Latest information is available
 I- Integration of business activities is better
 S- Security is better
 A- Ability to process large volume of data

When testing in an automated environment, some of the more common methods are as follows:

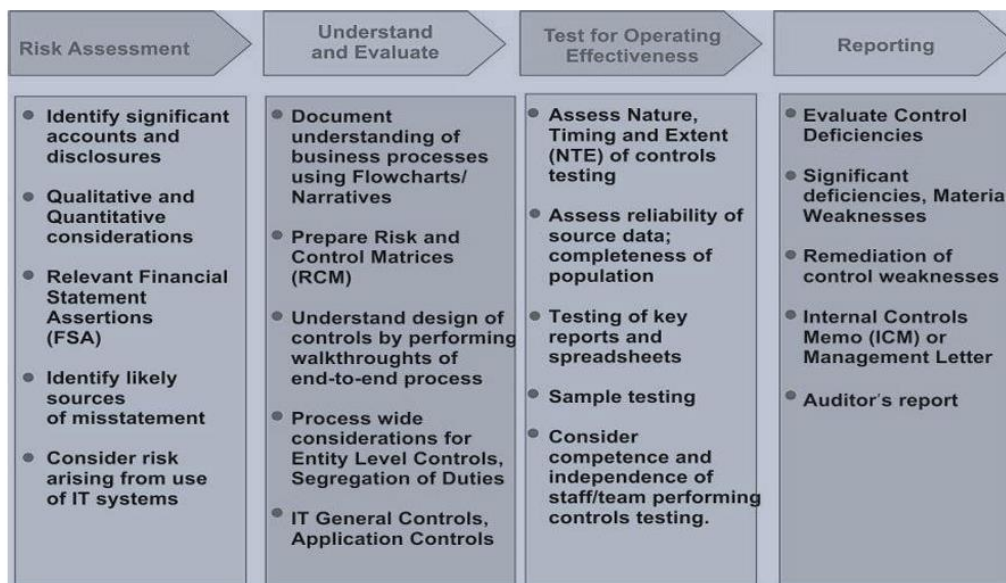
A) Understanding of how an automated transaction is processed, b) how a user processes transactions under different scenarios. c) Inspect the configuration

Understanding an automated environment

Inform the Architect that it's key purpose is to locate the package's latest version
 Inform- Information system being used
 Architect- Architecture (desktop based, client-server, web application, cloud based)
 Key- Key persons
 Purpose- Purpose of the system?
 Locate- Location of IT system- local vs global
 Package- Packaged system vs In-house system
 Latest version- Version (functions and risks could vary in different versions of same application)

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AUDIT APPROACH IN AN AUTOMATED ENVIRONMENT



DATA ANALYTICS FOR AUDIT

CAAT- Computer Assisted Audit Techniques- Data analytics can be used to perform the following:

- Check completeness of data
- Selection of audit samples
- Re-computation of balances
- Reperformance of mathematical calculations
- Analysis of journal entries
- Fraud investigation.

ASSESS AND REPORT AUDIT FINDINGS

Some points to consider are as follows:

- Are there any weaknesses in IT controls?
- What is the impact of these weaknesses on overall audit?
- Report deficiencies to management – Internal controls memo or Management letter.
- Communicate in writing any significant deficiencies to those Charged with governance.

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INTERNAL FINANCIAL CONTROLS AS PER REGULATORY REQUIREMENTS

Section 134 (5)(e)

In case of listed Companies, the Directors' responsibility statement shall state that the Directors had laid down Internal financial controls to be followed by the company and that such Internal financial controls are adequate and were operating effectively.

Section 177(4)(vii) of the Act

Every audit Committee shall act in accordance with the terms of reference specified in writing by the Board which shall, inter alia, include - evaluation of internal financial controls and risk management systems.

As per Section 149(8) of the Act- the role and functions of independent directors include that they shall satisfy themselves on the integrity of financial information and that financial controls and the systems of risk management are robust and defensible.

Section 143(3)(i) of the Act

The auditor's report shall state whether the company has adequate Internal financial controls system in place and also on the operating effectiveness of such controls. This requirement shall not apply to a private company which:

- is One Person Company or a small company; or
- has turnover less than ₹ 50 crore as per latest audited Financial Statements; and which has aggregate borrowings from banks or financial institutions or any body corporate at any point of time during the financial Year for less than ₹ 25 crore.

Use of Materiality

SA 320 → While Planning and Performing an Audit of FS

SA 450 → Evaluation of Misstatements identified during the audit

Basic assumptions taken by the auditor regarding users of FS while determining materiality

Since materiality is based upon information needs of the users of FS. Auditor needs to take certain basic assumptions as follows:

- A) Users have basic understanding of the client's business and accounts
- B) Users understand that FS are prepared, presented and audited at the level of materiality
- C) Users understand that there is uncertainty in estimates and judgments made by the management.
- D) Users make rational economic decisions

Steps in determining materiality

While establishing overall audit strategy, auditor shall determine **materiality for FS as a whole**.

A **percentage is often applied to a chosen benchmark** as a starting point in determining materiality for the financial statements as a whole. E.g audit team shall focus on items which are 1% or more of Total Turnover/Expense etc.

Auditor may determine a **performance materiality** level to be applied

If, in the **specific circumstances** of the entity, there is one or more **particular classes of TBDs** for which misstatements of lesser amounts could be material then auditor may determine a **separate materiality level** to be applied those TBDs. Auditor's decision for this will depend upon:

- A) Law governing some specific items.
- B) Key disclosures which are important
- C) Whether any specific item attracts attention of users

Read next page for understanding these points.

These levels can **be revised** if the circumstances require it to do so.

Factors to be considered for identification of appropriate benchmark. (5 marks)

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In order to determine materiality level for FS as whole (a general standard set by the auditor to decide which items should be verified thoroughly) he needs to apply ___% of a benchmark (turnover, total assets, profit before tax etc.). How will auditor decide in which entity what benchmark should be applied? It depends upon following factors

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Element of Volatile UFO (ALL of these factors should be considered)

- A) The **elements** of the financial statements. (Analysing the revenue, expense, assets and liabilities)
- B) The relative **volatility (fluctuation)** of the benchmark. (If entity is going through a highly fluctuating stage then its difficult to set a benchmark based upon previous year as current year results may be different)
- B) Whether there are items on which the attention of the **users** of the particular entity's financial statements tends to be focused. (for example in a NPO, users will be focused on contribution and expenses, whereas in a commercial entity users will be focused on profit before tax)
- C) The nature (NPO/Commercial?) of the entity, where the entity is at in its life cycle (growth or maturity stage?), and the industry and economic environment in which the entity operates.
- D) The entity's **ownership** structure and the way it is **financed (debt-equity analysis)**. For example if entity is financed solely by debt then lenders are focused on total assets that entity has for repayments and not on profit before tax).

Note: Determining percentage is a matter of judgment.

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In relation to the chosen benchmark, relevant financial data ordinarily includes –

- prior periods' financial results and financial positions,
- the period to-date financial results and financial position (for example 01/04/2020 to 30/09/2020) results, and
- budgets or forecasts for the current period adjusted for significant changes in the circumstances of the entity (for example, a significant business acquisition) and relevant changes of conditions in the industry or economic environment in which the entity operates.

After determining overall materiality (a general standard for selecting financial items), auditor may be concerned what if there are individual undetected misstatements (below the level of materiality) which if aggregated to the misstatements identified exceed the materiality level?? Therefore auditor also applies the concept of performance materiality. Read below.

Performance Materiality- Technical Definition- 2-3 marks

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- performance materiality means the amount or amounts
- set by the auditor
- at less than materiality for the financial statements as a whole
- to reduce to an appropriately low level the probability that
- the aggregate of uncorrected and undetected misstatements
- exceeds materiality for the financial statements as a whole.

(It simply means auditor will also verify few transactions/balances below the materiality level so that he reduces the chances of not detecting material misstatements)

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Note: If auditor has determined separate materiality level for selected TBDs which is different than the overall materiality level then auditor may set a separate performance materiality relating to a materiality level determined for a particular class of TBDs

- to reduce to an appropriately low level the probability that
- the aggregate of uncorrected and undetected misstatements in that particular class of transactions, account balance or disclosure
- exceeds the materiality level for that particular class of transactions, account balance or disclosure.

Circumstances leading to Revision in Materiality -4 Marks

The auditor shall revise materiality for the financial statements as a whole (and, if applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures) **in the event of becoming aware of**

A) change in circumstances that occurred during the audit

B) new information

C) a change in the auditor's understanding of the entity and its operations as a result of performing further audit procedures

Note: If the auditor concludes that a lower materiality for the financial statements as a whole (and, if applicable, materiality level or levels for particular classes of transactions, account balances or disclosures) than that initially determined is appropriate, the auditor shall determine whether it is necessary to revise performance materiality, and whether the nature, timing and extent of the further audit procedures remain appropriate

Relationship between Materiality and Audit Risk.

Materiality and audit risk are considered throughout the audit, in particular, when:

(a) Identifying and assessing the risks of material misstatement

(b) Determining the nature, timing and extent of further audit procedures

(c) Evaluating the effect of uncorrected misstatements, if any, on the financial statements and in forming the opinion in the auditor's report

IF materiality of a financial item is high, auditor will perform more procedures and reduce his audit risk.

Documenting Materiality 2-3 marks

Auditor shall document the following:

→ Materiality for the financial statements as a whole

→ If applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures

→ Performance materiality

→ Any revision of (a)-(c) as the audit progressed