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Head Office

Shraddha, 4th Floor, Old Nagardas Road,
Near Chinai College, Andheri (E), Mumbai - 400 069.

 022 - 2683 66 66



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1

NATURE, OBJECTIVE AND SCOPE OF AUDIT

1. WHAT SCOPE DOES NOT INCLUDE

- (1) Auditor is not expected to perform duties which fall outside domain of his competence.

For example, physical condition of certain assets like that of sophisticated machinery cannot be determined by him. Similarly, it is not expected from an auditor to determine suitability and life of civil structures like buildings.

These require different skillsets which may be performed by qualified engineers in their respective fields.

- (2) An auditor is not an expert in authentication of documents. The genuineness of documents cannot be authenticated by him because he is not an expert in this field.

- (3) An audit is not an official investigation into alleged wrong doing. He does not have any specific legal powers of search or recording statements of witness on oath which may be necessary for carrying out an official investigation.

Audit is distinct from investigation. Investigation is a critical examination of the accounts with a special purpose. For example, if fraud is suspected and it is specifically called upon to check the accounts whether fraud really exists, it takes character of investigation.

2. INHERENT LIMITATIONS OF AUDIT

The process of audit suffers from certain inbuilt limitations due to which an auditor cannot obtain an absolute assurance that financial statements are free from misstatement due to fraud or error. These fundamental limitations arise due to the following factors:

- (1) **Nature of financial reporting**

Preparation of financial statements involves making many judgments by management. These judgments may involve subjective decisions or a degree of

uncertainty. Therefore, auditor may not be able to obtain absolute assurance that financial statements are free from material misstatements due to frauds or errors.

(2) Nature of Audit procedures

- The auditor carries out his work by obtaining audit evidence through performance of audit procedures. However, there are practical and legal limitations on ability of auditor to obtain audit evidence. For example, an auditor does not test all transactions and balances. He forms his opinion only by testing samples. It is an example of practical limitation on auditor's ability to obtain audit evidence.
- Management may not provide complete information as requested by auditor.
- The management may consist of dishonest and unscrupulous people and may be, itself, involved in fraud.
- It is quite possible that entity may have entered into some transactions with related parties. Such transactions may be only paper transactions and may not have actually occurred. The auditor may not be aware of such related party relationships or audit procedures may not be able to detect probable wrong doings in such transactions.

(3) Not in nature of investigation

As already discussed, audit is not an official investigation. Hence, auditor cannot obtain absolute assurance that financial statements are free from material misstatements due to frauds or errors.

(4) Timeliness of financial reporting and decrease in relevance of information over time

The relevance of information decreases over time and auditor cannot verify each and every matter. Therefore, a balance has to be struck between reliability of information and cost of obtaining it.

Consider, for example, an auditor who is conducting audit of a company since last two years. During these two years, he has sought detailed information from management of company regarding various matters. During his third year stint, he chooses to rely upon some information obtained as part of audit procedures of second year. However, it could be possible that something new has happened and that information is not relevant. So, the information being relied upon by auditor is not timely and may have lost its reliability.

(5) **Future events**

Future events or conditions may affect an entity adversely. Adverse events may seriously affect ability of an entity to continue its business. The business may cease to exist in future due to change in market conditions, emergence of new business models or products or due to onset of some adverse events.

3. MEANING OF ASSURANCE ENGAGEMENT

- “Assurance engagement” means an engagement in which a practitioner expresses a **conclusion** designed to enhance the degree of **confidence** of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria.
- It means that the practitioner gives an **opinion** about specific information due to which users of information are able to make confident decisions knowing well that chance of information being incorrect is diminished.

4. ELEMENTS OF ASSURANCE ENGAGEMENT

1. **A three party relationship involving a practitioner, a responsible party, and intended users**

- (i) A practitioner is a person who provides the assurance. The term **practitioner is broader than auditor**. Audit is related to historical information whereas practitioner may provide assurance not necessarily related to historical financial information.
- (ii) A **responsible party** is the party responsible for preparation of subject matter.
- (ii) Intended users are the persons for whom an assurance report is prepared. These persons may use the report in making decisions.

2. **An appropriate subject matter**

It refers to the information to be examined by the practitioner. For example, financial information contained in financial statements while conducting audit of financial statements.

3. **Suitable criteria**

These refer to benchmarks used to evaluate the subject matter like standards, guidance, laws, rules and regulations.

4. **Sufficient appropriate evidence**

“Sufficient” relates to quantity of evidence obtained by auditor. “Appropriate” relates to quality of evidence obtained by auditor.

5. A written assurance report in appropriate form

A written report is provided containing conclusion that conveys the assurance about the subject matter.

4.1 Meaning of Review; Audit Vs. Review

We have learnt that audit is a reasonable assurance engagement. It provides reasonable assurance. However, review is a limited assurance engagement. It provides lower level of assurance than audit. Further, review involves fewer procedures and gathers sufficient appropriate evidence on the basis of which limited conclusions can be drawn up. However, both “audit” and “review” are related to financial statements prepared on the basis of historical financial information.

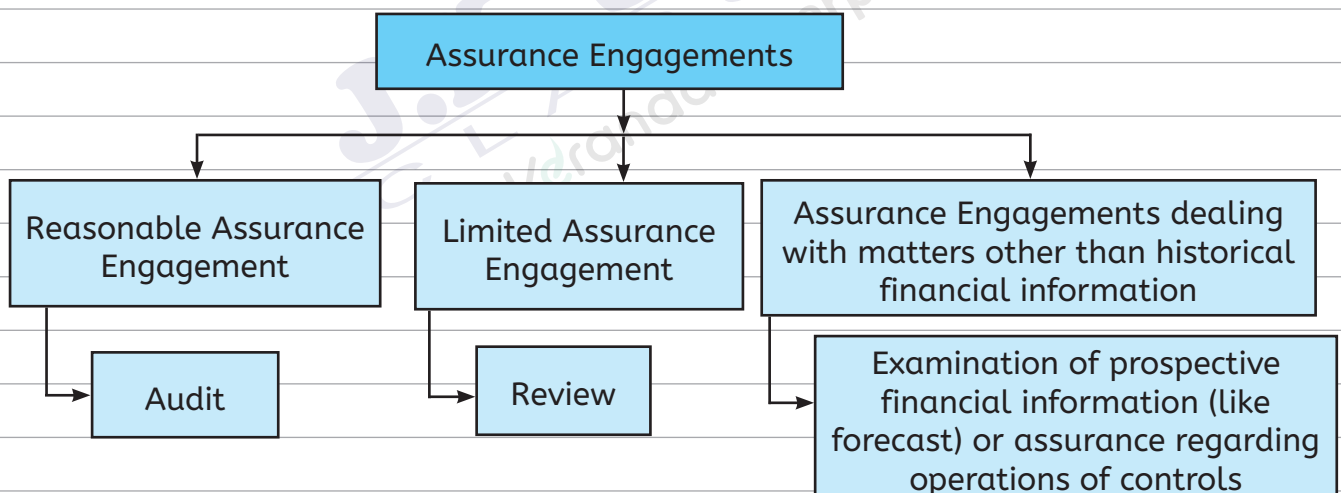
4.2 Types of Assurance Engagements- Reasonable assurance engagement vs. Limited assurance engagement

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

- Besides reasonable assurance engagements and limited assurance engagements, there is another kind of assurance which is related to matters other than historical financial information. Such an assurance may relate to **prospective financial information** and not to historical financial

information. It may relate to providing assurance on internal controls in an entity.

- “Prospective financial information” means financial information based on assumptions about events that may occur in the future and possible actions by an entity. It can be in the form of a forecast or projection or combination of both.
- Prospective financial information relates to future events. While evidence may be available to support the assumptions on which the prospective financial information is based, such evidence is itself generally future-oriented. The auditor is, therefore, not in a position to express an opinion as to whether the results shown in the prospective financial information will be achieved.
- Therefore, in such assurance engagements, practitioner provides a report assuring that nothing has come to practitioner’s attention to suggest that these assumptions do not provide a reasonable basis for the projection.
- Hence, such type of assurance engagement provides only a “moderate” level of assurance.



5. ENGAGEMENT AND QUALITY CONTROL STANDARDS: AN OVERVIEW

5.1. Why are Standards needed?

- Standards ensure carrying out of audit against established benchmarks at par with global practices.
- Standards improve quality of financial reporting thereby helping users to make diligent decisions.
- Standards promote uniformity as audit of financial statements is carried out following these Standards.

- Standards equip professional accountants with professional knowledge and skill.
- Standards ensure audit quality.

5.2 Duties in relation to Engagement and Quality Control Standards

- It is the duty of professional accountants to see that Standards are followed in engagements undertaken by them. Ordinarily, these are to be followed by professional accountants. However, a situation may arise when a specific procedure as required in Standards would be ineffective in a particular engagement. In such a case, he is required to document how alternative procedures performed achieve the purpose of required procedure.
- Also, reason for departure has also to be documented unless it is clear.
- Further, his report should draw attention to such departures. It is also to be noted that a mere disclosure in the report does not absolve a professional accountant from complying with applicable Standards.

2

AUDIT STRATEGY, AUDIT PLANNING AND AUDIT PROGRAMME

1. PLANNING PROCESS- ELEMENTS OF PLANNING

The elements of planning can be categorized as under:

(I) Preliminary engagement activities

The auditor considers whether relationship with client should be continued and whether ethical requirements including independence continue to be complied with. It includes: -

Preliminary engagement activities include the following:

(A) Performing procedures regarding the Continuance of Client Relationships and Audit Engagements

Matters such as integrity of principal owners and key management, competence of engagement team to perform the audit engagement and implications of matters that have arisen during current and previous audit engagement may need to be considered.

(B) Evaluating compliance with ethical requirements including independence

The engagement partner shall form a conclusion on compliance with independence requirements that apply to the audit engagement. In doing so, the engagement partner shall:

- (i) Obtain relevant information from the firm to identify and evaluate circumstances and relationships that create threats to independence
- (ii) Evaluate information on identified breaches, if any, of the firm's independence policies and procedures to determine whether they create a threat to independence for the audit engagement and
- (iii) Take appropriate action to eliminate such threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the audit engagement, where withdrawal is permitted by law or regulation. The engagement partner shall promptly report to the firm any inability to resolve the matter for appropriate action.

(C) Establishing an understanding of terms of engagement

It is in the interests of both the entity and the auditor that the auditor sends an audit engagement letter before the commencement of the audit to help avoid misunderstandings with respect to the audit.

(II) Planning activities

Planning activities involve:

(A) Establishing the overall audit strategy- Assistance for the auditor

Overall audit strategy sets the scope, timing and direction of the audit, and guides the development of the more detailed audit plan.

A.1 The process of establishing the overall audit strategy assists the auditor to determine, subject to the completion of the auditor's risk assessment procedures, such matters as: -

- (i) The **resources to deploy for specific audit areas**, such as the use of appropriately experienced team members for high-risk areas or the involvement of experts on complex matters
- (ii) The **amount of resources to allocate to specific audit areas**, such as the number of team members assigned to observe the inventory count at material locations, the extent of review of other auditors' work in the case of group audits, or the audit budget in hours to allocate to high risk areas
- (iii) **When these resources are to be deployed**, such as whether at an interim audit stage or at key cut-off dates
- (iv) **How such resources are managed, directed and supervised**, such as when team briefing and debriefing meetings are expected to be held, how engagement partner and manager reviews are expected to take place (for example, on-site or off-site), and whether to complete engagement quality control reviews

A.2 Factors to be taken into consideration by auditor for establishing audit strategy

(a) Identify the characteristics of the engagement that define its scope

There are many characteristics of engagement defining its scope. Some of characteristics are as under:

- Applicable financial reporting framework applicable to the entity
- Nature of business segments to be audited including the need for specialized knowledge

- Industry specific reporting requirements required by industry regulators
- Expected use of audit evidence obtained in previous audits

(b) Ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required.

The ascertaining of reporting objectives of engagement helps the auditor to plan timing of different audit procedures and also nature of communications. Some of the instances are given under:

- The entity's timetable for reporting
- Organization of meetings to discuss of nature, timing and extent of audit work with management
- Discussion with management regarding the expected type and timing of reports to be issued including the auditor's report
- Discussion with management regarding the expected communications on the status of audit work throughout the engagement.
- Expected nature and timing of communications among engagement team members.

(c) Consider the factors that, in the auditor's professional judgment, are significant in directing the engagement team's efforts

The auditor needs to direct efforts of engagement team towards matters that in his professional judgment are significant.

Few examples are listed as under:

- Volume of transactions which may determine whether it is more efficient for the auditor to rely on internal control
- Significant industry developments such as changes in industry regulations and new reporting requirements.
- Significant changes in the financial reporting framework, such as changes in accounting standards.
- Other significant relevant developments, such as changes in the legal environment affecting the entity.

- (d) Consider the results of preliminary engagement activities and, where applicable, whether knowledge gained on other engagements performed by the engagement partner for the entity is relevant.

Examples

- Results of previous audits that involved evaluating the operating effectiveness of internal control, including the nature of identified deficiencies and action taken to address them.

- (e) Ascertain the nature, timing and extent of resources necessary to perform the engagement.

(B) Development of Audit plan

Once the overall audit strategy has been established, an audit plan can be developed to address the various matters identified in the overall audit strategy, taking into account the need to achieve the audit objectives through the efficient use of the auditor's resources.

SA-300 states that auditor shall develop an audit plan that shall include description of-

- (i) The nature, timing and extent of planned risk assessment procedures
- (ii) The nature, timing and extent of planned further audit procedures at assertion level
- (iii) Other planned audit procedures that are required to be carried out so that the engagement complies with SAs.

3

RISK ASSESSMENT AND INTERNAL CONTROL

1. DETECTION RISK COMPRISES SAMPLING AND NON-SAMPLING RISK.

Examples

- **Sampling risk** is the risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure. It simply means that the sample was not representative of the population from which it was chosen.
- **Non-sampling risk** is the risk that the auditor reaches an erroneous conclusion for any reason not related to sampling risk. Like an auditor may reach an erroneous conclusion due to application to some inappropriate audit procedure.

2. RISKS OF MATERIAL MISSTATEMENT – GREATER FOR SIGNIFICANT NON-ROUTINE TRANSACTIONS

Examples:

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

3. FORMULATE AUDIT PROGRAM AFTER UNDERSTANDING INTERNAL CONTROL

- The auditor can formulate his entire audit programme only after he has had a satisfactory understanding of the internal control systems and their actual operation. If he does not care to study this aspect, it is very likely that his audit programme may become unwieldy and unnecessarily heavy and the object of the audit may be altogether lost in the mass of entries and vouchers.
- He will also be in a position to bring to the notice of the management the weaknesses of the system and to suggest measures for improvement. At a further interim date or in the course of the audit, he may ascertain how far the weaknesses have been removed.

(c) In a situation where the internal controls are considered weak in some areas, the auditor might choose an auditing procedure or test that otherwise might not be required; he might extend certain tests to cover a large number of transactions or other items than he otherwise would examine and at times he may perform additional tests to bring him the necessary satisfaction.

For example, normally the distribution of wages is not observed by the auditor. But if the internal control over wages is so weak that there exists a possibility of dummy workers being paid, the auditor might include observation of wages distribution in his programme in order to find out the workers who do not turn up for receipt of wages.

4. TESTING METHODS IN AN AUTOMATED ENVIRONMENT

There are basically four types of audit tests that should be used. These are inquiry, observation, inspection and Reperformance.

(a) Inquiry is the most efficient audit test but it also gives the least audit evidence. Hence, inquiry should always be used in combination with any one of the other audit testing methods. Inquiry alone is not sufficient. Reperformance is most effective as an audit test and gives the best audit evidence. However, testing by reperformance could be very time consuming and least efficient most of the time.

(b) Generally, applying inquiry in combination with inspection gives the most effective and efficient audit evidence. However, which audit test to use, when and in what combination is a matter of professional judgement and will vary depending on several factors including risk assessment, control environment, desired level of evidence required, history of errors/misstatements, complexity of business, assertions being addressed etc.

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

- Obtain an understanding of how an automated transaction is processed by doing a walkthrough of one end-to-end transaction using a combination of inquiry, observation and inspection.
- Observe how a user processes transactions under different scenarios.
- Inspect the configuration defined in an application.

- (d) Where the general IT controls are not existing or existing but ineffective, the auditor should plan alternative audit procedures in order to rely on the system-based information.

5. MANUAL ELEMENTS VS AUTOMATED ELEMENTS IN ENTITY'S INTERNAL CONTROL

- (a) Manual elements in internal control may be more suitable where judgment and discretion are required such as for the following circumstances:
- Large, unusual or non-recurring transactions.
 - Circumstances where errors are difficult to define, anticipate or predict.
 - In changing circumstances that require a control response outside the scope of an existing automated control.
 - In monitoring the effectiveness of automated controls.
- (b) Manual elements in internal control may be less reliable than automated elements because they can be more easily bypassed, ignored, or overridden and they are also more prone to simple errors and mistakes.
- (c) Manual control elements may be less suitable for the following circumstances:
- High volume or recurring transactions, or in situations where errors that can be anticipated or predicted can be prevented, or detected and corrected, by control parameters that are automated.
 - Control activities where the specific ways to perform the control can be adequately designed and automated.
- (d) The extent and nature of the risks to internal control vary depending on the nature and characteristics of the entity's information system. The entity responds to the risks arising from the use of IT or from use of manual elements in internal control by establishing effective controls in light of the characteristics of the entity's information system.

6. DIGITAL AUDIT

- (a) Entities are embracing digitization as part of their operations to keep pace with changing times. New technologies are helping companies revamp their operations and rethink the way business is conducted. Companies are restructuring their business models driven by technology. Automation is key to digitization.

- (b) In such a business environment, use of digital technology is being made by auditors right from planning to expression of final opinion. Auditors are making use of artificial intelligence, data analytics and other latest technologies to help understand business processes in a better way. By using such tools, auditors can conduct audit in a better way and devote more attention to areas requiring greater focus. Digital audit is helping auditors to better identify risks making use of technology.

7. THE AUDITOR'S RESPONSES TO ASSESSED RISKS

- (a) SA 330- The auditor's responses to assessed risks 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,
- (b) SA 330 states that:
- (i) The auditor shall design and implement overall responses to address the assessed risks of material misstatement at the financial statement level.
 - (ii) The auditor shall design and perform further audit procedures whose nature, timing and extent are based on and are responsive to the assessed risks of material misstatement at the assertion level.
- (c) In designing the further audit procedures to be performed, the auditor shall:
- (a) Consider the reasons for the assessment given to the risk of material misstatement at the assertion level including:
 - (i) The likelihood of material misstatement due to the particular characteristics of the relevant class of transactions, account balance, or disclosure (i.e., the inherent risk); and
 - (ii) Whether the risk assessment takes into account the relevant controls (i.e., the control risk), thereby requiring the auditor to obtain audit evidence to determine whether the controls are operating effectively and
 - (b) Obtain more persuasive audit evidence the higher the auditor's assessment of risk.

- (d) The auditor shall design and perform tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of relevant controls when:
- (a) The auditor's assessment of risks of material misstatement at the assertion level includes an expectation that the controls are operating effectively
 - (b) Substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level.

4

AUDIT EVIDENCE

1. ASSERTIONS CONTAINED IN THE FINANCIAL STATEMENTS:

(a) Assertions about classes of transactions and events for the period under audit:

- (i) **Occurrence** – transactions and events that have been recorded have occurred and pertain to the entity.
- (ii) **Completeness** – all transactions and events that should have been recorded have been recorded.
- (iii) **Accuracy** – amounts and other data relating to recorded transactions and events have been recorded appropriately.
- (iv) **Cut-off** – transactions and events have been recorded in the correct accounting period.
- (v) **Classification** – transactions and events have been recorded in the proper accounts.

(b) Assertions about account balances at the period end:

- (i) **Existence** – assets, liabilities, and equity interests exist.
- (ii) **Rights and obligations** – the entity holds or controls the rights to assets, and liabilities are the obligations of the entity.
- (iii) **Completeness** – all assets, liabilities and equity interests that should have been recorded have been recorded.
- (iv) **Valuation and allocation** – assets, liabilities, and equity interests are included in the financial statements at appropriate amounts and any resulting valuation or allocation adjustments are appropriately recorded.

(c) Assertions about presentation and disclosure:

- (i) **Occurrence and rights and obligations** – disclosed events, transactions, and other matters have occurred and pertain to the entity.
- (ii) **Completeness** – all disclosures that should have been included in the financial statements have been included.
- (iii) **Classification and understandability** – financial information is appropriately presented and described, and disclosures are clearly expressed.

(iv) **Accuracy and valuation** – financial and other information are disclosed fairly and at appropriate amounts.

1. The auditor may use the assertions as described above or may express them differently provided all aspects described above have been covered.
2. When making assertions about the financial statements of certain entities, especially.

For example, where the Government is a major stakeholder, in addition to above assertions assert that transactions and events have been carried out in accordance with legislation or proper authority.

Example:

Particulars	₹	₹
Plant and Machinery (at cost)		2,00,000
Less: Depreciation till the end of previous year	70,000	
Depreciation for the year	13,000	83,000
		1,17,000

The assertions are as follows:

- (i) the firm owns the plant and machinery;
- (ii) the historical cost of plant and machinery is ₹ 2 lacs;
- (iii) the plant and machinery physically exists;
- (iv) the asset is being utilised in the business of the company productively;
- (v) total charge of depreciation on this asset is ₹ 83,000 to date on which ₹ 13,000 relates to the year in respect of which the accounts are drawn up; and
- (vi) the amount of depreciation has been calculated on recognised basis and the calculation is correct.

From the above illustration we know the sort of assertions that are implied in the financial statements. Incidentally, the assertions are generally implied and not specifically spelt out, though some explicit assertions are also found in the financial statements.

Explicit assertions are made when otherwise the reader will be left with an incomplete picture; it may even be misleading.

An example of the former category may be found in the following items appearing in the liability side of the balance sheet:

Secured Loans ₹ 4,00,000

The description does not give us a complete picture. We do not know:

- (i) the name of the lender, if it is relevant;
- (ii) the nature of security provided; and
- (iii) the rate at which interest is payable.

A specific mention is required about these things for a proper appreciation of the item and the financial position.

Negative assertions are also encountered in the financial statements and the same may be expressed or implied.

For example, if it is stated that there is no contingent liability it would be an expressed negative assertion;

On the other hand, if in the balance sheet there is no item as “building”, it would be an **implied negative assertion** that the entity did not own any building on the balance sheet date.

2. AUDIT TRAIL

An audit trail is a documented flow of a transaction.

It is used as audit evidence to establish authentication and integrity of a transaction.

Audit trails (or audit logs) act as record-keepers that document evidence of certain events, procedures or operations, because their purpose is to reduce fraud, material errors, and unauthorized use. Audit trails help to enhance internal controls and data security. Audit trails can help in fixing responsibility, rebuilding events and in thorough analysis of problem areas.

However, audit trails involve costs. The cost is not only in terms of system expenditure but also in terms of time involved in analysing data made available by audit trails.

However, use of automated tools can be made to analyse large volume of data thrown up by audit trails.

3. USING THE WORK OF INTERNAL AUDITORS (SA 610)

3.1 Evaluating the Internal Audit Function

The external auditor shall determine whether the work of the internal audit function can be used for purposes of the audit by evaluating the following:

- (A) The extent to which the internal audit function’s organizational status and relevant policies and procedures support the **objectivity** of the internal auditors;
- (B) The level of **competence** of the internal audit function; and

- (C) Whether the internal audit function applies a systematic and disciplined approach, including quality control.

3.1A Objectivity and its evaluation

Objectivity refers to the ability to perform those tasks without allowing bias, conflict of interest or undue influence of others to override professional judgments.

Factors that may affect the external auditor's evaluation in relation to Objectivity include the following:

1. Whether the organizational status of the internal audit function, including the function's authority and accountability, supports the ability of the function to be free from bias, conflict of interest or undue influence of others to override professional judgments.

For example:

whether the internal audit function reports to those charged with governance or an officer with appropriate authority, or if the function reports to management, whether it has direct access to those charged with governance.

2. Whether those charged with governance oversee employment decisions related to the internal audit function.

For example, determining the appropriate remuneration policy.

3. Whether there are any constraints or restrictions placed on the internal audit function by management or those charged with governance, **for example,** in communicating the internal audit function's findings to the external auditor.

4. Whether the internal audit function is free of any conflicting responsibilities, **for example,** having managerial or operational duties or responsibilities that are outside of the internal audit function.

3.1B Competence and its evaluation

Competence of the internal audit function refers to the attainment and maintenance of knowledge and skills of the function as a whole at the level required to enable assigned tasks to be performed diligently and in accordance with applicable professional standards.

Factors that may affect the external auditor's determination in relation to competence include the following:

1. Whether the internal audit function is **adequately and appropriately resourced** relative to the size of the entity and the nature of its operations.
 2. Whether there are **established policies for hiring, training and assigning internal auditors to internal audit engagements.**
 3. Whether the internal auditors have **adequate technical training and proficiency in auditing.**
 4. Whether the internal auditors possess the required **knowledge relating to the entity's financial reporting and the applicable financial reporting framework.**
- Note:** Objectivity and competence may be viewed as a continuum.(i.e. Both should run together)

3.1C Application of a Systematic and Disciplined Approach

Factors that may affect the external auditor's determination of whether the internal audit function applies a systematic and disciplined approach include the following:

1. **The existence, adequacy and use of documented internal audit procedures or guidance.**
2. Whether the internal audit function has **appropriate quality control policies and procedures.**

3.2 Circumstances When Work of the Internal Audit Function Cannot Be Used

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

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

3.3 Circumstances in which the external auditor shall plan to use less of the work of the Internal audit function and perform more of the work directly

- (a) The more judgment is involved in:
 - (i) Planning and performing relevant audit procedures; and
 - (ii) Evaluating the audit evidence gathered;

- (b) The higher the assessed risk of material misstatement at the assertion level, with special consideration given to risks identified as significant;
- (c) The less the internal audit function's organizational status and relevant policies and procedures adequately support the objectivity of the internal auditors; and
- (d) The lower the level of competence of the internal audit function.

3.4 Using the Work of the Internal Audit Function

If the external auditor plans to use the work of the internal audit function, the external auditor shall

- (A) discuss the planned use of its work with the function as a basis for coordinating their respective activities.
- (B) read the reports of the internal audit function relating to the work of the function that the external auditor plans to use to obtain an understanding of the nature and extent of audit procedures it performed and the related findings.
- (C) perform sufficient audit procedures on the body of work of the internal audit function as a whole that the external auditor plans to use to determine its adequacy for purposes of the audit.

Discussion and Coordination with the Internal Audit Function

In discussing the planned use of their work with the internal audit function as a basis for coordinating the respective activities, it may be useful to address the following:

1. The timing of such work.
2. The nature of the work performed.
3. The extent of audit coverage.
4. Materiality for the financial statements as a whole (and, if applicable, materiality level or levels for particular classes of transactions, account balances or disclosures), and performance materiality.
5. Proposed methods of item selection and sample sizes.
6. Documentation of the work performed.
7. Review and reporting procedures.

Coordination between the external auditor and the internal audit function is effective when, for example;

1. Discussions take place at appropriate intervals throughout the period.
2. The external auditor informs the internal audit function of significant matters that may affect the function.
3. The external auditor is advised of and has access to relevant reports of the internal audit function and is informed of any significant matters that come to the attention of the function when such matters may affect the work of the external auditor so that the external auditor is able to consider the implications of such matters for the audit engagement.

3.5 Determining Whether, in Which Areas, and to What Extent Internal Auditors Can Be Used to Provide Direct Assistance

Direct assistance refers to the use of internal auditors to perform audit procedures under the direction, supervision and review of the external auditor.

The external auditor may be prohibited by law or regulation from obtaining direct assistance from internal auditors.

If using internal auditors to provide direct assistance is not prohibited by law or regulation, and the external auditor plans to use internal auditors to provide direct assistance on the audit, the external auditor shall evaluate the existence and significance of threats to objectivity and the level of competence of the internal auditors who will be providing such assistance.

The external auditor shall not use internal auditors to provide direct assistance to perform procedures that:

- (a) Involve making significant judgments in the audit;
- (b) Relate to higher assessed risks of material misstatement where the judgment required in performing the relevant audit procedures or evaluating the audit evidence gathered is more than limited;
- (c) Relate to work with which the internal auditors have been involved and which has already been, or will be, reported to management or those charged with governance by the internal audit function; or
- (d) Relate to decisions the external auditor makes in accordance with this SA regarding the internal audit function and the use of its work or direct assistance.

Prior to using internal auditors to provide direct assistance for purposes of the audit, the external auditor shall:

- (a) Obtain written agreement from an authorized representative of the entity that the internal auditors will be allowed to follow the external auditor's instructions, and that the entity will not intervene in the work the internal auditor performs for the external auditor; and
- (b) Obtain written agreement from the internal auditors that they will keep confidential specific matters as instructed by the external auditor and inform the external auditor of any threat to their objectivity.

4. **AUDIT EVIDENCE-SPECIFIC CONSIDERATIONS FOR SELECTED ITEMS (SA 501)**

4.1 **If the Auditor Assesses a Risk of Material Misstatement regarding Litigation or Claims - Communication with the Entity's External Legal Counsel**

If the auditor assesses a risk of material misstatement regarding litigation or claims that have been identified, or when audit procedures performed indicate that other material litigation or claims may exist, the auditor shall, in addition to the procedures required by other SAs, seek **direct communication with the entity's external legal counsel**.

The auditor shall do so through a letter of inquiry requesting the entity's external legal counsel to communicate directly with the auditor.

If law, regulation or the respective legal professional body prohibits the entity's external legal counsel from communicating directly with the auditor, the auditor shall perform alternative audit procedures.

If it is considered unlikely that the entity's external legal counsel will respond appropriately to a letter of general inquiry.

The auditor may seek direct communication through a letter of specific inquiry.

For this purpose, a letter of specific inquiry includes:

- (a) A list of litigation and claims;
- (b) Where available, management's assessment of the outcome of each of the identified litigation and claims and its estimate of the financial implications, including costs involved; and
- (c) A request that the entity's external legal counsel confirm the reasonableness of management's assessments and provide the auditor with further information if the list is considered by the entity's external legal counsel to be incomplete or incorrect.

In certain circumstances, the auditor also may judge it necessary to meet with the entity's external legal counsel to discuss the likely outcome of the litigation or claims.

This may be the case, for example, where:

- (i) The auditor determines that the matter is a significant risk.
- (ii) The matter is complex.
- (iii) There is disagreement between management and the entity's external legal counsel. Ordinarily, such meetings require management's permission and are held with a representative of management in attendance.

Further if:

- (a) management refuses to give the auditor permission to communicate or meet with the entity's external legal counsel, or the entity's external legal counsel refuses to respond appropriately to the letter of inquiry, or is prohibited from responding; and
- (b) the auditor is unable to obtain sufficient appropriate audit evidence by performing alternative audit procedures, the auditor shall modify the opinion in the auditor's report in accordance with SA 705.

5. RELATED PARTIES (SA 550)

5.1 Understanding the Entity's Related Party Relationships & Transactions

The auditor shall inquire of management regarding:

- (a) The identity of the entity's related parties, including changes from the prior period;
- (b) The nature of the relationships between the entity and these related parties; and
- (c) Whether the entity entered into any transactions with these related parties during the period and, if so, the type and purpose of the transactions.

The auditor shall inquire of management and others within the entity, and perform other risk assessment procedures considered appropriate, to obtain an understanding of the controls, if any, that management has established to -

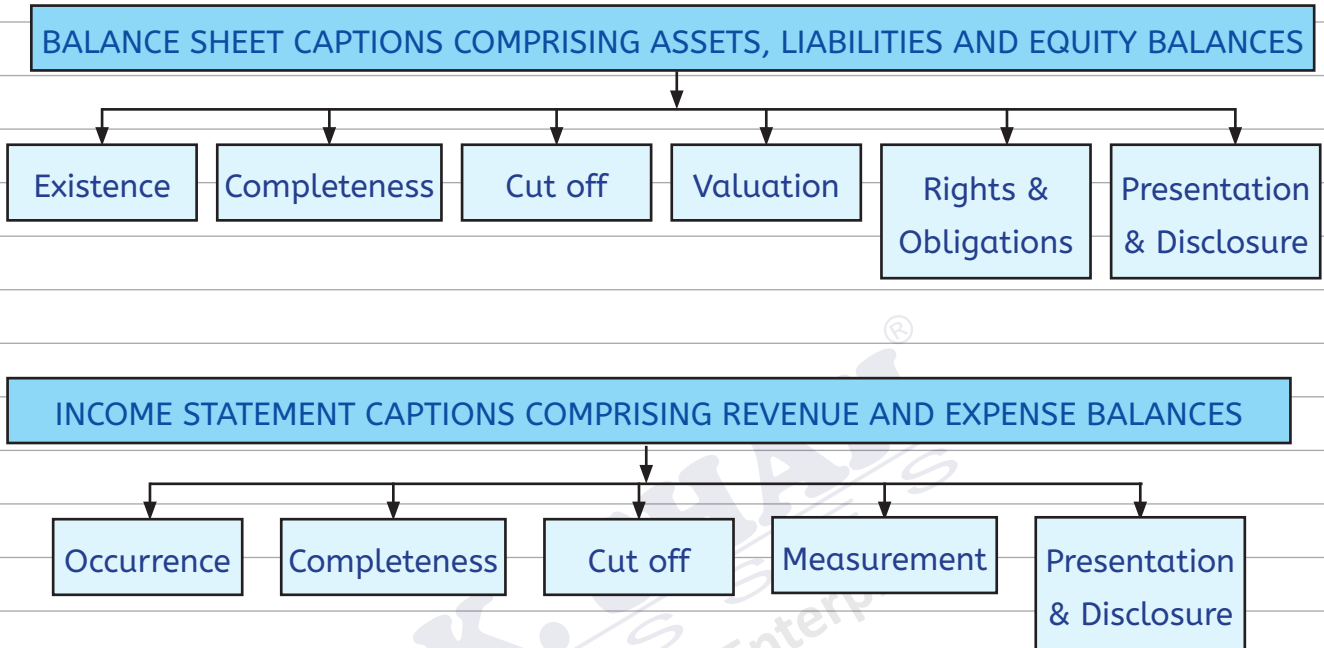
- (a) Identify, account for, and disclose related party relationships and transactions in accordance with the applicable financial reporting framework;
- (b) Authorise and approve significant transactions and arrangements with related parties; and
- (c) Authorise and approve significant transactions and arrangements outside the normal course of business.

5.2 Considerations specific to smaller entities by the auditor

Control activities in smaller entities are likely to be less formal and smaller entities may have no documented processes for dealing with related party relationships and transactions.

For such entities, the auditor may obtain an understanding of the related party relationships and transactions, and any controls that may exist over these, through inquiry of management combined with other procedures, such as observation of management's oversight and review activities, and inspection of available relevant documentation.

5 AUDIT OF ITEMS OF FINANCIAL STATEMENTS



INTRODUCTION

DEFINITION OF ASSERTION:

It refers to the representations by management, explicit or otherwise, that are embodied in the financial statements, as used by the auditor to consider the different types of potential misstatements that may occur.

1. INCOME STATEMENT CAPTIONS COMPRISING REVENUE AND EXPENSE BALANCES

Assertions	Explanation	Example: Employee benefit expenses and sales
Occurrence	Transactions recognized in the financial statements have occurred and relate to the entity.	(i) Employee benefit expense has been incurred during the period in respect of the personnel employed by the entity. Employee benefit expense does not include the cost of any unauthorized personnel.

		(ii) Recorded Sales represent goods which were ordered by valid customers and were despatched and invoiced in the period.
Completeness	All transactions that were supposed to be recorded have been recognized in the financial statements. Transactions have not been omitted.	(i) Employee benefit expenses in respect of all personnel have been fully accounted for. (ii) All genuine Sales have been recorded.
Cut-off	Whether all income and expenses are reported in the correct accounting period. Cut-off is a separate assertion because the substantive procedures to verify it are typically different from those applied to the other components of completeness.	(i) Employee benefit expenses recognized during the period relates to the current accounting period only. (ii) Sales shall include the despatch of goods made at the year end as they belong to the relevant period.
Measurement	Transactions have been recorded accurately at their appropriate amounts in the financial statements. There have been no errors while preparing documents or in posting transactions to ledger. The figures and explanations are not misstated.	(i) Employee benefit expense has been measured/ calculated accurately. Any adjustments such as tax deduction at source have been correctly reconciled and accounted for. (ii) Sales are recorded correctly in the books base on the invoices. Discounts have been properly adjusted or accounted for.
Presentation and Disclosure	Transactions have been classified and presented fairly in the financial statements.	(1) A Company shall disclose by way of notes additional information regarding aggregate expenditure and income on the following items:—

	<p>Transactions and events are appropriately segregated or disaggregated.</p> <p>Presentation and disclosure assertions are considered during the course of the audit to determine that the disclosures are complete and accurate.</p> <p>The disclosures that are most susceptible to material misstatement are those that require significant judgement and qualitative assessments. Audit teams assess the completeness and accuracy of disclosures by determining that the disclosures provide information in a manner that does not materially omit, distort or mislead the user. The description and disclosure of transactions are relevant and easy to understand.</p>	<p>Employee Benefits Expense [showing separately</p> <ul style="list-style-type: none"> (i) salaries and wages, (ii) contribution to provident and other funds, (iii) expense on Employee Stock Option Scheme (ESOP) and Employee Stock Purchase Plan (ESPP), (iv) staff welfare expenses]. <p>(2) In respect of a company other than a finance company revenue from operations shall disclose separately in the notes revenue from—</p> <ul style="list-style-type: none"> (a) Sale of products; (b) Sale of services; (ba) Grants or donations received (relevant in case of section 8 companies only),] (c) Other operating revenues; Less: (d) Excise duty
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2. BALANCE SHEET CAPTIONS COMPRISING ASSETS, LIABILITIES AND EQUITY BALANCES

Assertions	Explanation	Example: Inventory balance
Existence	Assets, liabilities and equity balances exist as at the period end.	Inventory recognized in the balance sheet actually existed as at the period end.
Completeness	All assets, liabilities and equity balances that were supposed to be recorded have been recognized in the financial statements.	All inventory units held by the entity that should have been recorded, have been recognized appropriately in the financial statements. Any inventory held by a third party on

		<p>behalf of the entity has been included as part of the inventory balance. Inventory held by the entity as a Consignee (on behalf of third party i.e. Consignor) shall be excluded.</p>
Cut-off	<p>Whether all assets and liabilities are reported in the appropriate period.</p>	<p>Inventory balance as at the yearend does not include any element of next financial year. All items of inventory pertaining to the relevant year shall be included regardless of the location.</p>
Valuation	<p>Assets, liabilities and equity balances have been valued appropriately i.e. the amounts at which they are recorded are appropriate. There has been no overstatement or understatement.</p>	<p>Inventory has been recognized at the lower of -cost and - net realizable value in accordance with AS 2 - Inventories. Any costs that could not be reasonably allocated to the cost of production (e.g. general and administrative costs) and any abnormal wastage have been excluded from the cost of inventory. An acceptable valuation basis (eg. FIFO, Weighted average etc.) has been used to value inventory as at the periodend.</p>
Rights & Obligations	<p>Entity has the right to assets i.e. (whether the entity has ownership and legal title to assets) and the liabilities recognized in the financial statements represent all the entity's obligations to repayment as at a given date.</p>	<p>The entity owns or controls the inventory recorded in the financial statements i.e. the purchase invoices have been made in the name of client. Any inventory held by the entity on behalf of another entity has not been recognized as part of inventory of the entity. (Eg: Consignment agreements can be checked).</p>

<p>Presentation and Disclosure</p>	<p>Whether particular items in the financial statements are properly classified, described and disclosed. Presentation and disclosure assertions are considered during the course of the audit to determine that disclosures are complete and accurate. The disclosures that are most susceptible to material misstatement are those that require significant judgement and qualitative assessments. Audit teams assess the completeness and accuracy of disclosures by determining that the disclosures provide</p>	<p>Example 1: Inventories</p> <p>(i) Inventories shall be classified as:</p> <ul style="list-style-type: none">(a) Raw materials;(b) Work-in-progress;(c) Finished goods;(d) Stock-in-trade (in respect of goods acquired for trading);(e) Stores and spares;(f) Loose tools;(g) Others (specify nature). <p>(ii) Goods-in-transit shall be disclosed under the relevant sub-head of inventories.</p> <p>(iii) Mode of valuation shall be stated.</p> <p>Example 2: For Share capital, a reconciliation of the number of shares outstanding at the beginning and at the end of the reporting period is required to be disclosed in the notes to accounts of the company.</p>
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AUDIT DOCUMENTATION

DOCUMENTATION OF SIGNIFICANT MATTERS AND RELATED SIGNIFICANT PROFESSIONAL JUDGEMENTS:

→ Judging the significance of a matter requires an objective analysis of the facts and circumstances.

Examples of significant matters include:

Matters that give rise to significant risks.

- Results of audit procedures indicating (a) that the financial statements could be materially misstated, or (b) a need to revise the auditor's previous assessment of the risks of material misstatement and the auditor's responses to those risks.
- Circumstances that cause the auditor significant difficulty in applying necessary audit procedures.
- Findings that could result in a modification to the audit opinion or the inclusion of an Emphasis of Matter Paragraph in the auditor's report.

→ Documentation of the professional judgements made, where significant, serves to explain the auditor's conclusions and to reinforce the quality of the judgement.

→ **Some examples of circumstances in which it is appropriate to prepare audit documentation relating to the use of professional judgement include, where the matters and judgements are significant:**

The rationale for the auditor's conclusion when a requirement provides that the auditor 'shall consider' certain information or factors, and that consideration is significant in the context of the particular engagement.

The basis for the auditor's conclusion on the reasonableness of areas of subjective judgements (for example, the reasonableness of significant accounting estimates).

→ The basis for the auditor's conclusions about the authenticity of a document when further investigation (such as making appropriate use of an expert or of confirmation procedures) is undertaken in response to conditions identified during the audit that caused the auditor to believe that the document may not be authentic.

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COMPLETION AND REVIEW

1. EVALUATION OF MISSTATEMENTS IDENTIFIED DURING THE AUDIT

Before forming an opinion on the financial statements, the auditor evaluates effects of identified misstatements on the audit and of uncorrected misstatements on financial statements after consideration of materiality. Uncorrected misstatements refer to those misstatements that the auditor has accumulated **after than those that are cliare trivia** during the audit and that have not been corrected.

1.1 Objectives of auditor in accordance with SA 450

The objective of the auditor is to evaluate: -

- (a) The effect of identified misstatements on the audit and
- (b) The effect of uncorrected misstatements, if any, on the financial statements.

1.2 Consideration of identified misstatements as the audit progresses

The auditor shall determine whether the overall audit strategy and audit plan need to be revised if: -

- (a) The nature of identified misstatements and the circumstances of their occurrence indicate that other misstatements may exist that, when aggregated with misstatements accumulated during the audit, could be material or
- (b) The aggregate of misstatements accumulated during the audit approaches materiality determined in accordance with SA 320.

The auditor may request management to examine a class of transactions, account balance or disclosure in order for management to understand the cause of a misstatement identified by the auditor, perform procedures to determine the amount of the actual misstatement in the class of transactions, account balance or disclosure, and to make appropriate adjustments to the financial statements. Such a request may be made, for example, based on the auditor's projection of misstatements.

If, at the auditor's request, management has examined a class of transactions, account balance or disclosure and corrected misstatements that were detected, the auditor shall perform additional audit procedures to determine whether misstatements remain.

1.3 Communication and correction of misstatements

The auditor shall communicate on a timely basis all misstatements accumulated during the audit with the appropriate level of management, unless prohibited by law or regulation. The auditor shall request management to correct those misstatements.

If management refuses to correct some or all of the misstatements communicated by the auditor, the auditor shall obtain an understanding of management's reasons for not making the corrections and shall take that understanding into account when evaluating whether the financial statements as a whole are free from material misstatement.

1.4 Evaluating the effect of uncorrected misstatements

The auditor shall determine whether uncorrected misstatements are material, individually or in aggregate. In making this determination, the auditor shall consider: -

- (a) The size and nature of the misstatements, both in relation to particular classes of transactions, account balances or disclosures and the financial statements as a whole, and the particular circumstances of their occurrence and
- (b) The effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole.

1.5 Communication with those charged with governance

The auditor shall communicate with those charged with governance regarding uncorrected misstatements and the effect that they, individually or in aggregate, may have on the opinion in the auditor's report, unless prohibited by law or regulation. The auditor's communication shall identify material uncorrected misstatements individually. The auditor shall request that uncorrected misstatements be corrected.

1.6 Written Representation from management regarding effects of uncorrected statements

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

1.7 Documentation regarding misstatements identified during audit

The audit documentation shall include: -

- (a) The amount below which misstatements would be regarded as clearly trivial;
- (b) All misstatements accumulated during the audit and whether they have been corrected; and
- (c) The auditor's conclusion as to whether uncorrected misstatements are material, individually or in aggregate, and the basis for that conclusion.

2. WRITTEN REPRESENTATIONS [SA 580]

2.1 Written representations about management's responsibilities

Written representation about management's responsibilities involves confirmation of fulfilment of management's responsibilities in following areas: -

(I) Preparation of the financial statements

The auditor shall request management to provide a written representation that it has fulfilled its responsibility for the preparation of the financial statements in accordance with the applicable financial reporting framework.

In some cases, however, management may decide to make inquiries of others who participate in preparing and presenting the financial statements and assertions therein, including individuals who have specialized knowledge

Such individuals may include:

- An actuary responsible for actuarially determined accounting measurements.
- Staff engineers who may have responsibility for and specialized knowledge about environmental liability measurements.
- Internal counsel who may provide information essential to provisions for legal claims.

(II) Information provided and completeness of transactions

- (a) It has provided the auditor with all relevant information and access as agreed in the terms of the audit engagement and
- (b) All transactions have been recorded and are reflected in the financial statements.

2.2 Why Written representations about management responsibilities are necessary?

- This is because the auditor is not able to judge solely on other audit evidence whether management has prepared and presented the financial statements and provided information to the auditor on the basis of the agreed acknowledgement and understanding of its responsibilities.
- For example, the auditor could not conclude that management has provided the auditor with all relevant information agreed in the terms of the audit engagement without asking it whether, and receiving confirmation that, such information has been provided.
- The auditor may also ask management to reconfirm its acknowledgement and understanding of those responsibilities in written representations. This is particularly appropriate when: -
 - Those who signed the terms of the audit engagement on behalf of the entity no longer have the relevant responsibilities;
 - The terms of the audit engagement were prepared in a previous year;
 - There is any indication that management misunderstands those responsibilities; or
 - Changes in circumstances make it appropriate to do so.
- In addition to the written representation about management's responsibilities regarding preparation of financial statements, the auditor may consider it necessary to request other written representations about the financial statements.
- Such written representations may supplement, but do not form part of, the written representation relating to management's responsibilities regarding preparation of financial statements. They may include representations about the following:

- Whether the selection and application of accounting policies are appropriate; and
- Whether matters such as the following, have been recognized, measured, presented or disclosed in accordance with that framework: -
 - ❖ Plans or intentions that may affect the carrying value or classification of assets and liabilities;
 - ❖ Liabilities, both actual and contingent;
 - ❖ Title to, or control over, assets, the liens or encumbrances on assets, and assets pledged as collateral; and
 - ❖ Aspects of laws, regulations and contractual agreements that may affect the financial statements, including non-compliance.

2.3 Written representations about specific assertions

- When obtaining evidence about, or evaluating, judgments and intentions, the auditor may consider one or more of the following:
 - The entity's past history in carrying out its stated intentions.
 - The entity's reasons for choosing a particular course of action.
 - The entity's ability to pursue a specific course of action.
 - The existence or lack of any other information that might have been obtained during the course of the audit that may be inconsistent with management's judgment or intent.
- In addition, the auditor may consider it necessary to request management to provide written representations about specific assertions in the financial statements, in particular, to support an understanding that the auditor has obtained from other audit evidence of management's judgment or intent in relation to, or the completeness of, a specific assertion.
- For example, if the intent of management is important to the valuation basis for investments, it may not be possible to obtain sufficient appropriate audit evidence without a written representation from management about its intentions. Although such written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own for that assertion.

3. SIGNIFICANCE OF COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE

Communication from auditor is important with those charged with governance. An effective two-way communication is important in assisting:

- (a) The auditor and those charged with governance in understanding matters related to the audit and in developing a constructive working relationship. This relationship is developed while maintaining the auditor's independence and objectivity.
- (b) The auditor in obtaining from those charged with governance information relevant to the audit. For example, those charged with governance may assist the auditor in understanding the entity and its environment, in identifying appropriate sources of audit evidence, and in providing information about specific transactions or events; and
- (c) Those charged with governance in fulfilling their responsibility to oversee the financial reporting process, thereby reducing the risks of material misstatement of the financial statements.

3.1 Who are "Those charged with governance"?

The person(s) or organization(s) (e.g., a corporate trustee) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process. For some entities, those charged with governance may include management personnel, for example, executive members of a governance board of a private or public sector entity, or an owner-manager.

3.2 Scope of SA 260- Communication with Those Charged with Governance

SA 260 deals with the auditor's responsibility to communicate with those charged with governance in an audit of financial statements.

3.3 Objectives of auditor in accordance with SA 260

The objectives of the auditor are: -

- (a) To communicate clearly with those charged with governance the responsibilities of the auditor in relation to the financial statement audit, and an overview of the planned scope and timing of the audit;
- (b) To obtain from those charged with governance information relevant to the audit;
- (c) To provide those charged with governance with timely observations arising

from the audit that are significant and relevant to their responsibility to oversee the financial reporting process and

- (d) To promote effective two-way communication between the auditor and those charged with governance.

3.4 Determining appropriate persons with whom to communicate

The auditor shall determine the appropriate person(s) within the entity's governance structure with whom to communicate.

3.5 Matters to be communicated by auditor

(a) The auditor's responsibilities in relation to the financial statement audit

- ✓ The auditor is responsible for forming and expressing an opinion on the financial statements
- ✓ The audit of the financial statements does not relieve management or those charged with governance of their responsibilities.

(b) Planned scope and timing of the audit

The auditor shall communicate with those charged with governance an overview of the planned scope and timing of the audit, which includes communicating about the significant risks identified by the auditor.

(c) Significant findings from the audit

(d) Significant difficulties, if any, encountered during the audit;

(e) Unless all of those charged with governance are involved in managing the entity: -

- (i) Significant matters arising during the audit that were discussed, or subject to correspondence, with management;
- (ii) Written representations the auditor is requesting

(f) Circumstances that affect the form and content of the auditor's report, if any and

(g) Any other significant matters arising during the audit that, in the auditor's professional judgment, are relevant to the oversight of the financial reporting process.]

3.6 Communication of auditor's independence in case of listed entities

In the case of listed entities, the auditor shall communicate with those charged with governance:

- (a) A statement that the engagement team and others in the firm have complied with relevant ethical requirements regarding independence and
- (b) (i) All relationships and other matters between the firm, network firms, and the entity that, in the auditor's professional judgment,

may reasonably be thought to bear on independence. This shall include total fees charged during the period covered by the financial statements for audit and non-audit services provided by the firm and network firms to the entity and components controlled by the entity. These fees shall be allocated to categories that are appropriate to assist those charged with governance in assessing the effect of services on the independence of the auditor and

- (ii) The related safeguards that have been applied to eliminate identified threats to independence or reduce them to an acceptable level.

3.9 Documentation

Where matters required by SA 260 to be communicated are communicated orally, the auditor shall include them in the audit documentation, and when and to whom they were communicated. Where matters have been communicated in writing, the auditor shall retain a copy of the communication as part of the audit documentation.

4. WHY COMMUNICATION OF SIGNIFICANT DEFICIENCIES IN INTERNAL CONTROL IS NECESSARY?

Reflects the importance of these matters and assists those charged with governance in fulfilling their oversight responsibilities.

4.1 Scope of SA 265- Communicating Deficiencies in Internal Control to Those Charged with Governance and Management

The auditor is required to obtain an understanding of internal control relevant to the audit when identifying and assessing the risks of material misstatement. In making those risk assessments, the auditor considers internal control in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control.

4.2 Objective of auditor in accordance with SA 265

The objective of the auditor is to communicate appropriately to those charged with governance and management deficiencies in internal control that the auditor has identified during the audit and that, in the auditor's professional judgment, are of sufficient importance to merit their respective attentions.

4.3 Meaning of “Deficiency in internal control” and “significant deficiency in internal control”

(a) **Deficiency in internal control** – This exists when: -

- (i) A control is designed, implemented or operated in such a way that it is unable to prevent, or detect and correct, misstatements in the financial statements on a timely basis

(b) **Significant deficiency in internal control** – A deficiency or combination of deficiencies in internal control that, in the auditor’s professional judgment, is of sufficient importance to merit the attention of those charged with governance.

Examples of matters that the auditor may consider in determining whether a deficiency or combination of deficiencies in internal control constitutes a significant deficiency

- The likelihood of the deficiencies leading to material misstatements in the financial statements in the future.
- The susceptibility to loss or fraud of the related asset or liability.
- The subjectivity and complexity of determining estimated amounts, such as fair value accounting estimates.
- The financial statement amounts exposed to the deficiencies.
- The volume of activity that has occurred or could occur in the account balance or class of transactions exposed to the deficiency or deficiencies.
- The importance of the controls to the financial reporting process, for example:
 - ❖ General monitoring controls (such as oversight of management).
 - ❖ Controls over the prevention and detection of fraud.
 - ❖ Controls over the selection and application of significant accounting policies.
 - ❖ Controls over significant transactions with related parties.
 - ❖ Controls over significant transactions outside the entity’s normal course of business.
 - ❖ Controls over the period-end financial reporting process (such as controls over non-recurring journal entries).
- The cause and frequency of the exceptions detected as a result of the deficiencies in the controls.

Examples of indicators of significant deficiencies in internal control

- ❖ Management’s failure to implement appropriate remedial action on significant deficiencies previously communicated.

- Absence of a risk assessment process within the entity where such a process would ordinarily be expected to have been established.
- Evidence of an ineffective entity risk assessment process, such as management's failure to identify a risk of material misstatement that the auditor would expect the entity's risk assessment process to have identified.
- Evidence of an ineffective response to identified significant risks (e.g., absence of controls over such a risk).
- Misstatements detected by the auditor's procedures that were not prevented, or detected and corrected, by the entity's internal control.
- Disclosure of a material misstatement due to error or fraud as prior period items in the current year's Statement of Profit and Loss.
- Evidence of management's inability to oversee the preparation of the financial statements.

4.5 Communication of significant deficiencies in internal control to those charged with governance

The auditor shall communicate in writing significant deficiencies in internal control identified during the audit to those charged with governance on a timely basis. The auditor shall also communicate to management at an appropriate level of responsibility on a timely basis: -

- (a) In writing, significant deficiencies in internal control that the auditor has communicated or intends to communicate to those charged with governance, unless it would be inappropriate to communicate directly to management in the circumstances; and (b) Other deficiencies in internal control identified during the audit that have not been communicated to management by other parties and that, in the auditor's professional judgment, are of sufficient importance to merit management's attention.

The auditor shall include in the written communication of significant deficiencies in internal control: -

- (a) A description of the deficiencies and an explanation of their potential effects; and
(b) Sufficient information to enable those charged with governance and management to understand the context of the communication.

In particular, the auditor shall explain that: -

- (i) The purpose of the audit was for the auditor to express an opinion on the financial statements;

- (ii) The audit included consideration of internal control relevant to the preparation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control; and
- (iii) The matters being reported are limited to those deficiencies that the auditor has identified during the audit and that the auditor has concluded are of sufficient importance to merit being reported to those charged with governance.

8

AUDIT REPORT

1. MODIFICATIONS TO THE OPINION IN THE INDEPENDENT AUDITOR'S REPORT(SA 705)

1.1 Form and Content of the Auditor's Report When the Opinion is Modified

→ Auditor's Opinion:

When the auditor modifies the audit opinion, the auditor shall use the heading "Qualified Opinion," "Adverse Opinion," or "Disclaimer of Opinion," as appropriate, for the Opinion section.

→ Qualified Opinion:

When the auditor expresses a qualified opinion due to a material misstatement in the financial statements, the auditor shall state that, in the auditor's opinion, **except for the effects of the matter(s) described in the Basis for Qualified Opinion section,**

(a) When reporting in accordance with a fair presentation framework, the accompanying financial statements present fairly, in all material respects (or give a true and fair view of) [...] in accordance with [the applicable financial reporting framework]; or

(b) When reporting in accordance with a compliance framework, the accompanying financial statements have been prepared, in all material respects, in accordance with [the applicable financial reporting framework].

When the modification arises from an inability to obtain sufficient appropriate audit evidence, the auditor shall use the corresponding phrase "except for the possible effects of the matter(s) ..." for the modified opinion.

→ Adverse Opinion:

When the auditor expresses an adverse opinion, the auditor shall state that, in the auditor's opinion, **because of the significance of the matter(s) described in the Basis for Adverse Opinion section,**

- (a) When reporting in accordance with a fair presentation framework, the accompanying financial statements do not present fairly (or give a true and fair view of) [...] in accordance with [the applicable financial reporting framework]; or
- (b) When reporting in accordance with a compliance framework, the accompanying financial statements have not been prepared, in all material respects, in accordance with [the applicable financial reporting framework].

→ **Disclaimer of Opinion:**

When the auditor disclaims an opinion due to an inability to obtain sufficient appropriate audit evidence, the auditor shall:

- (a) State that the auditor does not express an opinion on the accompanying financial statements;
- (b) State that, because of the significance of the matter(s) described in the Basis for Disclaimer of Opinion section, **the auditor has not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements;** and
- (c) Amend the statement required by SA 700 (Revised), which indicates that the financial statements have been audited, to state that the auditor was engaged to audit the financial statements.

1.2 Basis for Opinion

When the auditor modifies the opinion on the financial statements, the auditor shall, in addition to the specific elements required by SA 700 (Revised):

- (a) Amend the heading “Basis for Opinion” required by SA 700 (Revised) to “Basis for Qualified Opinion,” “Basis for Adverse Opinion,” or “Basis for Disclaimer of Opinion,” as appropriate; and
- (b) Within this section, include a description of the matter giving rise to the modification.

- If there is a material misstatement of the financial statements that relates to specific amounts in the financial statements (including quantitative disclosures in the notes to the financial statements), the auditor shall include in the Basis for Opinion section a description and quantification of the financial effects of the misstatement, unless impracticable.

- If it is not practicable to quantify the financial effects, the auditor shall so state in this section.
- If there is a material misstatement of the financial statements that relates to narrative disclosures, the auditor shall include in the Basis for Opinion section an explanation of how the disclosures are misstated.
- If there is a material misstatement of the financial statements that relates to the non-disclosure of information required to be disclosed, the auditor shall:
 - (a) Discuss the non-disclosure with those charged with governance;
 - (b) Describe in the Basis for Opinion section the nature of the omitted information; and
 - (c) Unless prohibited by law or regulation, include the omitted disclosures, provided it is practicable to do so and the auditor has obtained sufficient appropriate audit evidence about the omitted information.
- If the modification results from an inability to obtain sufficient appropriate audit evidence, the auditor shall include in the Basis for Opinion section the reasons for that inability.
- When the auditor expresses a qualified or adverse opinion, the auditor shall amend the statement about whether the audit evidence obtained is sufficient and appropriate to provide a basis for the auditor's opinion required by SA 700 (Revised) to include the word "qualified" or "adverse", as appropriate.
- When the auditor disclaims an opinion on the financial statements, the auditor's report shall not include the following elements required by SA 700 (Revised).
 - (a) A reference to the section of the auditor's report where the auditor's responsibilities are described; and
 - (b) A statement about whether the audit evidence obtained is sufficient and appropriate to provide a basis for the auditor's opinion.Even if the auditor has expressed an adverse opinion or disclaimed an opinion on the financial statements, the auditor shall describe

in the Basis for Opinion section the reasons for any other matters of which the auditor is aware that would have required a modification to the opinion, and the effects thereof.

1.3 Description of Auditor's Responsibilities for the Audit of the Financial Statements When the Auditor Disclaims an Opinion on the Financial Statements

When the auditor disclaims an opinion on the financial statements due to an inability to obtain sufficient appropriate audit evidence, the auditor shall amend the description of the auditor's responsibilities required by SA 700 (Revised) to include only the following:

- (a) A statement that the auditor's responsibility is to conduct an audit of the entity's financial statements in accordance with Standards on Auditing and to issue an auditor's report;
- (b) A statement that, however, because of the matter(s) described in the Basis for Disclaimer of Opinion section, the auditor was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements; and
- (c) The statement about auditor independence and other ethical responsibilities required by SA 700 (Revised).

1.4 Considerations When the Auditor Disclaims an Opinion on the Financial Statements

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

2. STANDARD ON AUDITING - 710, "COMPARATIVE INFORMATION - CORRESPONDING FIGURES AND COMPARATIVE FINANCIAL STATEMENTS"

2.1 Audit Reporting regarding Corresponding Figures

Definition of Corresponding figures:

Comparative information where amounts and other disclosures for the prior period are included as an integral part of the current period financial statements

and are intended to be read only in relation to the amounts and other disclosures relating to the current period (referred to as "current period figures").

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

When corresponding figures are presented, the auditor's opinion shall not refer to the corresponding figures except in the following circumstances:

1. If the auditor's report on the prior period, as previously issued, included a qualified opinion, a disclaimer of opinion, or an adverse opinion and the matter which gave rise to the modification is unresolved, the auditor shall modify the auditor's opinion on the current period's financial statements. In the Basis for Modification paragraph in the auditor's report, the auditor shall either:
 - (a) Refer to both the current period's figures and the corresponding figures in the description of the matter giving rise to the modification when the effects or possible effects of the matter on the current period's figures are material; or
 - (b) In other cases, explain that the audit opinion has been modified because of the effects or possible effects of the unresolved matter on the comparability of the current period's figures and the corresponding figures.
2. If the auditor obtains audit evidence that a material misstatement exists in the prior period financial statements on which an unmodified opinion has been previously issued, the auditor shall verify whether the misstatement has been dealt with as required under the applicable financial reporting framework and, if that is not the case, the auditor shall express a qualified opinion or an adverse opinion in the auditor's report on the current period financial statements, modified with respect to the corresponding figures included therein.
3. **Prior Period Financial Statements Not Audited-** If the prior period financial statements were not audited, the auditor shall state in an Other Matter paragraph in the auditor's report that the corresponding figures are unaudited. Such a statement does not, however, relieve the auditor of the requirement to obtain sufficient appropriate audit evidence that the opening balances do not contain misstatements that materially affect the current period's financial statements.

Prior Period Financial Statements Audited by a Predecessor Auditor

If the financial statements of the prior period were audited by a predecessor auditor and the auditor is permitted by law or regulation to refer to the predecessor auditor's report on the corresponding figures and decides to do so, the auditor shall state in an Other Matter paragraph in the auditor's report:

- (a) That the financial statements of the prior period were audited by the predecessor auditor;
- (b) The type of opinion expressed by the predecessor auditor and, if the opinion was modified, the reasons therefore; and
- (c) The date of that report.

2.2 Comparative Financial Statements

- **Definition:** Comparative information where amounts and other disclosures for the prior period are included for comparison with the financial statements of the current period but, if audited, are referred to in the auditor's opinion. The level of information included in those comparative financial statements is comparable with that of the financial statements of the current period.
- **When reporting on prior period financial statements in connection with the current period's audit,** if the auditor's opinion on such prior period financial statements differs from the opinion the auditor previously expressed, the auditor shall disclose the substantive reasons for the different opinion in an Other Matter paragraph in accordance with SA 706.
- **Prior Period Financial Statements Audited by a Predecessor Auditor**
If the financial statements of the prior period were audited by a predecessor auditor, in addition to expressing an opinion on the current period's financial statements, the auditor shall state in an Other Matter paragraph:
 - (a) That the financial statements of the prior period were audited by a predecessor auditor;
 - (b) The type of opinion expressed by the predecessor auditor and, if the opinion was modified, the reasons therefor; and
 - (c) The date of that report, unless the predecessor auditor's report on the prior period's financial statements is revised with the financial statements.

If the auditor concludes that a material misstatement exists that affects the prior period financial statements on which the predecessor auditor had previously reported without modification, the auditor shall communicate the misstatement with the appropriate level of management and those charged with governance and request that the predecessor auditor be

informed. If the prior period financial statements are amended, and the predecessor auditor agrees to issue a new auditor's report on the amended financial statements of the prior period, the auditor shall report only on the current period.

→ **Prior Period Financial Statements Not Audited**

If the prior period financial statements were not audited, the auditor shall state in an Other Matter paragraph that the comparative financial statements are unaudited. Such a statement does not, however, relieve the auditor of the requirement to obtain sufficient appropriate audit evidence that the opening balances do not contain misstatements that materially affect the current period's financial statements.

(d) **SA 600, "Using the Work of another Auditor"**.

Where another auditor has been appointed for the component, the principal auditor would normally be entitled to rely upon the work of such auditor unless there are special circumstances to make it essential for him to visit the component and/or to examine the books of account and other records of the said component. Further, it requires that 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. When using the work of another auditor, the principal auditor should ordinarily perform the following procedures:

- (a) advise the other auditor of the use that is to be made of the other auditor's work and report and make sufficient arrangements for co-ordination of their efforts at the planning stage of the audit. The principal auditor would inform the other auditor of matters such as are as requiring special consideration, procedures for the identification of inter -component transactions that may require disclosure and the time-table for completion of audit; and
- (b) advise the other auditor of the significant accounting, auditing and reporting requirements and obtain representation as to compliance with them. The principal auditor might discuss with

the other auditor the audit procedures applied or review a written summary of the other auditor's procedures and findings which may be in the form of a completed questionnaire or check-list. The principal auditor may also wish to visit the other auditor. The nature, timing and extent of procedures will depend on the circumstances of the engagement and the principal auditor's knowledge of the professional competence of the other auditor.

3. REPORTING ON ACCOUNTS EXAMINED [SECTION 143(3)]

Whether the company has used such accounting software for maintaining its books of account which has a feature of recording audit trail (edit log) facility and the same has been operated throughout the year for all transactions recorded in the software and the audit trail feature has not been tampered with and the audit trail has been preserved by the company as per the statutory requirements for record retention.

While reporting, where any of the matters required to be included in the audit report is answered in the negative or with a qualification, the report shall state the reasons therefor in terms of Section 143(4). Further, every auditor shall comply with the auditing standards as required under section 143(9).

9

SPECIAL FEATURES OF AUDIT OF DIFFERENT TYPES OF ENTITIES

1. AUDIT OF FIRM

(A) Matters to be considered before starting audit:

1. The name and style under which the business shall be conducted.
2. The duration of the partnership, if any, that has been agreed upon.
3. The amount of capital that shall be contributed by each partner—whether it will be fixed or could be varied from year to year.
4. The period at the end of which the accounts of the partnership will be closed periodically and the proportions in which the profit shall be divided among the partners or losses shall have to be contributed by them; whether the losses shall be borne by the partners or whether any of the partners will not be required to do so.
5. The provisions as regards maintenance of books of account and the matters which must be taken into account for determining the profits of the firm available for division among the partners e.g., creation of reserves, provision for depreciation, etc. also the period within which accounts can be reopened for correcting a manifest error.
6. Borrowing capacity of the partnership (when it is not implied as in the case of non-trading firms).
7. The rate at which interest will be allowed on the capitals and loans provided by partners and the rate at which it will be charged on their drawings and current accounts.
8. Whether any salaries are payable to the partners or withdrawals are permitted against shares of profits and, if so, to what extent?
9. Duties of the partners as regards the management of business of the firm; also, the partners who shall act as managing partners.
10. Who shall operate the bank account of the firm? How will the surplus funds of the partnership be invested?
11. Limitations and restrictions that have been agreed upon, the rights and powers of partners and on their implied authority to pledge the firm's credit or to render it liable.

1.1 Basics of Limited Liability Partnerships (LLP) Audit

(A) LLP is governed by Limited Liability Partnership Act, 2008.

A Small Limited Liability Partnership to denote any LLP:

- (a) the **Contribution** of which, does not exceed **twenty-five lakh rupees (INR 25,00,000)** or such higher amount, not exceeding five crore rupees, as may be prescribed; and
- (b) the **Turnover** of which, as per the Statement of Accounts and Solvency for the immediately preceding financial year, does not exceed **forty lakh rupees (INR 40,00,000)** or such higher amount, not exceeding **fifty crore rupees**, as may be prescribed;

(B) Whether LLP is required to maintain Books of Accounts:

LLP's are required to maintain books of accounts which shall contain-

- 1. Particulars of all sums of money received and expended by the LLP and the matters in respect of which the receipt and expenditure takes place,
- 2. A record of the assets and liabilities of the LLP,
- 3. Statements of costs of goods purchased, inventories, work-in-progress, finished goods and costs of goods sold,
- 4. Any other particulars which the partners may decide.

(C) **Audit of the Accounts of an LLP:**

The accounts of every LLP shall be audited in accordance with Rule 24 of LLP, Rules 2009. Such rules, inter-alia, provides that any LLP, whose turnover does not exceed, in any financial year, forty lakh rupees, or whose contribution does not exceed twenty five lakh rupees, is not required to get its accounts audited. However, if the partners of such limited liability partnership decide to get the accounts of such LLP audited, the accounts shall be audited only in accordance with such rule.

2. AUDIT OF TRUSTS & SOCIETIES

BOOKS OF ACCOUNT: The Auditor is required to report whether the Trust has maintained proper books of accounts, including the following, namely:

- (i) cash book;
- (ii) ledger;

- (iii) journal;
- (iv) copies of bills,
- (v) original bills wherever issued to the person and receipts in respect of payments made by the person;
- (vi) any other book that may be required to be maintained in order to give a true and fair view of the state of the affairs of the person and explain the transactions effected;

TRUSTS

The auditor has to ascertain:

- (a) whether accounts are maintained regularly and in accordance with the provisions of the applicable Act and the rules;
- (b) whether receipts and disbursements are properly and correctly shown in the accounts and money received in the form of donations is being applied as per the objects of the trust and as per the specific direction by the donor, if any.
- (c) whether the cash balance and vouchers in the custody of the manager or trustee on the date of audit were in agreement with the accounts;
- (d) whether all books, deeds, accounts, vouchers or other documents or records required by the auditor were produced before him;
- (e) whether a register of movable and immovable properties is maintained.
- (f) whether the manager or trustee or any other person required by the auditor to appear before him did so and furnished the necessary information required by him;
- (g) whether any property or funds of the Trust were applied for any object or purpose other than the object or purpose of the Trust;
- (h) the amounts of outstanding for more than one year and the amounts written off, if any;
- (i) whether any money of the public trust has been invested contrary to the provisions of applicable Act which have come to the notice of the Auditor
- (j) all cases of irregular, illegal or improper expenditure, or failure or omission to recover monies or of loss or waste of money or other property thereof,
- (k) whether the maximum and minimum number of the trustees is maintained;
- (l) whether the meetings are held regularly as provided in such instrument
- (m) whether the minute books of the proceedings of the meeting is maintained
- (n) whether any of the trustees has any interest in the investment of the trust
- (o) whether any of the trustees is a debtor or creditor of the trust.
- (p) whether anonymous donations received are properly accounted for and

donations in cash are not received by the Trust over and above the prescribed limit of accepting cash donations.

- (q) whether the irregularities pointed out by the auditors in the accounts of the previous year have been duly complied with by the trustees during the period of audit
- (r) any special matter which the auditor may think fit or necessary to bring to the notice of the Deputy or Assistant Charity Commissioner

SOCIETIES

The auditor's considerations:-

- (a) The auditor should ascertain governing legislation of society i.e. Societies Registration act, 1860 or any applicable state law under which it has been registered.
- (b) Object of society needs to be ascertained from its memorandum of association/bye laws. Its activities may include charitable, social, cultural or educational activities.
- (c) Ascertain whether society has obtained registration under Foreign Contribution (Regulation) Act, 2010 in case foreign contributions are received.
- (d) Ascertain whether it is also registered under relevant provisions of Income Tax Act which may make it eligible for tax exemption on its income.
- (e) Obtain an understanding of internal control to design audit procedures with special reference to donations and various expenditures incurred in relation to achievements of objects of society.
- (f) Evaluate appropriateness of accounting policies with special reference to donations and grants. Also evaluate accounting policies in relation to specific grants.
- (g) In case some expenses incurred by society are reimbursed by donors, ascertain how these are recognized in financial statements.
- (h) Ascertain, if any inquiry has been held by Registrar under applicable law in the working or financial condition of society and its implications for auditor's opinion.
- (i) Ascertain all cases of irregular, illegal or improper expenditure or failure or omission to recover monies or other property belonging to society or of loss or waste of money or other property thereof.
- (j) Ascertain whether such expenditure or waste was caused in consequence of breach of trust or misapplication or any other misconduct on the part of governing body.

10

ETHICS AND TERMS OF AUDIT ENGAGEMENTS

1. MEANING OF ETHICS – A STATE OF MIND

The term “Ethics” means moral principles which govern a person’s behaviour or his conducting of an activity.

2. NEED FOR PROFESSIONAL ETHICS

Professional ethics seek to protect the interests of the profession as a whole and act as a shield that enables us to command respect.

A Chartered Accountant, either in practice or in service, has to abide by ethical behaviours. They are expected to follow the fundamental principles of professional ethics while performing their duties.

3. PRINCIPLES BASED APPROACH VS RULES BASED APPROACH TO ETHICS (ETHICAL OR LEGAL)

The essence of principles-based approach to ethics is that it requires compliance with spirit of ethics. It requires accountants to exercise professional judgment in every situation based upon their professional knowledge, skill and expertise.

However, rules-based approach to ethics strictly follows clearly established rules. It may lead to a narrow outlook and spirit of ethics may be overlooked while strictly adhering to rules. Further, rules- based approach is somewhat rigid as it may not be possible to deal with every practical situation relying upon rules.

Therefore, it is necessary that spirit of code is followed.

4. SQC 1 – “QUALITY CONTROL FOR FIRMS THAT PERFORM AUDITS AND REVIEWS OF HISTORICAL FINANCIAL INFORMATION, AND OTHER ASSURANCE AND RELATED SERVICES ENGAGEMENTS”

SQC 1 requires that the firm should establish a system of quality control designed to provide it with reasonable assurance that the firm and its personnel comply with professional standards and regulatory and legal requirements and that reports issued by the firm or engagement partners are appropriate in the circumstances.

Firm’s system of quality control should consist of policies designed to achieve these objectives.

5. ELEMENTS OF SYSTEM OF QUALITY CONTROL

The firm's system of quality control should include policies and procedures addressing each of the following elements: -

- (A) Leadership responsibilities for quality within the firm
- (B) Ethical requirements
- (C) Acceptance and continuance of client relationships and specific engagements
- (D) Human resources
- (E) Engagement performance
- (F) Monitoring

5A. Leadership responsibilities for quality within the firm

Such policies and procedures should require the firm's chief executive officer or the firm's managing partners to assume ultimate responsibility for the firm's system of quality control. Managing partners should have sufficient and appropriate experience, ability and the necessary authority to assume that responsibility.

5B. Ethical requirements

- The firm should establish policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with relevant ethical requirements contained in the Code of ethics issued by ICAI.
- The Code establishes the fundamental principles of professional ethics which include integrity, objectivity, professional competence and due care, confidentiality and professional behaviour.
- Observance of "Independence" in all engagements is the basic requirement. The firm should establish policies and procedures designed to provide it with reasonable assurance that the firm, its personnel and (including experts contracted by the firm and network firm personnel) maintain independence where required by the Code. Such policies and procedures should enable the firm to: -
 - (a) Communicate its independence requirements to its personnel
 - (b) Identify and evaluate circumstances and relationships that create threats to independence, and to take appropriate action to eliminate those threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the engagement.

5C. Acceptance and Continuance of Client Relationships and Specific Engagements

A firm before accepting an engagement should acquire vital information about the client. Such an information should help firm to decide about: -

- Integrity of Client
- Competence (including capabilities, time and resources) to perform engagement
- Compliance with ethical requirements

With regard to the integrity of a client, matters that the firm considers include, for example:

- The identity and business reputation of the client's principal owners, key management, related parties and those charged with its governance.
- The nature of the client's operations, including its business practices.
- Information concerning the attitude of the client's principal owners, key management and those charged with its governance towards such matters as aggressive interpretation of accounting standards and the internal control environment.
- Whether the client is aggressively concerned with maintaining the firm's fees as low as possible.
- Indications of an inappropriate limitation in the scope of work.
- Indications that the client might be involved in money laundering or other criminal activities.
- The reasons for the proposed appointment of the firm and non-reappointment of the previous firm.

If there is any conflict of interest between the firm and client, it should be properly resolved before accepting the engagement. Where the firm obtains information that would have caused it to decline an engagement if that information had been obtainable earlier, policies and procedures on the continuance of the engagement and the client relationship should include consideration of:

- (a) The professional and legal responsibilities that apply to the circumstances, including whether there is a requirement for the firm to report to the person or persons who made the appointment or, in some cases, to regulatory authorities; and
- (b) The possibility of withdrawing from the engagement or from both the engagement and the client relationship.

5D. Human resources

The firm should establish policies and procedures designed to provide it with reasonable assurance that it has sufficient personnel with the capabilities, competence, and commitment to ethical principles necessary to perform its engagements in accordance with professional standards and regulatory and legal requirements and to enable the firm or engagement partners to issue reports that are appropriate in the circumstances. Such policies and procedures should address relevant HR issues including recruitment, compensation, training, career development, performance evaluation etc.

5F. Monitoring

The firm should ensure that policies and procedures relating to the system of quality control are relevant, adequate, operating effectively and complied with in practice. Such policies and procedures should include an ongoing consideration and evaluation of the firm's system of quality control, including a periodic inspection of a selection of completed engagements.

6. SA 220- "QUALITY CONTROL FOR AN AUDIT OF FINANCIAL STATEMENTS"

As per SA 220, the objective of the auditor is to implement quality control procedures at the engagement level that provide the auditor with reasonable assurance that:

- (a) The audit complies with professional standards and regulatory and legal requirements and
- (b) The auditor's report issued is appropriate in the circumstances.

SA 220 is modelled on lines of SQC 1. It describes responsibilities of engagement partner in relation to following matters:

- (A) Leadership responsibilities for quality on audits
- (B) Relevant ethical requirements
- (C) Acceptance and continuance of client relationships and audit engagements
- (D) Assignment of engagement teams
- (E) Engagement performance
- (F) Monitoring

6A. Leadership responsibilities for quality on audits

Leadership responsibility of an engagement partner is to take responsibility for the overall quality on each audit engagement. The actions of the engagement

partner and appropriate messages to the other members of the engagement team, in taking responsibility for the overall quality on each audit engagement, emphasise

- (a) The importance to audit quality of: -
- (i) Performing work that complies with professional standards and regulatory and legal requirements;
 - (ii) Complying with the firm's quality control policies and procedures as applicable;
 - (iii) Issuing auditor's reports that are appropriate in the circumstances; and
 - (iv) The engagement team's ability to raise concerns without fear of reprisals.
- (b) The fact that quality is essential in performing audit engagements.

6B. Relevant ethical requirements

The responsibilities of an engagement partner in relation to ethical requirements in an audit engagement are as under: -

- Identifying a threat to independence regarding the audit engagement that safeguards may not be able to eliminate or reduce to an acceptable level.
- Reporting by engagement partner to the relevant persons within the firm to determine appropriate action, which may include eliminating the activity or interest that creates the threat, or withdrawing from the audit engagement, where withdrawal is legally permitted.

6C. Acceptance and Continuance of Client Relationships and audit Engagements

Information like integrity of principal owners, competence of engagement team and consideration of necessary capabilities including time and resources, compliance with relevant ethical requirements and significant matters arisen during current or previous audit engagement and their implications assist the engagement partner in determining whether the conclusions reached regarding the acceptance and continuance of client relationships and audit engagements are appropriate.

6D. Assignment of engagement teams

It should be ensured by engagement partner that the engagement team and any auditor's experts who are not part of the engagement team, collectively have the appropriate competence and capabilities to perform the engagement in accordance with professional standards and regulatory and legal requirements.

6E. Engagement Performance

Engagement partner has the responsibility for direction, supervision and performance of audit engagement in accordance with professional standards and regulatory and legal requirements.

Engagement partner is also responsible for ensuring undertaking appropriate consultation on difficult or contentious matters by engagement team not only within the team but also with others at appropriate level within or outside the firm.

For audits of financial statements of listed entities, and those other audit engagements, if any, for which the firm has determined that an engagement quality control review is required, the engagement partner shall:

- (a) Determine that an engagement quality control reviewer has been appointed.
- (b) Discuss significant matters arising during the audit engagement, including those identified during the engagement quality control review, with the engagement quality control reviewer.
- (c) Not date the auditor's report until the completion of the engagement quality control review.

If differences of opinion arise within the engagement team, with those consulted or, where applicable, between the engagement partner and the engagement quality control reviewer, the engagement team shall follow the firm's policies and procedures for dealing with and resolving differences of opinion.

6F. Monitoring

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

The engagement partner shall consider the results of the firm's monitoring process as evidenced in the latest information circulated by the firm and, if applicable, other network firms and whether deficiencies noted in that information may affect the audit engagement.

The engagement partner should document following matters pertaining to an audit engagement:

- (a) Issues identified with respect to compliance with relevant ethical requirements and how they were resolved.

- (b) Conclusions on compliance with independence requirements that apply to the audit engagement, and any relevant discussions with the firm that support these conclusions.
- (c) Conclusions reached regarding the acceptance and continuance of client relationships and audit engagements.
- (d) The nature and scope of, and conclusions resulting from, consultations undertaken during the course of the audit engagement.