After studying this chapter, you will be able to:

- Apply logical, critical and creative thinking to analyse, synthesise and apply theoretical knowledge, and technical skills to conduct Audit & Assurance as per Engagement and Quality Control Standards.
- Determine and apply knowledge of Auditing Standards to your professional practice and/or further study.
- Understand the requirements of each Standard to conduct Audit in Accordance with Standards.

CHAPTER OVERVIEW

Auditing Standards, Statements & Guidance Notes

IFAC - IAASB

Engagement and Quality Control Standards

ICAI - AASB

Guidance Notes

Statements

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1. INTRODUCTION

The past decade has been one of unprecedented change in the global economy and capital markets. Key aspects of the current business environment include a globalized, highly competitive, expanding economy; explosive growth in the development and use of technology; dramatic increases in new economy service- and technology-based businesses with predominantly intangible assets; unparalleled expansion in the number of public entities; large increases in the number of individuals who directly or indirectly own equity securities; and unprecedented growth in the market value of those securities.

The expanded use of technology in both the operating and financial systems of companies also has significantly affected the audit environment, forcing audit firms to recruit, train and deploy a large number of information technology specialists to support their audit efforts. It also has caused firms to reconsider their audit methods and techniques in an effort to harness technology to improve audit efficiency and effectiveness.

In the changing environment, it is obvious that a professional accountant should adhere to standards and procedures laid down by the professional accountancy bodies of which he is a member while discharging his duties in a responsible manner. In this direction, the role of a professional accounting body is to lay down such standards and procedures with the aim of providing guidance to members.

The Institute of Chartered Accountants of India (ICAI) has been formulating auditing and accounting standards for the guidance of its members on its own volition in the larger interests of the society. In this chapter, we provide an overview of auditing standards and guidance notes issued by the Institute from time to time.

Though these standards and guidance notes have been dealt at appropriate places, the main purpose is to acquaint and inculcate appreciation on the part of students in a focused manner as to significance of the standards in their day to day auditing activities. Towards the end of the Chapter, the clarification issued by the Council of the Institute is also included, which would go a long way in understanding as well as significance to the mandatory status of “Statements” and “Standards”.

2. HISTORICAL RETROSPECT

The Institute, since its inception, has been committed to research in the field of accountancy. As early as in 1955, the Council set up the Research Committee. The Council at that point of time felt
the necessity to establish such a Committee to deal with the growing complexities of the problems faced by membership at large and with a view to ensuring the highest of traditions and technical competence in the discharge of the duties by chartered accountants.

As back as in 1964, the Council published the “Statement on Auditing Practices” as prepared by the Research Committee not only for the benefit of its members but also for others outside the profession, who might be interested in this subject. It was hoped that this Statement would provide valuable guidance in the performance of audits, particularly of companies.

The Council of the Institute fully realised that techniques of accounting and auditing had undergone and were undergoing important changes. Since the members were expected to keep pace with recent developments, this Statement attempted to set out practices which were generally accepted in other countries and which the Council considered desirable in the light of prevailing circumstances in India. The issuance of the Statement on Auditing Practices might be considered as a path break as far as establishing sound auditing practices is concerned.

3. AUDITING AND ASSURANCE STANDARDS BOARD – SCOPE AND FUNCTIONS

The Following are the important points as regards scope and functions of Auditing and Assurance Standards Board –

3.1 Setting up of AASB: The International Federation of Accountants (IFAC) came into existence in 1977 and constituted International Auditing Practices Committee (IAPC) to formulate International Auditing Guidelines. These guidelines were later on converted into International Standards on Auditing (ISA). Considering the developments in the field of auditing at international level, the need for issuing Standards and Guidance Notes in tandem with international standards but conforming to national laws, customs, usages and business environments was felt. With this objective, our Institute constituted the Auditing Practices Committee (APC) on September 17, 1982, to spearhead the new framework of Statements on Standard Auditing Practices (SAPs) and Guidance Notes (GNs) inter alia to replace various chapters of the old omnibus Statement on Auditing Practices issued in 1964.

International Auditing and Assurance Standards Board (IAASB): The IFAC Board has established the IAASB to develop and issue, in the public interest and under its own authority, high quality auditing standards for use around the world. The IAASB functions as an independent standard-setting body under the auspices of IFAC.
Auditing and Assurance Standards Board: ICAI is a member of the IFAC and is committed to work towards the implementation of the guidelines issued by the IFAC. ICAI constituted the AASB (erstwhile Auditing Practices Committee) to review the existing auditing practices in India and to develop Engagement and Quality Control Standards (erstwhile Statements on Standard Auditing Practices) so that these may be issued by the Council of the Institute.

In July, 2002, the Auditing Practices Committee has been converted into an Auditing and Assurance Standards Board by the Council of the Institute, to be in line with the international trend. A significant step has been taken aimed at bringing in the desired transparency in the working of the Auditing and Assurance Standards Board, through participation of representatives of various segments of the society and interest groups, such as, regulators, industry and academics. The nomenclature of SAPs had been changed to Auditing and Assurance Standards (AASs). As per the Preface to Standards on Quality Control Auditing Review, other Assurance and Related Services w.e.f. April 1, 2008, the nomenclature of AASs under the authority of the Council are collectively known as the Engagement Standards and Quality Control Standards which include the following:

- Standards on Auditing (SAs) are applied in the audit of historical financial information.
- Standards on Review Engagements (SREs) are applied in the review of historical financial information.
- Standards on Assurance Engagements (SAEs) are applied in assurance engagements, dealing with subject matters other than historical financial information.
- Standards on Related Services (SRSs), are applied to engagements involving application of agreed-upon procedures to information, compilation engagements, and other related services engagements, as may be specified by the ICAI.
- Standard on Quality Control which contains extensive requirements in relation to establishment and maintenance of a system of quality control in the audit firms as well as even for sole practitioners.

3.2 Scope and Functions of AASB: The main function of the AASB is to review the existing auditing practices in India and to develop Statements on Standards on Auditing (SAs) so that these may be issued by the Council of the Institute. While formulating the SAs, the AASB takes into consideration the ISAs issued by the IAPC, applicable laws, customs, usages and business environment in India. The SAs are issued under the authority of the Council of the Institute. The AASB also issues Guidance Notes on the issues arising from the SAs wherever necessary. The AASB has also been entrusted with the responsibility to review the SAs at periodical intervals.
3.3 Scope of SAs: The SAs apply whenever an independent audit is carried out; that is, in the independent examination of financial information of any entity, whether profit oriented or not, and irrespective of its size, or legal form (unless specified otherwise) when such an examination is conducted with a view to expressing an opinion. The SAs may also have application, as appropriate, to other related functions of auditors. Any limitation on the applicability of a specific SA is made clear in the introductory paragraph of the SA.

3.4 Procedure for issuing SAs: Broadly, the following procedure is adopted for the formulation of SAs:

1. The AASB determines the broad areas in which the SAs need to be formulated and the priority in regard to the selection thereof.

2. In the preparation of SAs, the AASB is assisted by Study Groups constituted to consider specific subjects. In the formation of Study Groups, provision is made for participation of a cross-section of members of the Institute.

3. On the basis of the work of the Study Groups, an exposure draft of the proposed SA is prepared by the Committee and issued for comments by members of the Institute.

4. After taking into consideration the comments received, the draft of the proposed SA is finalised by the AASB and submitted to the Council of the Institute.

5. The Council of the Institute considers the final draft of the proposed SA, and, if necessary, modifies the same in consultation with the AASB. The SA is then issued under the authority of the Council.

3.5 Compliance with the SAs: While discharging their attest function, it is the duty of the members of the Institute to ensure that the SAs are followed in the audit of financial information covered by their audit reports. If for any reason a member has not been able to perform an audit in accordance with the SAs, his report should draw attention to the material departures therefrom. Auditors are expected to follow SAs in the audits commencing on or after the date specified in the Standard. Further, compliance of SAs are mandatory requirement as per the Companies Act, 2013.

3.6 Linkage between SAs and Disciplinary Proceedings: The SAs (as well as other statements on auditing) represent the generally accepted procedure(s) of audit. As such, a member
who does not perform his audit in accordance with these statements and fails to disclose the material departures there from, becomes liable to the disciplinary proceedings of the Institute under Clause (9) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 (as amended by the Chartered Accountants (Amendment) Act, 2006), which specifies that a member of the Institute engaged into practice shall be guilty of professional misconduct if he “fails to invite attention to any material departure from the generally accepted procedure of audit applicable to the circumstances”.

4. FRAMEWORK OF STANDARDS AND GUIDANCE NOTES ON RELATED SERVICES

Framework of Standards on Auditing and Guidance Notes on Related Services issued recently distinguishes audits from related services. Related services comprise reviews, agreed-upon procedures and compilations. As illustrated in the diagram below, audits and reviews are designed to enable the auditor to provide high and moderate levels of assurance respectively, such terms being used to indicate their comparative ranking. Engagements to undertake agreed-upon procedures and compilations are not intended to enable the auditor to express assurance.

<table>
<thead>
<tr>
<th>Nature of service</th>
<th>Auditing</th>
<th><em><strong>Related Services</strong></em>_</th>
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<td>Audit</td>
<td>Review</td>
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<td>Agreed-upon Procedures</td>
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<td>Comparative level of assurance provided by the auditor</td>
<td>High, but not absolute assurance</td>
<td>Moderate assurance</td>
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<tr>
<td>Report provided</td>
<td>Positive assurance on assertion(s)</td>
<td>Negative assurance on assertion(s)</td>
</tr>
</tbody>
</table>

Assurance in the above context refers to the auditor’s satisfaction as to the reliability of an assertion being made by one party for use by another party. To provide such assurance, the auditor assesses the evidence collected as a result of procedures conducted and expresses a conclusion. The degree of satisfaction achieved and, therefore, the level of assurance which may be provided is determined by the procedures performed and their results.

In an audit engagement, the auditor provides a high, but not absolute, level of assurance (i.e. reasonable level of assurance) that the information subject to audit is free of material misstatement expressed positively in the audit report.

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In a review engagement, the auditor provides a moderate level of assurance that the information subject to review is free of material misstatement. This is expressed in the form of negative assurance (also known as limited assurance).

For agreed-upon procedures, auditor simply provides a report of the factual findings, no assurance is expressed. Instead, users of the report draw their own conclusions from the auditor's work. In a compilation engagement, although the users of the compiled information derive some benefit from the involvement of a member of the Institute, no assurance is expressed in the report. Objective of an audit is to enable the auditor to express an opinion whether the financial statements are prepared, in all material respects, in accordance with an identified financial reporting framework "give a true and fair view". Absolute assurance in auditing is not attainable as a result of such factors as the need for judgement, the use of test checks, the inherent limitations of any accounting and internal control systems and the fact that most of the evidence available to the auditor is persuasive, rather than conclusive, in nature.

The objective of a review of financial statements is to enable an auditor to state whether, on the basis of procedures which do not provide all the evidence that would be required in an audit, anything has come to the auditor's attention that causes the auditor to believe that the financial statements are not prepared, in all material respects, in accordance with an identified financial reporting framework. While a review involves the application of audit skills and techniques and the gathering of evidence, it does not ordinarily involve on assessment of accounting and internal control systems, tests of records and of responses to inquiries by obtaining corroborating evidence through inspection, observation, confirmation and computation, the auditor attempts to become aware of all significant matters, the procedures of a review make the achievement less likely than in an audit engagement, thus the level of assurance provided in a review report is correspondingly less than that given in an audit report.

In an engagement to perform agreed-upon procedures and auditor is engaged to carry out those procedures of an audit nature to which the auditor and the entity and any appropriate third parties have agreed and to report on factual findings.

The report is restricted to those parties that have agreed to the procedures to be performed since others, unaware of the reasons for the procedures, may misinterpret the results. In a compilation engagement, a member of the Institute is engaged to use accounting expertise as opposed to auditing expertise to collect, classify, and summaries financial information.

The procedures employed are not designed and do not enable the member to express any assurance on the financial information. However, users derive some benefit as a result of the member's involvement because the service has been performed with due professional skill and care. An auditor is associated with financial information when the auditor attaches a report to that information or consents to the use of the auditor's name in a professional connection. If the auditor is not associated in this manner, third parties can assume no responsibility of the auditor.
5. QUALITY CONTROL AND ENGAGEMENT STANDARDS

Diagrammatic Representation of the Structure of Standards Under the New Preface

AUDITING STANDARDS - AN OVERVIEW

Auditing and Assurance Standard Board - (AASB)- Scope / Objective

STRUCTURE OF PRONOUNCEMENTS ISSUED BY AASB

FRAMEWORK FOR AUDIT & ASSURANCE & OTHER SERVICES

ENGAGEMENTS – Scope/ Objective/ Definitions/ Requirements

Standard for Quality Control (SQC 01 - 99)

Standards on Review Engagements (SRE 2000 - 2699)

Standard on Assurance Engagements SAE (3000-3699)

Standards on Related Services SRS- 4000 & 4699

Standards on Auditing (SA 100-999) - aspects covered in series:

- Introductory Matters SA100 - 199
- General Principles and Responsibilities SA200 - 299
- Risk Assessment and Response to Assessed Risk SA300 - 499
- Audit Evidence SA500 - 599
- Using Work of Others SA600 - 699
- Audit Conclusions and Reporting SA700 – 799
- Specialised Areas SA800 - 899

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The Council of the ICAI has issued following Quality Control and Engagement Standards:

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<th>S. No.</th>
<th>No. of Standard</th>
<th>Title of the Standard</th>
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<td>1</td>
<td>SQC 1</td>
<td>Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements</td>
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<td>Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing</td>
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<td>SA 805</td>
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<td>46</td>
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5.1 Structure of SAs

SAs are structured in the particular manner:

- **Introduction**: It includes the purpose, scope, and subject matter as well as the responsibilities of the auditor and others in that context.

- **Objective**: It includes the objective of the auditor in the audit area addressed by that particular SA.

- **Definitions**: For higher understanding of the SAs, pertinent terms are delineated in each SA.

- **Requirements**: Every objective is shored up by clearly stated requirements. Requirements are always expressed by the phrase “the auditor shall.”

- **Application and Other Explanatory Material**: The application and other explanatory material explains more exactly what is meant by a requirement or is intended to cover, or includes examples of procedures that can be appropriate under certain circumstances.

(Students may note that the above mentioned Quality Control and Engagement Standards are reproduced in Auditing Pronouncements)

6. GUIDANCE NOTES

Various technical committees of the Institute are involved in the task of issuing guidance notes on topics relating to accounting and auditing for guidance of the members. Some of the important topics in auditing on which guidance notes have been issued are discussed below:

6.1 Guidance Note on Independence of Auditors: Professional integrity and independence is an essential characteristic of any member of the accounting profession. A detailed note on this topic was first published by the Council in 1968. In the light of the experience gained over a period of years, this note was revised by the Council and published as a guidance note in 1975. The revised Guidance Note contains essentially a discussion on relevant section of the Companies Act and the provisions of the Chartered Accountants Act, 1949 which aim at ensuring independence of auditors.
6.2 Guidance Note on Audit Reports and Certificates for Special Purposes: The purpose of this Guidance Note is to provide guidance on engagements which require a ‘professional accountant in public practice’ (hitherto known as “practitioner”) to issue reports other than those which are issued in audits or reviews of historical financial information. The reports which are issued pursuant to audits or reviews of historical financial information are dealt with in Standards on Auditing (SAs) and Standards on Review Engagements (SREs), respectively, issued by the Institute of Chartered Accountants of India (ICAI).

In some cases, Government and other authorities under various statutes or notifications require reports or certificates from practitioners in support of statements or other information provided by an entity. Such reports or certificates can also be required to be issued to fulfill a contractual reporting obligation or may be required by the management or those charged with governance of an entity for its own special purposes.

Sometimes, the applicable law and regulation or a contractual arrangement that an entity might have entered into, prescribe the wording of report or certificates. The wording often requires the use of word or phrase like “certify” or “true and correct” to indicate absolute level of assurance expected to be provided by the practitioner on the subject matter. Absolute assurance indicates that a practitioner has performed procedures as considered appropriate to reduce the engagement risk to zero.

The increasing involvement of members in giving audit reports or certificates on special purpose statements or other information prepared by an enterprise necessitated the need for guidance to the auditor regarding various facets of such assignments including the form and contents of audit reports and certificates for special purposes. In view of this, the Institute brought out this Guidance Note on Audit Reports and Certificates for Special Purposes.

The following is an overview of the areas touched upon by the Guidance Note:

- Scope of special purpose reports and certificates
- Responsibility for preparation of special purpose statements
- Scope of the reporting auditor’s functions
- Contents of such reports and certificates
- Reports and certificates on specific items of financial statements
- Communication of report or certificate
- Communication with previous auditor.

The Guidance Note also contains examples of such reports and certificates.
6.3 **Guidance Note on Tax Audit under Section 44AB of the Income-Tax Act:** This Guidance Note was first issued by the Taxation Committee in 1985 and was revised from time to time by the Direct Taxes Committee. Refer to Chapter 13 for a detailed discussion.

6.4 **Guidance Note on Audit of Inventories:** The Guidance Note deals with procedures of the auditor in respect of audit of inventories. It outlines the peculiar features of inventories, which impact the audit procedures. The following is a gist of the important aspects of audit of inventories covered by the Guidance Note:

- **Internal Control Evaluation:** segregation of incompatible functions, standard form for recording movement of inventory, cross checking of data generated by different departments.
- **Verification:** management’s responsibility for physical verification, sufficient appropriate audit evidence for existence, ownership and valuation, procedures for verification by auditor.
- **Examination of Records:** type of records, extent of auditor’s examination, auditor’s procedures in case of absence or insufficiency of records.
- **Attendance at Stock Taking:** need for auditor’s attendance at stock taking, methods and procedures for stock taking, factors to be considered and procedures to be adopted in assessing the adequacy of stock taking, movement of stocks during stock taking, cut off procedures.
- **Confirmation from Third Parties:** factors to be seen, confirmations from third parties.
- **Examination of Valuation and Disclosures:** basis for valuation of inventories and methods of applying the basis, compliance with Accounting Standard (AS) 2, “Valuation of Inventories”, use of standard costing, examination of the disclosure in financial statements.
- **Analytical Review Procedures:** illustrative analytical procedures, comprising mainly of comparison of various elements.
- **Work in Progress:** assessing appropriateness of its valuation etc.
- **Management Representations.**
- **Documentation by the auditor.**

The Guidance Note also gives illustrated set of instructions to be issued by the client to its staff responsible for stock taking, illustrative letter of confirmation of inventories held by others, illustrative letter of confirmation of inventories held by the entity on behalf of others and an illustrative management representation letter for inventories.

6.5 **Guidance Note on Audit of Debtors, Loans and Advances:** The Guidance Note deals with the audit procedures that might be adopted by the auditor in case of audit of debtors, loans and advances. A gist of the relevant areas covered by the Guidance Note is as follows:

- **Internal Control Evaluation in Respect of Debtors:** fixing of credit/ loan/ advance limits, procedure for recording, realising and correlating outstandings from parties, aging schedule, periodic balance confirmation, authority for material adjustments to parties’ account, periodic
reconciliation statements, form and adequacy of security, recognition and realisation of interest income.

- **Verification**: audit evidence regarding existence, completeness, valuation and disclosure.
- **Examination of Records**: audit procedures for examining records.
- Indications of doubtful debts/loans.
- **Direct Confirmation Procedures**: methods of obtaining confirmations, types of confirmations, timing of confirmations.
- **Analytical Review Procedures**: comparison of some important elements of debtors/loans and advances.
- Disclosure.
- Management Representations.
- Documentation.

The Guidance Note also contains an illustrative confirmation letters to be sent to debtors and management representation letter for debtors, loans and advances.

### 6.6 Guidance Note on Audit of Investments:

This Guidance Note deals with the procedures that might be adopted by the auditor for auditing investments. The Guidance Note also throws light on the exceptional features of investments which have an impact on the audit procedures. The important aspects of audit of investments covered by the Guidance Note are highlighted as follows:

- **Internal Control Evaluation**: control over acquisition, accretion and disposal of investments, safeguarding of investments, controls in respect of title of investments, information controls.
- **Verification of Transactions**: authority to invest, legal requirements, supporting documents, terms of sale or purchase (ex or cum dividend/interest), rights issues, bonus issues.
- **Physical Verification**: responsibility of auditor, use of depository/ custodial services by the client, scripless trading, timing of physical examination, investments held by others, investments not held in the name of the client vis a vis legal requirements, procedure in finance/chit fund/nidhi companies etc., immovable properties held as investments.
- **Examination of Valuation or Disclosures**: valuation and disclosure of investments vis a vis, compliance with Accounting Standard (AS) 13 and statutory requirements, method of valuation.
- **Analytical Procedures**: comparison of various ratios.
- Management Representations.
- Documentation by the auditor.

The Guidance Note, for the benefit of the members, also give a gist of legal requirements, including disclosure norms, relating to investments under certain prominent statutes, illustrative letter of confirmation for investments held by banks, and management representation letter for investments.
6.7 Guidance Note on Audit of Cash and Bank Balances: The Guidance Note deals with the audit procedures that might be adopted while auditing cash and bank balances. The following is a gist of the relevant areas covered by the Guidance Note:

- **Internal Control Evaluation**: segregation of incompatible functions, authorisation, recording of transactions, safe custody of cash, chequebooks etc., reconciliation statements, etc.
- **Verification of Cash Balances**: timing of carrying out verifications, procedure for verification, situations of unduly large cash balances, IOUs, procedures in case of discrepancies, frequency of verification.
- **Verification of Bank Balances**: procedures for verification, examination of bank reconciliation statements and unusually old outstandings therein, post dated cheques, obtaining confirmations from banks, inoperative bank accounts, fixed deposits, remittance in transit, treatment of stale cheques, valuation of foreign exchange transactions.
- **Examination of Valuation and Disclosure**: compliance with recognised accounting policies, practices, statutory requirements.

The Guidance Note also gives an illustrative letter of confirmation for bank balances.

6.8 Guidance Note on Audit of Liabilities: This Guidance Note contains recommended audit procedures in case of audit of liabilities. The following is an outline of the relevant areas discussed in the Guidance Note:

- **Internal Control Evaluation in Respect of Loans and Borrowings**: credit limits/borrowing powers and limits, authority, terms of borrowing, compliance with statutory requirements, variation in terms, security against loans, documentation, reporting of non compliance, balance confirmations, foreign exchange loans.
- **Internal Control Evaluation in Respect of Trade Creditors, Current Liabilities, Provisions, Trade Deposits**: in addition to those above, payment on duplicate invoices, schedule of creditors, adjustments to creditors, accounts to be authorised, cut off procedures.
- **Examination of Records of Loans and Borrowings**: validity and accuracy, agreement with the statements from creditors and loanees, loan agreements, change in the value of security, deferred payment credits.
- **Examination of Records of Trade Creditors and Other Current Liabilities**: cut off procedures, control accounts, documentary evidence, important aspects to be seen in the schedule of creditors etc., year end transactions, subsequent events.
- **Examination of Records of Provisions**: meaning of provision, objectives of audit of provisions, provision for taxes and duties, provision for gratuity, provision for bonus, provision for dividend, other provisions.
- **Examination of Records of Contingent Liabilities**: meaning, general procedures for verifying contingencies.
Direct Confirmation Procedures: meaning, types – negative/positive, suitability of each type, discrepancies in books of account vis a vis confirmations.

Examination of Disclosures.


Special Considerations in case of a Company: compliance with the relevant sections of the Companies Act.

Management Representations.

Documentation.

The Guidance Note also contains illustrative letter of confirmation to be sent to creditors and management representation letter for liabilities and contingencies.

6.9 Guidance Note on Audit of Revenue: The Guidance Note contains recommended audit procedures in case of audit of liabilities. The following is an outline of the areas covered by the Guidance Note:

- Assertions Regarding Revenue: occurrence, completeness, measurement, presentation and disclosure.
- Internal Control Evaluation.
- Examination of Records: compliance with AS 9, cut-off procedures, sales journal, dispatch documents, sales to intermediate parties, realisation in installments, export sales, revenue from services rendered.
- Examination of Presentation and Disclosure.
- Analytical Procedures: comparison of various relevant components of revenue.
- Special Considerations in case of a Company: compliance with relevant statutory requirements.
- Documentation.

6.10 Guidance Note on Audit of Expenses: This Guidance Note deals with the illustrative audit procedures that might be adopted by the auditors in auditing various items of expenses. The introductory part of the Guidance Note deals with the explanation of the term "expense" and the different approaches to identify the expense. It also deals with the peculiar features of "expenses" which impact the audit procedures as also the assertions to be examined in respect thereof.

The following is a gist of the relevant aspects of audit of expenses covered by the Guidance Note:

- Internal Control Evaluation
- Verification – Examining Records and Analytical Procedures
- Examination of Presentation and Disclosure
- Management Representation
6.11 Guidance Note on Computer Assisted Audit Techniques (CAATs): Recognising the developments in the field of technology and its impact on the accounting profession in India, Auditing and Assurance Standards Board had issued Standard on Auditing (SA) 315, “Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment” and SA 330, “The Auditor’s Responses to Assessed Risks”. The Guidance Note deals extensively, with the concept of CAATs and related pertinent issues such what CAATs are, where they may be used, considerations in use of CAATs, how to use CAATs, testing of CAATs, controlling application of CAATs, documentation required when using CAATs, use of CAATs in small entities, etc. The Guidance Note also contains a comprehensive appendix containing examples of CAATs, their description and comparable advantages and disadvantages of each of these CAATs.

6.12 Guidance Note on Audit of Capital and Reserves: The Auditing and Assurance Standards Board of India has issued Guidance Note on Audit of Capital and Reserves in order to keep the members abreast in resolving the technical intricacies involved in auditing of capital and reserves. The Guidance Note discusses the auditing aspect of capital and reserves separately. It deals in detail, with different principle related aspects dealing with the audit of capital and reserves including implications of key legal requirements. This Guidance Note not only gives special consideration to companies but partnerships and sole proprietary concerns as well. The Guidance Note also incorporates circulars issued by the Government and other regulatory authorities wherever applicable.

The Guidance Note on Audit of Capital and Reserves discusses significant aspects of their audit such as evaluation of internal controls and verification, the audit evidence, the auditing procedure to be followed in case of issue of shares for consideration other than cash and in case of issue of Sweat Equity shares etc. The Guidance Note also deals with various types of reserves and their accounting treatment while discussing auditing aspects. It also lays down the documentation requirements for the audit of capital and reserves.

6.13 Guidance Note on Reporting under section 143(3)(f) and (h) of the Companies Act, 2013: This Guidance Note is intended to assist the auditors in discharging their duties in respect of clauses (f) and (h) of sub-section (3) of section 143 of the Act. Clause (f) of the said sub-section creates a requirement for the auditor to consider observations or comments of the auditor on financial transactions or matters which have an adverse effect on the functioning of the company.
Such observations or comments would ordinarily lead to the modification of or an emphasis of matter in the auditor’s report on financial statements. It may be noted that the matters that lead to modification in the auditor’s report on financial statements are matters that give rise to a qualified opinion, adverse opinion or a disclaimer of opinion. Further, matters that lead to an emphasis of matter paragraphs are matters appropriately presented or disclosed in the financial statements that, in the auditor’s judgement, are of such importance that they are fundamental to the users’ understanding of the financial statements. If the matter leading to the modification of the auditor’s opinion or an emphasis of matter in the auditor’s report on financial statements is likely to have an adverse effect on the functioning of the company, the auditor is required to report such matter.

Under clause (h) of sub-section (3) of section 143 of the Act, the auditor is required to state whether any matter leading to a qualification, reservation or adverse remark, that is, effectively the modification of the auditor’s report on financial statements, relates to the maintenance of accounts and other matters connected therewith.

**6.14 Guidance Note on Audit of Consolidated Financial Statements (CFS):** An entity which prepares the consolidated financial statements, either under any law or regulation governing the entity or suo motu, might be required to or otherwise engage the auditor for conducting the audit of consolidated financial statements. However, a law or regulation governing the entity may require the consolidated financial statements to be audited by the statutory auditor of the entity. This Guidance Note provides guidance on the specific issues and audit procedures to be applied in an audit of consolidated financial statements. This Guidance Note can also be used while auditing consolidated financial statements prepared for special purpose, to the extent applicable. However, this Guidance Note does not deal with accounting matters arising on consolidation of financial statements. Consolidated financial statements are presented, to the extent possible, in the same format as adopted by the parent for its separate financial statements. The formats for preparation of balance sheet, statement of profit and loss and a statement of change in equity (if applicable) are prescribed under the Schedule III of the Companies Act, 2013.

Students are advised to Refer Chapter 9 Audit Reports and Auditing Pronouncements for details.

**6.15 Guidance Note on CARO 2016:** The purpose of this Guidance Note is to enable the members to comply with the reporting requirements of the Order. It should, however, be noted that the clarifications and explanations contained in this Guidance Note are not intended to be exhaustive and the auditors should exercise their professional judgment and experience on various matters on which they are required to report under the Order. Further, the Order is also not intended to limit the duties and responsibilities of auditors but only requires a statement to be included in the audit report in respect of the matters specified therein.
Students are advised to Refer Chapter 6 Audit Reports and Auditing Pronouncements for details.

6.16 Guidance Note on Audit of Internal Financial Controls over Financial Reporting:
To help the members properly understand and perform the various aspects of reporting responsibility related to audits of internal financial controls over financial reporting, the Auditing and Assurance Standards Board of the Institute of Chartered Accountants of India has brought out this Guidance Note on Audit of Internal Financial Controls Over Financial Reporting. The Guidance Note covers aspects such as Scope of reporting on internal financial controls under Companies Act 2013, essential components of internal financial controls, Technical guidance on audit of internal financial controls, Implementation guidance on audit of internal financial controls.

The Companies Act, 2013 has introduced some new requirements relating to audits and reporting by the statutory auditors of companies. One of these requirements is given under Section 143(3)(i) of the Act which requires the statutory auditor to state in his audit report whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls. The section has cast onerous responsibilities on the statutory auditors because reporting on internal financial controls is not covered under the Standards on Auditing issued by the ICAI.

6.17 Guidance Note on Reporting on Fraud under section 143(12) of the Companies Act, 2013: This guidance note deals with section 143(12) of the Companies Act, 2013 which states that “Notwithstanding anything contained in this section, if an auditor of a company, in the course of the performance of his duties as auditor, has reason to believe that an offence of fraud involving such amount or amounts as may be prescribed, is being or has been committed in the company by its officers or employees, the auditor shall report the matter to the Central Government within such time and in such manner as may be prescribed:

It is also provided that in case of fraud involving lesser than the specified amount, the auditor shall report the matter to the audit committee constituted under section 177 or to the Board in other cases within such time and in such manner as may be prescribed: It also provide guidance that the companies, whose auditors have reported frauds under this sub-section to the audit committee or the Board but not reported to the Central Government, shall disclose the details about such frauds in the Board’s report in such manner as may be prescribed.”

Note: For detailed Guidance Notes students may refer Handbook on Auditing Pronouncements.

7. GUIDANCE NOTE(S) ON RELATED SERVICES

The framework for auditing and related services makes it clear that there can be different layers of assurance depending upon the nature of services being performed by the chartered accountant. Related Services comprise of Review engagements, Agreed upon Procedures and Compilation Engagement. Reviews engagements involve providing moderate assurance (or negative assurance)
but other two services, viz., and compilation and agreed upon procedures provide no assurance at all. The Institute has issued guidance notes covering these aspects of related services in a comprehensive manner.

8. AUTHORITY ATTACHED TO THE DOCUMENTS ISSUED BY THE INSTITUTE/MCA

The Institute has, from time to time, issued ‘Statements’ and ‘Guidance Notes’ on a number of matters. With the formation of the Accounting Standards Board and the Auditing and Assurance Standards Board, Accounting Standards and Standards on Auditing have also been issued. The level of authority attached to these documents and the degree of compliance required in respect thereof has been explained by the Institute through its various announcements issued from time to time.

8.1 Statements: The ‘statements’ have been issued with a view to securing compliance by members on matters which in the opinion of the council of the institute are critical for the proper discharge of their functions. ‘Statements’ therefore are mandatory. Accordingly, while discharging their attest function, it is the duty of the members of the institute.

(a) to examine whether ‘Statements’ relating to accounting matters are complied with in the presentation of financial statements covered by their audit. In the event of any deviation from such ‘Statements’, it is their duty to make adequate disclosures in their audit reports so that the users of financial statements may be aware of such deviations; and

(b) to ensure that the ‘Statements’ relating to auditing matters, are followed in the audit of financial information covered by their audit reports. If, for any reason, a member, has not been able to perform an audit in accordance with such ‘Statements’ his report should draw attention to the material departures there from.

8.2 Guidance Notes: ‘guidance notes’ are primarily designed to provide guidance to members on matters which may arise in the course of their professional work and on which they may desire assistance in resolving issues which may pose difficulty. Guidance notes are recommendatory in nature. A member should ordinarily follow recommendations in a guidance note relating to an auditing matter except where he is satisfied that in the circumstances of the case, it may not be necessary to do so. Similarly, while discharging his attest function, a member should examine whether the recommendations in a guidance note relating to an accounting matter have been followed or not. If the same have not been followed, the member should consider whether keeping in view the circumstances of the case, a disclosure in his report is necessary. There are, however a few guidance notes in case of which the Council has specifically stated that they should be considered as mandatory on members while discharging their attest function.
8.3 Accounting Standards and Standards on Auditing: The ‘accounting standards’ and ‘Standards on Auditing’ establish standards which have to be complied with to ensure that financial statements are prepared in accordance with generally accepted accounting standards and that auditors carry out their audit in accordance with the generally accepted auditing practices. They become mandatory on the dates specified in the respective document or notified by the council.

There can be situations in which certain matters are covered both by a ‘Statement’ and by an ‘Accounting Standard’/ ‘Standards on Auditing’. In such a situation, the ‘Statement’ prevails till the time the relevant ‘Accounting Standard’/ Standards on Auditing becomes mandatory. Once an ‘Accounting Standard’/ ‘Standards on Auditing’ becomes mandatory, the concerned ‘Statement’ or the relevant part thereof automatically stands withdrawn.

Standards on Auditing (SAs) establish standards, which have to be complied with to ensure that auditors carry out their duties in accordance with the generally accepted auditing practices. They become operative (i.e., mandatory) in respect of audit of all enterprises on the dates specified in the respective SAs or notified by the Council. The duties of the members of the Institute in relation to operative SAs are similar to those in respect of ‘Statements’ relating to auditing matters.

8.4 Accounting Standards: Accounting Standards are formulated by the Accounting Standards Board and issued by the Council of the Institute. The Accounting Standards are issued for use in the presentation of ‘general purpose financial statements’ which are issued to the public by such ‘commercial, industrial or business enterprises’ as may be specified by the Institute from time to time and subject to the attest function of its members. They become mandatory on the dates specified in the respective Accounting Standards or notified by the Council in this behalf.

(a) The term ‘General Purpose Financial Statements’ includes balance sheet, statement of profit and loss and other statements and explanatory notes which form part thereof, issued for the use of shareholders/members, creditors, employees and public at large.

(b) The reference to ‘commercial, industrial or business enterprises’ is in the context of the nature of activities carried on by an enterprise rather than with reference to its objects. The Accounting Standards apply in respect of commercial, industrial or business activities of any enterprise, irrespective of whether it is profit oriented or is established for charitable or religious purposes. Accounting Standards will not, however, apply to those activities which are not of commercial, industrial or business nature (e.g. an activity of collecting donations and giving them to flood affected people). The exclusion of an entity from the applicability of the Accounting Standards is permissible only if no part of the activity of entity is commercial, industrial or business in nature. In other words, even if a very small proportion of the activities of an entity is considered to be commercial, industrial or business in nature, then it cannot claim exemption from the application of Accounting Standards. In such a case the Accounting Standards will apply to all its activities including those which are not commercial, industrial or business in nature.
The Companies Act as well as many other statutes require that the financial statements of an enterprise should give a true and fair view of its financial position and working results. This requirement is implicit even in the absence of a specific statutory provision to this effect. However, what constitutes ‘true and fair’ view has not been defined either in the Companies Act or in any other statute. The Accounting Standards (as well as other pronouncements of the Institute on accounting matters) seek to describe the accounting principles and the methods of applying these principles in the preparation and presentation of financial statements so that they give a true and fair view.

The ‘Preface to the Statements of Accounting Standards’ issued by the Institute in 2004 states (paragraphs 6.1 and 6.3):

“6.1 While discharging their attest function, it will be the duty of the members of the Institute to examine whether the Accounting Standard is complied with in the presentation of financial statements covered by their audit. In the event of any deviation from the Accounting Standard, it will be their duty to make adequate disclosures in their reports so that the users of such statements may be aware of financial deviations.”

“6.3 Financial Statements cannot be described as complying with the Accounting Standards unless they comply with all the requirements of each applicable standard.”

Once an Accounting Standard becomes mandatory, the duties of an auditor with respect to such standard are the same as those specified at paragraph 2(a) above.

While discharging their attest function, the members of the Institute may keep the following in mind with regard to mandatory Accounting Standards.

**AS 1 - Disclosure of Accounting Policies** - In the case of a company, members should qualify their audit reports in case:

(a) accounting policies required to be disclosed under Schedule III or any other provisions of the Companies Act, 2013, have not been disclosed, or

(b) accounts have not been prepared on accrual basis, or

(c) the fundamental accounting assumption of going concern has not been followed and this fact has not been disclosed in the financial statements, or

(d) proper disclosures regarding changes in the accounting policies have not been made.

Where a company has been given a specific exemption regarding any of the matters stated in paragraph 16 above but the fact of such exemption has not been adequately disclosed in the accounts, the member should mention the fact of exemption in his audit report without necessarily making it a subject matter of audit qualification.
If accounting policies have not been disclosed at one place or if certain significant accounting policies have not been disclosed, by a company on the ground that their disclosure is not required under the Companies Act, 2013, the member should disclose the fact in his audit report without necessarily making it a subject matter of audit qualification. Such a disclosure would not constitute a reservation, qualification or adverse remark except where the auditor has specifically made it a subject matter of audit qualification. Accordingly in the case of a company, the Board of Directors need not provide information or explanation with regard to such a disclosure (except where the same constitutes a qualification) in their report under sub-section (3) of Section 134 of the Companies Act, 2013.

In the case of enterprises not governed by the Companies Act, 2013, the member should examine the relevant statute and make suitable qualification in his audit report in case adequate disclosures regarding accounting policies have not been made as per the statutory requirements. Similarly, the member should examine if the fundamental accounting assumptions have been followed in preparing the financial statements or not. In appropriate cases, he should consider whether, keeping in view the requirements of the applicable laws, a qualification in his report is necessary. In the event of non-compliance, by enterprises not governed by the Companies Act, 2013, with the disclosure requirements of AS1 in situations where the relevant statute does not require such disclosures to be made, the member should make adequate disclosure in his audit report without necessarily making it a subject matter of audit qualification.

Other Mandatory Accounting Standards - While making a qualification, the auditor should follow the requirements of the ‘Statement on Qualifications in Auditor’s Report’ issued by the Institute. Subject to this, non-compliance with any of the requirements of a mandatory Accounting Standard other than AS 1 by any enterprise should be a subject matter of qualification except that, to the extent that the disclosure requirements in the relevant standard are in addition to the requirements of the Companies Act, 2013, or any other applicable statute, the member should disclose the fact of non-compliance with such disclosure requirements in his audit report without necessarily making it a subject matter of audit qualifications.

Financial Statements Prepared on a Basis other than Accrual - With regard to the fundamental accounting assumption of accrual, the Council of the Institute has made a specific announcement that in respect of individuals/bodies covered by para AS I - Disclosure of Accounting Policies above, the auditor should examine whether the financial statements have been prepared on accrual basis. In cases where the statute governing the enterprise requires the preparation and presentation of financial statements on accrual basis but the financial statements have not been so prepared, the auditor should qualify his report. On the other hand, where there is no statutory requirement for preparation and presentation of financial statements on accrual basis, and the financial statements have been prepared on a basis other than ‘accrual’, the auditor should describe in his audit report, the basis of accounting followed, without necessarily making it a subject matter of a qualification. In such a case the auditor should also examine whether those provisions of the accounting standards
which are applicable in the context of basis of accounting followed by the enterprise have been complied with or not and consider making suitable disclosures/qualifications in his audit report accordingly.

8.5 Ind AS: Indian Accounting Standards (Ind-AS) are the International Financial Reporting Standards (IFRS) converged standards issued by the Central Government of India under the supervision and control of Accounting Standards Board (ASB) of ICAI and in consultation with National Advisory Committee on Accounting Standards (NACAS). The Ind AS are named and numbered in the same way as the corresponding International Financial Reporting Standards (IFRS).

In July 2014, the Finance Minister of India at that time, Shri Arun Jaitley ji, in his Budget Speech, announced an urgency to converge the existing accounting standards with the International Financial Reporting Standards (IFRS) through adoption of the new Indian Accounting Standards (Ind AS) by the Indian companies from the financial year 2015-16 voluntarily and from the financial year 2016-17 on a mandatory basis.

Pursuant to the above announcement, various steps have been taken to facilitate the implementation of IFRS-converged Indian Accounting Standards (Ind AS). Moving in this direction, the Ministry of Corporate Affairs (MCA) has issued the Companies (Indian Accounting Standards) Rules, 2015 vide Notification dated February 16, 2015 covering the revised roadmap of implementation of Ind AS for companies other than Banking companies, Insurance Companies and NBFCs and Indian Accounting Standards (Ind AS). As per the Notification, Indian Accounting Standards (Ind AS) converged with International Financial Reporting Standards (IFRS) shall be implemented on voluntary basis from 1st April, 2015 and mandatorily from 1st April, 2016.

**Manner of Making Qualification Disclosure in the Audit Report** - In making a qualification/disclosure in the audit report in respect of non-compliance with a Statement, SA, Accounting Standard or Guidance Note, the auditor should consider the materiality of the relevant item. Thus, the auditor need not make qualification/disclosure in respect of items which, in his judgement, are not material.

While making a qualification, the auditor should follow the requirements of the ‘Statement on Qualifications in Auditor’s Report’ issued by the Institute.

A disclosure, which is not a subject matter of audit qualification, should be made in the auditor’s report in a manner that it is clear to the reader that the disclosure does not constitute an audit qualification. The paragraph containing the auditor’s opinion on true and fair view should not include a reference to the paragraph containing the aforesaid disclosure.

**Examples of Qualifications/Disclosures in the Audit Report** - Given below are some examples which illustrate the manner of making qualification/disclosure in the audit report. It may be clarified that these examples are aimed only at illustrating the manner
of making qualifications/disclosures and are not intended in any way to be exhaustive.

<table>
<thead>
<tr>
<th>Qualifications</th>
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<tr>
<td>(a) Where proper disclosures regarding changes in accounting policies have not been made by a company.</td>
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</tbody>
</table>

"The statement of profit and loss and balance sheet comply with the accounting standards referred to Section 133 of the Companies Act, 2013, except Accounting Standard (AS) 5, 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', as the company has not disclosed in its accounts the fact of change, from this year, in the method of providing depreciation on plant and machinery from straight-line method to written-down value method, as also the effect of this change. As a result of this change, the net profit for the year, the net block as well as the reserves and surplus are lower by ₹ .... Each as compared to the position which would have prevailed had this change not been made.

Subject to the above, we report that ......

(b) Where a manufacturing company has accounted for interest income on receipt basis and not on time proportion basis.

"The statement of profit and loss and balance sheet comply with the accounting standards referred to in Section 133 of the Companies Act, 2013, except Accounting Standard (AS) 9, 'Revenue Recognitions', as the company has followed the policy of accounting for interest income on receipt basis rather than on time proportion basis. As a result, the net profit for the year and the current assets are understated by ₹ .... each as compared to the position which would have prevailed if the company had accounted for interest income on time proportion basis.

Subject to the above, we report that ......

(c) Where an enterprise has capitalised financing costs related to certain fixed assets for periods after such assets were ready to be put to use.

"The statement of profit and loss and balance sheet comply with the accounting standards referred to in Section 133 of the Companies Act, 2013, except Accounting Standard (AS) 16, 'Borrowing Costs', as interest payable on borrowings related to the acquisition of fixed assets has been capitalised for the periods after which the assets were put to use. Consequently, the net profit for the year, the net block of fixed assets and the reserves and surplus have been overstated by ₹ .... each as compared to the position which would have prevailed if the company had complied with the requirements of AS 16.

Subject to the above, we report that ......
Disclosures

(a) Where a company has not disclosed all significant accounting policies and has also not disclosed the accounting policies at one place.

"The statement of profit and loss and balance sheet comply with the accounting standards referred to in Section 133 of the Companies Act, 2013, except Accounting Standard (AS) 1, 'Disclosure of Accounting Policies', as the company has disclosed those accounting policies, the disclosure of which is required by the Companies Act, 2013. Other significant accounting policies, relating to treatment of research and development costs have not been disclosed nor have all the policies been disclosed at one place.

We report that ….."

(b) Where a sole proprietary concern enterprise follows cash basis of accounting.

"It is the policy of the enterprise to prepare its financial statements on the cash receipts and disbursements basis. On this basis revenue and the related assets are recognised when received rather than when earned, and expenses are recognised when paid rather than when the obligation is incurred.

In our opinion, the financial statements give a true and fair view of the assets and liabilities arising from cash transactions of ........ at .......... and of the revenue collected and expenses paid during the year then ended on the cash receipts and disbursements basis as described in Note X."

Applicability of Accounting Standards to Charitable and/or Religious Organisations - The Accounting Standards Board has received a query as to whether the accounting standards formulated by it are applicable to organisations whose objects are charitable or religious. The Board has considered this query and its views in the matter are set forth in the following paragraphs.

The Preface to the Statements of Accounting Standards states:

“The Institute will issue Accounting Standards for use in the presentation of the general purpose financial statements issued to the public by such commercial, industrial or business enterprises as may be specified by the Institute from time to time and subject to the attest function of its members”.

The reference to commercial, industrial or business enterprises in the aforesaid paragraph is in the context of the nature of activities carried on by an enterprise rather than with reference to its objects. It is quite possible that an enterprise has charitable objects but it carries on, either wholly or in part, activities of a commercial, industrial or business nature in furtherance of its objects. The Board believes that Accounting Standards apply in respect of commercial, industrial or business activities of any enterprise, irrespective of whether it is profit oriented or is established for charitable or religious purposes. Accounting Standards will not, however, apply to those activities which are not of a commercial, industrial or business nature. (e.g. an activity of collecting donations and giving them to flood affected people).
It is also clarified that exclusion of an entity from the applicability of the Accounting Standards would be permissible only if no part of the activity of such entity was commercial, industrial or business in nature. For the removal of doubts, it is clarified that even if a very small proportion of the activities of an entity were considered to be commercial, industrial or business in nature, then it could not claim exemption from the application of Accounting Standards. The Accounting standards would apply to all its activities including those which were not commercial, industrial or business in nature.

9. SQC 1 - QUALITY CONTROL FOR FIRMS THAT PERFORM AUDITS AND REVIEWS OF FINANCIAL STATEMENTS, AND OTHER ASSURANCE AND RELATED SERVICES ENGAGEMENTS

It is a mother Standard for all other Standards and is all pervasive Standard in respect of quality control. As the name suggests, the SQC 1 contains extensive requirements in relation to establishment and maintenance of a system of quality control (QC) in the audit firms as well as even for sole practitioners. The important elements of a system of quality control discussed by the Standard include Elements of a System of Quality Control, Leadership Responsibilities for Quality Within the Firm, Ethical Requirements – Independence, Acceptance and Continuation of Client Relationships and Specific Engagements, Human Resources - Assignment of Engagement Team, Engagement Performance - Consultation, Differences of Opinion, Engagement Quality Control Review and Documentation of the Engagement Quality Control Review - Engagement Documentation.

**Introduction:**

| **Scope** | This Standard on Quality Control (SQC) deals with  
| A firm’s responsibilities for its system of quality control for Audits and Reviews of financial statements, and other Assurance and related services engagements and  
| Consists of policies designed to achieve the objective set out in SQC. |
| **Authority** | Applicable to all Professional Accountants Firms in respect of audits and reviews of financial statements, and other assurance and related services engagements.  
| The nature and extent of the policies and procedures will depend on the size and operating characteristics of the firm. |
| **Effective Date** | Systems of quality control in compliance with this SQC are required to be established by April 1, 2009 |
Objective

The objective of the firm is to establish and maintain a system of quality control to provide reasonable assurance that

(a) the firm and its personnel comply with the respective standards and regulatory and legal requirements; and

(b) Reports issued are appropriate in the circumstances.

Definitions

In this SQC the following terms have the meanings attributed below:

<p>| Engagement team | All personnel performing an engagement, including any experts contracted by the firm in connection with that engagement. |
| Engagement partner | The partner or other person in the firm who is a member of the Institute of Chartered Accountants of India and is in full time practice and is responsible for the engagement and its performance, and for the report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body. |
| Engagement quality control review | A process designed to provide an objective evaluation, before the report is issued, of the significant judgments the engagement team made and the conclusions they reached in formulating the report. |
| Engagement documentation | The record of work performed, results obtained, and conclusions the practitioner reached (terms such as “working papers” or “work-papers” are sometimes used). |
| Engagement quality control reviewer | A partner, other person (should be a member of the Institute of Chartered Accountants of India) in the firm, suitably qualified external person, or a team made up of such individuals, with sufficient and appropriate experience and authority to objectively evaluate, before the report is issued, the significant judgments the engagement team made and the conclusions they reached in formulating the report. However, in case the review is done by a team of individuals, such team should be headed by a member of the Institute. |
| Firm | A sole practitioner, partnership or corporation or other entity of professional accountants. |</p>
<table>
<thead>
<tr>
<th><strong>Partner</strong></th>
<th>Any individual with authority to bind the firm with respect to the performance of a professional services engagement.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Professional standards</strong></td>
<td>Engagement standards, as defined in the AASB’s “Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services,” and relevant ethical requirements as contained in the Code.</td>
</tr>
<tr>
<td><strong>Reasonable assurance</strong></td>
<td>In the context of this SQC, a high, but not absolute, level of assurance.</td>
</tr>
<tr>
<td><strong>Staff</strong></td>
<td>Professionals, other than partners, including any experts the firm employs.</td>
</tr>
</tbody>
</table>

**Requirements**

**Complying, with relevant Requirements**

The Partners and Staff within the firm are responsible for establishing and maintaining the system and applying its requirements properly.

**Elements of the System of Quality Control**

- **Leadership Responsibilities for Quality within the Framework**
  - Establish Policies & Procedures to
  - Design an internal culture recognising Quality control.
  - Firm’s chief executive officer or, managing board of partners to assume ultimate responsibility for Quality Control
  - Person assigned has sufficient and appropriate experience and ability to adhere the responsibility.

  **Example**

  Internal Culture recognising Quality Control includes compliances with Professional Standards, Legal Compliances and Laws and Regulations.

- **Relevant Ethical Requirement**
  - Establish Policies and procedures designed to provide that the firm and its personnel comply with relevant ethical requirements of.
  - (a) Integrity;
  - (b) Objectivity;
  - (c) Professional competence and due care;
  - (d) Confidentiality; and
  - (e) Professional behaviour.
| **Independence** | Establish Policies and procedures designed to maintain independence to  
|                  | ➢ Communicate its requirements to the Management.  
|                  | ➢ Identify and evaluate circumstances and relationships that create threats to independence, and to take appropriate action against them.  
|                  | ➢ Resolutions on Breach of Independence.  
|                  | ➢ Written confirmation of compliance with its policies and procedures on independence from all firm personnel. |
| **Acceptance and Continuance of Client Relationships and Specific Engagements** | Establish Policies and procedures for the acceptance/continuance and withdrawal of client relationships and specific engagements, designed to provide the  
|                  | ➢ Firm is Competent to perform the engagement.  
|                  | ➢ Has the capabilities, including time and resources, ethical values  
|                  | ➢ Client integrity is available. |
| **Human Resources & Engagement Performance** | Establish Policies and Procedures designed to provide and assign sufficient personnel with the  
|                  | ➢ competence, capabilities, and commitment to perform engagements with professional standards and  
|                  | ➢ to issue reports that are appropriate in the circumstances |
| **Monitoring** | Establish policies and procedures for Monitoring.  
|                  | ➢ Firm’s Quality Control Policies and Procedures  
|                  | ➢ Evaluating, Communicating and Remedying Identified Deficiencies  
|                  | ➢ Complaints and Allegations |
| **Documentation of the System of Quality Control** | Establish policies and procedures requiring appropriate documentation for  
|                  | ➢ Evidence of the operation of each element of its system. |
10. **SA/SRE/SAE/SRS—BRIEF OVERVIEW**

**10.1 SA 200: Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing** - it establishes the independent auditor’s overall responsibilities when conducting an audit of financial statements in accordance with SAs. Specifically, it sets out the overall objectives of the independent auditor, and explains the nature and scope of an audit designed to enable the independent auditor to meet those objectives. It also explains the scope, authority and structure of the SAs, and includes requirements establishing the general responsibilities of the independent auditor applicable in all audits, including the obligation to comply with the SAs. It has to be adapted as necessary in the circumstances when applied to audits of other historical financial information. This SA requires that the auditor to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error.

The SAs require that the auditor exercise professional judgment and maintain professional skepticism throughout the planning and performance of the audit and, among other things:

- Identify and assess risks of material misstatement, whether due to fraud or error, based on an understanding of the entity and its environment, including the entity’s internal control (further expounded in SA 315 and SA 330).
- Obtain sufficient appropriate audit evidence about whether material misstatements exist,
through designing and implementing appropriate responses to the assessed risks (further expounded in SA 500 and SA 501).

- Form an opinion on the financial statements based on conclusions drawn from the audit evidence obtained (further expounded in SA 700, SA 705, SA 706 and SA 720).

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

10.2 SA 210: Agreeing the Terms of Audit Engagements - It is a revised version of the erstwhile Auditing and Assurance Standard (AAS) 26, “Terms of Audit Engagements” issued by the Institute in 2003. The revised Standard deals with the auditor’s responsibilities in agreeing the terms of audit engagement with management and, where appropriate, those charged with governance. SA 210 establishes certain preconditions for an audit, responsibility for which rests with management or those charged with governance. SA 210 also deals with the requirements relating to preconditions for an audit, agreement on audit engagement terms, recurring audits, acceptance of a change in the terms of the audit engagement and additional considerations in engagement acceptance. The appendices to revised SA 210 contain the illustrative example of an audit engagement letter and the factors determining the acceptability of general purpose frameworks.

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

10.3 SA 220: Quality Control for an Audit of Financial Statements - SA 220 is a revised version of the erstwhile Auditing and Assurance Standard (AAS) 17, “Quality Control for Audit Work” issued by the Institute in 1999. The revised Standard deals with the specific responsibilities of the auditor regarding quality control procedures for an audit of financial statements. It also addresses, where applicable, the responsibilities of the engagement quality control reviewer. Revised SA 220 also deals with the aspects relating to leadership responsibilities for quality on audits, relevant ethical requirements, acceptance and continuance of client relationships and audit engagement, assignment of engagement teams, engagement performance, monitoring and documentation requirements.

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

10.4 SA 230: Audit Documentation - SA 230 is a revised version of the erstwhile Auditing and Assurance Standard (AAS) 3, “Documentation” issued by the Institute in 1985. The new Standard deals with the auditor’s responsibility to prepare audit documentation for an audit of financial statements. SA 230 also deals with the requirements of timely preparation of audit documentation, documentation of the audit procedures performed and audit evidence obtained and assembly of the final audit file. SA 230 also outlines about vesting of property of working papers with the Auditor. SQC 1 read with SA 230 spells out two essential principles viz. period of maintaining working papers and assembly of audit file by the auditor.

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

10.5 SA 240: The Auditor’s Responsibility Relating to Fraud in an Audit of Financial Statements - The Standard adopts a risk-based approach to auditor’s responsibility relating to fraud

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

10.6 SA 250: Consideration of Laws and Regulations in an Audit of Financial Statements - SA 250 is a revised version of the erstwhile Auditing and Assurance Standard (AAS) 21, “Considerations of Laws and Regulations in an Audit of Financial Statements” issued by the Institute in 2001. The revised Standard deals with the auditor’s responsibility to consider laws and regulations when performing an audit of financial statements. Revised SA 250 also deals with the effect of laws and regulations, responsibility of management for compliance with laws and regulations, responsibility of the auditor, audit procedures and reporting of identified or suspected non-compliance and documentation requirements.

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

10.7 SA 260: Communication with Those Charged with Governance - This Standard deals with the auditor’s responsibility to communicate with those charged with governance in an audit of financial statements. SA 260 also describes the requirements regarding communication with those charged with governance and regarding matter to be communicated and documentation required. This standard also spells out the distinction between the Management and Those Charged with Governance.

Although this SA applies irrespective of an entity’s governance structure or size, particular considerations apply where all of those charged with governance are involved in managing an entity, and for listed entities. This SA does not establish requirements regarding the auditor’s communication with an entity’s management or owners unless they are also charged with a governance role.

This SA is effective for audits of financial statements for periods beginning on or after April 1, 2017.

10.8 SA 265: Communicating Deficiencies in Internal Control to Those Charged with Governance and Management - SA 265 is a new Standard on Auditing which deals with the auditor’s responsibility to communicate appropriately to those charged with governance and management deficiencies in internal control that the auditor has identified in an audit of financial statements. SA 265 defines the terms “Deficiency in internal control” and “Significant deficiency in internal control”. This SA also deals with the aspects like determination of whether deficiencies in internal control have been identified, whether it is significant deficiencies in internal control and communicating deficiencies in internal control. This standard somehow supplements the concept of ‘Letter of Weakness.’
This SA is effective for audits of financial statements for periods beginning on or after April 1, 2010.

10.9 SA 299: Responsibility of Joint Auditors - This SA deals with the professional responsibilities which the auditors undertake in accepting appointments as joint auditors. The SA, inter alia, lays down that the joint auditors should, normally, by mutual discussion, divide the audit work among themselves. The division of work among joint auditors as also the areas of work to be covered by all of them should be adequately documented and preferably communicated to the entity. The SA also states that each joint auditor is responsible only for the work allotted to him, whether or not he has prepared a separate report on the work performed by him. The SA describes the areas for which joint auditors are jointly and severally responsible. As per the SA, each joint auditor is entitled to assume that the other joint auditors have carried out their part of the audit work in accordance with generally accepted audit procedures. It also deals with the reporting responsibilities of the joint auditors. This standard very specifically states that the majority opinion would not be binding upon the other joint auditor(s).

The SA became effective for all audits relating to accounting periods commencing on or after April 1, 1996.

10.10 SA 300: Planning an Audit of Financial Statements - This Standard on Auditing (SA) deals with the auditor’s responsibility to plan an audit of financial statements. As per this SA the objective of the auditor is to plan the audit so that it will be performed in an effective manner.

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

10.11 SA 315: Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment - The Standard deals with the auditor’s responsibility to obtain an understanding of the entity and its environment and using that understanding to identify and assess the risks of material misstatement at the financial statement level and assertion level.

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

10.12 SA 320: Materiality in Planning and Performing an Audit - SA 320 is a revised version of the erstwhile Auditing and Assurance Standard (AAS) 13, “Audit Materiality” issued by the Institute in 1997. The revised Standard deals with the auditor’s responsibility to apply the concept of materiality in planning and performing an audit of financial statements. This SA also deals with the requirements of determining materiality and performance materiality when planning the audit, revision as the audit progresses and documentation requirements.

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

10.13 SA 330: The Auditor’s Responses to Assessed Risks - SA 330 is a new Standard on Auditing which deals with the auditor’s responsibility to design and implement responses to the risks of material misstatement identified and assessed by the auditor in accordance with SA 315 at the financial statement level and assertion level. This SA also deals with the aspects relating to overall
responses to assessed risks, audit procedures responsive to the assessed risks of material misstatement at the assertion level, adequacy of presentation and disclosure, evaluating the sufficiency and appropriateness of audit evidence and documentation requirements.

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

10.14 SA 402: Audit Considerations Relating to an Entity Using a Service Organisation- SA 402 is a revised version of the erstwhile Auditing and Assurance Standard (AAS) 24, “Audit Considerations Relating to Entities Using Service Organisations” issued by the Institute in 2002. The revised Standard deals with the user auditor's responsibility to obtain sufficient appropriate audit evidence when a user entity uses the services of one or more service organizations. SA 402 also deals with the aspects like obtaining an understanding of the services provided by a service organisation, including internal control, responding to the assessed risks of material misstatement, Type 1 and Type 2 reports, fraud, non-compliance with laws and regulations and uncorrected misstatements in relation to activities at the service organisation and reporting by the user auditor.

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

10.15 SA 450: Evaluation of Misstatements Identified During the Audit - SA 450 is a new Standard on Auditing which deals with the auditor’s responsibility to evaluate the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial statements. SA 450 defines the terms “Misstatement” and “Uncorrected misstatements”. This SA also deals with the aspects like accumulation of identified misstatements, consideration of identified misstatements as the audit progresses, communication and correction of misstatements, evaluating the effect of uncorrected misstatements, written representation and documentation.

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

10.16 SA 500: Audit Evidence - SA 500 is a revised version of the erstwhile Auditing and Assurance Standard (AAS) 5, “Audit Evidence” issued by the Institute in 1988. The revised Standard is quite detailed in terms of audit evidence in an audit of financial statements, and deals with the auditor’s responsibility to design and perform audit procedures to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor’s opinion. This SA also deals with the requirements of obtaining sufficient appropriate audit evidence, how information to be used as audit evidence, how to select items for testing to obtain audit evidence and procedures in case of inconsistency in, or doubts over reliability of, audit evidence.

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

10.17 SA 501: Audit Evidence—Specific Considerations for Selected Items - SA 501 is a revised version of the erstwhile Auditing and Assurance Standard (AAS) 34, “Audit Evidence – Additional Considerations for Specific Items” issued by the Institute in 2005. The revised Standard deals with specific considerations by the auditor in obtaining sufficient appropriate audit evidence in accordance with SA 330, SA 500 (Revised) and other relevant SAs, with respect to certain aspects of inventory,
litigation and claims involving the entity, and segment information in an audit of financial statements. Revised SA 501 also deals with the requirements and application of the aspects relating to inventory, litigation and claims and segment information.

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

**10.18 SA 505: External Confirmations** - SA 505 is a revised version of the erstwhile Auditing and Assurance Standard (AAS) 30, “External Confirmations” issued by the Institute in 2003. The revised Standard deals with the auditor’s use of external confirmation procedures to obtain audit evidence in accordance with the requirements of SA 330. Revised SA 505 also deals with the requirements and application of the aspects relating to external confirmation procedures, management’s refusal to allow the auditor to send a confirmation request, results of the external confirmation procedures, negative confirmations and evaluating the evidence obtained.

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

**10.19 SA 510: Initial Audit Engagements - Opening Balances** - SA 510 is a revised version of the erstwhile Auditing and Assurance Standard (AAS) 22, “Initial Engagements - Opening Balances” issued by the Institute in 2001. The revised Standard establishes the principles regarding audit of opening balances in case of initial engagements, i.e., when the financial statements are audited for the first time or when the financial statements for the preceding period were audited by another auditor. This SA also deals with the audit procedures and audit conclusions and reporting requirements in case of initial audit engagements.

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

**10.20 SA 520: Analytical Procedures** - SA 520 is a revised version of the erstwhile Auditing and Assurance Standard (AAS) 14, “Analytical Procedures” issued by the Institute in 1997. The revised Standard deals with the auditor’s use of analytical procedures as substantive procedures (“substantive analytical procedures”), and as procedures near the end of the audit that assist the auditor when forming an overall conclusion on the financial statements.

Revised SA 520 also deals with the requirements and application of the aspects relating to substantive analytical procedures, analytical procedures that assist when forming an overall conclusion and investigating results of analytical procedures.

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

**10.21 SA 530: Audit Sampling** - SA 530 is a revised version of the erstwhile Auditing and Assurance Standard (AAS) 15, “Audit Sampling” issued by the Institute in 1998. The revised Standard applies when the auditor has decided to use audit sampling in performing audit procedures. It also deals with the auditor’s use of statistical and non-statistical sampling when designing and selecting the audit sample, performing tests of controls and tests of details, and evaluating the results from the sample. This SA also deals with the requirements relating to sample design, size and selection of items for testing, performing audit procedures, nature and cause of deviations and misstatements, projecting misstatements and
evaluating results of audit sampling. This SA contains four Appendices also.

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

10.22 SA 540: Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures - SA 540 is a revised version of the erstwhile Auditing and Assurance Standard (AAS) 18, “Audit of Accounting Estimates” issued by the Institute in 2000. The revised Standard deals with the auditor’s responsibilities regarding accounting estimates, including fair value accounting estimates, and related disclosures in an audit of financial statements. Specifically, it expands on how SA 315 and SA 330 and other SAs are to be applied in relation to accounting estimates. It also includes requirements and guidance on misstatements of individual accounting estimates, and indicators of possible management bias. Considering the application of Ind AS/ IFRS in times to come and resulting estimates to be made, this Standard assumes special significance for the auditors.

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

10.23 SA 550: Related Parties - SA 550 is a revised version of the erstwhile Auditing and Assurance Standard (AAS) 23, “Related Parties” issued by the Institute in 2001. The revised Standard deals with the auditor’s responsibilities regarding related party relationship and transactions when performing an audit of financial statements. This standard also deals with the risk assessment procedures and related activities, identification and assessment of the risks of material misstatement associated with related party relationships and transactions, responses to the risks of material misstatement associated with related party relationships and transactions and evaluation of the accounting for and disclosure of identified related party relationships and transactions etc.

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

10.24 SA 560: Subsequent Events - SA 560 is a revised version of the erstwhile Auditing and Assurance Standard (AAS) 19, “Subsequent Events” issued by the Institute in 2000. The revised Standard deals with the auditor’s responsibilities relating to subsequent events in an audit of financial statements. SA 560 also deals with the events occurring between the date of the financial statements and the date of the auditor’s report, facts which become known to the auditor after the date of the auditor’s report but before the date the financial statements are issued and facts which become known to the auditor after the financial statements have been issued.

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

10.25 SA 570 Going Concern - The revised Standard is quite detailed in terms of auditor’s responsibility in the audit of financial statements with respect to management’s use of the going concern assumption in the preparation and presentation of the financial statements. SA 570 requires the auditor to inquire of management as to its knowledge of events or conditions beyond the period of management’s assessment that may cast significant doubt on the entity’s ability to continue as a going concern. SA 570 also deals with the requirements of risk assessment procedures and related
activities, evaluating management’s assessment, additional procedures, audit conclusions and reporting, use of going concern assumption etc. The standard also discusses the principles when mitigating factors are present vis-à-vis Going Concern of the enterprise.

This SA is effective for audits of financial statements for periods beginning on or after April 1, 2017.

10.26 SA 580: Written Representations - SA 580 is a revised version of the erstwhile Auditing and Assurance Standard (AAS) 11, “Representations by Management” issued by the Institute in 1996. The revised Standard is quite detailed in terms of the duties and objectives of the auditors regarding the acknowledgement by the management that it is fulfilling its responsibility relating to preparation and presentation of financial statements and internal controls, the various forms of management representations, situations where management representations are unreliable or where the management refuses to provide requested representations.

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

10.27 SA 600: Using the Work of Another Auditor - This SA discusses the procedures to be applied in situations where an independent auditor reporting on the financial statements of an entity, uses the work of an independent auditor with respect to the financial statements of one or more divisions or branches included in the financial statement of the entity. The Statement also discusses the principal auditor’s responsibility in relation to his use of the work of other auditor. This Standard becomes operative for all audits relating to accounting periods beginning on or after April 1, 1995.

When the principal auditor uses the work of another auditor, the principal auditor should determine how the work of the other auditor will affect the audit.

The auditor should consider whether the auditor’s own participation is sufficient to be able to act as the principal auditor.

When planning to use the work of another auditor, the principal auditor should consider the professional competence of the other auditor in the context of specific assignment if the other auditor is not a member of the Institute of Chartered Accountants of India.

The principal auditor should perform procedures to obtain sufficient appropriate audit evidence, that the work of the other auditor is adequate for the principal auditor’s purposes, in the context of the specific assignment.

The principal auditor should consider the significant findings of the other auditor.

There should be sufficient liaison between the principal auditor and the other auditor.

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

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

When the principal auditor has to base his opinion on the financial information of the entity as a whole relying upon the statements and reports of the other auditors, his report should state clearly the division of responsibility for the financial information of the entity by indicating the extent to which the financial information of components audited by the other auditors have been included in the financial information of the entity, e.g., the number of divisions/branches/subsidiaries or other components audited by other auditors.

10.28 SA 610: Using the work of Internal Auditors - This SA deals with the external auditor’s responsibilities if using the work of internal auditors. This includes (a) using the work of the internal audit function in obtaining audit evidence and (b) using internal auditors to provide direct assistance under the direction, supervision and review of the external auditor.

Furthermore, the requirements in this SA relating to direct assistance do not apply if the external auditor does not plan to use internal auditors to provide direct assistance.

This SA is effective for audits of financial statements for periods beginning on or after April 1, 2016.

10.29 SA 620: Using the Work of an Auditor’s Expert - SA 620 is a revised version of the erstwhile Auditing and Assurance Standard (AAS) 9 “Using the Work of An Expert” issued by the Institute in 1991. The revised Standard deals with the auditor’s responsibilities regarding the use of an individual or organisation’s work in a field of expertise other than accounting or auditing, when that work is used to assist the auditor in obtaining sufficient appropriate audit evidence. Revised SA 620 also deals with the requirements and application of the aspects relating to determining the need for an auditor’s expert, nature, timing and extent of audit procedures, the competence, capabilities and objectivity of the auditor’s expert, obtaining an understanding of the field of expertise of the auditor’s expert, agreement with the auditor’s expert, evaluating the adequacy of the auditor’s expert’s and reference to the auditor’s expert in the auditor’s report. This standard should be read in conjunction with SA 500 because Expert’s opinion also serves as audit evidence in appropriate cases.

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

10.30 SA 700: Forming an Opinion and Reporting on Financial Statements - The revised Standard deals with the auditor’s responsibilities to form an opinion on the financial statements and the form and content of the auditor’s report issued as a result of an audit of financial statements. Revised SA 700 also deals with the requirements relating to forming an opinion on the financial statements, form of opinion, auditor’s report, supplementary information presented with the financial statements and the application guidance of these aspects. Appendix to revised SA 700 also contains the Illustrative Formats of Auditors’ Reports on Financial Statements.
This SA is effective for audits of financial statements for periods beginning on or after April 1, 2017.

10.31 SA 701: Communicating Key Audit Matters in the Independent Auditor’s Report-
This Standard on Auditing (SA) deals with the auditor’s responsibility to communicate key audit matters in the auditor’s report. It is intended to address both the auditor’s judgment as to what to communicate in the auditor’s report and the form and content of such communication. The purpose of communicating key audit matters is to enhance the communicative value of the auditor’s report by providing greater transparency about the audit that was performed. Communicating key audit matters provides additional information to intended users of the financial statements (“intended users”) to assist them in understanding those matters that, in the auditor’s professional judgment, were of most significance in the audit of the financial statements of the current period. Communicating key audit matters may also assist intended users in understanding the entity and areas of significant management judgment in the audited financial statements.

The communication of key audit matters in the auditor’s report may also provide intended users a basis to further engage with management and those charged with governance about certain matters relating to the entity, the audited financial statements, or the audit that was performed.

This SA is effective for audits of financial statements for periods beginning on or after April 1, 2017.

10.32 SA 705: Modifications to the Opinion in the Independent Auditor’s Report - This Standard on Auditing (SA) deals with the auditor’s responsibility to issue an appropriate report in circumstances when, in forming an opinion in accordance with SA 700 (Revised), the auditor concludes that a modification to the auditor’s opinion on the financial statements is necessary. The objective of the auditor is to express clearly an appropriately modified opinion on the financial statements that are necessary when:

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<td>(a)</td>
<td>The auditor concludes, based on the audit evidence obtained, that the financial statements as a whole are not free from material misstatement; or</td>
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<td>(b)</td>
<td>The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.</td>
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This SA is effective for audits of financial statements for periods beginning on or after April 1, 2017.

10.33 SA 706: Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor’s Report - This Standard on Auditing (SA) deals with additional communication in the auditor’s report when the auditor considers it necessary to draw users’ attention to a matter or matters presented or disclosed in the financial statements that are of such importance that they are fundamental to users’ understanding of the financial statements; or draw users’ attention to any matter or matters other than those presented or disclosed in the financial statements that are relevant to users’ understanding of the audit, the auditor’s responsibilities or the auditor’s report.
SA 701 establishes requirements and provides guidance when the auditor determines key audit matters and communicates them in the auditor’s report. When the auditor includes a Key Audit Matters section in the auditor’s report, this SA addresses the relationship between key audit matters and any additional communication in the auditor’s report in accordance with this SA.

This SA is effective for audits of financial statements for periods beginning on or after April 1, 2017.

10.34 SA 710: Comparative Information—Corresponding Figures and Comparative Financial Statements - SA 710 is a revised version of the erstwhile Auditing and Assurance Standard (AAS) 25, “Comparatives” issued by the Institute in 2002. The revised Standard deals with the auditor’s responsibilities regarding comparative information in an audit of financial statements. This SA defines the terms ‘Corresponding figures’, ‘Comparative information’ and ‘Comparative financial statements’. Revised SA 710 also deals with the requirements and application of the aspects relating to audit procedures and audit reporting relating to Corresponding Figures and Comparative Financial Statements. Appendix to revised SA 710 contains the ‘Example of Auditors’ Reports’.

This SA is effective for audits of financial statements for periods beginning on or after April 1, 2011.

10.35 SA 720: The Auditor’s Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements - This Standard on Auditing (SA) deals with the auditor’s responsibility regarding other information in documents containing audited financial statements and the auditor’s report thereon. As per SA 720 the objective of the auditor is to respond appropriately when documents containing audited financial statements and the auditor’s report thereon include other information that could undermine the credibility of those financial statements and the auditor’s report. This SA also deals with the requirements related to reading other information, material inconsistencies and material misstatements of fact.

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

10.36 SA 800: Special Considerations—Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks - This SA deals with special considerations in the application of those SAs to an audit of financial statements prepared in accordance with a special purpose framework. It does not override the requirements of the other SAs; nor does it purport to deal with all special considerations that may be relevant in the circumstances of the engagement. The objective of the auditor, when applying SAs in an audit of financial statements prepared in accordance with a special purpose framework, is to address appropriately the special considerations that are relevant to:

(a) The acceptance of the engagement;

(b) The planning and performance of that engagement; and

1 SA 701, Communicating Key Audit Matters in the Independent Auditor’s Report
(c) Forming an opinion and reporting on the financial statements.

This SA is effective for audits of financial statements for periods beginning on or after April 1, 2011.

10.37 SA 805: Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement - This SA deals with special considerations in the application of those SAs to an audit of a single financial statement or of a specific element, account or item of a financial statement. The single financial statement or the specific element, account or item of a financial statement may be prepared in accordance with a general or special purpose framework. If prepared in accordance with a special purpose framework, SA 800 also applies to the audit. It does not apply to the report of a component auditor, issued as a result of work performed on the financial information of a component at the request of a group engagement team for purposes of an audit of group financial statements. Further it does not override the requirements of the other SAs; nor does it purport to deal with all special considerations that may be relevant in the circumstances of the engagement. The objective of the auditor, when applying SAs in an audit of a single financial statement or of a specific element, account or item of a financial statement, is to address appropriately the special considerations that are relevant to:

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<td>(a)</td>
<td>The acceptance of the engagement;</td>
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<td>The planning and performance of that engagement; and</td>
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<td>(c)</td>
<td>Forming an opinion and reporting on the single financial statement or on the specific element, account or item of a financial statement.</td>
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This SA is effective for audits of single financial statements or of specific elements, accounts or items for periods beginning on or after April 1, 2011. In the case of audits of single financial statements or of specific elements, accounts or items of a financial statement prepared as at a specific date, this SA is effective for audits of such information prepared as at a date on or after April 1, 2011.

10.38 SA 810: Engagements to Report on Summary Financial Statements - This SA deals with the auditor’s responsibilities when undertaking an engagement to report on summary financial statements derived from financial statements audited in accordance with SAs by that same auditor. The objectives of the auditor are to:

(a) Determine whether it is appropriate to accept the engagement to report on summary financial statements;

(b) Form an opinion on the summary financial statements based on an evaluation of the conclusions drawn from the evidence obtained; and

(c) Express clearly that opinion through a written report that also describes the basis for that opinion.
The auditor shall, ordinarily, accept an engagement to report on summary financial statements in accordance with this SA only when the auditor has been engaged to conduct an audit in accordance with SAs of the financial statements from which the summary financial statements are derived.

Before accepting an engagement to report on summary financial statements, the auditor shall

(a) Determine whether the applied criteria are acceptable;

(b) Obtain the agreement of management that it acknowledges and understands its responsibility:

i. For the preparation of the summary financial statements in accordance with the applied criteria;

ii. To make the audited financial statements available to the intended users of the summary financial statements without undue difficulty (or, if law or regulation provides that the audited financial statements need not be made available to the intended users of the summary financial statements and establishes the criteria for the preparation of the summary financial statements, to describe that law or regulation in the summary financial statements); and

iii. To include the auditor’s report on the summary financial statements in any document that contains the summary financial statements and that indicates that the auditor has reported on them.

(c) Agree with management the form of opinion to be expressed on the summary financial statements.

If the auditor concludes that the applied criteria are unacceptable or is unable to obtain the agreement of management set out above, the auditor shall not accept the engagement to report on the summary financial statements, unless required by law or regulation to do so. An engagement conducted in accordance with such law or regulation does not comply with this SA. Accordingly, the auditor’s report on the summary financial statements shall not indicate that the engagement was conducted in accordance with this SA. The auditor shall include appropriate reference to this fact in the terms of the engagement. The auditor shall also determine the effect that this may have on the engagement to audit the financial statements from which the summary financial statements are derived.

This SA is effective for engagements for periods beginning on or after April 1, 2011.

10.39 SRE 2400: Engagements to Review Historical Financial Statements – This Standard on Review Engagements (SRE) deals with the practitioner’s responsibilities when engaged to perform a review of historical financial statements, when the practitioner is not the auditor of the entity’s financial statements; and the form and content of the practitioner’s report on the financial statements.
The practitioner’s objectives in a review of financial statements under this SRE are to obtain limited assurance, primarily by performing inquiry and analytical procedures, about whether the financial statements as a whole are free from material misstatement, thereby enabling the practitioner to express a conclusion on whether anything has come to the practitioner’s attention that causes the practitioner to believe the financial statements are not prepared, in all material respects, in accordance with an applicable financial reporting framework; and report on the financial statements as a whole and communicate, as required by this SRE.

In all cases when limited assurance cannot be obtained and a qualified conclusion in the practitioner’s report is insufficient in the circumstances, this SRE requires that the practitioner either disclaim a conclusion in the report issued for the engagement or, where appropriate, withdraw from the engagement if withdrawal is possible under applicable law or regulation.

This SRE is effective for reviews of financial statements for periods beginning on or after April 1, 2016.

10.40 SRE 2410: Review of Interim Financial Information Performed by the Independent Auditor of the Entity – The purpose of this Standard on Review Engagements (SRE) is to establish standards and provide guidance on the auditor’s professional responsibilities when the auditor undertakes an engagement to review interim financial information of an audit client, and on the form and content of the report. The term “auditor” is used throughout this SRE, not because the auditor is performing an audit function but because the scope of this SRE is limited to a review of interim financial information performed by the independent auditor of the financial statements of the entity.

For purposes of this SRE, interim financial information is financial information that is prepared and presented in accordance with an applicable financial reporting framework and comprises either a complete or a condensed set of financial statements for a period that is shorter than the entity’s financial year.

This SRE is effective for reviews of interim financial information for periods beginning on or after April 1, 2010.

10.41 SAE 3400: The Examination of Prospective Financial Information - The purpose of this Standard on Assurance Engagement (SAE) is to establish standards and provide guidance on engagements to examine and report on prospective financial information including examination procedures for best-estimate and hypothetical assumptions. This SAE does not apply to the examination of prospective financial information expressed in general or narrative terms, such as that found in management’s discussion and analysis in an entity’s annual report, though many of the procedures outlined herein may be suitable for such an examination. Here it would be worthwhile to mention that Clause 3 of Part I of Second Schedule to the Chartered Accountants Act, 1949 as amended states that a member of ICAI into practice shall be deemed guilty of professional misconduct if he permits his name or the name of his firm to be used in connection with...
an estimate of earnings contingent upon future transactions in manner which may lead to the belief that he vouches for the accuracy of the forecast.

In an engagement to examine prospective financial information, the auditor should obtain sufficient appropriate evidence as to whether:

(a) management’s best-estimate assumptions on which the prospective financial information is based are not unreasonable and, in the case of hypothetical assumptions, such assumptions are consistent with the purpose of the information;

(b) the prospective financial information is properly prepared on the basis of the assumptions;

(c) the prospective financial information is properly presented and all material assumptions are adequately disclosed, including a clear indication as to whether they are best-estimate assumptions or hypothetical assumptions; and

(d) the prospective financial information is prepared on a consistent basis with historical financial statements, using appropriate accounting principles.

The auditor should not accept, or should withdraw from, an engagement when the assumptions are clearly unrealistic or when the auditor believes that the prospective financial information will be inappropriate for its intended use.

This SAE is effective in relation to reports on projections/forecasts, issued on or after April 1, 2007.

10.42 SAE 3402 - Assurance Reports on Controls at a Service Organisation - This Standard on Assurance Engagements (SAE) deals with assurance engagements undertaken by a professional accountant in public practice to provide a report for use by user entities and their auditors on the controls at a service organization that provides a service to user entities that is likely to be relevant to user entities’ internal control as it relates to financial reporting. It complements SA 402, in that reports prepared in accordance with this SAE are capable of providing appropriate evidence under SA 402.

This SAE only deals with assertion-based engagements that convey reasonable assurance, with the assurance conclusion worded directly in terms of the subject matter and the criteria.

This SAE applies only when the service organization is responsible for, or otherwise able to make an assertion about, the suitable design of controls.

This SAE is effective for service auditors’ assurance reports covering periods ending on or after April 1, 2011.

10.43 SAE 3420 - Assurance Engagements to Report on the Compilation of Pro Forma Financial Information Included in a Prospectus - This Standard on Assurance Engagements

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2 The term "auditor" is used throughout this SAE when describing services involving examination of prospective financial information. Such reference is not intended to imply that a member performing such services need necessarily be the statutory auditor of the entity’s financial statements.
(SAE) deals with reasonable assurance engagements undertaken by a practitioner to report on the responsible party’s compilation of pro forma financial information included in a prospectus. The SAE applies where: Such reporting is required by securities law or the regulation of the securities exchange (“relevant law or regulation”) in the jurisdiction in which the prospectus is to be issued; or this reporting is generally accepted practice in such jurisdiction.

The purpose of pro forma financial information included in a prospectus is solely to illustrate the impact of a significant event or transaction on unadjusted financial information of the entity as if the event had occurred or the transaction had been undertaken at an earlier date selected for purposes of the illustration. This is achieved by applying pro forma adjustments to the unadjusted financial information. Pro forma financial information does not represent the entity’s actual financial position, financial performance, or cash flows.

This SAE is effective for assurance reports dated on or after 01st April 2016.

**10.44 SRS 4400: Engagements to Perform Agreed-upon Procedures regarding Financial Information** - The purpose of this Standard on Related Services is to establish standards and provide guidance on the auditor’s professional responsibilities when an engagement to perform agreed-upon procedures regarding financial information is undertaken and on the form and content of the report that the auditor issues in connection with such an engagement.

The objective of an agreed-upon procedures engagement is for the auditor to carry-out procedures of an audit nature to which the auditor and the entity and any appropriate third parties have agreed and to report on factual findings.

The auditor should ensure with representatives of the entity and, ordinarily, other specified parties who will receive copies of the report of factual findings, that there is a clear understanding regarding the agreed procedures and the conditions of the engagement.

The auditor should carry out the procedures agreed-upon and use the evidence obtained as the basis for the report of factual findings.

The procedures applied in an engagement to perform agreed-upon procedures may include:

- Inquiry and analysis
- Recomputation, Comparison and other clerical accuracy checks
- Observation
- Inspection
- Obtaining confirmations

The report on an agreed-upon procedures engagement needs to describe the purpose and the agreed-upon procedure of the engagement in sufficient detail to enable the reader to understand the
nature and the extent of the work performed. The report should also clearly mention that no audit or review has been performed.

This Standard on Related Services is applicable to all agreed-upon procedures engagements beginning on or after April 1, 2004.

10.45 SRS 4410: Compilation Engagements - This Standard on Related Services (SRS) deals with the practitioner’s responsibilities when engaged to assist management with the preparation and presentation of historical financial information without obtaining any assurance on that information, and to report on the engagement in accordance with this SRS.

This SRS applies to compilation engagements for historical financial information. The SRS may be applied, adapted as necessary, to compilation engagements for financial information other than historical financial information, and to compilation engagements for non-financial information. Hereinafter in this SRS, reference to “financial information” means “historical financial information.”

When the practitioner is requested to assist management with the preparation and presentation of financial information, appropriate consideration may need to be given to whether the engagement should be undertaken in accordance with this SRS. Factors that indicate that it may be appropriate to apply this SRS, including reporting under this SRS, include whether:

- The financial information is required under provisions of applicable law or regulation, and whether it is required to be publicly filed.

- External parties other than the intended users of the compiled financial information are likely to associate the practitioner with the financial information, and there is a risk that the level of the practitioner’s involvement with the information may be misunderstood, for example if the financial information is intended for use by parties other than management or those charged with governance, or may be provided to, or obtained by, parties who are not the intended users of the information; and if the practitioner’s name is identified with the financial information.

This Standard on Related Services (SRS) is applicable to all compilation engagements undertaken after March 31, 2016.

(Note: Till the time Statements, Engagement and Quality Control Standards, Guidance Notes etc. bare document gets updated from Auditing and Assurance Standard Board of ICAI in pursuance of the Companies Act, 2013, students are required to understand the basic nature of the provision and quote the same along with the new corresponding provisions. Further, students may note that the Framework of Standards, Engagement and Quality Control Standards and Guidance Notes on Related Services are reproduced in Auditing Pronouncements)
Theoretical Questions

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

    (b) T & Co. wants to issue a prospectus, to provide potential investors with information about future expectations of the Company. You are hired by T & Co. to examine the projected financial statements and give report thereon. What things you will consider before accepting the audit engagement and what audit evidence will be obtained for reporting on projected financial statements?

    (c) In the course of audit of K Ltd., its auditor Mr. 'N' observed that there was a special audit conducted at the instance of the management on a possible suspicion of a fraud and requested for a copy of the report to enable him to report on the fraud aspects. Despite many reminders it was not provided. In absence of the special audit report, Mr. 'N' insisted that he be provided with at least a written representation in respect of fraud on/by the company. For this request also, the management remained silent. Please guide Mr. 'N'.

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

2. (a) Mr. Z who is appointed as auditor of Elite Co. Ltd. wants to use confirmation request as audit evidence during the course of audit. What are the factors to be considered by Mr. Z when designing a confirmation request? Also state the effects of using positive external confirmation request by Mr. Z.

    (b) R & M Co. wants to be alert on the possibility of non-compliance with Laws and Regulations during the course of audit of SRS Ltd. R & M Co. seeks your guidance for identifying the indications of non compliance with Laws and Regulations.

    (c) The management of CSITA Ltd. has prepared its summary financial statements for the year 2015-16 to be provided to its investors. Consequently the company wants to appoint
you for conducting audit of summary financial statements. What are the procedures that you will perform and consider necessary as the basis for forming an opinion on the summary financial statements?

(d) The financial statements of Ace Ltd. have been prepared by the management in accordance with special purpose frame work to meet the financial reporting provisions of a regulator. As an auditor, what considerations would be undertaken while planning and performing an audit in case of such special purpose frame work?

3. KRP Ltd., at its annual general meeting, appointed Mr. X, Mr. Y and Mr. Z as joint auditors to conduct auditing for the financial year 2015-16. For the valuation of gratuity scheme of the company, Mr. X, Mr. Y and Mr. Z wanted to refer their own known Actuaries. Due to difference of opinion, all the joint auditors consulted their respective Actuaries. Subsequently, major difference was found in the actuary reports. However, Mr. X agreed to Mr. Y’s actuary report, though, Mr. Z did not. Mr. X contends that Mr. Y’s actuary report shall be considered in audit report due to majority of votes. Now, Mr. Z is in dilemma.

(a) You are required to briefly explain the responsibilities of auditors when they are jointly and severally responsible in respect of audit conducted by them and also guide Mr. Z in such situation.

(b) Explain the responsibility of auditors, in case, report made by Mr. Y’s actuary, later on, found faulty.

4. (a) As an auditor of RST Ltd. Mr. P applied the concept of materiality for the financial statements as a whole. On the basis of obtaining additional information of significant contractual arrangements that draw attention to a particular aspect of a company’s business, he wants to re-evaluate the materiality concept. Please, guide him.

(b) The financial statements of TC & Co. have been prepared by management of an entity in accordance with the financial reporting provisions of a contract (that is, a special purpose framework) to comply with provisions of the contract. Based on the contract, management does not have a choice of financial reporting frameworks. As an auditor what considerations would be undertaken while planning and performing audit?

(c) When a sub-service organization performs services for a service organization, there are two alternative methods of presenting the description of controls. The service organization determines which method will be used. As a user auditor what information would you obtain about controls at a sub-service organization?

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

5. An auditor of Sagar Ltd. was not able to get the confirmation about the existence and value of certain machineries. However, the management gave him a certificate to prove the existence and value of the machinery as appearing in the books of account. The auditor accepted the same without any further procedure and signed the audit report. Is he right in his approach?

**Answers to Theoretical Questions**

1. (a) **Existence of Contingent Liability:** As per AS 29 "Provisions, Contingent liabilities and Contingent Assets", a contingent liability is a possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise.

   Further, future events that may affect the amount required to settle an obligation should be reflected in the amount of a provision where there is sufficient objective evidence that the event will occur.

   As per SA 570 "Going Concern", there are certain examples of events or conditions that, individually or collectively, may cast significant doubt about the going concern assumption. Pending legal or regulatory proceedings against the entity that may, if successful, result in claims that the entity is unlikely to be able to satisfy is one of the example of such event.

   When the auditor concludes that the use of the going concern assumption is appropriate in the circumstances but a material uncertainty exists, the auditor shall determine whether the financial statements adequately describe the principal events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern and management’s plans to deal with these events or conditions; and disclose clearly that there is a material uncertainty related to events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern and, therefore, that it may be unable to realize its assets and discharge its liabilities in the normal course of business.

   In the instant case, ABC Company has filed a law suit against Unlucky Company for ₹ 5 crores. Though, the attorney of Unlucky Company feels that the suit is without merit so the company merely discloses the existence of law suit in the notes accompanying its financial statements. But the auditor may evaluate the source data on which basis the opinion is formed. If the auditor finds the uncertainty, he may request the management to adjust the sum of ₹ 5 crore by making provision for expenses as per AS 29. If the management does not accept the request the auditor should qualify the audit report.
(b) **Projected Financial Statements:** As per SAE 3400, “The Examination of Prospective Financial Information”, the answer is divided into two parts i.e. (i) the things to be considered before accepting the engagement and (ii) audit evidence to be obtained for reporting on projected financial statements.

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

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

Further, the auditor should not accept, or should withdraw from, an engagement when the assumptions are clearly unrealistic or when the auditor believes that the prospective financial information will be inappropriate for its intended use.

In accordance with SA 210, “Terms of Audit Engagement”, it is necessary that the auditor and the client should agree on the terms of the engagement.

(ii) **Audit evidence to be obtained for Reporting on Projected Financial Statements:** The auditor should document matters, which are important in providing evidence to support his report on examination of prospective financial information, and evidence that such examination was carried out.

The audit evidence in form of working papers will include:

1. the sources of information,
2. basis of forecasts,
3. the assumptions made in arriving the forecasts,
4. hypothetical assumptions, evidence supporting the assumptions,
5. management representations regarding the intended use and distribution of the information, completeness of material assumptions,
6. management’s acceptance of its responsibility for the information,
7. audit plan,
8. the nature, timing and extent of examination procedures performed, and,
9. in case the auditor expresses a modified opinion or withdraws from the engagement, the reasons forming the basis of such decision.
(c) **Auditor's Responsibilities Relating to Fraud:** As per SA 240 on “The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements”, the auditor is responsible for obtaining reasonable assurance that the financial statements, taken as a whole, are free from material misstatement, whether caused by fraud or error.

As per SA 580 “Written Representations”, if management modifies or does not provide the requested written representations, it may alert the auditor to the possibility that one or more significant issues may exist.

In the instant case, the auditor observed that there was a special audit conducted at the instance of the management on a possible suspicion of fraud. Therefore, the auditor requested for special audit report which was not provided by the management despite of many reminders. The auditor also insisted for written representation in respect of fraud on/by the company. For this request also management remained silent.

It may be noted that, if management does not provide one or more of the requested written representations, the auditor shall discuss the matter with management; re-evaluate the integrity of management and evaluate the effect that this may have on the reliability of representations (oral or written) and audit evidence in general; and take appropriate actions, including determining the possible effect on the opinion in the auditor’s report.

Further, as per section 143(12) of the Companies Act, 2013, if an auditor of a company, in the course of the performance of his duties as auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the Central Government (in case amount of fraud is ₹ 1 crore or above) or Audit Committee or Board in other cases (in case the amount of fraud involved is less than ₹ 1 crore) within such time and in such manner as may be prescribed.

The auditor is also required to report as per Clause (x) of Paragraph 3 of CARO, 2016, Whether any fraud by the company or any fraud on the company by its officers or employees has been noticed or reported during the year; if yes, the nature and the amount involved is to be indicated.

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

(i) Determine the professional and legal responsibilities applicable in the circumstances, including whether there is a requirement for the auditor to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities;

(ii) Consider whether it is appropriate to withdraw from the engagement, where
withdrawal from the engagement is legally permitted; and

(iii) If the auditor withdraws:

(1) Discuss with the appropriate level of management and those charged with governance, the auditor’s withdrawal from the engagement and the reasons for the withdrawal; and

(2) Determine whether there is a professional or legal requirement to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities, the auditor’s withdrawal from the engagement and the reasons for the withdrawal.

(d) **External Confirmation:** As per SA 505, “External Confirmation”, Negative Confirmation is a request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request. Negative confirmations provide less persuasive audit evidence than positive confirmations.

The failure to receive a response to a negative confirmation request does not explicitly indicate receipt by the intended confirming party of the confirmation request or verification of the accuracy of the information contained in the request. Accordingly, a failure of a confirming party to respond to a negative confirmation request provides significantly less persuasive audit evidence than does a response to a positive confirmation request. Confirming parties also may be more likely to respond indicating their disagreement with a confirmation request when the information in the request is not in their favor, and less likely to respond otherwise.

In the instant case, the auditor sent the negative confirmation requesting the trade payables having outstanding balances in the balance sheet while doing audit of Star Limited. One of the old outstanding of ₹ 15 lacs has not sent the confirmation on the credit balance. In case of non response, the auditor may examine subsequent cash disbursements or correspondence from third parties, and other records, such as goods received notes. Further non response for negative confirmation request does not means that there is some misstatement as negative confirmation request itself is to respond to the auditor only if the confirming party disagrees with the information provided in the request.

But, if the auditor identifies factors that give rise to doubts about the reliability of the response to the confirmation request, he shall obtain further audit evidence to resolve those doubts.

2. (a) As per SA 505, “External Confirmation”, factors to be considered when designing confirmation requests include:

(i) The assertions being addressed.
(ii) Specific identified risks of material misstatement, including fraud risks.

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

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

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

(vi) Management’s authorisation or encouragement to the confirming parties to respond to the auditor. Confirming parties may only be willing to respond to a confirmation request containing management’s authorisation.

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

A positive external confirmation request asks the confirming party to reply to the auditor in all cases, either by indicating the confirming party’s agreement with the given information, or by asking the confirming party to provide information. A response to a positive confirmation request ordinarily is expected to provide reliable audit evidence. There is a risk, however, that a confirming party may reply to the confirmation request without verifying that the information is correct. The auditor may reduce this risk by using positive confirmation requests that do not state the amount (or other information) on the confirmation request, and ask the confirming party to fill in the amount or furnish other information. On the other hand, use of this type of “blank” confirmation request may result in lower response rates because additional effort is required of the confirming parties.

(b) As per SA 250, “Consideration of Laws and Regulations, the auditor shall perform the audit procedures to help identify instances of non-compliance with other laws and regulations that may have a material effect on the financial statements by inquiring of management and, where appropriate, those charged with governance, as to whether the entity is in compliance with such laws and regulations; and Inspecting correspondence, if any, with the relevant licensing or regulatory authorities.

However, when the auditor becomes aware of the existence of, or information about, the following matters, it may also be an indication of non-compliance with laws and regulations:

- Investigations by regulatory organisations and government departments or payment of fines or penalties.
- Payments for unspecified services or loans to consultants, related parties, employees or government employees.
- Sales commissions or agent’s fees that appear excessive in relation to those ordinarily paid by the entity or in its industry or to the services actually received.
- Purchasing at prices significantly above or below market price.
Unusual payments in cash, purchases in the form of cashiers’ cheques payable to bearer or transfers to numbered bank accounts.

Unusual payments towards legal and retainership fees.

Unusual transactions with companies registered in tax havens.

Payments for goods or services made other than to the country from which the goods or services originated.

Payments without proper exchange control documentation.

Existence of an information system which fails, whether by design or by accident, to provide an adequate audit trail or sufficient evidence.

Unauthorised transactions or improperly recorded transactions.

Adverse media comment.

As per SA 810, “Engagement to Report on Summary Financial Statements”, the auditor shall perform the following procedures, and any other procedures that the auditor may consider necessary, as the basis for the auditor’s opinion on the summary financial statements:

(i) Evaluate whether the summary financial statements adequately disclose their summarised nature and identify the audited financial statements.

(ii) When summary financial statements are not accompanied by the audited financial statements, evaluate whether they describe clearly:

(1) From whom or where the audited financial statements are available; or

(2) The law or regulation that specifies that the audited financial statements need not be made available to the intended users of the summary financial statements and establishes the criteria for the preparation of the summary financial statements.

(iii) Evaluate whether the summary financial statements adequately disclose the applied criteria.

(iv) Compare the summary financial statements with the related information in the audited financial statements to determine whether the summary financial statements agree with or can be re-calculated from the related information in the audited financial statements.

(v) Evaluate whether the summary financial statements are prepared in accordance with the applied criteria.

(vi) Evaluate, in view of the purpose of the summary financial statements, whether the summary financial statements contain the information necessary, and are at an appropriate level of aggregation, so as not to be misleading in the circumstances.

(vii) Evaluate whether the audited financial statements are available to the intended users of the summary financial statements without undue difficulty, unless law or regulation
provides that they need not be made available and establishes the criteria for the preparation of the summary financial statements.

(d) Considerations for Planning and Performing Audit in case of Special Purpose Framework:
As per SA 800 “Special Considerations-Audits of Financial Statements Prepared in accordance with Special Purpose Frameworks”, financial statements prepared in accordance with a special purpose framework may be the only financial statements an entity prepares. In such circumstances, those financial statements may be used by users other than those for whom the financial reporting framework is designed.

While planning and performing audit of such special purpose framework based company, the auditor should consider below mentioned factors:

(i) To obtain an understanding of the entity’s selection and application of accounting policies. In the case of financial statements prepared in accordance with the provisions of a contract, the auditor shall obtain an understanding of any significant interpretations of the contract that management made in the preparation of those financial statements.

(ii) Compliance of all SAs relevant to audit, the auditor may judge it necessary to depart from a relevant requirement in an SA by performing alternative audit procedures to achieve the aim of that requirement.

(iii) Application of some of the requirements of the SAs in an audit of special purpose financial statements may require special consideration by the auditor. For example, in SA 320, judgments about matters that are material to users of the financial statements are based on a consideration of the common financial information needs of users as a group. In the case of an audit of special purpose financial statements, however, those judgments are based on a consideration of the financial information needs of the intended users.

(iv) In the case of special purpose financial statements, such as those prepared in accordance with the requirements of a contract, management may agree with the intended users on a threshold below which misstatements identified during the audit will not be corrected or otherwise adjusted. The existence of such a threshold does not relieve the auditor from the requirement to determine materiality in accordance with SA 320 for purposes of planning and performing the audit of the special purpose financial statements.

(v) Communication with those charged with governance in accordance with SAs is based on the relationship between those charged with governance and the financial statements subject to audit, in particular, whether those charged with governance are responsible for overseeing the preparation of those financial statements. In the case of special purpose financial statements, those charged with governance may not have such a responsibility.
3. (a) **Difference of Opinion Among Joint Auditors**: SA 299 on, “Responsibility of Joint Auditors” deals with the professional responsibilities, which the auditors undertake in accepting such appointments as joint auditors. In respect of the work divided amongst the joint auditors, each joint auditor is responsible only for the work allocated to him, whether or not he has made a separate report on the work performed by him. On the other hand the joint auditors are jointly and severally responsible in respect of the audit conducted by them as under:

(i) in respect of the audit work which is not divided among the joint auditors and is carried out by all of them;

(ii) in respect of decisions taken by all the joint auditors concerning the nature, timing or extent of the audit procedures to be performed by any of the joint auditors;

(iii) in respect of matters which are brought to the notice of the joint auditors by any one of them and on which there is an agreement among the joint auditors;

(iv) for examining that the financial statements of the entity comply with the disclosure requirements of the relevant statute;

(v) for ensuring that the audit report complies with the requirements of the relevant statute;

(vi) it is the separate and specific responsibility of each joint auditor to study and evaluate the prevailing system of internal control relating to the work allocated to him, the extent of enquiries to be made in the course of his audit;

(vii) the responsibility of obtaining and evaluating information and explanation from the management is generally a joint responsibility of all the auditors;

(viii) each joint auditor is entitled to assure that the other joint auditors have carried out their part of work in accordance with the generally accepted audit procedures and therefore it would not be necessary for joint auditor to review the work performed by other joint auditors.

Normally, the joint auditors are able to arrive at an agreed report. However where the joint auditors are in disagreement with regard to any matters to be covered by the report, each one of them should express their own opinion through a separate report. A joint auditor is not bound by the views of majority of joint auditors regarding matters to be covered in the report and should express his opinion in a separate report in case of a disagreement.

In the instant case, there are three auditors, namely, Mr. X, Mr. Y and Mr. Z, jointly appointed as an auditor of KRP Ltd. For the valuation of gratuity scheme of the Company they referred their own known Actuaries. Mr. Z (one of the joint auditor) is not satisfied with the report submitted by Mr. Y’s referred actuary. He is not agreed with the matters to be covered by the report whereas Mr. X agreed with the same.
Hence, as per SA 299, Mr. Z is suggested to express his own opinion through a separate report whereas Mr. X and Mr. Y may provide their joint report for the same.

(b) Using the work of an Auditor’s Expert: As per SA 620 “Using the Work of an Auditor’s Expert”, the expertise of an expert may be required in the actuarial calculation of liabilities associated with insurance contracts or employee benefit plans etc., however, the auditor has sole responsibility for the audit opinion expressed, and that responsibility is not reduced by the auditor’s use of the work of an auditor’s expert.

The auditor shall evaluate the adequacy of the auditor’s expert’s work for the auditor’s purposes, including the relevance and reasonableness of that expert’s findings or conclusions, and their consistency with other audit evidence as per SA 500.

Further, in view of SA 620, if the expert’s work involves use of significant assumptions and methods, then the relevance and reasonableness of those assumptions and methods must be ensured by the auditor and if the expert’s work involves the use of source data that is significant to that expert’s work, the relevance, completeness, and accuracy of that source data in the circumstances must be verified by the auditor.

In the instant case, Mr. X, Mr. Y and Mr. Z, jointly appointed as an auditor of KRP Ltd., referred their own known Actuaries for valuation of gratuity scheme. Actuaries are an auditor’s expert as per SA 620. Mr. Y’s referred actuary has provided the gratuity valuation report, which later on found faulty. Further, Mr. Z is not agreed with this report therefore he submitted a separate audit report specifically for such gratuity valuation.

In such situation, it was duty of Mr. X, Mr. Y and Mr. Z, before using the gratuity valuation report of Actuary, to ensure the relevance and reasonableness of assumptions and methods used. They were also required to examine the relevance, completeness and accuracy of source data used for such report before expressing their opinion.

Mr. X and Mr. Y will be held responsible for grossly negligence and using such faulty report without examining the adequacy of expert actuary’s work whereas Mr. Z will not be held liable for the same due to separate opinion expressed by him.

4. (a) Re-evaluation of the Materiality Concept: In the instant case, Mr. P, as an auditor of RST Ltd. has applied the concept of materiality for the financial statements as a whole. But he wants to re-evaluate the materiality concept on the basis of additional information of significant contractual arrangements which draws attention to a particular aspect of the company’s business.

As per SA 320 “Materiality in Planning and Performing an Audit”, while establishing the overall audit strategy, the auditor shall determine materiality for the financial statement as a whole. He should set the benchmark on the basis of which he performs his audit procedure. If, in the specific circumstances of the entity, there is one or more particular
classes of transactions, account balances or disclosures for which misstatements of lesser amounts than the materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements, the auditor shall also determine the materiality level or levels to be applied to those particular classes of transactions, account balances or disclosures.

The auditor shall revise materiality for the financial statements in the event of becoming aware of information during the audit that would have caused the auditor to have determined a different amount (or amounts) initially.

If the auditor concludes a lower materiality for the same, then he should consider the fact that whether it is necessary to revise performance materiality and whether the nature, timing and extent of the further audit procedures remain appropriate.

Thus, Mr. P can re-evaluate the materiality concepts after considering the necessity of such revision.

(b) Considerations for Planning and Performing Audit in case of Special Purpose Framework: As per SA 800 “Special Considerations-Audits of Financial Statements Prepared in accordance with Special Purpose Frameworks”, financial statements prepared in accordance with a special purpose framework may be the only financial statements an entity prepares. In such circumstances, those financial statements may be used by users other than those for whom the financial reporting framework is designed.

While planning and performing audit of such special purpose framework based company, the auditor should consider below mentioned factors:

(i) To obtain an understanding of the entity’s selection and application of accounting policies. In the case of financial statements prepared in accordance with the provisions of a contract, the auditor shall obtain an understanding of any significant interpretations of the contract that management made in the preparation of those financial statements.

(ii) Compliance of all SAs relevant to audit, the auditor may judge it necessary to depart from a relevant requirement in an SA by performing alternative audit procedures to achieve the aim of that requirement.

(iii) Application of some of the requirements of the SAs in an audit of special purpose financial statements may require special consideration by the auditor. For example, in SA 320, judgments about matters that are material to users of the financial statements are based on a consideration of the common financial information needs of users as a group. In the case of an audit of special purpose financial statements, however, those judgments are based on a consideration of the financial information needs of the intended users.

(iv) In the case of special purpose financial statements, such as those prepared in...
accordance with the requirements of a contract, management may agree with the intended users on a threshold below which misstatements identified during the audit will not be corrected or otherwise adjusted. The existence of such a threshold does not relieve the auditor from the requirement to determine materiality in accordance with SA 320 for purposes of planning and performing the audit of the special purpose financial statements.

(v) Communication with those charged with governance in accordance with SAs is based on the relationship between those charged with governance and the financial statements subject to audit, in particular, whether those charged with governance are responsible for overseeing the preparation of those financial statements. In the case of special purpose financial statements, those charged with governance may not have such a responsibility.

(c) Controls at a Sub-Service Organisation: In accordance with SA 402 “Audit Considerations relating to an Entity Using a Service Organisation”, a user entity may use a service organisation that in turn uses a sub-service organisation to provide some of the services provided to a user entity that are part of the user entity’s information system relevant to financial reporting. The sub-service organisation may be a separate entity from the service organisation or may be related to the service organisation.

A user auditor may need to consider controls at the sub-service organisation. In situations where one or more sub-service organisations are used, the interaction between the activities of the user entity and those of the service organisation is expanded to include the interaction between the user entity, the service organisation and the sub-service organisations. The degree of this interaction, as well as the nature and materiality of the transactions processed by the service organisation and the sub-service organisations are the most important factors for the user auditor to consider in determining the significance of the service organisation’s and sub-service organisation’s controls to the user entity’s controls.

Further, the user auditor shall determine whether a sufficient understanding of the nature and significance of the services provided by the service organisation and their effect on the user entity’s internal control relevant to the audit has been obtained to provide a basis for the identification and assessment of risks of material misstatement.

If the user auditor is unable to obtain a sufficient understanding from the user entity, the user auditor shall obtain that understanding by application of the following two methods of presenting description of internal controls i.e. (i) Type 1 report; or (ii) Type 2 report.

If a service organisation uses a subservice organisation, the service auditor’s report may either include or exclude the subservice organisation’s relevant control objectives and related controls in the service organisation’s description of its system and in the scope of
the service auditor's engagement. These two methods of reporting are known as the inclusive method and the carve-out method respectively.

In either method, the service organisation includes in its description of controls a description of the functions and nature of the processing performed by the sub-service organisation.

If the Type 1 or Type 2 report excludes the control at a subservice organization and the services provided by the subservice organization are relevant to the audit of the user entity’s financial statements, the user auditor is required to apply the requirements of the SA 402 in respect of the subservice organization.

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

(d) Audit Procedure for ensuring correctness of Opening Balances: As per SA 510 “Initial Audit Engagements-Opening Balances”, the auditor shall obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period’s financial statements by -

(i) Determining whether the prior period’s closing balances have been correctly brought forward to the current period or, when appropriate, any adjustments have been disclosed as prior period items in the current year’s Statement of Profit and Loss;

(ii) Determining whether the opening balances reflect the application of appropriate accounting policies; and

(iii) By evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances; or performing specific audit procedures to obtain evidence regarding the opening balances.

If the auditor obtains audit evidence that the opening balances contain misstatements that could materially affect the current period’s financial statements, the auditor shall perform such additional audit procedures as are appropriate in the circumstances to determine the effect on the current period's financial statements. If the auditor concludes that such misstatements exist in the current period’s financial statements, the auditor shall communicate the misstatements with the appropriate level of management and those charged with governance.

Approach for drafting Audit Report: If the auditor concludes that the opening balances contain a misstatement that materially affects the current period’s financial statements and the effect of the misstatement is not properly accounted for or not adequately presented or disclosed, the auditor shall express a qualified opinion or an adverse opinion, as appropriate, in accordance with SA 705 and in case where the auditor is unable to
obtain sufficient appropriate audit evidence regarding the opening balances, the auditor shall express a qualified opinion or a disclaimer of opinion, as appropriate, in accordance with SA 705.

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

As per SA 580 “Written Representations”, when representation relate to matters which are material to the financial information, then the auditor should seek corroborative audit evidence from other sources inside or outside the entity.

He should evaluate whether such representations are reasonable and consistent with other evidences and should consider whether individuals making such representations can be expected to be well informed on the matter. “Written Representations” cannot be a substitute for other audit evidence that the auditor could reasonably expect to be available.

If the auditor is unable to obtain sufficient appropriate audit evidence that he believes would be available regarding a matter which has or may have a material effect on the financial information, this will constitute a limitation on the scope of his examination even if he has obtained a representation from management on the matter. Therefore, the approach adopted by the auditor is not right.