Guidance on Non-Compliances Observed by Quality Review Board During Quality Reviews (Volume 3)

Observations related to Engagement and Quality Control Standards and Internal Financial Controls

The Institute of Chartered Accountants of India

(Set up by an Act of Parliament)

New Delhi

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Foreword

The Quality Review Board (QRB) was constituted in June 2007 under the provisions of the Chartered Accountants Act, 1949. QRB conducts quality reviews of audit services of audit firms which are covered under its domain. These quality reviews bring out instances of various non - compliances of Standards on Quality Control (SQC), Standards on Auditing (SAs), audit reports, Companies (Auditor's Report) Order (CARO), Accounting Standards (AS), Indian Accounting Standards (Ind AS), Schedule VI of Companies Act, 1956/ Schedule III of Companies Act, 2013 etc.

Based on observations noticed during these quality reviews, QRB issues necessary advisories to concerned audit firms. On the matter, QRB requested the Council of ICAI to bring out necessary guidance for the members of ICAI based on common non-compliances observed. I am happy to note that the Auditing and Assurance Standards Board ('Board' or 'AASB') has undertaken the project and earlier, in May 2024 released Volume 1 of "Guidance on Non - Compliances Observed by Quality Review Board During Quality Reviews" and in July 2024, Volume 2 of "Guidance on Non - Compliances Observed by Quality Review Board During Quality Reviews". Now, it is heartening to learn that the Board is bringing out Volume 3 of "Guidance on Non-Compliances Observed by Quality Review Board During Quality Reviews".

This publication is a compilation of 46 common non-compliances observed by QRB while conducting quality reviews and covering 151 cases (including NIL cases) received from QRB. The publication also contains guidance suggested by AASB for the members on these common non-compliances. The purpose of this publication is to provide awareness to the members about common non - compliances observed by QRB and help them in performing quality audits.

I compliment CA. (Dr.) Sanjeev Kumar Singhal, Chairman, CA. Vishal Doshi, Vice-Chairman and all other members of the Auditing and Assurance Standards Board for their efforts in developing and bringing out this publication for the benefit of the members at large.

I am confident that the members and other interested readers would find this publication immensely useful

3rd January, 2025 **CA. Ranjeet Kumar Agarwal**
New Delhi President, ICAI

Preface

Review of the quality of audit services performed by audit firms is an important mechanism to improve audit quality. In this regard, the role performed by the Quality Review Board (QRB) over the years is significant. The quality reviews conducted by QRB bring out instances of various non-compliances regarding (a) auditing requirements e.g. Standards on Quality Control, Standards on Auditing, audit reports, CARO, and (b) accounting requirements e.g. Accounting Standards, Indian Accounting Standards, Schedule VI of Companies Act, 1956/ Schedule III of Companies Act, 2013. Based on observations noticed during these quality reviews, QRB issues necessary advisories to concerned audit firms. QRB requested the Council of ICAI to bring out necessary guidance for the members of ICAI. The task was entrusted to the Auditing and Assurance Standards Board (AASB) of ICAI.

AASB decided to engage various experts to prepare suggested guidance for the members on the matter. AASB also decided to constitute a consolidating group to review guidance prepared by these experts. It was also decided by AASB to bring out the guidance in separate volumes since this task is quite voluminous. In May 2024, AASB released Volume 1 of the publication “Guidance on Non-Compliances Observed by Quality Review Board During Quality Reviews” and in July 2024, AASB released Volume 2 of the publication “Guidance on Non-Compliances Observed by Quality Review Board During Quality Reviews”.

It gives us immense pleasure to place in hands of the members, this Volume 3 of the publication, “Guidance on Non-Compliances Observed by Quality Review Board During Quality Reviews” brought out by AASB. The publication is a compilation of some common non-compliances of auditing requirements observed by QRB while conducting quality reviews. The publication also contains suggested guidance by AASB for the members on these common non-compliances. The publication contains the observations related to Engagement and Quality Control Standards and internal financial controls.

We would like to thank CA. Ranjeet Kumar Agarwal, President, ICAI and CA. Charanjot Singh Nanda, Vice-President, ICAI for their guidance and support in various endeavours of the Board.

We express our sincere thanks to Ms. Shefali Shah, IRS (Retd.), Chairperson, Quality Review Board and all the members and special invitees of the Quality Review Board for providing us the various observations noted by the Quality Review Board during quality reviews, which form the basis of this publication.

We are grateful to all experts *viz.* CA. Himanshu Agarwal, CA. Nitesh Jain, CA. Nilanjan Paul, CA. Umesh Chand Goyal and CA. Vikram Agarwal for preparing the basic draft of guidance which has been included in this publication. We are also grateful to all members of the consolidating group *viz.* CA. Amit Gupta, CA. Ashish Gupta, CA. Gulshan Grover, CA. Kapil Kedar, CA. Rajeev Saxena, CA. Sandeep Sharma and CA. Viren Shah for their contribution in reviewing and finalizing the guidance.

We wish to place on record high appreciation of all Council members and all Board members for their valuable contribution in finalising the publication. We appreciate the technical and administrative contribution/support provided by CA. Megha Saxena, Secretary, AASB, CA. Rajnish Aggarwal, Assistant Director, CA. Vikas Kumar, CA Professional, CA. Anubhuti Mathur, CA Professional, Ms. Anitha P., Private Secretary (SU) and other staff of AASB in finalising the publication.

We are confident that the publication would be well received by the members and other interested readers. We are of the firm belief that the publication would enhance the knowledge of auditors and would help them in performing quality audits.

CA. Vishal Doshi	**CA. (Dr.) Sanjeev Kumar Singhal**
Vice Chairman, AASB	Chairman, AASB

Introduction

About the Quality Review Board

With a view to improving the quality of audit services in India, the Ministry of Corporate Affairs, Government of India has established the Quality Review Board ("QRB") under Section 28A of the Chartered Accountants Act, 1949. Section 28B of the Chartered Accountants Act, 1949 authorises the QRB to perform the following functions:

(a) to make recommendations to the Council with regard to the quality of services provided by the members of the Institute;

(b) to review the quality of services provided by the members of the Institute including audit services;

(c) to guide the members of the Institute to improve the quality of services and adherence to the various statutory and other regulatory requirements; and

(d) to forward cases of non-compliance with various statutory and regulatory requirements by the members of the Institute or firms, noticed by it during the course of its reviews, to the Disciplinary Directorate for its examination.

QRB conducts quality reviews of audit services of audit firms which are covered under its domain. These quality reviews involve assessment of the work of statutory auditors so that QRB is able to assess (a) quality of audit and reporting by the statutory auditors; and (b) quality control framework adopted by the audit firms in conducting audit.

These quality reviews bring out instances of various non-compliances regarding Standards on Quality Control, Standards on Auditing, audit reports, CARO, Accounting Standards, Indian Accounting Standards, Schedule VI of Companies Act, 1956/ Schedule III of Companies Act, 2013. Based on observations noticed during these quality reviews, QRB issues necessary advisories to concerned audit firms. QRB also refers these instances to the Council of the Institute of Chartered Accountants of India (ICAI). On the matter, QRB requested the Council of ICAI to bring out necessary guidance for the members of ICAI. The task of developing the guidance was entrusted to the Auditing and Assurance Standards Board (AASB) of ICAI.

About the Publication

In May 2024, AASB released Volume 1 of the publication "Guidance on Non-Compliances Observed by Quality Review Board During Quality Reviews". In July 2024, AASB released Volume 2 of the publication "Guidance on Non-Compliances Observed by Quality Review Board During Quality Reviews". AASB has brought out this Volume 3 of the publication, "Guidance on Non-Compliances Observed by Quality Review Board During Quality Reviews". The publication is a compilation of some common non-compliances regarding Standards on Quality Control, Standards on Auditing, internal financial controls observed by QRB while conducting quality reviews. The publication also contains suggested guidance developed by AASB on these common non-compliances. The number of observations is given in Table below.

S. No.	Topic	No. of Observations
1	SQC 1	1
2	SA 200	1
3	SA 220	1
4	SA 230	2
5	SA 240	7
6	SA 315	5
7	SA 330	4
8	SA 450	2
9	SA 500	1
10	SA 501	2
11	SA 510	1
12	SA 530	1
13	SA 540	1
14	SA 550	2
15	SA 560	1
16	SA 600	1
17	SA 610 (Revised)	2
18	SA 700 (Revised)	3
19	SA 705 (Revised)	1
20	SA 706 (Revised)	2
21	SA 710	2
22	SA 720 (Revised)	1
23	Internal Financial Controls	2
Total		**46**

Readers may note that some observations given in this publication are based on the past provisions of law and the pre-revised Standards on Auditing. In case of these observations, guidance has been given based on the current provisions of law and currently applicable Standards on Auditing. Further, these observations should be read in the light of any subsequent amendments/developments.

Readers may also note that this publication neither supersedes nor it is a replacement of any Standards, Guidance Notes, Pronouncements issued by ICAI. Readers are advised to read or use this publication in conjunction with the relevant Standards, Guidance Notes, Pronouncements issued by ICAI.

Contents

Chapter 1

Observations related to SQC 1, Quality Control for Firms that Performs Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements

Observation 1:

Not documenting the policies and procedures for communicating to relevant engagement partner and other appropriate personal, deficiencies noted as a result of the monitoring process and recommendations for appropriate remedial action.

What is the issue?	AASB Suggested Guidance	Technical Literature
Why it is necessary for firm to communicate the results of the monitoring of its quality control system to engagement partners and other appropriate individuals within the firm?	**Implementation Guide to SQC 1** **<u>Element 6: Monitoring</u>** **Policy 3:** The firm communicates (a) deficiencies noted as a result of the monitoring process and recommendations for appropriate remedial action to relevant engagement partners and other appropriate personnel and (b)the results of the monitoring of its Quality Control system process to relevant Firm personnel at least annually. **Para 6.4** The firm implements this policy through the following procedures: • Discussing the engagement related observations of the	**Para 96 of SQC 1:** Where the results of the monitoring procedures indicate that a report may be inappropriate or that procedures were omitted during the performance of the engagement, the firm should determine what further action is appropriate to comply with relevant professional standards and regulatory and legal requirements. It should also consider obtaining legal advice. **Para 97 of SQC 1:** At least annually, the firm should communicate the results of the monitoring of its quality control system to engagement partners and other appropriate individuals within the firm, including the firm's chief executive officer or, if appropriate, its managing partner(s). Such communication should enable the firm and these individuals to take prompt and appropriate action where necessary in accordance with their defined roles and responsibilities. Information communicated should include the following: (a) A description of the monitoring procedures performed.

	inspection with the engagement partner and seeking his concurrence therewith. • Preparing a summary report that evaluates the overall results of the monitoring and sets forth any recommended changes that should be made to the Firm's policies and procedures. • Reviewing the recommended corrective actions and reaching final conclusions as to the actions to be taken. • Communicating to all professional personnel the deficiencies noted and the related changes in Quality Control procedures. • Following up on planned corrective actions to determine whether those actions were taken and whether they achieved the intended objective(s).	(b) The conclusions drawn from the monitoring procedures. (c) Where relevant, a description of systemic, repetitive or other significant deficiencies and of the actions taken to resolve or amend those deficiencies. **Para 98 of SQC 1:** The reporting of identified deficiencies to individuals other than the relevant engagement partners ordinarily does not include an identification of the specific engagements concerned, unless such identification is necessary for the proper discharge of the responsibilities of the individuals other than the engagement partners. **Para 99 of SQC 1:** Some firms operate as part of a network and, for consistency, may implement some or all of their monitoring procedures on a network basis. Where firms within a network operate under common monitoring policies and procedures designed to comply with this SQC, and these firms place reliance on such a monitoring system: (a) At least annually, the network communicates the overall scope, extent and results of the monitoring process to appropriate individuals within the network firms; (b) The network communicates promptly any identified deficiencies in the quality control system to appropriate individuals within the relevant network firm or firms so that the necessary action can be taken; and (c) Engagement partners in the network firms are entitled to rely on the results of the monitoring process implemented within the network, unless the firms or the network

		advises otherwise. **Para 100 of SQC 1:** Appropriate documentation relating to monitoring: (a) Sets out monitoring procedures, including the procedure for selecting completed engagements to be inspected; (b) Records the evaluation of: (i) Adherence to professional standards and regulatory and legal requirements; (ii) Whether the quality control system has been appropriately designed and effectively implemented; and (iii) Whether the firm's quality control policies and procedures have been appropriately applied, so that reports that are issued by the firm or engagement partners are appropriate in the circumstances; and (c) Identifies the deficiencies noted, evaluates their effect, and sets out the basis for determining whether and what further action is necessary.

Chapter 2

Observations related to SA 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing

Observation 1:

It was observed that there have been deficiencies in the compliance and documentation of the Standards on Auditing.

What is the issue?	AASB Suggested Guidance	Technical Literature
What are the requirements of SA 200 regarding conduct of an audit in accordance with SAs?	As per SA 200, the SAs, taken together, provide the standards for the auditor's work in fulfilling the overall objectives of the auditor. The SAs deal with the general responsibilities of the auditor, as well as the auditor's further considerations relevant to the application of those responsibilities to specific topics. In using the objectives, the auditor is required to have regard to the interrelationships among the SAs. This is because, as indicated in SA 200, the SAs deal in some cases with general responsibilities and in others with the application of those responsibilities to specific topics. For example, this SA requires the auditor to adopt an attitude of professional skepticism; this is necessary in all aspects of planning and performing an audit but is not repeated as a requirement of each SA. At a more detailed level, SA 315 and SA 330 contain, among other things, objectives and requirements that deal with the auditor's responsibilities to identify and assess the risks of material misstatement and to	**Para 18 of SA 200:** The auditor shall comply with all SAs relevant to the audit. An SA is relevant to the audit when the SA is in effect and the circumstances addressed by the SA exist. (Ref: Para. A54-A57) **Para 19 of SA 200:** The auditor shall have an understanding of the entire text of an SA, including its application and other explanatory material, to understand its objectives and to apply its requirements properly. (Ref: Para. A58-A66) **Para 20 of SA 200:** The auditor shall not represent compliance with SAs in the auditor's report unless the auditor has complied with the requirements of this SA and all other SAs relevant to the audit. **Para 21 of SA 200:** To achieve the overall objectives of the auditor, the auditor shall use the objectives stated in relevant SAs in planning and performing the audit, having regard to the interrelationships among the SAs, to: (Ref: Para. A67-A69) (a) Determine whether any audit procedures in addition to those required by the SAs are necessary in pursuance of the objectives stated

	design and perform further audit procedures to respond to those assessed risks, respectively; these objectives and requirements apply throughout the audit. An SA dealing with specific aspects of the audit (for example, SA 540) may expand on how the objectives and requirements of such SAs as SA 315 and SA 330 are to be applied in relation to the subject of the SA but does not repeat them. Thus, in achieving the objective stated in SA 540, the auditor has regard to the objectives and requirements of other relevant SAs. SA 230 establishes documentation requirements in those exceptional circumstances where the auditor departs from a relevant requirement. The SAs do not call for compliance with a requirement that is not relevant in the circumstances of the audit. Audit documentation that meets the requirements of SA 230 and the specific documentation requirements of other relevant SAs provides evidence of the auditor's basis for a conclusion about the achievement of the overall objectives of the auditor. While it is unnecessary for the auditor to document separately (as in a checklist, for example) that individual objectives have been achieved, the documentation of a failure to achieve an objective assists the auditor's evaluation of whether such a failure has prevented the auditor from achieving the overall objectives of the auditor.	in the SAs; and (Ref: Para. A70) (b) Evaluate whether sufficient appropriate audit evidence has been obtained. (Ref: Para. A71) **Para 22 of SA 200:** Subject to paragraph 23, the auditor shall comply with each requirement of an SA unless, in the circumstances of the audit: (a) The entire SA is not relevant; or (b) The requirement is not relevant because it is conditional and the condition does not exist. (Ref: Para. A72-A73) **Para 23 of SA 200:** In exceptional circumstances, the auditor may judge it necessary to depart from a relevant requirement in an SA. In such circumstances, the auditor shall perform alternative audit procedures to achieve the aim of that requirement. The need for the auditor to depart from a relevant requirement is expected to arise only where the requirement is for a specific procedure to be performed and, in the specific circumstances of the audit, that procedure would be ineffective in achieving the aim of the requirement. (Ref: Para. A74) **Para 24 of SA 200:** If an objective in a relevant SA cannot be achieved, the auditor shall evaluate whether this prevents the auditor from achieving the overall objectives of the auditor and thereby requires the auditor, in accordance with the SAs, to modify the auditor's opinion or withdraw from the engagement. Failure to achieve an objective represents a significant matter requiring documentation in accordance with SA 230. (Ref: Para. A75-A76)

Chapter 3

Observations related to SA 220, Quality Control for an Audit of Financial Statements

Observation 1:

It was noted that distribution of income and expense and equity and owner equity testing are performed by performing negative testing in SAP and related screenshots were filed in the documentation, as there is no IT Specialist involved. The company has SAP in place, however, IT testing performed by direct testing by auditor in SAP which are thereby substantive procedures rather than control testing procedures. There is DMS (Dealer Management System) Portal, based on which the dealers place their orders. These orders are interfaced with SAP for creation of sales orders. Similarly, there is Oracle for warranty claims (DMS warranty claim system). However, there is no testing performed for correctness and completeness of integration of DMS and Oracle with SAP.

Involvement of IT Specialist in respect of testing procedures concerning General IT controls, automated controls and information produced from such IT systems need to be factored right from the audit planning stage.

What is the issue?	AASB Suggested Guidance	Technical Literature
Whether professional with specialized knowledge of auditing IT systems is an engagement team member?	The ultimate responsibility for the audit rests with the engagement partner. As per SA 220, an audit firm should establish an engagement team that has the appropriate balance of skills, experience, competence and capacity necessary to perform the audit. To address the specific needs of audit, an audit firm should include professionals on the engagement team who not only have accounting or auditing expertise, but also specialized knowledge, to perform audit procedures. (e.g., A professional with specialized knowledge of auditing IT systems is included on the engagement team to assist with the audit procedures that address the entity's use of IT when the IT environment is complex.)	**Para 14 of SA 220:** The engagement partner shall be satisfied 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: (a) Perform the audit engagement in accordance with professional standards and regulatory and legal requirements; and (b) Enable an auditor's report that is appropriate in the circumstances to be issued. (Ref: Para. A10-A12)

Is the engagement partner required to review the work of professional with a specialised knowledge in accounting/ auditing?	The work of professionals with specialized knowledge is directed, supervised and reviewed by the engagement partner as per requirements set out in SA 220 and SA 300. The engagement partner should maintain a questioning mindset, apply his knowledge, experience and professional skepticism, and evaluate whether sufficient appropriate audit evidence has been obtained. As per SA 220, such procedures would include evaluation of the adequacy, relevance and reasonableness of work of audit professional with specialized knowledge (e.g., IT auditors), their findings or conclusions and their consistency with other audit evidence.	**Para 15 of SA 220:** The engagement partner shall take responsibility for: (a) The direction, supervision and performance of the audit engagement in compliance with professional standards and regulatory and legal requirements; and (Ref: Para. A13-A15, A20) (b) The auditor's report being appropriate in the circumstances. **Para 16 of SA 220:** The engagement partner shall take responsibility for reviews being performed in accordance with the firm's review policies and procedures. (Ref: Para. A16-A17, A20) **Para 17 of SA 220:** On or before the date of the auditor's report, the engagement partner shall, through a review of the audit documentation and discussion with the engagement team, be satisfied that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued. (Ref: Para. A18-A20) **Para 10 of SA 300:** The auditor shall plan the nature, timing and extent of direction and supervision of engagement team members and the review of their work. (Ref: Para. A15-A16)

Chapter 4

Observations related to SA 230, Audit Documentation

Observation 1:

The working papers were collectively maintained in electronic files and in manual files. There was no cross referencing between the work papers in electronic files and the manual file to be viewed as one combined set of audit file. Cross referencing of work papers in manual file and the electronic file is recommended to evidence a single set of audit work papers.

What is the issue?	AASB Suggested Guidance	Technical Literature
Can a particular engagement documentation include cross reference of relevant information filed in another section of an audit file?	Engagement documentation encompasses electronic as well as manual records. To avoid unnecessary repetition and to demonstrate cohesion of the audit work as a whole, an audit firm, as provided under SA 230, may find it appropriate to cross refer certain information with corresponding information filed in another section of an audit file.	**Para A11 of SA 230:** The auditor may consider it helpful to prepare and retain as part of the audit documentation a summary (sometimes known as a completion memorandum) that describes the significant matters identified during the audit and how they were addressed, or that includes cross-references to other relevant supporting audit documentation that provides such information. Such a summary may facilitate effective and efficient reviews and inspections of the audit documentation, particularly for large and complex audits. Further, the preparation of such a summary may assist the auditor's consideration of the significant matters. It may also help the auditor to consider whether, in light of the audit procedures performed and conclusions reached, there is any individual relevant SA objective that the auditor cannot achieve that would prevent the auditor from achieving the overall objectives of the auditor. **Para A17 of SA 230:** When preparing audit documentation, the auditor of a smaller entity may also find it helpful and efficient to record various aspects of the audit together in a

		single document, with cross references to supporting working papers as appropriate. Examples of matters that may be documented together in the audit of a smaller entity include the understanding of the entity and its internal control, the overall audit strategy and audit plan, materiality, determined in accordance with SA 320, assessed risks, significant matters noted during the audit, and conclusions reached.

Observation 2:

It was noted that the audit file did not contain any documentation for board minutes or summary of board meetings that have happened during the period under audit. Further, the file also did not contain summary of minutes of any other meeting of other committees. The matters in such documents are critical in nature and require adequate consideration which presently has not been evidenced in the file. Engagement team needs to ensure that adequate documentation is maintained in the audit file including conclusions, on such critical documents.

What is the issue?	AASB Suggested Guidance	Technical Literature
Is it necessary for an audit firm to obtain a copy of minutes of meetings of governing body/ owners?	Obtaining and reviewing the minutes of meetings of the governing body/ owners is a standard part of the audit process to ensure a comprehensive understanding of the organization's governance and operations. These minutes provide important insights into the organization's decision-making processes, governance practices, and significant events or decisions that could impact the financial statements or the audit process. Various Standards on Auditing generally expect an audit firm to obtain the minutes of the meeting e.g., minutes of meeting of governing body/owners.	**Para 8 of SA 230:** The auditor shall prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand: (Ref: Para. A2-A5, A16-A17) (a) The nature, timing, and extent of the audit procedures performed to comply with the SAs and applicable legal and regulatory requirements; (Ref: Para. A6-A7) (b) The results of the audit procedures performed, and the audit evidence obtained; and (c) Significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions. (Ref: Para. A8- A11) **Para 5 of SA 315:** The auditor shall perform risk assessment procedures to provide a basis for the identification and assessment of risks of material misstatement at the financial statement and assertion levels. Risk assessment procedures by themselves, however, do not provide sufficient appropriate audit evidence on which to base the audit

		opinion. (Ref: Para. A1-A5) **Para 6 of SA 315:** The risk assessment procedures shall include the following: (a) Inquiries of management, of appropriate individuals within the internal audit function (if the function exists), and of others within the entity who in the auditor's judgment may have information that is likely to assist in identifying risks of material misstatement due to fraud or error. (Ref: Para. A6-A12) (b) Analytical procedures. (Ref: Para. A13-A16) (c) Observation and inspection. (Ref: Para. A17) **Para A17 of SA 315:** Observation and inspection may support inquiries of management and others, and may also provide information about the entity and its environment. Examples of such audit procedures include observation or inspection of the following: • The entity's operations. • Documents (such as business plans and strategies), records, and internal control manuals. • Reports prepared by management (such as quarterly management reports and interim financial statements) and those charged with governance (such as minutes of board of directors' meetings). • The entity's premises and plant facilities. **Para 6 of SA 500:** The auditor shall design and perform audit procedures that are appropriate in the circumstances for the purpose of

		obtaining sufficient appropriate audit evidence. (Ref: Para. A1-A25) **Para A8 of SA 500:** More assurance is ordinarily obtained from consistent audit evidence obtained from different sources or of a different nature than from items of audit evidence considered individually. For example, corroborating information obtained from a source independent of the entity may increase the assurance the auditor obtains from audit evidence that is generated internally, such as evidence existing within the accounting records, minutes of meetings, or a management representation. **Para 15 of SA 550:** During the audit, the auditor shall remain alert, when inspecting records or documents, for arrangements or other information that may indicate the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor. (Ref: Para. A22-A23) In particular, the auditor shall inspect the following for indications of the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor: (a) Bank, legal and third-party confirmations obtained as part of the auditor's procedures; (b) Minutes of meetings of shareholders and of those charged with governance; and (c) Such other records or documents as the auditor considers necessary in the circumstances of the entity. **Para 7 of SA 560:** The auditor shall perform the procedures required by paragraph 6 so that they

		cover the period from the date of the financial statements to the date of the auditor's report, or as near as practicable thereto. The auditor shall take into account the auditor's risk assessment in determining the nature and extent of such audit procedures, which shall include the following: (Ref: Para. A7-A8) (a) Obtaining an understanding of any procedures management has established to ensure that subsequent events are identified. (b) Inquiring of management and, where appropriate, those charged with governance as to whether any subsequent events have occurred which might affect the financial statements. (Ref: Para. A9) (c) Reading minutes, if any, of the meetings, of the entity's owners, management and those charged with governance, that have been held after the date of the financial statements and inquiring about matters discussed at any such meetings for which minutes are not yet available. (Ref: Para. A10) (d) Reading the entity's latest subsequent interim financial statements, if any. **Extract from Para A16 of SA 570 (Revised):** Audit procedures that are relevant to the requirement in paragraph 16 may include the following: • Reading minutes of the meetings of shareholders, those charged with governance and relevant committees for reference to financing difficulties.

Chapter 5

Observations related to SA 240, The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements

Observation 1:

There has been no documentation showing the performance of audit procedures to detect fraud as required by SA 240. Also, it has been seen that the management representation obtained does not contain confirmations from the management or (those charged with governance) stating that they have disclosed to the auditor the results of management's assessment of the risk that the financial statements may be materially misstated as a result of fraud; and stating whether they have disclosed to the auditor their knowledge of fraud, suspected fraud, or any allegations of fraud or suspected fraud, affecting the entity.

What is the issue?	AASB Suggested Guidance	Technical Literature
What are the requirements of SA 240 w.r.t. documentation and obtaining management representation?	As per SA 240, due to the nature of fraud and the difficulties encountered by auditors in detecting material misstatements in the financial statements resulting from fraud, it is important that the auditor obtain a written representation from management and, where appropriate, those charged with governance confirming that they have disclosed to the auditor: (a) The results of management's assessment of the risk that the financial statements may be materially misstated as a result of fraud; and (b) Their knowledge of actual, suspected or alleged fraud affecting the entity. SA 240 prescribes detailed documentation requirements w.r.t. identifying and assessing risks of material	**Para 5 of SA 240:** An auditor conducting an audit in accordance with SAs is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error. Owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with the SAs. **Para 8 of SA 240:** When obtaining reasonable assurance, the auditor is responsible for maintaining professional skepticism throughout the audit, considering the potential for management override of controls and recognizing the fact that audit procedures that are effective for detecting error may not be effective in detecting fraud. The requirements in this SA are designed to assist the auditor in identifying and assessing the risks of material misstatement due to fraud and in designing procedures to detect such misstatement.

	misstatements due to fraud and auditor's responses to assessed risks of material misstatements due to fraud.	**Para 12 of SA 240:** In accordance with SA 200, the auditor shall maintain professional skepticism throughout the audit, recognizing the possibility that a material misstatement due to fraud could exist, notwithstanding the auditor's past experience of the honesty and integrity of the entity's management and those charged with governance. (Ref: Para. A7- A8) **Para 17 of SA 240:** The auditor shall make inquiries of management regarding: (a) Management's assessment of the risk that the financial statements may be materially misstated due to fraud, including the nature, extent and frequency of such assessments; (Ref: Para. A12-A13) (b) Management's process for identifying and responding to the risks of fraud in the entity, including any specific risks of fraud that management has identified or that have been brought to its attention, or classes of transactions, account balances, or disclosures for which a risk of fraud is likely to exist; (Ref: Para. A14) (c) Management's communication, if any, to those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity; and (d) Management's communication, if any, to employees regarding its views on business practices and ethical behavior. **Para 18 of SA 240:** The auditor shall make inquiries of management, and others within the entity as appropriate, to determine whether they have knowledge of any actual, suspected or alleged fraud

		affecting the entity. (Ref: Para. A15-A17) **Para 21 of SA 240:** The auditor shall make inquiries of those charged with governance to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity. These inquiries are made in part to corroborate the responses to the inquiries of management. **Para 24 of SA 240:** The auditor shall evaluate whether the information obtained from the other risk assessment procedures and related activities performed indicates that one or more fraud risk factors are present. While fraud risk factors may not necessarily indicate the existence of fraud, they have often been present in circumstances where frauds have occurred and therefore may indicate risks of material misstatement due to fraud. (Ref: Para. A23-A27) **Para 25 of SA 240:** In accordance with SA 315, the auditor shall identify and assess the risks of material misstatement due to fraud at the financial statement level, and at the assertion level for classes of transactions, account balances and disclosures. **Para 28 of SA 240:** In accordance with SA 330, the auditor shall determine overall responses to address the assessed risks of material misstatement due to fraud at the financial statement level.(Ref: Para. A33) **Para 30 of SA 240:** In accordance with SA 330, the auditor shall design and perform further audit procedures whose nature, timing and extent are responsive to the assessed

		risks of material misstatement due to fraud at the assertion level. (Ref: Para. A37-A40) **Para 39 of SA 240:** The auditor shall obtain written representations from management and, where applicable, those charged with governance that: (a) They acknowledge their responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud; (b) They have disclosed to the auditor the results of management's assessment of the risk that the financial statements may be materially misstated as a result of fraud; (c) They have disclosed to the auditor their knowledge of fraud or suspected fraud affecting the entity involving: (i) Management; (ii) Employees who have significant roles in internal control; or (iii) Others where the fraud could have a material effect on the financial statements; and (d) They have disclosed to the auditor their knowledge of any allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators or others. (Ref: Para. A57-A58) **Para 44 of SA 240:** The auditor's documentation of the understanding of the entity and its environment and the assessment of the risks of material misstatement required by SA 315 shall include:

		(a) The significant decisions reached during the discussion among the engagement team regarding the susceptibility of the entity's financial statements to material misstatement due to fraud; and (b) The identified and assessed risks of material misstatement due to fraud at the financial statement level and at the assertion level. **Para 45 of SA 240:** The auditor's documentation of the responses to the assessed risks of material misstatement required by SA 330 shall include: (a) The overall responses to the assessed risks of material misstatement due to fraud at the financial statement level and the nature, timing and extent of audit procedures, and the linkage of those procedures with the assessed risks of material misstatement due to fraud at the assertion level; and (b) The results of the audit procedures, including those designed to address the risk of management override of controls. **Para 46 of SA 240:** The auditor shall document communications about fraud made to management, those charged with governance, regulators and others.

Observation 2:

The firm did not document identification and assessment of risk of material misstatements due to fraud in the financial statements and did not document the relevant audit procedures in response to the assessed risk of material misstatement due to fraud at the assertion level.

What is the issue?	AASB Suggested Guidance	Technical Literature
What audit procedures are required to be performed for identifying and assessing the risks of material misstatements due to fraud?	**Implementation Guide to Risk-based Audit of Financial Statements** **Para 2.30:** Documentation will, normally, include: • Discussions among the audit team regarding the susceptibility of the entity's financial statements to material misstatement due to error or fraud and the significant decisions reached. • Key elements of the understanding of the entity obtained regarding: o Each of the aspects of the entity and its environment outlined above; o Each of the internal control components; o Sources of information from which the understanding was obtained; and o The risk assessment procedures performed. • The identified and assessed risks of material	**Para 25 of SA 240:** In accordance with SA 315, the auditor shall identify and assess the risks of material misstatement due to fraud at the financial statement level, and at the assertion level for classes of transactions, account balances and disclosures. **Para 26 of SA 240:** When identifying and assessing the risks of material misstatement due to fraud, the auditor shall, based on a presumption that there are risks of fraud in revenue recognition, evaluate which types of revenue, revenue transactions or assertions give rise to such risks. Paragraph 47 specifies the documentation required when the auditor concludes that the presumption is not applicable in the circumstances of the engagement and, accordingly, has not identified revenue recognition as a risk of material misstatement due to fraud. (Ref: Para. A28-A30) **Para 27 of SA 240:** The auditor shall treat those assessed risks of material misstatement due to fraud as significant risks and accordingly, to the extent not already done so, the auditor shall obtain an understanding of the entity's related controls,

	misstatement at the financial statement level and assertion level. • Significant risks identified and evaluation of related controls. **Para 2.31:** In the documentation, it is important to obtain, in writing, management's acceptance of responsibility for the design and implementation of internal control. Refer Appendix 4 and Appendix 5 to the Guide for a template for understanding the entity and information systems. **Extract from Para 2.83:** Because materiality amounts are based on the auditor's professional judgment, it is important that the factors and amounts involved in determining materiality at the various levels be properly documented. This would typically occur during the planning phase and then later in the audit should revisions be required. Documentation would address: • The users of the financial statements; • Determination of overall materiality relating to the financial statements as a whole; • Performance materiality indicating any specific considerations relating to particular classes of transactions, account balances or disclosures and any revisions made to performance materiality	including control activities, relevant to such risks. (Ref: Para. A31-A32) **Para 28 of SA 240:** In accordance with SA 330, the auditor shall determine overall responses to address the assessed risks of material misstatement due to fraud at the financial statement level. (Ref: Para. A33) **Para 30 of SA 240:** In accordance with SA 330, the auditor shall design and perform further audit procedures whose nature, timing and extent are responsive to the assessed risks of material misstatement due to fraud at the assertion level. (Ref: Para. A37-A40) **Para 31 of SA 240:** Management is in a unique position to perpetrate fraud because of management's ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Although the level of risk of management override of controls will vary from entity to entity, the risk is nevertheless present in all entities. Due to the unpredictable way in which such override could occur, it is a risk of material misstatement due to fraud and thus a significant risk. **Para 32 of SA 240:** Irrespective of the auditor's assessment of the risks of management override of controls, the auditor shall design and perform audit procedures to: (a) Test the appropriateness of journal entries recorded in the general ledger and other

	during the audit; and • Nature of revisions (if any) made to the overall or performance materiality amounts. **Para 2.130:** SA 300 states: “11. The auditor shall document: (a) The overall audit strategy; (b) The audit plan; and (c) Any significant changes made during the audit engagement to the overall audit strategy or the audit plan, and the reasons for such changes. (Ref: Para. A17-A20)” The overall audit strategy and detailed audit plan, including details of any significant changes made during the audit engagement, should be documented. **Extract from Para 2.131**: The form and extent of documentation will depend on such matters as the size and complexity of the entity, materiality, the extent of other documentation, and the circumstances of the specific audit engagement. It may take the form of a memorandum or a standard planning checklist.	adjustments made in the preparation of the financial statements. In designing and performing audit procedures for such tests, the auditor shall: (i) Make inquiries of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments; (ii) Select journal entries and other adjustments made at the end of a reporting period; and (iii) Consider the need to test journal entries and other adjustments throughout the period. (Ref: Para. A41-A44) (b) Review accounting estimates for biases and evaluate whether the circumstances producing the bias, if any, represent a risk of material misstatement due to fraud. In performing this review, the auditor shall: (i) Evaluate whether the judgments and decisions made by management in making the accounting estimates included in the financial statements, even if they are individually reasonable, indicate a possible bias on the part of the entity’s management that may represent a risk of material misstatement due to fraud. If so, the auditor shall re-evaluate the accounting estimates taken as a whole; and (ii) Perform a retrospective

		review of management judgments and assumptions related to significant accounting estimates reflected in the financial statements of the prior year. (Ref: Para. A45-A46) (c) For significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual given the auditor's understanding of the entity and its environment and other information obtained during the audit, the auditor shall evaluate whether the business rationale (or the lack thereof) of the transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets. (Ref: Para. A47) **Para 33 of SA 240:** The auditor shall determine whether, in order to respond to the identified risks of management override of controls, the auditor needs to perform other audit procedures in addition to those specifically referred to above (i.e., when there are specific additional risks of management override that are not covered as part of the procedures performed to address the requirements in paragraph 32). **Para 44 of SA 240:** The auditor's documentation of the understanding of the entity and its environment and the assessment of the risks of material misstatement required by SA 315 shall include: (a) The significant decisions reached during the discussion among the engagement team regarding the

		susceptibility of the entity's financial statements to material misstatement due to fraud; and (b) The identified and assessed risks of material misstatement due to fraud at the financial statement level and at the assertion level. **Para 45 of SA 240:** The auditor's documentation of the responses to the assessed risks of material misstatement required by SA 330 shall include: (a) The overall responses to the assessed risks of material misstatement due to fraud at the financial statement level and the nature, timing and extent of audit procedures, and the linkage of those procedures with the assessed risks of material misstatement due to fraud at the assertion level; and (b) The results of the audit procedures, including those designed to address the risk of management override of controls. **Para 46 of SA 240:** The auditor shall document communications about fraud made to management, those charged with governance, regulators and others.

Observation 3:

It was observed that the audit firm has not documented below mentioned procedures and documentation prescribed under relevant SAs:

- Minutes of engagement team discussions did not include discussion over identifying and performing procedures on fraud risk factors applicable to the entity.
- Documentation in respect of discussion with management in terms of enquiries over fraud risks factors and control implemented by the company to mitigate the same risk.
- In the overall audit strategy, consideration of fraud and identification of fraud risk factors was not documented. Also, test of control related to fraud risk were not specifically documented.

What is the issue?	AASB Suggested Guidance	Technical Literature
What is the importance of discussion among the engagement team about the risks of material misstatements due to fraud?	As per SA 240, the engagement team should discuss the potential for material misstatement due to fraud. This discussion is crucial for identifying and assessing the risks of material misstatement due to fraud and for determining the nature, timing, and extent of audit procedures necessary to address these risks. Here are some key points that the engagement team might discuss regarding fraud risk factors as per SA 240: • **Understanding the entity and Its environment:** The engagement team should discuss the entity's industry, regulatory environment, operations, and other factors that might make it susceptible to fraud. • **Management's assessment of fraud risk:** The engagement team should consider management's assessment of fraud risk and how they address it, including any known instances of fraud.	**Para 15 of SA 240:** SA 315 requires a discussion among the engagement team members and a determination by the engagement partner of matters which are to be communicated to those team members not involved in the discussion. This discussion shall place particular emphasis on how and where the entity's financial statements may be susceptible to material misstatement due to fraud, including how fraud might occur. The discussion shall occur notwithstanding the engagement team members' beliefs that management and those charged with governance are honest and have integrity. (Ref: Para. A10-A11).

	• **Fraud risk factors**: The engagement team should discuss fraud risk factors, which are events or conditions that indicate an incentive or pressure to commit fraud, an opportunity to do so, or an attitude or rationalization that justifies a fraudulent action. These factors are often categorized into three groups: o Management's characteristics and influence over the control environment. o Industry conditions that provide opportunities for fraud. o Operating characteristics and financial stability that may motivate fraud. • **Fraud triangle:** The discussion should include the elements of the fraud triangle: incentive/pressure, opportunity, and rationalization/attitude. Each element should be considered in the context of the entity being audited. • **Types of fraud:** The engagement team should discuss the potential for both fraudulent financial reporting and misappropriation of assets. Each type of fraud has different characteristics and may require different audit approaches. • **Past experience:** The engagement team should consider any past experience with the entity that might indicate areas where there is a higher risk of fraud. • **Analytical procedures:** The use of analytical procedures to identify unusual transactions or events that might indicate fraud should be discussed.	

	• **Internal controls:** The engagement team should discuss the adequacy of the entity's internal controls in preventing and detecting fraud, including any known weaknesses or deficiencies. • **Communication:** The importance of communication among the team members throughout the audit regarding any fraud risks or actual fraud identified should be emphasized. • **Professional skepticism**: The engagement team should discuss the need to maintain professional skepticism throughout the audit, recognizing the possibility that a material misstatement due to fraud could exist, notwithstanding past experience with the entity or beliefs about management's honesty and integrity. • **Responses to assessed risks:** Finally, the engagement team should discuss how to respond to the assessed risks of material misstatement due to fraud, including the design and implementation of appropriate audit procedures. This discussion is intended to ensure that all engagement team members are aware of the potential for fraud and are actively considering it throughout the audit process. It is a key part of the auditor's overall responsibility to obtain reasonable assurance that the financial statements as a whole are free from material misstatement, whether caused by fraud or error.	
Why auditor's discussion with management regarding	When discussing and making enquiries with management regarding fraud risk factors as per SA 240, the auditor should consider the following steps:	**Para 17 of SA 240**: The auditor shall make inquiries of management regarding:

enquiries over fraud and detection of fraud is important?	1. **Understanding the entity and its environment**: Before discussing fraud risks with management, the auditor should have a thorough understanding of the entity and its environment, including the entity's internal control system. 2. **Identifying and assessing risks**: The auditor should identify and assess the risks of material misstatement due to fraud at both the financial statement level and the assertion level. 3. **Enquiries of management**: The auditor should make enquiries of management, and others within the entity as appropriate, to determine their views on the risks of fraud and how they are addressed. This includes: o Enquiring about management's process for identifying and responding to the risks of fraud in the entity. o Discussing with management whether they have knowledge of any actual, suspected, or alleged fraud affecting the entity. o Enquiring about management's assessment of the risk that the financial statements may be materially misstated due to fraud, including any specific fraud risks the entity is facing. 4. **Consideration of fraud risk factors**: The auditor should consider whether any of the information obtained indicates the existence of one or more fraud risk factors. Fraud risk factors include, but are not limited to: o Incentives/pressures that might lead individuals to commit fraud. o Opportunities for fraud to be perpetrated (such as weak	(a) Management's assessment of the risk that the financial statements may be materially misstated due to fraud, including the nature, extent and frequency of such assessments; (Ref: Para. A12-A13) (b) Management's process for identifying and responding to the risks of fraud in the entity, including any specific risks of fraud that management has identified or that have been brought to its attention, or classes of transactions, account balances, or disclosures for which a risk of fraud is likely to exist; (Ref: Para. A14) (c) Management's communication, if any, to those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity; and (d) Management's communication, if any, to employees regarding its views on business practices and ethical behavior. **Para 18 of SA 240:** The auditor shall make inquiries of management, and others within the entity as appropriate, to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity. (Ref: Para. A15-A17) **Para 19 of SA 240:** For those entities that have an internal audit function, the auditor shall make inquiries of internal audit to determine whether it has

	internal controls). o Attitudes/rationalizations that could allow an individual to commit fraud. 5. **Communication with those charged with governance**: The auditor should communicate with those charged with governance regarding the overall scope and timing of the audit, including an explanation of how the auditor plans to address the risk of fraud in the audit. 6. **Documentation**: The auditor should document the discussion with management and others, the procedures performed to identify and assess the risk of material misstatement due to fraud, the results of those procedures, and the conclusions reached. 7. **Ongoing assessment**: Throughout the audit, the auditor should maintain an attitude of professional skepticism, considering the potential for management override of controls and reassessing fraud risks as new information comes to light. 8. **Responding to the risks of material misstatement due to fraud**: The auditor should design and implement appropriate responses to the assessed risks of material misstatement due to fraud. This may involve modifying the nature, timing, and extent of audit procedures.	knowledge of any actual, suspected or alleged fraud affecting the entity, and to obtain its views about the risks of fraud. (Ref: Para. A18) **Para 20 of SA 240:** Unless all of those charged with governance are involved in managing the entity, the auditor shall obtain an understanding of how those charged with governance exercise oversight of management's processes for identifying and responding to the risks of fraud in the entity and the internal control that management has established to mitigate these risks. (Ref: Para. A19-A21) **Para 21 of SA 240:** The auditor shall make inquiries of those charged with governance to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity. These inquiries are made in part to corroborate the responses to the inquiries of management.
What is the requirement for overall audit strategy w.r.t. consideration and identification of fraud risk	As per SA 240, the overall audit strategy with regard to consideration and identification of fraud risk factors and the design of procedures to test controls related to fraud risk factors includes the following requirements:	**Para 25 of SA 240**: In accordance with SA 315, the auditor shall identify and assess the risks of material misstatement due to fraud at the financial statement level, and at the assertion level for classes of transactions, account balances

factors and designing of procedures to test controls related to fraud risk factors?	1. **Professional skepticism**: The auditor should maintain professional skepticism throughout the audit, recognizing the possibility that a material misstatement due to fraud could exist, regardless of past experience with the entity or management's integrity. 2. **Discussion among the engagement team**: The engagement team should discuss the susceptibility of the entity's financial statements to material misstatements due to fraud. This discussion should include an exchange of ideas or brainstorming session about how and where the entity's financial statements might be susceptible to fraud. 3. **Identification and assessment of fraud risks**: The auditor should identify and assess the risks of material misstatement due to fraud at the financial statement level and the assertion level. This involves considering various factors such as fraud risk factors, complex transactions, judgments in applying accounting policies, and unusual or unexpected relationships identified through analytical procedures. 4. **Responses to the assessed risks of fraud**: Based on the identified fraud risks, the auditor should design and implement appropriate responses. This includes designing audit procedures that are responsive to the assessed fraud risks and modifying the nature, timing, and extent of audit procedures as necessary. 5. **Evaluation of audit evidence**: The auditor should evaluate whether the results of audit procedures and	and disclosures. **Para 26 of SA 240**: When identifying and assessing the risks of material misstatement due to fraud, the auditor shall, based on a presumption that there are risks of fraud in revenue recognition, evaluate which types of revenue, revenue transactions or assertions give rise to such risks. Paragraph 47 specifies the documentation required when the auditor concludes that the presumption is not applicable in the circumstances of the engagement and, accordingly, has not identified revenue recognition as a risk of material misstatement due to fraud. (Ref: Para. A28-A30) **Para 27 of SA 240:** The auditor shall treat those assessed risks of material misstatement due to fraud as significant risks and accordingly, to the extent not already done so, the auditor shall obtain an understanding of the entity's related controls, including control activities, relevant to such risks. (Ref: Para. A31-A32) **Para 28 of SA 240:** In accordance with SA 330, the auditor shall determine overall responses to address the assessed risks of material misstatement due to fraud at the financial statement level. (Ref: Para. A33) **Para 29 of SA 240:** In determining overall responses to address the assessed risks of material misstatement due to fraud at the financial statement level, the auditor shall:

	other observations affect the assessment of fraud risks and whether the audit procedures need to be modified. 6. **Management representations**: The auditor should obtain written representations from management and, where appropriate, those charged with governance, that they acknowledge their responsibility for the design, implementation, and maintenance of internal control to prevent and detect fraud. 7. **Communication of fraud**: The auditor should communicate appropriately to management and those charged with governance about fraud risks and findings. If the auditor has identified a fraud or has obtained information that indicates that a fraud may exist, the auditor should communicate these matters on a timely basis. 8. **Documentation**: The auditor should document the discussion among the engagement team, the procedures performed to identify and assess the risks of material misstatement due to fraud, the results of those procedures, and the conclusions reached. 9. **Test of controls**: When the auditor has determined that an identified fraud risk could result in a material misstatement, the auditor should evaluate whether the entity's related controls are designed and implemented to prevent or detect and correct such fraud risks and should test the operating effectiveness of such controls when relevant. The auditor's consideration of fraud is a critical aspect of the audit process, and SA 240 provides a framework for auditors to follow in order to fulfil their	(a) Assign and supervise personnel taking account of the knowledge, skill and ability of the individuals to be given significant engagement responsibilities and the auditor's assessment of the risks of material misstatement due to fraud for the engagement; (Ref: Para. A34-A35) (b) Evaluate whether the selection and application of accounting policies by the entity, particularly those related to subjective measurements and complex transactions, may be indicative of fraudulent financial reporting resulting from management's effort to manage earnings; and (c) Incorporate an element of unpredictability in the selection of the nature, timing and extent of audit procedures. (Ref: Para. A36) **Para 30 of SA 240**: In accordance with SA 330, the auditor shall design and perform further audit procedures whose nature, timing and extent are responsive to the assessed risks of material misstatement due to fraud at the assertion level. (Ref: Para. A37-A40).

	responsibilities in this area. The standard emphasizes the importance of a thoughtful and thorough approach to assessing fraud risks and designing audit procedures to address those risks.	
What are the documentation requirements of SA 240?	Documentation requirements of SA 240 are given in para 44-47 of SA 240.	**Para 44 of SA 240**: The auditor's documentation of the understanding of the entity and its environment and the assessment of the risks of material misstatement required by SA 315 shall include: (a) The significant decisions reached during the discussion among the engagement team regarding the susceptibility of the entity's financial statements to material misstatement due to fraud; and (b) The identified and assessed risks of material misstatement due to fraud at the financial statement level and at the assertion level. **Para 45 of SA 240**: The auditor's documentation of the responses to the assessed risks of material misstatement required by SA 330 shall include: (a) The overall responses to the assessed risks of material misstatement due to fraud at the financial statement level and the nature, timing and extent of audit procedures, and the linkage of those procedures with the assessed risks of material misstatement due to fraud at the assertion level; and

		(b) The results of the audit procedures, including those designed to address the risk of management override of controls. **Para 46 of SA 240**: The auditor shall document communications about fraud made to management, those charged with governance, regulators and others. **Para 47 of SA 240**: When the auditor has concluded that the presumption that there is a risk of material misstatement due to fraud related to revenue recognition is not applicable in the circumstances of the engagement, the auditor shall document the reasons for that conclusion.

Observation 4:

It was observed that the firm has not identified management override of controls as a fraud risk and performed testing of journal entries as part of audit documentation.

What is the issue?	AASB Suggested Guidance	Technical Literature
What is rational of identification of management override of control as a fraud risk and testing of journal entries?	Identification of management override of controls as a fraud risk and testing of journal entries are critical components of an auditor's responsibility to detect fraud during an audit of financial statements. Here are key points of the process: **Identification of management override of controls as fraud risk** 1. **Understanding the environment**: The auditor should first understand the entity's business environment, including the internal control system and the areas where management has the ability to override these controls. 2. **Risk assessment**: During the planning phase, the auditor should assess the risk of fraud, including the risk of management override of controls. This involves considering factors such as incentives/pressures, opportunities, and attitudes/rationalizations that could lead to fraud. 3. **Identifying red flags**: The auditor should look for red flags that might indicate the possibility of management override of controls, such as significant changes in financial performance, complex or unusual transactions, and issues raised by whistleblowers.	**Para 31 of SA 240:** Management is in a unique position to perpetrate fraud because of management's ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Although the level of risk of management override of controls will vary from entity to entity, the risk is nevertheless present in all entities. Due to the unpredictable way in which such override could occur, it is a risk of material misstatement due to fraud and thus a significant risk. **Para 32 of SA 240:** Irrespective of the auditor's assessment of the risks of management override of controls, the auditor shall design and perform audit procedures to: (a) Test the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements. In designing and performing audit procedures for such tests, the auditor shall: (i) Make inquiries of

	4. **Communication**: Auditor should discuss among the engagement team the potential for management override of controls and how it may be manifested in the financial statements. **Testing of Journal Entries** Testing journal entries is a way to detect whether management override of controls has occurred. Here are key points of the process: 1. **Selection of journal entries**: Auditor should select journal entries and other adjustments for testing. The selection can be based on a risk-based approach, focusing on entries that are unusual or outside the normal course of business. 2. **Examine evidence**: Auditor should examine evidence supporting the selected journal entries to ensure they are valid, authorized, and properly recorded. 3. **Analytical procedures**: These procedures are used to identify journal entries that are inconsistent with the entity's financial history or deviate from predictable patterns. 4. **Interviews and inquiries**: Auditor may interview personnel involved in the journal entry process to understand the nature of the entries and the reasons for any unusual items. 5. **Testing controls**: If journal entries are used to test the effectiveness of controls, auditor will assess whether the controls are designed properly and operating effectively. 6. **Documentation**:	individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments; (ii) Select journal entries and other adjustments made at the end of a reporting period; and (iii) Consider the need to test journal entries and other adjustments throughout the period. (Ref: Para. A41-A44) (b) Review accounting estimates for biases and evaluate whether the circumstances producing the bias, if any, represent a risk of material misstatement due to fraud. In performing this review, the auditor shall: (i) Evaluate whether the judgments and decisions made by management in making the accounting estimates included in the financial statements, even if they are individually reasonable, indicate a possible bias on the part of the entity's management that may represent a risk of material misstatement due to fraud. If so, the auditor shall re-evaluate the accounting estimates taken as a whole; and

	Auditor should document the rationale for the selection of journal entries, the procedures performed, and the conclusions reached. 7. **Reporting**: If auditor finds evidence of management override of controls, he should communicate these findings to the appropriate level of management and those charged with governance and consider the implications for the audit and the financial statements.	(ii) Perform a retrospective review of management judgments and assumptions related to significant accounting estimates reflected in the financial statements of the prior year. (Ref: Para. A45-A46) (c) For significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual given the auditor's understanding of the entity and its environment and other information obtained during the audit, the auditor shall evaluate whether the business rationale (or the lack thereof) of the transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets. (Ref: Para. A47). **Para 33 of SA 240:** The auditor shall determine whether, in order to respond to the identified risks of management override of controls, the auditor needs to perform other audit procedures in addition to those specifically referred to above (i.e., when there are specific additional risks of management override that are not covered as part of the procedures performed to address the requirements in paragraph 32).

Observation 5:

It was noted that in relation to substantive procedures:

(a) Primarily vouching done and number of model-wise vehicles sold not available.

(b) Reconciliation with sales register, sales tax returns etc. not available in the file.

Adequate and appropriate audit procedures need to be planned and performed for revenue.

What is the issue?	AASB Suggested Guidance	Technical Literature
What are the illustrative procedures for audit of revenue?	The principal objectives when auditing revenue are to determine whether: • All revenue included in the Statement of Profit and Loss represents an amount that reflects the considerations to which the entity expects to be entitled in exchange for transferring goods or services to customers. • Revenue applicable to future periods has been deferred. • All revenue that is earned by the entity during the period is included in the Statement of Profit and Loss. • Revenue is stated in the Statement of Profit and Loss at the appropriate amounts. • Revenue is properly classified, described, and disclosed in the financial statements, including notes, in accordance with the applicable financial reporting framework. As per Standards on Auditing particularly Appendix 2 of SA 240 and SA 330, an audit firm should design and perform audit procedures to identify material	**Extract from Appendix 2 of SA 240: Examples of Possible Audit Procedures to Address the Assessed Risks of Material Misstatement Due to Fraud** *Specific Responses—Misstatement Resulting from Fraudulent Financial Reporting* Examples of responses to the auditor's assessment of the risks of material misstatement due to fraudulent financial reporting are as follows: **Revenue Recognition** • Performing substantive analytical procedures relating to revenue using disaggregated data, for example, comparing revenue reported by month and by product line or business segment during the current reporting period with comparable prior periods. Computer-assisted audit techniques may be useful in identifying unusual or unexpected revenue relationships or transactions. • Confirming with customers certain relevant contract terms and the absence of side agreements, because the appropriate accounting often is influenced by such terms or agreements and basis for rebates or the period to which they relate are often poorly documented. For example, acceptance criteria, delivery and payment terms, the

	misstatements and, if material misstatements are found, to quantify their effect in the financial statements. The design of procedures is a focused response to the specific risks of material misstatement (including presumed fraud risk) identified through risk assessment procedures. Procedures should be designed to provide explanatory, confirmatory or contrary information that contributes to audit evidence related to an assertion.	absence of future or continuing vendor obligations, the right to return the product, guaranteed resale amounts, and cancellation or refund provisions often are relevant in such circumstances. • Inquiring of the entity's sales and marketing personnel or in-house legal counsel regarding sales or shipments near the end of the period and their knowledge of any unusual terms or conditions associated with these transactions. • Being physically present at one or more locations at period end to observe goods being shipped or being readied for shipment (or returns awaiting processing) and performing other appropriate sales and inventory cut-off procedures. • For those situations for which revenue transactions are electronically initiated, processed, and recorded, testing controls to determine whether they provide assurance that recorded revenue transactions occurred and are properly recorded. **Para A68 of SA 315:** Controls over the completeness and accuracy of information produced by the entity may be relevant to the audit if the auditor intends to make use of the information in designing and performing further procedures. For example, in auditing revenue by applying standard prices to records of sales volume, the auditor considers the accuracy of the price information and the completeness and accuracy of the sales volume data. Controls relating to operations and compliance objectives may also be relevant to an audit if they relate to data the auditor evaluates or uses in applying audit procedures.

		Para A53 of SA 330: Paragraph 21 of this SA requires the auditor to perform substantive procedures that are specifically responsive to risks the auditor has determined to be significant risks. Audit evidence in the form of external confirmations received directly by the auditor from appropriate confirming parties may assist the auditor in obtaining audit evidence with the high level of reliability that the auditor requires to respond to significant risks of material misstatement, whether due to fraud or error. For example, if the auditor identifies that management is under pressure to meet earnings expectations, there may be a risk that management is inflating sales by improperly recognising revenue related to sales agreements with terms that preclude revenue recognition or by invoicing sales before shipment. In these circumstances, the auditor may, for example, design external confirmation procedures not only to confirm outstanding amounts, but also to confirm the details of the sales agreements, including date, any rights of return and delivery terms. In addition, the auditor may find it effective to supplement such external confirmation procedures with inquiries of non-financial personnel in the entity regarding any changes in sales agreements and delivery terms.

Observation 6:

Based on the documents available it was observed that the firm did not have any audit program and plan to assess the fraud risk during the audit of the entity's financial statements. During discussion it was noted that fraud identification is sought to be done based on experience of audit of the entity. Audit plan has not adequately documented the evidence that the firm has identified and assessed risks of material misstatements, whether due to error or fraud.

What is the issue?	AASB Suggested Guidance	Technical Literature
Why should an auditor identify fraud risk factors?	The auditor identifies fraud risk factors to assist in identifying risks of material misstatement due to fraud. The auditor should use professional judgment in determining whether a fraud risk factor is present. The auditor determines fraud risk factors in the context of the three conditions generally present when fraud occurs (i.e., incentive/pressure, opportunity and attitude/rationalization).	**Para 11(b) of SA 240:** **Definition** *Fraud risk factors* - Events or conditions that indicate an incentive or pressure to commit fraud or provide an opportunity to commit fraud. **Para A25 of SA 240:** Examples of fraud risk factors related to fraudulent financial reporting and misappropriation of assets are presented in Appendix 1. These illustrative risk factors are classified based on the three conditions that are generally present when fraud exists: • An incentive or pressure to commit fraud; • A perceived opportunity to commit fraud; and • An ability to rationalize the fraudulent action. Risk factors reflective of an attitude that permits rationalization of the fraudulent action may not be susceptible to observation by the auditor. Nevertheless, the auditor may become aware of the existence of such information. Although the fraud risk factors described in Appendix 1 cover a broad range of situations that may be faced by auditors, they are only examples and other risk factors may exist.
What are the examples of fraud risk factors?	Examples of fraud risk factors are given in Appendix 1 of SA 240.	**Extract from Appendix 1 of SA 240 - Examples of Fraud Risk Factors** The fraud risk factors identified in this Appendix are examples of such factors that

		may be faced by auditors in a broad range of situations. Separately presented are examples relating to the two types of fraud relevant to the auditor's consideration, i.e., fraudulent financial reporting and misappropriation of assets. For each of these types of fraud, the risk factors are further classified based on the three conditions generally present when material misstatements due to fraud occur: (a) incentives/pressures, (b) opportunities, and (c) attitudes/rationalizations. Although the risk factors cover a broad range of situations, they are only examples and, accordingly, the auditor may identify additional or different risk factors. Not all of these examples are relevant in all circumstances, and some may be of greater or lesser significance in entities of different size or with different ownership characteristics or circumstances. Also, the order of the examples of risk factors provided is not intended to reflect their relative importance or frequency of occurrence. **Please refer Appendix 1 of SA 240 for examples of fraud risk factors.**
How should an auditor respond to the assessed risks of material misstatement due to fraud?	SA 240 provides guidance on overall responses to address risk of material misstatement due to fraud at financial statements level as follows: • Assign additional individuals with specialized skill and knowledge, such as forensic and IT experts, or by assigning more experienced individuals to the engagement. • Evaluate the appropriateness of accounting policies relating to subjective measurements and complex transactions.	**Para 28 of SA 240:** In accordance with SA 330, the auditor shall determine overall responses to address the assessed risks of material misstatement due to fraud at the financial statement level. (Ref: Para. A33) **Para 29 of SA 240:** In determining overall responses to address the assessed risks of material misstatement due to fraud at the financial statement level, the auditor shall: (a) Assign and supervise personnel taking account of the knowledge, skill and ability of the individuals to be given significant engagement responsibilities and the auditor's assessment of the risks of material misstatement due to fraud for the engagement; (Ref: Para. A34-A35) (b) Evaluate whether the selection and

	• Incorporate an element of unpredictability in the selection of the nature, timing and extent of audit procedures to be performed as individuals within the entity who are familiar with the audit procedures normally performed on engagements may be more able to conceal fraudulent financial reporting. Further, the auditor is required to design and perform audit procedures whose nature, timing and extent are responsive to the assessed risks of material misstatement due to fraud at the assertion level. As per SA 240, the auditor is also required to design and perform audit procedures which are responsive to risks related to management override of controls.	application of accounting policies by the entity, particularly those related to subjective measurements and complex transactions, may be indicative of fraudulent financial reporting resulting from management's effort to manage earnings; and (c) Incorporate an element of unpredictability in the selection of the nature, timing and extent of audit procedures. (Ref: Para. A36) **Para 30 of SA 240:** In accordance with SA 330, the auditor shall design and perform further audit procedures whose nature, timing and extent are responsive to the assessed risks of material misstatement due to fraud at the assertion level. (Ref: Para. A37-A40) **Para 31 of SA 240:** Management is in a unique position to perpetrate fraud because of management's ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Although the level of risk of management override of controls will vary from entity to entity, the risk is nevertheless present in all entities. Due to the unpredictable way in which such override could occur, it is a risk of material misstatement due to fraud and thus a significant risk. **Para 32 of SA 240:** Irrespective of the auditor's assessment of the risks of management override of controls, the auditor shall design and perform audit procedures to: (a) Test the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements. In designing and performing audit procedures for such tests, the auditor

		shall: (i) Make inquiries of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments; (ii) Select journal entries and other adjustments made at the end of a reporting period; and (iii) Consider the need to test journal entries and other adjustments throughout the period. (Ref: Para. A41-A44) (b) Review accounting estimates for biases and evaluate whether the circumstances producing the bias, if any, represent a risk of material misstatement due to fraud. In performing this review, the auditor shall: (i) Evaluate whether the judgments and decisions made by management in making the accounting estimates included in the financial statements, even if they are individually reasonable, indicate a possible bias on the part of the entity's management that may represent a risk of material misstatement due to fraud. If so, the auditor shall re-evaluate the accounting estimates taken as a whole; and (ii) Perform a retrospective review of management judgments and assumptions related to significant accounting estimates reflected in the financial statements of the prior year. (Ref: Para. A45-A46) (c) For significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual given the auditor's understanding of the entity and its

		environment and other information obtained during the audit, the auditor shall evaluate whether the business rationale (or the lack thereof) of the transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets. (Ref: Para. A47) **Para 33 of SA 240:** The auditor shall determine whether, in order to respond to the identified risks of management override of controls, the auditor needs to perform other audit procedures in addition to those specifically referred to above (i.e., when there are specific additional risks of management override that are not covered as part of the procedures performed to address the requirements in paragraph 32).

Observation 7:

The management representation letter does not contain any reference to any fraud related disclosure made in the financial statements though the audit report states "as per information and explanation given to us".

No documentary evidence was obtained based on which such assertion was made by the firm. The management representation letter must contain a declaration from the management regarding their responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud.

What is the issue?	AASB Suggested Guidance	Technical Literature
Whether specific representations about management's responsibility relating to fraud should be obtained by auditor?	SA 240 requires the auditor to obtain specific written representations from management about their responsibilities relating to fraud.	**Para 39 of SA 240:** The auditor shall obtain written representations from management and, where applicable, those charged with governance that: (a) They acknowledge their responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud; (b) They have disclosed to the auditor the results of management's assessment of the risk that the financial statements may be materially misstated as a result of fraud; (c) They have disclosed to the auditor their knowledge of fraud or suspected fraud affecting the entity involving: (i) Management; (ii) Employees who have significant roles in internal control; or (iii) Others where the fraud could have a material effect on the financial statements; and (d) They have disclosed to the auditor their knowledge of any allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators or others. (Ref: Para. A57-A58)

Chapter 6

Observations related to SA 315, Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and its Environment

Observation 1:

SA 315 states that the auditor shall identify and assess the risks of material misstatement at: (a) the financial statement level, and (b) the assertion level for classes of transactions, account balances, and disclosures, to provide a basis for designing and performing further audit procedures.

It was observed that the firm had not documented the different (additional/specific) audit procedures performed for identifying and assessing the risks of material misstatement to comply with the requirements of the Standards on Auditing.

What is the issue?	AASB Suggested Guidance	Technical Literature
What are the risk assessment procedures and related activities that should be performed by the auditor for identification and assessment of the risks of material misstatement?	The objective of the auditor is to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels, through understanding the entity and its environment, including the entity's internal control, thereby providing a basis for designing and implementing responses to the assessed risks of material misstatement. This will help the auditor to reduce the risk of material misstatement to an acceptably low level. The auditor should obtain an understanding of the following: (a) Relevant industry, regulatory, and other external factors including the applicable financial reporting framework. (b) The nature of the entity, including: (i) its operations; (ii) its ownership and governance structures;	**Para 5 of SA 315:** The auditor shall perform risk assessment procedures to provide a basis for the identification and assessment of risks of material misstatement at the financial statement and assertion levels. Risk assessment procedures by themselves, however, do not provide sufficient appropriate audit evidence on which to base the audit opinion. (Ref: Para. A1-A5) **Para 6 of SA 315:** The risk assessment procedures shall include the following: (a) Inquiries of management, of appropriate individuals within the internal audit function (if the function exists), and of others

	(iii) the types of investments that the entity is making and plans to make, including investments in special-purpose entities; and (iv) the way that the entity is structured and how it is financed; to enable the auditor to understand the classes of transactions, account balances, and disclosures to be expected in the financial statements. (c) The entity's selection and application of accounting policies, including the reasons for changes thereto. The auditor shall evaluate whether the entity's accounting policies are appropriate for its business and consistent with the applicable financial reporting framework and accounting policies used in the relevant industry. (d) The entity's objectives and strategies, and those related business risks that may result in risks of material misstatement. (e) The measurement and review of the entity's financial performance.	within the entity who in the auditor's judgment may have information that is likely to assist in identifying risks of material misstatement due to fraud or error. (Ref: Para. A6-A12) (b) Analytical procedures. (Ref: Para. A13-A16) (c) Observation and inspection. (Ref: Para. A17)
How shall the auditor identify and assess the risk of material misstatement at financial statement level and assertion level?	As per SA 315, the auditor is required to identify and assess the risks of material misstatement at: • The financial statement level. • The assertion level for individual classes of transactions, account balances, and disclosures. For this purpose, the auditor is required to perform the procedures prescribed in SA 315. Information gathered by performing risk assessment procedures, including the audit evidence obtained in evaluating the design of controls and determining whether they have been implemented, is used as audit evidence to support the	**Para 25 of SA 315:** The auditor shall identify and assess the risks of material misstatement at: (a) The financial statement level; and (Ref: Para. A117-A120) (b) The assertion level for classes of transactions, account balances, and disclosures; (Ref: Para. A121-A125) to provide a basis for designing and performing further audit procedures.

	risk assessment. The risk assessment determines the nature, timing, and extent of further audit procedures to be performed. Appendix 2 of SA 315 provides examples of conditions and events that may indicate the existence of risks of material misstatement. **Relating controls to assertions** In making risk assessments, the auditor may identify the controls that are likely to prevent, or detect and correct, material misstatement in specific assertions. Generally, it is useful to obtain an understanding of controls and relate them to assertions in the context of processes and systems in which they exist because individual control activities often do not in themselves address a risk. Often, only multiple control activities, together with other components of internal control, will be sufficient to address a risk. Conversely, some control activities may have a specific effect on an individual assertion embodied in a particular class of transactions or account balance, for example, the control activities that an entity established to ensure that its personnel are properly counting and recording the annual physical inventory relate directly to the existence and completeness assertions for the inventory account balance. Controls can be either directly or indirectly related to an assertion. The more indirect the relationship, the less effective that control may be in preventing, or detecting and correcting, misstatements in that assertion, for example, a sales manager's review of a summary of sales activity for specific stores by region ordinarily is only indirectly related to the completeness assertion for sales revenue. Accordingly,	**Para 26 of SA 315:** For this purpose, the auditor shall: (a) Identify risks throughout the process of obtaining an understanding of the entity and its environment, including relevant controls that relate to the risks, and by considering the classes of transactions, account balances, and disclosures in the financial statements; (Ref: Para. A126-A127) (b) Assess the identified risks, and evaluate whether they relate more pervasively to the financial statements as a whole and potentially affect many assertions; (c) Relate the identified risks to what can go wrong at the assertion level, taking account of relevant controls that the auditor intends to test; and (Ref: Para. A128-A130) (d) Consider the likelihood of misstatement, including the possibility of multiple misstatements, and whether the potential misstatement is of a magnitude that could result in a material misstatement.

	it may be less effective in reducing risk for that assertion than controls more directly related to that assertion, such as matching shipping documents with billing documents.	
Is documentation necessary with respect to identifying and assessing the risks of material misstatement at the financial statement level and at the assertion level?	Para A1 of SA 230 provides that preparing sufficient and appropriate audit documentation on a timely basis helps to enhance the quality of the audit and facilitates the effective review and evaluation of the audit evidence obtained and conclusions reached before the auditor's report is finalised. Documentation prepared after the audit work has been performed is likely to be less accurate than documentation prepared at the time such work is performed. The manner in which the requirements of paragraph 32 of SA 315 are documented is for the auditor to determine using professional judgment. For example, in audits of small entities the documentation may be incorporated in the auditor's documentation of the overall strategy and audit plan that is required by SA 300, "Planning an Audit of Financial Statements". Similarly, for example, the results of the risk assessment may be documented separately or may be documented as part of the auditor's documentation of further procedures (see SA 330). The form and extent of the documentation is influenced by the nature, size and complexity of the entity and its internal control, availability of information from the entity and the audit methodology and technology used in the course of the audit.	**Para 32 of SA 315:** The auditor shall document: (a) The discussion among the engagement team where required by paragraph 10, and the significant decisions reached; (b) Key elements of the understanding obtained regarding each of the aspects of the entity and its environment specified in paragraph 11 and of each of the internal control components specified in paragraphs 14-24; the sources of information from which the understanding was obtained; and the risk assessment procedures performed; (c) The identified and assessed risks of material misstatement at the financial statement level and at the assertion level as required by paragraph 25; and (d) The risks identified, and related controls about which the auditor has obtained an understanding, as a result of the requirements in paragraphs 27-30. (Ref: Para. A143-A146)

Observation 2:

As per SA 315, the auditor shall obtain an understanding of internal control relevant to the audit. Although most controls relevant to the audit are likely to relate to financial reporting, not all controls that relate to financial reporting are relevant to the audit. It is a matter of the auditor's professional judgment whether a control, individually or in combination with others, is relevant to the audit.

The objective of SA 620 deals with the auditor's responsibilities regarding the use of an individual or organization's work in a field of expertise other than accounting or auditing, when that work is used to assist the auditor in obtaining sufficient appropriate audit evidence.

It was observed that audit firm has not tested IT related general, automated and application controls and also not involved IT expert to understand IT environment of the entity and related control testing. The auditor relied on the work of internal auditor and not documented rational for the same.

What is the issue?	AASB Suggested Guidance	Technical Literature
Why and how the auditor can involve an IT expert for evaluation of IT related general and application controls?	SA 315 provides guidance to auditors on how to identify and assess risks of material misstatement in financial statements through understanding the entity and its environment, including the entity's internal control. The involvement of an IT expert during the testing of IT general controls (ITGC) and application controls is often necessary due to the specialized nature of information technology systems. ITGCs are the policies and procedures that relate to many applications and support the effective functioning of application controls by helping to ensure the reliability of data generated by systems. Application controls, on the other hand, apply to the processing of individual applications and help to ensure the complete and accurate processing of transactions. Here is how an IT expert can contribute to the testing of IT controls as per SA 315: 1. **Understanding IT**	**Para 18 of SA 315:** The auditor shall obtain an understanding of the information system, including the related business processes, relevant to financial reporting, including the following areas: (a) The classes of transactions in the entity's operations that are significant to the financial statements. (b) The procedures, within both information technology (IT) and manual systems, by which those transactions are initiated, recorded, processed, corrected as necessary, transferred to the general ledger and reported in the financial statements; (c) The related accounting records, supporting information and specific accounts in the financial statements that are used to initiate, record, process and report transactions; this includes the correction of

	environment: An IT expert can help the auditor understand the complexity of the IT environment, including the software, hardware, and networks used by the entity. 2. **Identifying IT risks**: An IT expert can assist in identifying risks related to IT that could affect financial reporting, including risks associated with data integrity, unauthorized access, and system outages. 3. **Evaluating IT general controls**: An IT expert can evaluate ITGCs such as system access controls, data backup procedures, change management processes, and system operations controls. 4. **Testing application controls**: An IT expert can test application controls to ensure that transactions are processed correctly. This includes testing of automated controls such as input validation, processing controls, and output controls. 5. **Assessing IT control design and implementation**: An IT expert can assess whether the IT controls are properly designed and implemented to prevent or detect material misstatements. 6. **Assessing IT control effectiveness**: An IT expert can perform tests to determine the operational effectiveness of IT controls over a period of time. 7. **Advising on IT-related audit risks**: An IT expert can advise the audit	incorrect information and how information is transferred to the general ledger. The records may be in either manual or electronic form; (d) How the information system captures events and conditions, other than transactions, that are significant to the financial statements; (e) The financial reporting process used to prepare the entity's financial statements, including significant accounting estimates and disclosures; (f) Controls surrounding journal entries, including non-standard journal entries used to record non-recurring, unusual transactions or adjustments. (Ref: Para. A88-A92) **Para 20 of SA 315:** The auditor shall obtain an understanding of control activities relevant to the audit, being those the auditor judges it necessary to understand in order to assess the risks of material misstatement at the assertion level and design further audit procedures responsive to assessed risks. An audit requires an understanding of only those control activities related to significant class of transactions, account balance, and disclosure in the financial statements and the assertions which the auditor finds relevant in his risk assessment process. (Ref: Para. A95-A101) **Para 21 of SA 315:** In understanding the entity's control activities, the auditor shall obtain an understanding of how the entity has responded to risks arising from IT. (Ref: Para. A102-A104).

	team on the potential impact of IT risks on the audit and the extent to which reliance can be placed on the IT systems. 8. **Specialized tools and techniques**: An IT expert can use specialized audit software and techniques to extract and analyze electronic data, which can be crucial for the audit. 9. **Compliance with laws and regulations**: An IT expert can help ensure that the IT systems are in compliance with relevant laws and regulations that may impact financial reporting. 10. **Reporting**: An IT expert can assist in preparing audit findings related to IT controls and provide recommendations for improvements. It is important to note that while an IT expert can provide valuable assistance, the auditor remains responsible for the audit opinion and should have sufficient knowledge to evaluate the work of the expert. The auditor should also ensure that the expert's work complies with relevant auditing standards and is appropriately integrated into the overall audit process. In case auditor decides to use an IT expert for testing of IT controls, auditor is required to comply with SA 620.	**Para 7 of SA 620:** If expertise in a field other than accounting or auditing is necessary to obtain sufficient appropriate audit evidence, the auditor shall determine whether to use the work of an auditor's expert. (Ref: Para. A4-A9) **Para 8 of SA 620:** The nature, timing and extent of the auditor's procedures with respect to the requirements in paragraphs 9-13 of this SA will vary depending on the circumstances. In determining the nature, timing and extent of those procedures, the auditor shall consider matters including: (Ref: Para. A10) (a) The nature of the matter to which that expert's work relates; (b) The risks of material misstatement in the matter to which that expert's work relates. (c) The significance of that expert's work in the context of the audit; (d) The auditor's knowledge of and experience with previous work performed by that expert; and (e) Whether that expert is subject to the auditor's firm's quality control policies and procedures. (Ref: Para. A11-A13)

Observation 3:

(1) The firm has prepared a yes/ no checklist specifying that the risks have been identified but the control risk is not documented.

(2) The firm has not taken the details of business risk that may have effect on the misstatements.

(3) The system of initiating, processing, approving, and correction is not documented.

What is the issue?	AASB Suggested Guidance	Technical Literature
What understanding the audit firm is required to obtain regarding the entity and its environment?	As per SA 315, the audit firm is required to obtain an understanding of the entity and its environment, its operations, governance structures etc. The audit firm should also understand the accounting policies of the entity, objectives, strategies etc.	**Para 11 of SA 315:** The auditor shall obtain an understanding of the following: (a) Relevant industry, regulatory, and other external factors including the applicable financial reporting framework. (Ref: Para. A23-A28) (b) The nature of the entity, including: (i) its operations; (ii) its ownership and governance structures; (iii) the types of investments that the entity is making and plans to make, including investments in special-purpose entities; and (iv) the way that the entity is structured and how it is financed; to enable the auditor to understand the classes of transactions, account balances, and disclosures to be expected in the financial statements. (Ref: Para.A29-A33) (c) The entity's selection and application of accounting policies, including the reasons for changes thereto. The auditor shall evaluate whether the entity's

		accounting policies are appropriate for its business and consistent with the applicable financial reporting framework and accounting policies used in the relevant industry. (Ref: Para. A34) (d) The entity's objectives and strategies, and those related business risks that may result in risks of material misstatement. (Ref: Para.A35-A41) (e) The measurement and review of the entity's financial performance. (Ref: Para.A42-A47)
What aspects should be covered in understanding the control environment?	As per SA 315, the audit firm should obtain an understanding of the control environment.	**Para 14 of SA 315:** The auditor shall obtain an understanding of the control environment. As part of obtaining this understanding, the auditor shall evaluate whether: (a) Management, with the oversight of those charged with governance, has created and maintained a culture of honesty and ethical behaviour; and (b) The strengths in the control environment elements collectively provide an appropriate foundation for the other components of internal control, and whether those other components are not undermined by deficiencies in the control environment.(Ref: Para.A75-A85)
What steps should an audit firm take for understanding the process of risk identification, assessment and action plan?	As per SA 315, the audit firm should obtain understanding of the process of risk identification, assessment and action plan.	**Para 15 of SA 315:** The auditor shall obtain an understanding of whether the entity has a process for: (a) Identifying business risks relevant to financial reporting objectives; (b) Estimating the significance of the risks;

		(c) Assessing the likelihood of their occurrence; and (d) Deciding about actions to address those risks. (Ref: Para.A86) **Para 16 of SA 315:** If the entity has established such a process (referred to hereafter as the 'entity's risk assessment process'), the auditor shall obtain an understanding of it, and the results thereof. Where the auditor identifies risks of material misstatement that management failed to identify, the auditor shall evaluate whether there was an underlying risk of a kind that the auditor expects would have been identified by the entity's risk assessment process. If there is such a risk, the auditor shall obtain an understanding of why that process failed to identify it, and evaluate whether the process is appropriate to its circumstances or determine if there is a significant deficiency in internal control with regard to the entity's risk assessment process. **Para 17 of SA 315:** If the entity has not established such a process or has an ad hoc process, the auditor shall discuss with management whether business risks relevant to financial reporting objectives have been identified and how they have been addressed. The auditor shall evaluate whether the absence of a documented risk assessment process is appropriate in the circumstances, or determine whether it represents a significant deficiency in internal control. (Ref: Para. A87)

Is documentation necessary with respect to identifying and assessing the risks of material misstatement?	Para A1 of SA 230 provides that preparing sufficient and appropriate audit documentation on a timely basis helps to enhance the quality of the audit and facilitates the effective review and evaluation of the audit evidence obtained and conclusions reached before the auditor's report is finalised. Documentation prepared after the audit work has been performed is likely to be less accurate than documentation prepared at the time such work is performed. The manner in which the requirements of paragraph 32 of SA 315 are documented is for the auditor to determine using professional judgment. For example, in audits of small entities the documentation may be incorporated in the auditor's documentation of the overall strategy and audit plan that is required by SA 300, "Planning an Audit of Financial Statements". Similarly, for example, the results of the risk assessment may be documented separately or may be documented as part of the auditor's documentation of further procedures (see SA 330). The form and extent of the documentation is influenced by the nature, size and complexity of the entity and its internal control, availability of information from the entity and the audit methodology and technology used in the course of the audit.	**Para 32 of SA 315:** The auditor shall document: (a) The discussion among the engagement team where required by paragraph 10, and the significant decisions reached; (b) Key elements of the understanding obtained regarding each of the aspects of the entity and its environment specified in paragraph 11 and of each of the internal control components specified in paragraphs 14-24; the sources of information from which the understanding was obtained; and the risk assessment procedures performed; (c) The identified and assessed risks of material misstatement at the financial statement level and at the assertion level as required by paragraph 25; and (d) The risks identified, and related controls about which the auditor has obtained an understanding, as a result of the requirements in paragraphs 27-30. (Ref: Para. A143-A146)

Observation 4:

No documentation was found evidencing understanding of the internal controls and procedures of the entity. The internal controls of the entity must be studied to formulate an effective audit programme.

What is the issue?	AASB Suggested Guidance	Technical Literature
Why is it necessary to obtain an understanding of an entity's internal controls that are relevant to audit?	Understanding an entity and its environment is key to planning and executing an effective risk-based audit. The understanding of the business helps in identifying risks of material misstatement in the financial statements. The understanding of the business, along with understanding of the system of internal control at the entity level and significant classes of transactions, also forms the primary source of information in fraud risk identification and assessment process as provided in SA 315. An audit firm should obtain understanding during audit planning and update it as a result of engagement team discussion and throughout the performance of the audit to the extent that changes affect the overall audit strategy or the nature, timing, and extent of audit procedures.	**Para 12 of SA 315:** The auditor shall obtain an understanding of internal control relevant to the audit. Although most controls relevant to the audit are likely to relate to financial reporting, not all controls that relate to financial reporting are relevant to the audit. It is a matter of the auditor's professional judgment whether a control, individually or in combination with others, is relevant to the audit. (Ref: Para. A48-A71) **Please also refer Para 14-24 of SA 315 which deal with various components of internal controls.**
Is documentation necessary with respect to understanding of internal controls of the entity?	As per SA 315, the auditor should document the key elements of understanding obtained regarding each of the five components of internal controls i.e.: • Control environment. • The entity's risk assessment process.	**Para 32 of SA 315:** The auditor shall document: (a) The discussion among the engagement team where required by paragraph 10, and the significant decisions reached; (b) Key elements of the understanding obtained regarding each of the

	• Information systems, including the related business processes, relevant to financial reporting, and communication. • Control activities relevant to the audit. • Monitoring of controls. The auditor is also required to document the sources of information from which such understanding was obtained.	aspects of the entity and its environment specified in paragraph 11 and of each of the internal control components specified in paragraphs 14-24; the sources of information from which the understanding was obtained; and the risk assessment procedures performed; (c) The identified and assessed risks of material misstatement at the financial statement level and at the assertion level as required by paragraph 25; and (d) The risks identified, and related controls about which the auditor has obtained an understanding, as a result of the requirements in paragraphs 27-30. (Ref: Para. A143-A146)

Observation 5:

Documentation detailing review of IT controls for both general application and automated controls as regards their design and implementation was not found. Documentation for understanding IT controls system must be maintained.

What is the issue?	AASB Suggested Guidance	Technical Literature
Whether understanding of entity's IT environment is critical in audit of financial statements?	The understanding of the role of information technology (IT) and its use by an entity is important to performing an effective audit because the entity's use of IT affects how the information relevant to the financial statements is input, processed, maintained and reported. Therefore, the entity's use of IT affects the overall audit strategy, risk assessment and the design of audit procedures. The audit firm's understanding of the IT environment includes understanding how the entity's business model integrates the use of IT and how the components of the system of internal control at the entity level address the IT environment. In obtaining this understanding, an audit firm considers the aspects prescribed in paragraph 18 of SA 315.	**Para 18 of SA 315:** The auditor shall obtain an understanding of the information system, including the related business processes, relevant to financial reporting, including the following areas: (a) The classes of transactions in the entity's operations that are significant to the financial statements; (b) The procedures, within both information technology (IT) and manual systems, by which those transactions are initiated, recorded, processed, corrected as necessary, transferred to the general ledger and reported in the financial statements; (c) The related accounting records, supporting information and specific accounts in the financial statements that are used to initiate, record, process and report transactions; this includes the correction of incorrect information and how information is transferred to the general ledger. The records may be in either manual or electronic form; (d) How the information system captures events and conditions, other than transactions, that are significant to the financial statements; (e) The financial reporting process used to prepare the entity's financial statements, including significant accounting estimates and disclosures;

		(f) Controls surrounding journal entries, including non-standard journal entries used to record non-recurring, unusual transactions or adjustments. (Ref: Para. A88-A92) **Para 19 of SA 315:** The auditor shall obtain an understanding of how the entity communicates financial reporting roles and responsibilities and significant matters relating to financial reporting, including: (a) Communications between management and those charged with governance; and (b) External communications, such as those with regulatory authorities. (Ref: Para. A93-A94) **Para 20 of SA 315:** The auditor shall obtain an understanding of control activities relevant to the audit, being those the auditor judges it necessary to understand in order to assess the risks of material misstatement at the assertion level and design further audit procedures responsive to assessed risks. An audit requires an understanding of only those control activities related to significant class of transactions, account balance, and disclosure in the financial statements and the assertions which the auditor finds relevant in his risk assessment process. (Ref: Para. A95-A101) **Para 21 of SA 315:** In understanding the entity's control activities, the auditor shall obtain an understanding of how the entity has responded to risks arising from IT. (Ref: Para. A102-A104)
Is documentation necessary with respect to understanding of internal controls	As per SA 315, the auditor should document the key elements of understanding obtained regarding each of the five components of	**Para 32 of SA 315:** The auditor shall document: (a) The discussion among the engagement team where required by

of the entity?	internal controls i.e.: • Control environment. • The entity's risk assessment process. • Information systems, including the related business processes, relevant to financial reporting, and communication. • Control activities relevant to the audit. • Monitoring of controls. The auditor is also required to document the sources of information from which such understanding was obtained.	paragraph 10, and the significant decisions reached; (b) Key elements of the understanding obtained regarding each of the aspects of the entity and its environment specified in paragraph 11 and of each of the internal control components specified in paragraphs 14-24; the sources of information from which the understanding was obtained; and the risk assessment procedures performed; (c) The identified and assessed risks of material misstatement at the financial statement level and at the assertion level as required by paragraph 25; and (d) The risks identified, and related controls about which the auditor has obtained an understanding, as a result of the requirements in paragraphs 27-30. (Ref: Para. A143-A146)

Chapter 7

Observations related to SA 330, The Auditor's Responses to Assessed Risks

Observation 1:

Procedures performed have not been linked to material class of transaction, account balance and disclosures and the risk of material misstatements.

The working papers where substantive testing was performed, were not cross-referenced to the groupings/trial balance with reference numbers in all cases. Further, there was no evidence of referencing/cross-referencing the financial statements to the trial balance.

OR

The demonstration of the understanding with respect to risk assessment at an assertion level is very theoretical and does not contain any specific risks identified and the auditor's response to the assessed risk. The controls which were tested across the various operating areas relevant to financial reporting & substantive procedures related to the financial statement closing process have not been documented.

What is the issue?	AASB Suggested Guidance	Technical Literature
What audit procedures are required to be performed w.r.t. each material class of transaction, account balances and disclosures?	As per SA 330, the auditor's assessed risks may affect both the types of audit procedures to be performed and their combination. For example, when an assessed risk is high, the auditor may confirm the completeness of the terms of a contract with the counterparty, in addition to inspecting the document. Further, certain audit procedures may be more appropriate for some assertions than others. For example, in relation to revenue, tests of controls may be most responsive to the assessed risk of misstatement of the completeness assertion, whereas substantive procedures may be most responsive to the assessed risk of misstatement of the	**Para 3 of SA 330:** The objective of the auditor is to obtain sufficient appropriate audit evidence about the assessed risks of material misstatement, through designing and implementing appropriate responses to those risks. **Para 5 of SA 330:** The auditor shall design and implement overall responses to address the assessed risks of material misstatement at the financial statement level. (Ref: Para. A1-A3) **Para 6 of SA 330:** 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. (Ref: Para. A4-A8)

	occurrence assertion. In addition, certain audit procedures can be performed only at or after the period end, for example: • Agreeing the financial statements to the accounting records; • Examining adjustments made during the course of preparing the financial statements; and • Procedures to respond to a risk that, at the period end, the entity may have entered into improper sales contracts, or transactions may not have been finalised. SA 330 requires the auditor to design and perform substantive procedures for each material class of transactions, account balance, and disclosure, irrespective of the assessed risks of material misstatement. This requirement reflects the facts that: (i) the auditor's assessment of risk is judgmental and so may not identify all risks of material misstatement; and (ii) there are inherent limitations to internal control, including management override.	**Para 7 of SA 330:** 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 for each class of transactions, account balance, and disclosure, 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 (i.e., the auditor intends to rely on the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures); and (Ref: Para. A9-A18) (b) Obtain more persuasive audit evidence the higher the auditor's assessment of risk. (Ref: Para. A19) **Para 18 of SA 330:** Irrespective of the assessed risks of material misstatement, the auditor shall design and perform substantive procedures for each material class of transactions, account balance, and disclosure. (Ref: Para. A42-A47) **Para 20 of SA 330:** The auditor's substantive procedures shall include the following audit procedures related to the financial statement closing process:

		(a) Agreeing or reconciling the financial statements with the underlying accounting records; and (b) Examining material journal entries and other adjustments made during the course of preparing the financial statements. (Ref: Para. A52) **Para 21 of SA 330:** When the auditor has determined that an assessed risk of material misstatement at the assertion level is a significant risk, the auditor shall perform substantive procedures that are specifically responsive to that risk. When the approach to a significant risk consists only of substantive procedures, those procedures shall include tests of details. (Ref: Para. A53) **Para 25 of SA 330:** Based on the audit procedures performed and the audit evidence obtained, the auditor shall evaluate before the conclusion of the audit whether the assessments of the risks of material misstatement at the assertion level remain appropriate. (Ref: Para. A60-A61) **Para 26 of SA 330:** The auditor shall conclude whether sufficient appropriate audit evidence has been obtained. In forming an opinion, the auditor shall consider all relevant audit evidence, regardless of whether it appears to corroborate or to contradict the assertions in the financial statements. (Ref: Para. A62) **Para 27 of SA 330:** If the auditor has not obtained sufficient appropriate audit evidence as to a material financial statement assertion, the auditor shall attempt to obtain further audit evidence. If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor shall express a

		qualified opinion or a disclaimer of opinion. **Para 28 of SA 330:** The auditor shall document: (a) The overall responses to address the assessed risks of material misstatement at the financial statement level, and the nature, timing and extent of the further audit procedures performed; (b) The linkage of those procedures with the assessed risks at the assertion level; and (c) The results of the audit procedures, including the conclusions where these are not otherwise clear. (Ref: Para. A63) **Para 29 of SA 330:** If the auditor plans to use audit evidences about the operating effectiveness of controls obtained in previous audits, the auditor shall document the conclusions reached about relying on such controls that were tested in a previous audit. **Para 30 of SA 330:** The auditors' documentation shall demonstrate that the financial statements agree or reconcile with the underlying accounting records.

Observation 2:

The following observations regarding not performing audit procedures required by SA 330 were noticed:

(i) Process of identifying significant accounts, risk of material statement and relevant controls mitigating the risk.

(ii) Testing of design and implementation of relevant controls.

(iii) Testing operating effectiveness of the controls for the period under audit. The firm has not tested controls for the purpose of reporting on internal financial controls.

(iv) Procedures performed to ensure adequacy of scope of internal auditors.

(v) Lack of evidence w.r.t. the firm observing the physical verification of inventory or performing physical verification after the year-end with roll back procedures upto the date of balance sheet.

(vi) Testing management override of controls, including testing controls over recording of journal entries.

(vii) Procedures performed to evaluate and assess severity of deficiencies identified during testing operating effectiveness of internal controls over financial reporting.

What is the issue?	AASB Suggested Guidance	Technical Literature
When should an audit firm decide to test controls?	SA 330 requires an audit firm to design audit strategy to respond to the identified risks of material misstatement. Designing audit strategy includes a decision on whether the audit firm will be following a controls reliance strategy or substantive procedures only strategy as stated in SA 330. When use of a controls reliance strategy is planned, the audit firm should design and execute tests of the relevant controls and conclude whether relevant controls are properly designed and operated effectively throughout the audit period.	**Para 5 of SA 330:** The auditor shall design and implement overall responses to address the assessed risks of material misstatement at the financial statement level. (Ref: Para. A1-A3) **Para 6 of SA 330:** 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. (Ref: Para. A4-A8) **Para 7 of SA 330:** 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 for each class of transactions, account balance, and disclosure, 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 (i.e., the auditor intends to rely on the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures); and (Ref: Para. A9-A18) (b) Obtain more persuasive audit evidence the higher the auditor's assessment of risk. (Ref: Para. A19) **Para 8 of SA 330:** 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 (i.e., the auditor intends to rely on the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures); or (b) Substantive procedures alone cannot provide sufficient

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<td>appropriate audit evidence at the assertion level. (Ref: Para. A20-A24)

Para 9 of SA 330:

In designing and performing tests of controls, the auditor shall obtain more persuasive audit evidence the greater the reliance the auditor places on the effectiveness of a control. (Ref: Para. A25)

Para 10 of SA 330:

In designing and performing tests of controls, the auditor shall:

(a) Perform other audit procedures in combination with inquiry to obtain audit evidence about the operating effectiveness of the controls, including:

(i) How the controls were applied at relevant times during the period under audit.

(ii) The consistency with which they were applied.

(iii) By whom or by what means they were applied. (Ref: Para. A26-A29)

(b) Determine whether the controls to be tested depend upon other controls (indirect controls), and if so, whether it is necessary to obtain audit evidence supporting the effective operation of those indirect controls. (Ref: Para. A30-A31)</td>
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<td>Why is it necessary for statutory auditor to comply with Guidance Note on Audit of Internal Financial Controls Over Financial</td>
<td>The necessity for a statutory auditor to comply with the Guidance Note on Audit of Internal Financial Controls Over Financial Reporting issued by ICAI and the relevant Standards on Auditing arises from the following reasons:

1. Legal and regulatory compliance:</td>
<td>Para 36 of the Guidance Note on Audit of Internal Financial Controls Over Financial Reporting

Applicability of Standards on Auditing for the audit of internal financial controls over financial reporting

Paragraph A1 of SA 200, inter alia, states “In some cases, however, the</td>
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Reporting issued by ICAI and Standards on Auditing while reporting on internal controls over financial reporting?	Statutory auditors are required by law to follow the guidelines and standards set by regulatory bodies. In India, ICAI also regulates the auditing profession, and non-compliance with its directives can lead to legal and professional consequences. 2. **Professional standards**: Adhering to the Guidance Note and Standards on Auditing ensures that the auditor maintains the highest level of professional standards. This includes due diligence, objectivity, and the exercise of professional skepticism. 3. **Quality and reliability of audit**: Compliance with established standards and Guidance Notes helps to ensure that the audit is conducted with a consistent and systematic approach, leading to a more reliable and high-quality audit report. 4. **Risk management**: Compliance with these guidelines helps the auditor in identifying and assessing the risks of material misstatement in the financial statements due to fraud or error. It also aids in designing and implementing appropriate responses to those risks. 5. **Stakeholder confidence**: Investors, creditors, and other stakeholders rely on the auditor's report to make informed decisions. Compliance with the ICAI's Guidance Note and Standards on Auditing enhances the	applicable laws and regulations may require auditors to provide opinions on other specific matters, such as the effectiveness of internal control, or the consistency of a separate management report with the financial statements. While the SAs include requirements and guidance in relation to such matters to the extent that they are relevant to forming an opinion on the financial statements, the auditor would be required to undertake further work if the auditor had additional responsibilities to provide such opinions." Accordingly, the Standards on Auditing do not fully address the auditing requirements for reporting on the system of internal financial controls over financial reporting. However, relevant portions of the Standards on Auditing need to be considered by the auditor when performing an audit of internal financial controls over financial reporting. For example, the auditor should consider the requirements of SA 230, "Audit Documentation" when documenting the work performed on internal financial controls; the auditor should consider and apply the requirements of SA 315 when understanding internal controls, etc. **Para 37 of the Guidance Note on Audit of Internal Financial Controls Over Financial Reporting** This guidance aims to provide the supplementary procedures that would need to be considered by the auditor for planning, performing and reporting in an audit of internal financial controls over financial reporting under Clause (i) of Sub-section 3 of Section 143 of the 2013 Act. The applicable standards on

	credibility of the auditor's report, thereby increasing stakeholder confidence in the financial statements. 6. **Framework for evaluation**: The Guidance Note provides a framework for the auditor to evaluate the company's internal control system over financial reporting. It helps in understanding the design and operation of the controls and in assessing their effectiveness. 7. **Benchmarking best practices**: The Standards on Auditing represent best practices in the field of audit. They are based on extensive research and are regularly updated to reflect changes in the business environment, technology, and regulatory landscape. 8. **Global alignment**: Standards on Auditing are aligned with international standards. Compliance with these standards ensures that the audit is recognized and respected on a global scale, which is particularly important for entities that operate internationally or are listed on foreign stock exchanges. 9. **Responsibility to report deficiencies**: The auditor has a responsibility to report significant deficiencies and material weaknesses in internal control to those charged with governance and management. Compliance with the Guidance Note and Standards on Auditing helps	auditing which, inter alia, need to be considered by the auditor when performing an audit of internal financial controls is given in the respective paragraphs of this guidance.

	the auditor in fulfilling this responsibility effectively. 10. **Continuous improvement**: By adhering to the Guidance Note and Standards on Auditing, auditors are encouraged to continuously improve their audit methodologies and stay updated with the latest developments in auditing practices.	

Observation 3:

It was observed that the auditor has not performed any audit procedures for referencing and linking of financial statements and work papers with trial balance to ensure completeness and accuracy of financial statements.

What is the issue?	AASB Suggested Guidance	Technical Literature
Why financial statements should be cross referenced to the trial balance as per SA 330?	Financial statements should be referenced/cross-referenced to the trial balance as per SA 330 for several reasons: 1. **Accuracy and completeness**: Cross-referencing ensures that all accounts from the trial balance have been accurately transferred to the financial statements. This is a check on the completeness and accuracy of the financial statements. 2. **Verification of balances**: It allows the auditor to verify that the balances reported in the financial statements agree with the underlying accounting records, ensuring that the financial statements are based on the entity's books and records. 3. **Detection of misstatements**: By referencing the trial balance, auditors can detect any discrepancies or misstatements that may have occurred during the preparation of the financial statements. 4. **Audit trail**: Cross-referencing provides a clear audit trail that can be followed during the audit process. This is important for both the auditor and those charged with governance, as it facilitates the review and understanding of how the financial statements were prepared.	**Para 20 of SA 330:** The auditor's substantive procedures shall include the following audit procedures related to the financial statement closing process: (a) Agreeing or reconciling the financial statements with the underlying accounting records; and (b) Examining material journal entries and other adjustments made during the course of preparing the financial statements. (Ref: Para. A52)

	5. **Risk assessment**: Cross-referencing helps auditors in assessing the risk of material misstatement in the financial statements. It is a part of the audit procedures that auditors perform in response to the risks identified. 6. **Supporting audit opinion**: The cross-referencing process provides evidence to support the auditor's opinion on whether the financial statements are free from material misstatement, whether due to fraud or error. 7. **Regulatory compliance**: Financial reporting standards and accounting principles often require that financial statements should be prepared based on the trial balance. Cross-referencing ensures compliance with these standards and principles. 8. **Professional skepticism**: Cross-referencing encourages auditors to exercise professional skepticism by not taking the financial statements at face value and instead verifying the figures against the trial balance.	

Observation 4:

During the course of review of files, it has been observed that in a few cases no audit procedure has been performed.

What is the issue?	AASB Suggested Guidance	Technical Literature
What procedures are to be performed for material class of transactions, account balance and disclosures?	SA 330 mandates that audit firm should perform substantive procedures for each material class of transactions, account balance and disclosures, regardless of the assessed risk of material misstatement. Substantive procedures are audit procedures aimed at identifying material misstatements at the assertion level. They include: **(i) Tests of details:** These involve examining specific classes of transactions, account balances, and disclosures. **(ii) Substantive analytical procedures:** These involve evaluating financial information through analysis of relationships and trends to identify potential misstatements.	**Para 4(a) of SA 330:** **Definition** *Substantive procedure* – An audit procedure designed to detect material misstatements at the assertion level. Substantive procedures comprise: (i) Tests of details (of classes of transactions, account balances, and disclosures), and (ii) Substantive analytical procedures. **Para 18 of SA 330:** Irrespective of the assessed risks of material misstatement, the auditor shall design and perform substantive procedures for each material class of transactions, account balance, and disclosure. (Ref: Para. A42-A47)
Why is it necessary for audit firm to perform detailed testing on each material class of transactions, account balance, and disclosure, even if the assessed risk of material misstatement is low?	Audit firm is required to perform detailed testing on each material class of transactions, account balance and disclosures, regardless of the assessed risk of material misstatement, for several key reasons: **1. Limitations of risk assessment:** Risk assessments are based on judgment and may not identify all risks of material misstatement. **2. Limitations of internal control:** Internal controls can be overridden or may have inherent weaknesses.	**Para A42 of SA 330:** Paragraph 18 requires the auditor to design and perform substantive procedures for each material class of transactions, account balance, and disclosure, irrespective of the assessed risks of material misstatement. This requirement reflects the facts that: (i) the auditor's assessment of risk is judgmental and so may not identify all risks of material misstatement; and (ii) there are inherent limitations to internal control, including management override.

	3. Comprehensive coverage: Detailed testing ensures all significant areas are reviewed, enhancing the reliability of the financial statements. **4. Mitigation of audit risk:** Performing substantive procedures reduces the overall audit risk and ensures that material misstatements are detected.	
What factors might lead an audit firm to choose between performing only substantive analytical procedures, solely tests of details, or a combination of both to reduce audit risk to an acceptably low level?	Under SA 330, an audit firm should decide on the audit procedures based on: **1. Risk assessment:** • *Substantive analytical procedures*: If the assessed risk is low and supported by effective controls, these procedures alone may suffice. **2. Nature of transactions:** • *Tests of details*: When the risk is high or transactions are complex, detailed tests are needed for accuracy. **3. Effectiveness of controls:** • *Effective controls:* Effective internal controls can support the use of analytical procedures alone. • *Weak controls:* If controls are ineffective, tests of details are necessary. **4. Combination approach:** • *Mixed procedures:* Combining both approaches ensures comprehensive coverage and addresses various risks effectively. This approach ensures that audit risk is reduced to an acceptably low level.	**Para A43 of SA 330:** Depending on the circumstances, the auditor may determine that: • Performing only substantive analytical procedures will be sufficient to reduce audit risk to an acceptably low level. For example, where the auditor's assessment of risk is supported by audit evidence from tests of controls. • Only tests of details are appropriate. • A combination of substantive analytical procedures and tests of details are most responsive to the assessed risks.

Chapter 8

Observations related to SA 450, Evaluation of Misstatements Identified During the Audit

Observation 1:

The auditor should have documented uncorrected errors and if there were no such errors it should have been documented.

What is the issue?	AASB Suggested Guidance	Technical Literature
What are the requirements of SA 450 regarding uncorrected misstatements?	SA 450 requires the auditor to evaluate the effect of uncorrected misstatements on the financial statements to determine whether they are material to the financial statements, either individually or in aggregate. SA 450 also requires the auditor to obtain written representation from the 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. SA 450 also contains documentation requirements regarding uncorrected misstatements. Considering the above, the auditor should document all the misstatements identified during the audit. In order to evaluate the cumulative impact of	**Para 5 of SA 450:** The auditor shall accumulate misstatements identified during the audit, other than those that are clearly trivial. (Ref: Para. A2-A3) **Para 8 of SA 450:** 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. (Ref: Para. A7-A9) **Para 9 of SA 450:** 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. (Ref: Para. A10) **Para 10 of SA 450:** Prior to evaluating the effect of uncorrected misstatements, the auditor shall reassess materiality determined in

	misstatements and also to include them in management representation, it is imperative for the auditor to accumulate these misstatements in a single working paper. In case there are no identified misstatements, the auditor should document the same in audit working papers to support the auditor's opinion. The auditor may also include this fact in management representation.	accordance with SA 320 to confirm whether it remains appropriate in the context of the entity's actual financial results. (Ref: Para. A11-A12) **Para 11 of SA 450:** 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 (Ref: Para. A13-A17, A19-A20) (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. (Ref: Para. A18) **Para 12 of SA 450:** The auditor shall communicate with those charged with governance 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. (Ref: Para. A21-A23) **Para 13 of SA 450:** The auditor shall also communicate with those charged with governance 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. **Para 14 of SA 450:** 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. (Ref: Para. A24) **Para 15 of SA 450:** The audit documentation shall include: (Ref: Para. A25) (a) The amount below which misstatements would be regarded as clearly trivial (paragraph 5); (b) All misstatements accumulated during the audit and whether they have been corrected (paragraphs 5, 8 and 12); and (c) The auditor's conclusion as to whether uncorrected misstatements are material, individually or in aggregate, and the basis for that conclusion. (Paragraph 11) **Para 5 of SA 320:** The concept of materiality is applied by the auditor both in planning and performing the audit, and in evaluating the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial statements and in forming the opinion in the auditor's report. (Ref: Para. A1) **Para 6 of SA 320:** In planning the audit, the auditor makes judgments about the size of misstatements that will be considered

		material. These judgments provide a basis for: (a) Determining the nature, timing and extent of risk assessment procedures; (b) Identifying and assessing the risks of material misstatement; and (c) Determining the nature, timing and extent of further audit procedures. The materiality determined when planning the audit does not necessarily establish an amount below which uncorrected misstatements, individually or in aggregate, will always be evaluated as immaterial. The circumstances related to some misstatements may cause the auditor to evaluate them as material even if they are below materiality. Although, it is not practicable to design audit procedures to detect misstatements that could be material solely because of their nature, the auditor considers not only the size but also the nature of uncorrected misstatements, and the particular circumstances of their occurrence, when evaluating their effect on the financial statements.

Observation 2:

Misstatements were found during audit, but neither the differences were corrected at the time of finalization of accounts nor audit comment was found by the firm.

What is the issue?	AASB Suggested Guidance	Technical Literature
What steps should an audit firm take in response to uncorrected misstatements that are below the materiality level, according to SA 450?	If uncorrected misstatements are below the materiality level, the audit firm should: 1. **Document the misstatements**: Record the details of all uncorrected misstatements, including their nature and amount, in the audit working papers. 2. **Assess cumulative impact:** Evaluate the combined effect of all uncorrected misstatements to ensure that their total impact remains below the materiality threshold. Determine whether the overall audit strategy and audit plan needs to be revisited. 3. **Communicate with management and those charged with governance:** Inform management and those charged with governance about the uncorrected misstatements, regardless of their immateriality and obtain written representation that they believe the effects of uncorrected misstatements are immaterial, individually and in aggregate, to the financial statements as a whole. 4. **Re-evaluate materiality**: Reassess the materiality level to confirm that the uncorrected misstatements do not aggregate to a material amount that could affect the financial statements. 5. **Review financial statements**: Ensure that the financial statements	**Para 6 of SA 450:** 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 (Ref: Para. A4) (b) The aggregate of misstatements accumulated during the audit approaches materiality determined in accordance with SA 320. (Ref: Para. A5) **Para 8 of SA 450:** 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 (Ref: Para. A7-A9) **Para 10 of SA 450:** Prior to evaluating the effect of uncorrected misstatements, the auditor shall reassess materiality determined in accordance with SA 320 to confirm whether it remains appropriate in the context of the

	are presented fairly despite the presence of these uncorrected misstatements.	entity's actual financial results. (Ref: Para. A11-A12) **Para 14 of SA 450:** 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. (Ref: Para. A24) **Para 15 of SA 450:** The audit documentation shall include: (Ref: Para. A25) (a) The amount below which misstatements would be regarded as clearly trivial (paragraph 5); (b) All misstatements accumulated during the audit and whether they have been corrected (paragraphs 5, 8 and 12); and (c) The auditor's conclusion as to whether uncorrected misstatements are material, individually or in aggregate, and the basis for that conclusion. (paragraph 11)
What factors should be considered by the audit firm when determining if uncorrected misstatements are material?	When determining if uncorrected misstatements are material, the audit firm should consider the following factors: **1. Nature of the misstatements:** Assess the type of misstatement and its potential impact on the financial statements. Certain types of misstatements, such as those involving fraud or violations of laws, may be material regardless of their size.	**Para 11 of SA 450:** 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

	2. Effect on financial statements: Evaluate how the misstatements affect the financial statements as a whole. Consider whether they distort the overall financial picture, affect the decisions of financial statements users or undermine the reliability of financial statements. **3. Aggregate impact:** Consider the cumulative effect of all uncorrected misstatements. Even if individual misstatements are below materiality thresholds, their combined impact might be material. **4.Trends or patterns:** Determine if there is a trend or pattern in the misstatements that could suggest ongoing issues with the entity's financial reporting or internal controls. **5.Potential to indicate other misstatements:** Assess whether the uncorrected misstatements could indicate that other areas of the financial statements might be materially misstated or that systemic issues exist. **6.Quantitative and qualitative factors:** Evaluate both quantitative aspects (size of misstatements relative to financial statements amounts) and qualitative aspects (such as the nature and context of the misstatements). By considering these factors, the audit firm ensures a comprehensive evaluation of the materiality of uncorrected misstatements and their potential impact on the financial statements.	statements as a whole, and the particular circumstances of their occurrence; and (Ref: Para. A13-A17, A19-A20) (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. (Ref: Para. A18)

Chapter 9

Observations related to SA 500, Audit Evidence

Observation 1:

Note No. 23 para (b) of "Notes forming part of financial statement" contains information that during the financial year, the management has technically re-evaluated the estimated useful life of fixed assets and consequently depreciation has been re-ascertained on the balance estimated useful life. As a result, additional depreciation of Rs. 50.49 million (previous year Rs. Nil) has been recognized in the Statement of Profit and Loss.

Current year's decision of charging depreciation using revised estimated life of plant, machinery & equipment is solely based on Chartered Engineer's certificate for revision in the estimate-change in accounting estimate i.e. change in rate of depreciation and this certificate is appear to be incomplete in the sense that no basis of estimation of useful life, limitations etc. have been mentioned therein; Competence, capability and objectivity of management's expert has not been assessed before accepting the same as an acceptable audit evidence; Even management representation letter is not having any mention about this revision in estimate process effecting accounts of financial year.

OR

The company obtained actuary's estimation of gratuity and leave encashment liability on quarterly basis, and in each quarter the rate of interest was different (ranging from 7.9% to 9.2%). There was no actuary's certificate for liability on annual basis as on year end. At the year end, liability and expenses were shown as summation of each quarter, whereas this liability should have been calculated as on year end for the whole year.

What is the issue?	AASB Suggested Guidance	Technical Literature
What audit procedures are required to be performed, when information to be used as audit evidence has been prepared using the work of a management's expert?	As per SA 500, when information is to be used as audit evidence has been prepared using the work of a management's expert, the auditor needs to: • Evaluate the competence, capabilities and objectivity of that expert. (Please refer Para. A37-A43 of SA 500) • Obtain an understanding of the work of that expert. (Please refer Para. A44-A47 of SA 500)	**Para 5(d) of SA 500:** **Definition** *Management's expert* – An individual or organisation possessing expertise in a field other than accounting or auditing, whose work in that field is used by the entity to assist the entity in preparing the financial statements. **Para 7 of SA 500:** When designing and performing audit procedures, the auditor shall consider the relevance and reliability of the information to be used as audit evidence. (Ref: Para. A26-A33)

	• Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion. (Please refer Para. A48 of SA 500)	**Para 8 of SA 500:** When information to be used as audit evidence has been prepared using the work of a management's expert, the auditor shall, to the extent necessary, having regard to the significance of that expert's work for the auditor's purposes: (Ref: Para. A34-A36) (a) Evaluate the competence, capabilities and objectivity of that expert; (Ref: Para. A37-A43) (b) Obtain an understanding of the work of that expert; and (Ref: Para. A44-A47) (c) Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion. (Ref: Para. A48) **Para A34 of SA 500:** The preparation of an entity's financial statements may require expertise in a field other than accounting or auditing, such as actuarial calculations, valuations, or engineering data. The entity may employ or engage experts in these fields to obtain the needed expertise to prepare the financial statements. Failure to do so when such expertise is necessary increases the risks of material misstatement. **Para A35 of SA 500:** When information to be used as audit evidence has been prepared using the work of a management's expert, the requirement in paragraph 8 of this SA applies. For example, an individual or organisation may possess expertise in the application of models to estimate the fair value of securities for which there is no observable market. If the individual or organisation applies that expertise in making an estimate which the entity uses in preparing its financial statements, the individual or organisation is a management's expert and paragraph 8 applies. If, on the other hand, that individual or organization merely provides price data regarding private transactions not otherwise available to the

		entity which the entity uses in its own estimation methods, such information, if used as audit evidence, is subject to paragraph 7 of this SA, but is not the use of a management's expert by the entity. **Para A36 of SA 500:** The nature, timing and extent of audit procedures in relation to the requirement in paragraph 8 of this SA, may be affected by such matters as: • The nature and complexity of the matter to which the management's expert relates. • The risks of material misstatement in the matter. • The availability of alternative sources of audit evidence. • The nature, scope and objectives of the management's expert's work. • Whether the management's expert is employed by the entity, or is a party engaged by it to provide relevant services. • The extent to which management can exercise control or influence over the work of the management's expert. • Whether the management's expert is subject to technical performance standards or other professional or industry requirements. • The nature and extent of any controls within the entity over the management's expert's work. • The auditor's knowledge and experience of the management's expert's field of expertise. • The auditor's previous experience of the work of that expert.

Chapter 10

Observations related to SA 501, Audit Evidence - Specific Considerations for Selected Items

Observation 1:

There is no mention of any inventory which is lying with third parties and how the physical quantity of the same was confirmed. Further, there is also absence of evidence of any confirmation being sent to such third party for confirmation of stock lying with them. Adequate documentation evidencing such matters including audit conclusions to be maintained in the audit work papers.

What is the issue?	AASB Suggested Guidance	Technical Literature
What are the audit considerations when inventory held by third parties is material to the financial statements?	SA 501 requires the audit firm to confirm significant inventory held by third parties at the physical inventory date. In addition to confirmation, the audit firm may also consider performing additional procedures on inventory held by third parties depending on the nature of the inventory and other circumstances. Additional procedures might include: • Attending, or arranging for another auditor to attend, the third party's physical counting of inventory, if practicable. • Obtaining another auditor's report, or a service auditor's report, on the adequacy of the third party's internal control for ensuring that inventory is properly counted and adequately safeguarded. • Inspecting documentation regarding inventory held by third parties, for example, warehouse receipts. • Requesting confirmation from	**Para 8 of SA 501:** When inventory under the custody and control of a third party is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of that inventory by performing one or both of the following: (a) Request confirmation from the third party as to the quantities and condition of inventory held on behalf of the entity. (Ref: Para. A15) (b) Perform inspection or other audit procedures appropriate in the circumstances. (Ref: Para. A16) **Para A16 of SA 501:** Depending on the circumstances, for example where information is obtained that raises doubt about the integrity and objectivity of the third party, the auditor may consider it appropriate to perform other audit procedures instead of, or in addition to, confirmation with the third party.

	other parties when inventory has been pledged as collateral.	Examples of other audit procedures include: • Attending, or arranging for another auditor to attend, the third party's physical counting of inventory, if practicable. • Obtaining another auditor's report, or a service auditor's report, on the adequacy of the third party's internal control for ensuring that inventory is properly counted and adequately safeguarded. • Inspecting documentation regarding inventory held by third parties, for example, warehouse receipts. • Requesting confirmation from other parties when inventory has been pledged as collateral.

Observation 2:

In respect of inventories, there was no attendance at the year-end inventory count. Reliance was placed on the periodical physical verification carried out by internal auditors of the company and management's verification procedures. However, it was not clear from the documentation what work was done on the inventories at the year end and whether roll forward procedures have been performed to ensure inventories at the year end.

What is the issue?	AASB Suggested Guidance	Technical Literature
What are the audit procedures the audit firm should perform to ensure that the physical inventory counting process is reliable, particularly in verifying inventory existence, assessing condition, and observing adherence to management's instructions and procedures?	In accordance with SA 501, management typically sets up procedures for counting inventory at least once a year. This counting is done to serve as a basis for the preparation of financial statements and to check if the ongoing inventory tracking system is reliable. When attending the physical inventory count, the audit firm should: • Verify the existence and condition of the inventory by inspecting it and performing test counts. • Observe whether management's instructions are followed and whether the procedures for recording and controlling inventory counts are properly executed. • Gather evidence to confirm that management's inventory counting procedures are reliable.	**Para 4 of SA 501:** When inventory is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by: (a) Attendance at physical inventory counting, unless impracticable, to: (Ref: Para. A1-A3) (i) Evaluate management's instructions and procedures for recording and controlling the results of the entity's physical inventory counting; (Ref: Para. A4) (ii) Observe the performance of management's count procedures; (Ref: Para. A5) (iii) Inspect the inventory; and (Ref: Para. A6) (iv) Perform test counts; and (Ref: Para. A7-A8) (b) Performing audit procedures over the entity's final inventory records to determine whether they accurately reflect actual inventory count results. **Para A1 of SA 501:** Management ordinarily establishes procedures under which inventory is physically counted at least once a year to serve as a basis for the preparation of

		the financial statements and, if applicable, to ascertain the reliability of the entity's perpetual inventory system. **Para A2 of SA 501:** Attendance at physical inventory counting involves: • Inspecting the inventory to ascertain its existence and evaluate its condition and performing test counts; • Observing compliance with management's instructions and the performance of procedures for recording and controlling the results of the physical inventory count; and • Obtaining audit evidence as to the reliability of management's count procedures.
What are the audit procedures the audit firm needs to perform in case the inventory counting is conducted at a date other than date of the financial statements?	If the physical count of inventory is done on a date other than the date of financial statements, the audit firm needs to perform additional procedures to ensure that any changes in inventory between the count date and the date of financial statements are accurately recorded. Sometimes, physical inventory counts are done on different dates rather than exactly on the date of financial statements. This can be acceptable if the controls over changes in inventory are effective. SA 330 gives guidelines on how to perform audit procedures when using interim dates. If an entity uses a perpetual inventory system (where records are updated continuously), management might perform physical counts to check the accuracy of these	**Para 5 of SA 501:** If physical inventory counting is conducted at a date other than the date of the financial statements, the auditor shall, in addition to the procedures required by paragraph 4, perform audit procedures to obtain audit evidence about whether changes in inventory between the count date and the date of the financial statements are properly recorded. (Ref: Para. A9-A11) **Para A9 of SA 501:** For practical reasons, the physical inventory counting may be conducted at a date, or dates, other than the date of the financial statements. This may be done irrespective of whether management determines inventory quantities by an annual physical inventory counting or maintains a perpetual inventory system. In either case, the effectiveness of the design, implementation and maintenance of controls over changes in inventory determines whether the conduct of physical inventory counting at a date, or

	records. Discrepancies between physical counts and perpetual inventory records may suggest problems with inventory controls. When planning audit procedures for inventory counts on different dates, auditor should consider: • Whether records are updated correctly. • The reliability of the inventory records. • The reasons for any major differences between physical counts and records.	dates, other than the date of the financial statements is appropriate for audit purposes. SA 330 establishes requirements and provides guidance on substantive procedures performed at an interim date. **Para A10 of SA 501:** Where a perpetual inventory system is maintained, management may perform physical counts or other tests to ascertain the reliability of inventory quantity information included in the entity's perpetual inventory records. In some cases, management or the auditor may identify differences between the perpetual inventory records and actual physical inventory quantities on hand; this may indicate that the controls over changes in inventory are not operating effectively. **Para A11 of SA 501:** Relevant matters for consideration when designing audit procedures to obtain audit evidence about whether changes in inventory amounts between the count date, or dates, and the final inventory records are properly recorded include: • Whether the perpetual inventory records are properly adjusted. • Reliability of the entity's perpetual inventory records. • Reasons for significant differences between the information obtained during the physical count and the perpetual inventory records.
What alternative procedures should an audit firm perform if attendance at physical inventory counting is impracticable?	Sometimes, attending physical inventory counts may not be feasible due to factors like the location or nature of the inventory, especially if it poses safety risks to the audit firm. However, general inconvenience alone does not	**Para 7 of SA 501:** If attendance at physical inventory counting is impracticable, the auditor shall perform alternative audit procedures to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory. If it is not possible to do so, the auditor

	justify skipping this procedure. Difficulties, time, or cost involved are not valid reasons for avoiding audit procedures, as they should be performed or substituted with other methods to ensure sufficient appropriate audit evidence has been obtained. If attending the physical count is not possible, alternative audit procedures can be used to gather sufficient appropriate audit evidence. For example, audit firm should review documentation related to the sale of inventory items acquired before the counting to verify the inventory's existence and condition. In cases where alternative procedures do not provide sufficient appropriate audit evidence about inventory's existence and condition, the audit firm should modify their audit opinion due to the scope limitation, as required by SA 705 (Revised).	shall modify the opinion in the auditor's report in accordance with SA 705(Revised). (Ref: Para. A12-A14) **Para A12 of SA 501:** In some cases, attendance at physical inventory counting may be impracticable. This may be due to factors such as the nature and location of the inventory, for example, where inventory is held in a location that may pose threats to the safety of the auditor. The matter of general inconvenience to the auditor, however, is not sufficient to support a decision by the auditor that attendance is impracticable. Further, as explained in SA 200, the matter of difficulty, time, or cost involved is not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative or to be satisfied with audit evidence that is less than persuasive. **Para A13 of SA 501:** In some cases where attendance is impracticable, alternative audit procedures, for example inspection of documentation of the subsequent sale of specific inventory items acquired or purchased prior to the physical inventory counting, may provide sufficient appropriate audit evidence about the existence and condition of inventory. **Para A14 of SA 501:** In other cases, however, it may not be possible to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by performing alternative audit procedures. In such cases, SA 705(Revised) requires the auditor to modify the opinion in the auditor's report as a result of the scope limitation.

Chapter 11

Observations related to SA 510, Initial Audit Engagements - Opening Balances

Observation 1:

SA 510 describes the additional procedures that auditor should perform when engaged to perform an audit of an entity's financial statements for the first time or when this is the first audit for the entity ('initial audit engagement').

It was observed that the audit firm was appointed as central statutory auditors, jointly with other auditors. It was observed that testing of opening balances to verify whether the audited balances were brought forward to the next year were not documented in respect of division/areas allocated to the firm.

What is the issue?	AASB Suggested Guidance	Technical Literature
What is the purpose of testing of opening balances in respect of the initial audit engagement?	The basic objectives in an initial audit engagement are similar to those in a recurring audit. However, when an auditor performs an initial audit engagement, the auditor reports on the current period's account balances which are dependent upon the appropriateness of the opening balances. Therefore, in an initial audit engagement, auditor should perform additional procedures to: • Determine the appropriateness of the account balances at the beginning of the period being audited. • Determine whether the accounting policies applied in prior periods have been consistently applied in the current period or changes thereto are properly accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.	**Para 3 of SA 510**: In conducting an initial audit engagement, the objective of the auditor with respect to opening balances is to obtain sufficient appropriate audit evidence about whether: (a) Opening balances contain misstatements that materially affect the current period's financial statements; and (b) Appropriate accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, or changes thereto are properly accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.

What audit procedures are required to be performed by the auditor for testing of opening balances?	The auditor needs to perform various procedures for testing of opening balances. These procedures are given in Para 5-9 of SA 510.	**Para 5 of SA 510**: The auditor shall read the most recent financial statements, if any, and the predecessor auditor's report thereon, if any, for information relevant to opening balances, including disclosures. **Para 6 of SA 510**: The auditor shall obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements by: (a) Determining whether the prior period's closing balances have been correctly brought forward to the current period or, when appropriate, any adjustments have been disclosed as prior period items in the current year's Statement of Profit and Loss; (b) Determining whether the opening balances reflect the application of appropriate accounting policies; and (c) Performing one or more of the following: (Ref: Para. A1–A4) (i) Where the prior year financial statements were audited, perusing the copies of the audited financial statements including the other relevant documents relating to the prior period financial statements; (ii) Evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances; or (iii) Performing specific audit procedures to obtain evidence regarding the opening balances.

		Para 7 of SA 510: If the auditor obtains audit evidence that the opening balances contain misstatements that could materially affect the current period's financial statements, the auditor shall perform such additional audit procedures as are appropriate in the circumstances to determine the effect on the current period's financial statements. If the auditor concludes that such misstatements exist in the current period's financial statements, the auditor shall communicate the misstatements with the appropriate level of management and those charged with governance in accordance with SA 450. **Para 8 of SA 510**: The auditor shall obtain sufficient appropriate audit evidence about whether the accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, and whether changes in the accounting policies have been properly accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework. **Para 9 of SA 510**: If the prior period's financial statements were audited by a predecessor auditor and there was a modification to the opinion, the auditor shall evaluate the effect of the matter giving rise to the modification in assessing the risks of material misstatement in the current period's financial statements in accordance with SA 315.
What step should be taken by auditor when predecessor	When the predecessor auditor's opinion regarding the prior period's financial statements included a modification to the auditor's	**Para 13 of SA 510:** If the predecessor auditor's opinion regarding the prior period's financial

auditor modified report of the prior period?	opinion, auditor should determine the effect on current year auditor's opinion. In some situations, a modification to the predecessor auditor's opinion may not be relevant and material to the opinion on the current period's financial statements, for example, there was a scope limitation in the prior period, but the matter giving rise to the scope limitation has been resolved in the current period.	statements included a modification to the auditor's opinion that remains relevant and material to the current period's financial statements, the auditor shall modify the auditor's opinion on the current period's financial statements in accordance with SA 705(Revised) and SA 710. (Ref: Para. A6)

Chapter 12

Observations related to SA 530, Audit Sampling

Observation 1:

In respect of sampling procedures adopted by the firm, the following observations were noticed:

(a) The firm has not identified any risk of material misstatement in the audit strategy whereas in one of the paragraphs it is recorded that revenue and management override of controls have presumed risk and are marked as high risk. The procedures designed for reducing risk in these cases have not been recorded.

(b) Basis for sample selection and techniques used have not been documented.

(c) Though there are no indications of impairment of going concern assumption for this entity, no standard checklist is used to record the same.

(d) The method of sampling technique used, and the basis of sample size arrived is not documented.

What is the issue?	AASB Suggested Guidance	Technical Literature
What is the auditor's responsibility relating to identifying risk of material misstatement, significant risk and fraud risk? What procedures the auditor should perform and document for identified risks?	As per SA 240 and SA 315, the auditor is required to identify and assess risk of material misstatement whether due to fraud or error, at the financial statements level and assertion level. The auditor is also required to assess whether an identified risk of material misstatement is a significant risk. Further, as per SA 240, while assessing the risks of material misstatements, the auditor is required to presume that there is a risk of fraud in revenue recognition. In case the auditor concludes that the presumption of fraud risk in revenue recognition does not exist, the auditor needs to document reasons for that conclusion. Apart from above, the auditor is also required to document the following:	**Para 5 of SA 240:** An auditor conducting an audit in accordance with SAs is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error. Owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with the SAs. **Para 25 of SA 315:** The auditor shall identify and assess the risks of material misstatement at: (a) The financial statement level; and (Ref: Para. A117-A120) (b) The assertion level for classes of transactions, account balances, and disclosures (Ref: Para. A121-A125)

	• Results of discussion with engagement team members relating to identification of risk of material misstatement due to fraud or error. • Result of enquiries with the management or those charged with governance. • The identified risk of material misstatement at the financial statements and assertion level. • Overall response to the risks identified. • Results of audit procedures performed including those designed to address the risk of management override of controls.	to provide a basis for designing and performing further audit procedures. **Para 26 of SA 315:** For this purpose, the auditor shall: (a) Identify risks throughout the process of obtaining an understanding of the entity and its environment, including relevant controls that relate to the risks, and by considering the classes of transactions, account balances, and disclosures in the financial statements; (Ref: Para. A126-A127) (b) Assess the identified risks, and evaluate whether they relate more pervasively to the financial statements as a whole and potentially affect many assertions; (c) Relate the identified risks to what can go wrong at the assertion level, taking account of relevant controls that the auditor intends to test; and (Ref: Para. A128-A130) (d) Consider the likelihood of misstatement, including the possibility of multiple misstatements, and whether the potential misstatement is of a magnitude that could result in a material misstatement. **Para 27 of SA 315:** As part of the risk assessment as described in paragraph 25, the auditor shall determine whether any of the risks identified are, in the auditor's judgment, a significant risk. In exercising this judgment, the auditor shall exclude the effects of identified controls related to the risk. **Para 28 of SA 315:** In exercising judgment as to which risks are significant risks, the auditor

		shall consider at least the following: (a) Whether the risk is a risk of fraud; (b) Whether the risk is related to recent significant economic, accounting, or other developments like changes in regulatory environment, etc., and, therefore, requires specific attention; (c) The complexity of transactions; (d) Whether the risk involves significant transactions with related parties; (e) The degree of subjectivity in the measurement of financial information related to the risk, especially those measurements involving a wide range of measurement uncertainty; and (f) Whether the risk involves significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual. (Ref: Para. A131-A135) **Para 29 of SA 315:** When the auditor has determined that a significant risk exists, the auditor shall obtain an understanding of the entity's controls, including control activities, relevant to that risk. (Ref: Para. A136-A138) **Para 26 of SA 240:** When identifying and assessing the risks of material misstatement due to fraud, the auditor shall, based on a presumption that there are risks of fraud in revenue recognition, evaluate which types of revenue, revenue transactions or assertions give rise to such risks. Paragraph 47 specifies the documentation required when the auditor concludes that the presumption is not applicable in the circumstances

		of the engagement and, accordingly, has not identified revenue recognition as a risk of material misstatement due to fraud. (Ref: Para. A28-A30) **Para 27 of SA 240:** The auditor shall treat those assessed risks of material misstatement due to fraud as significant risks and accordingly, to the extent not already done so, the auditor shall obtain an understanding of the entity's related controls, including control activities, relevant to such risks. (Ref: Para. A31-A32) **Para 47 of SA 240:** When the auditor has concluded that the presumption that there is a risk of material misstatement due to fraud related to revenue recognition is not applicable in the circumstances of the engagement, the auditor shall document the reasons for that conclusion.
How does the auditor ensure that the sample design, size, and selection process effectively reduce the risk of undetected fraud, and what evidence supports that each item in the population has a fair chance of being included in the sample?	When designing an audit sample, the auditor should consider both the purpose of the audit procedure and the characteristics of the population from which the sample is drawn. The auditor should choose a sample size large enough to minimize sampling risk to an acceptable level. The auditor should ensure that the sample selection process gives each item in the population a chance to be included.	**Para 6 of SA 530:** When designing an audit sample, the auditor shall consider the purpose of the audit procedure and the characteristics of the population from which the sample will be drawn. (Ref: Para. A4-A9) **Para 7 of SA 530:** The auditor shall determine a sample size sufficient to reduce sampling risk to an acceptably low level. (Ref: Para. A10-A11) **Para 8 of SA 530:** The auditor shall select items for the sample in such a way that each sampling unit in the population has a chance of selection. (Ref: Para. A12-A13)
How does the documentation	Under the going concern basis of accounting, financial statements	**Para 2 of SA 570 (Revised):** Under the going concern basis of

ensure that the use of the going concern basis of accounting is appropriately justified?	are prepared assuming that the entity will continue its operations for the foreseeable future. The auditor should ensure that there is sufficient documentation supporting the assumption of going concern and that any potential doubts about the entity's ability to continue its operations are thoroughly addressed. As per SA 570 (Revised), it is the auditor's responsibility to obtain sufficient appropriate audit evidence regarding the appropriateness of management's use of the going concern basis of accounting in preparation of financial statements. SA 570 (Revised) further states that the auditor's responsibility to assess the entity's ability to continue as a going concern exists even though the financial reporting framework does not include an explicit requirement for management to make a specific assessment of the entity's ability to continue as a going concern. As clearly stated in SA 570 (Revised), the auditor is required to assess the entity's ability to continue as going concern. Any assessment made by the auditor is required to be supported by documentation in line with SA 230, Audit Documentation. Therefore, the auditor should maintain sufficient documentation regarding his assessment about the entity's ability to continue as going concern. The auditor may use the "Checklist on Standards on Auditing" issued by the Auditing and Assurance Standards Board of ICAI to identify any indicators	accounting, the financial statements are prepared on the assumption that the entity is a going concern and will continue its operations for the foreseeable future. General purpose financial statements are prepared using the going concern basis of accounting, unless management either intends to liquidate the entity or to cease operations or has no realistic alternative but to do so. Special purpose financial statements may or may not be prepared in accordance with a financial reporting framework for which the going concern basis of accounting is relevant (e.g., the going concern basis of accounting is not relevant for some financial statements prepared on a tax basis). When the use of the going concern basis of accounting is appropriate, assets and liabilities are recorded on the basis that the entity will be able to realize its assets and discharge its liabilities in the normal course of business. (Ref: Para.A2) **Para 6 of SA 570 (Revised):** The auditor's responsibilities are to obtain sufficient appropriate audit evidence regarding, and conclude on, the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements, and to conclude, based on the audit evidence obtained, whether a material uncertainty exists about the entity's ability to continue as a going concern. These responsibilities exist even if the financial reporting framework used in the preparation of the financial statements does not include an explicit requirement for management to make a specific assessment of the entity's ability to continue as a going concern.

	questioning the going concern ability of the entity. Based on the checklist, if any such indicators are identified, the auditor should expand his audit procedures and prepare documentation evidencing performance of additional procedures and their results.	

Chapter 13

Observations related to SA 540, Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures

Observation 1:

In relation to payroll, the following observations were noticed:

1. Reconciliation of pay sheet to general ledger - not present in audit working papers.
2. Challenging and testing the assumptions considered by actuary - not present in the audit working papers.
3. Overall reconciliation / testing of the payroll balances - detail testing is being done which is based on judgmental sample size and samples picked on a random basis.
4. Headcount reconciliation.
5. Testing of other payroll related balances such as incentives/bonus/gratuity etc.

In relation to advance to employees, it was noted that the schedule detailed a debit balance of Rs. 2 million (account code 176001) against advances. However, in the trial balance the same is classified as a credit item and grouped with advances. Further, there is an amount of Rs. 1.3 million (account code 176020) which is also grouped with other advances. No explanation or reasoning given in audit documentation for classifying the credit balances as assets under advances.

Adequate documentation evidencing such matters including audit conclusions not maintained in the audit work papers.

OR

Audit documentation should be sufficient to explain the audit conclusions drawn from the testing of trade receivables. Provision for trade receivables being a management estimate, audit firm needs to exercise adequate professional skepticism over key management judgements and estimates and appropriately documented.

What is the issue?	AASB Suggested Guidance	Technical Literature
Why is the exercise of professional skepticism of critical importance while auditing significant accounting estimates?	Exercising professional skepticism is particularly important when auditing accounting estimates because of their inherent nature. Its importance increases when there is a greater degree of estimation uncertainty and when there is greater susceptibility to misstatement	**Para 2 of SA 540:** Some financial statement items cannot be measured precisely, but can only be estimated. For purposes of this SA, such financial statement items are referred to as accounting estimates. The nature and reliability of information available to management to support the making of an accounting estimate varies widely, which thereby affects the

	due to management bias or fraud. As required by SA 540, an audit firm should review the judgments and decisions made by management in the making of accounting estimates to identify whether there are indicators of possible management bias.	degree of estimation uncertainty associated with accounting estimates. The degree of estimation uncertainty affects, in turn, the risks of material misstatement of accounting estimates, including their susceptibility to unintentional or intentional management bias. (Ref: Para. A1- A11) **Para 21 of SA 540:** The auditor shall review the judgments and decisions made by management in the making of accounting estimates to identify whether there are indicators of possible management bias. Indicators of possible management bias do not themselves constitute misstatements for the purposes of drawing conclusions on the reasonableness of individual accounting estimates. (Ref: Para. A124-A125)
What are the common indicators of management bias in accounting estimates?	As per SA 540, management bias exists if there are changes in an accounting estimate, or the method for making it, when management has made a subjective assessment that there has been a change in circumstances, selectively developing significant assumptions or interpreting data to support a point estimate that is favorable for management objectives or selection of a point estimate that may indicate a pattern of optimism or pessimism. When indicators of possible management bias are identified, the audit firm should evaluate the implications for the audit. When there is intention to mislead, management bias is fraudulent in nature.	**Para A125 of SA 540:** Examples of indicators of possible management bias with respect to accounting estimates include: • Changes in an accounting estimate, or the method for making it, where management has made a subjective assessment that there has been a change in circumstances. • Use of an entity's own assumptions for fair value accounting estimates when they are inconsistent with observable marketplace assumptions. • Selection or construction of significant assumptions that yield a point estimate favourable for management objectives. • Selection of a point estimate that may indicate a pattern of optimism or pessimism.

What are the key considerations while documenting accounting estimates?	SA 540 requires the auditor to document the basis for the conclusions about the reasonableness of accounting estimates and their disclosure that give rise to significant risks and indicators of possible management bias, if any. To achieve these documentation requirements, the audit firm may also consider documenting the requirements of applicable financial reporting framework, regulatory factors, understanding of the control environment, relevant IT applications and the method/model, significant assumptions and data used by management to determine the accounting estimates and whether they are appropriate in the context of the applicable financial reporting framework.	**Para 23 of SA 540:** The audit documentation shall include: (a) The basis for the auditor's conclusions about the reasonableness of accounting estimates and their disclosure that give rise to significant risks; and (b) Indicators of possible management bias, if any. (Ref: Para. A128) **Para A128 of SA 540:** Documentation of indicators of possible management bias identified during the audit assists the auditor in concluding whether the auditor's risk assessment and related responses remain appropriate, and in evaluating whether the financial statements as a whole are free from material misstatement. See paragraph A125 for examples of indicators of possible management bias. **Para 8 of SA 230:** The auditor shall prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand: (Ref: Para. A2-A5, A16-A17) (a) The nature, timing, and extent of the audit procedures performed to comply with the SAs and applicable legal and regulatory requirements; (Ref: Para. A6-A7) (b) The results of the audit procedures performed, and the audit evidence obtained; and (c) Significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions. (Ref: Para. A8- A11)

Chapter 14
Observations related to SA 550, Related Parties

Observation 1:

Non-compliance of SA 550 in respect of not documenting the performance of audit procedures and related activities to obtain information relevant to identifying the risks of material misstatement associated with related party relationships and transactions.

What is the issue?	AASB Suggested Guidance	Technical Literature
What are the requirements of SA 550 w.r.t. identifying and assessing the risks of material misstatement associated with related party relationships and transactions?	Many financial reporting frameworks establish specific accounting and disclosure requirements for related party relationships, transactions and balances to enable users of the financial statements to understand their nature and actual or potential effects on the financial statements. Where the applicable financial reporting framework establishes such requirements, the auditor has a responsibility to perform audit procedures to identify, assess and respond to the risks of material misstatement arising from the entity's failure to appropriately account for or disclose related party relationships, transactions or balances in accordance with the requirements of the framework. Even if the applicable financial reporting framework establishes minimal or no related party requirements, as required under SA 550, the auditor nevertheless needs to obtain an understanding of the entity's related party relationships and transactions sufficient to be able to conclude whether the financial statements, insofar as they are affected by those relationships	**Para 11 of SA 550:** As part of the risk assessment procedures and related activities that SA 315 and SA 240 require the auditor to perform during the audit, the auditor shall perform the audit procedures and related activities set out in paragraphs 12-17 to obtain information relevant to identifying the risks of material misstatement associated with related party relationships and transactions. (Ref: Para. A8) **Para 18 of SA 550:** In meeting the SA 315 requirement to identify and assess the risks of material misstatement, the auditor shall identify and assess the risks of material misstatement associated with related party relationships and transactions and determine whether any of those risks are significant risks. In making this determination, the auditor shall treat identified significant related party transactions outside the entity's normal course of business as giving rise to significant risks. **Para 19 of SA 550:** If the auditor identifies fraud risk factors (including circumstances relating to the existence of a related party with dominant influence) when performing the risk assessment procedures and related activities in connection with related parties, the auditor shall consider such

	and transactions: (a) Achieve a true and fair presentation (for fair presentation frameworks); or (b) Are not misleading (for compliance frameworks). SA 550 also prescribes that an understanding of the entity's related party relationships and transactions is relevant to the auditor's evaluation of whether one or more fraud risk factors are present as required by SA 240 because fraud may be more easily committed through related parties. SA 550 also requires the auditor to obtain written representations from management, and where appropriate, those charged with governance regarding accounting and disclosure of related party relationships and transactions in accordance with the requirements of applicable financial reporting framework. Further, the auditor needs to document the names of the identified related parties and the nature of the related party relationships.	information when identifying and assessing the risks of material misstatement due to fraud in accordance with SA 240. (Ref: Para. A6 and A29-A30) **Para 26 of SA 550:** Where the applicable financial reporting framework establishes related party requirements, the auditor shall obtain written representations from management and, where appropriate, those charged with governance that: (Ref: Para. A48-A49) (a) They have disclosed to the auditor the identity of the entity's related parties and all the related party relationships and transactions of which they are aware; and (b) They have appropriately accounted for and disclosed such relationships and transactions in accordance with the requirements of the framework. **Para 27 of SA 550:** Unless all of those charged with governance are involved in managing the entity, the auditor shall communicate with those charged with governance significant matters arising during the audit in connection with the entity's related parties. (Ref: Para. A50) **Para 28 of SA 550:** In meeting the documentation requirements of SA 230 and other SAs, the auditor shall include in the audit documentation the names of the identified related parties and the nature of the related party relationships.

Observation 2:

The strategy document states that there are no additional related parties identified for the year. There has been no further updation of documentation in this regard to indicate whether any new related parties have been identified or a specific assertion that there are no new related parties. There could be a possibility of misstatement in respect of related party disclosures.

OR

It was noted as part of audit procedures, that the engagement team has verified MBP-1 of the directors for identification of related parties and to check directors' interest in other companies. However, no procedures and documentation performed to inspect records for identification of existence of related party relationships and transactions not previously identified or disclosed.

Also, shareholders and company in which key managerial persons having significant influence as part of MBP-1 was not disclosed as related party in the financial statements.

What is the issue?	AASB Suggested Guidance	Technical Literature
Why is it important for the auditor to evaluate related party transactions?	While many related party transactions occur in the normal course of business and may not pose a higher risk of material misstatement compared to similar transactions with unrelated parties, certain factors can increase the risk. Specifically, as provided under SA 550: • Related parties might engage in a wide range of complex relationships, structures and transactions, which can add complexity and elevate the risk of misstatement. • The entity's information systems may be ineffective to identify or summarize transactions and balances involving related parties. • Transactions with related parties might be conducted on terms that are not consistent with market conditions, such as transactions with no	**Para 2 of SA 550:** Many related party transactions are in the normal course of business. In such circumstances, they may carry no higher risk of material misstatement of the financial statements than similar transactions with unrelated parties. However, the nature of related party relationships and transactions may, in some circumstances, give rise to higher risks of material misstatement of the financial statements than transactions with unrelated parties. For example: • Related parties may operate through an extensive and complex range of relationships and structures, with a corresponding increase in the complexity of related party transactions. • Information systems may be ineffective at identifying or summarising transactions and outstanding balances between an entity and its related parties. • Related party transactions may not be conducted under normal market

	exchange of consideration, which can also heighten the risk of material misstatement.	terms and conditions; for example, some related party transactions may be conducted with no exchange of consideration. **Para 3 of SA 550:** Because related parties are not independent of each other, many financial reporting frameworks establish specific accounting and disclosure requirements for related party relationships, transactions and balances to enable users of the financial statements to understand their nature and actual or potential effects on the financial statements. Where the applicable financial reporting framework establishes such requirements, the auditor has a responsibility to perform audit procedures to identify, assess and respond to the risks of material misstatement arising from the entity's failure to appropriately account for or disclose related party relationships, transactions or balances in accordance with the requirements of the framework. **Para 4 of SA 550:** Even if the applicable financial reporting framework establishes minimal or no related party requirements, the auditor nevertheless needs to obtain an understanding of the entity's related party relationships and transactions sufficient to be able to conclude whether the financial statements, insofar as they are affected by those relationships and transactions: (Ref: Para. A1) (a) Achieve a true and fair presentation (for fair presentation frameworks); or (Ref: Para. A2) (b) Are not misleading (for compliance frameworks). (Ref: Para. A3)

		Para 5 of SA 550: In addition, an understanding of the entity's related party relationships and transactions is relevant to the auditor's evaluation of whether one or more fraud risk factors are present as required by SA 240 because fraud may be more easily committed through related parties.
What audit procedures the audit firm should perform if it discovers that a significant transaction was not reported which involves a related party?	As per SA 550, the audit firm should inquire with management and other relevant personnel, and perform appropriate risk assessment procedures, to understand the controls established by management for: • Identifying, accounting for, and disclosing related party relationships and transactions in accordance with the applicable financial reporting framework. • Authorizing and approving significant transactions and arrangements with related parties. • Authorizing and approving significant transactions and arrangements that are outside the normal course of business of the entity. As per SA 550, the audit firm should inspect the following documents to identify related party relationships or transactions that management has not previously identified or disclosed: • Bank, legal and third party confirmations obtained. • Minutes of meetings of shareholders and minutes of meetings of those charged with governance.	**Para 12 of SA 550:** The engagement team discussion that SA 315 and SA 240 require shall include specific consideration of the susceptibility of the financial statements to material misstatement due to fraud or error that could result from the entity's related party relationships and transactions. (Ref: Para. A9-A10) **Para 13 of SA 550:** The auditor shall inquire of management regarding: (a) The identity of the entity's related parties, including changes from the prior period; (Ref: Para. A11-A14) (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. **Para 14 of SA 550:** 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: (Ref: Para. A15-A20)

	• Any other records or documents that the auditor considers necessary. When inspecting records or documents, the auditor should remain alert for arrangements or other information that may indicate the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor.	(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 (Ref: Para. A21) (c) Authorise and approve significant transactions and arrangements outside the normal course of business. **Para 15 of SA 550** During the audit, the auditor shall remain alert, when inspecting records or documents, for arrangements or other information that may indicate the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor. (Ref: Para. A22-A23) In particular, the auditor shall inspect the following for indications of the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor: (a) Bank, legal and third party confirmations obtained as part of the auditor's procedures; (b) Minutes of meetings of shareholders and of those charged with governance; and (c) Such other records or documents as the auditor considers necessary in the circumstances of the entity.
How should the audit firm deal with inconsistencies between related party transactions	The audit firm should take the following steps: **Discovering new related parties or related party transactions:** If the audit firm uncovers information or arrangements	**Para 21 of SA 550:** If the auditor identifies arrangements or information that suggests the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor, the auditor shall determine

disclosed in the financial statements and those identified during the audit, to ensure the completeness and accuracy of related party disclosures?	suggesting that there are related parties or significant related party transactions that management had not previously identified or disclosed, the audit firm needs to investigate to confirm if these relationships or transactions actually exist. *Steps to be taken when new related parties or significant related party transactions not previously identified or disclosed are found:* **a. Notify other members of engagement team:** Inform other members of the engagement team about the new information or findings. **b. Request information:** Ask management to: 1. Identify all transactions involving the newly discovered related parties so that these can be further evaluated. 2. Explain why entity's controls did not detect or disclose these related parties or transactions. **c. Perform additional procedures:** Carry out detailed audit procedures on these newly identified related parties or transactions to ensure they are properly accounted for and disclosed. **d. Reassess risks:** Re-evaluate whether there might be other related parties or transactions that management has also failed to identify or disclose and perform additional audit procedures if necessary.	whether the underlying circumstances confirm the existence of those relationships or transactions. **Para 22 of SA 550:** If the auditor identifies related parties or significant related party transactions that management has not previously identified or disclosed to the auditor, the auditor shall: (a) Promptly communicate the relevant information to the other members of the engagement team; (Ref: Para. A35) (b) Where the applicable financial reporting framework establishes related party requirements: (i) Request management to identify all transactions with the newly identified related parties for the auditor's further evaluation; and (ii) Inquire as to why the entity's controls over related party relationships and transactions failed to enable the identification or disclosure of the related party relationships or transactions; (c) Perform appropriate substantive audit procedures relating to such newly identified related parties or significant related party transactions; (Ref: Para. A36) (d) Reconsider the risk that other related parties or significant related party transactions may exist that management has not previously identified or disclosed to the auditor, and perform additional audit procedures as necessary; and (e) If the non-disclosure by management appears intentional (and therefore indicative of a risk of material misstatement due to

	e. Evaluate fraud risk: If the non-disclosure appears to be intentional, which might indicate fraud, assess the implications for the audit and consider how it affects overall conclusions and audit opinion.	fraud), evaluate the implications for the audit. (Ref: Para. A37)
How should the audit firm mitigate the risk of related party transactions not being conducted at arm's length?	When management claims that a related party transaction was conducted on terms similar to those of a typical unrelated arm's length transaction, the audit firm needs to gather sufficient appropriate audit evidence to support that assertion. There may be a risk that management's assertion that a related party transaction was conducted on terms equivalent to those prevailing in an arm's length transaction may be materially misstated. *Below is an overview of the key considerations:* **1. Management's assertion:** The audit firm shall ask management to substantiate its assertion, which may include: • Comparing the terms of the related party transaction to those of an identical or similar transaction with unrelated parties. • Engaging an external specialist. • Comparing the terms of the related party transaction to known market terms for broadly similar transactions on an open market. **2. Auditor's evaluation:** The auditor should evaluate management's support for its assertion, which involves: • Evaluating the	**Para 24 of SA 550:** When management has made an assertion in the financial statements to the effect that a related party transaction was conducted on terms equivalent to those prevailing in an arm's length transaction, the auditor shall obtain sufficient appropriate audit evidence about the assertion. (Ref: Para. A42-A45) **Para A43 of SA 550:** Management is responsible for the substantiation of an assertion that a related party transaction was conducted on terms equivalent to those prevailing in an arm's length transaction. Management's support for the assertion may include: • Comparing the terms of the related party transaction to those of an identical or similar transaction with one or more unrelated parties. • Engaging an external expert to determine a market value and to confirm market terms and conditions for the transaction. • Comparing the terms of the transaction to known market terms for broadly similar transactions on an open market. **Para A44 of SA 550:** Evaluating management's support for this assertion may involve one or more of the following: • Considering the appropriateness of management's process for supporting the assertion.

	appropriateness of management's process for supporting the assertion. • Verifying the source data and testing the data to determine its accuracy, completeness and relevance. • Evaluating the reasonableness of any significant assumptions on which the assertion is based. **3. Practical difficulties:** While it is often possible to verify whether the price of the transaction is similar to market price, it is much difficult to confirm whether all other terms (like credit terms, contingencies, or specific charges) are equivalent to those in an independent transaction. Due to practical difficulties, it might not always be feasible for the audit firm to verify that every aspect of the related party transaction matches the terms of an arm's length deal. **4. Risk of misstatement:** Because of these challenges, there is a risk that management's claim about the transaction being at arm's length could be incorrect, which means that the financial statements could be misleading. In essence, the audit firm needs to carefully evaluate and gather sufficient and appropriate audit evidence to ensure that management's assertion about the related party transaction being at arm's length is accurate, despite the inherent difficulties in confirming all aspects of the related party transactions.	• Verifying the source of the internal or external data supporting the assertion, and testing the data to determine their accuracy, completeness and relevance. • Evaluating the reasonableness of any significant assumptions on which the assertion is based.

Chapter 15

Observations related to SA 560, Subsequent Events

Observation 1:

It was noted that no documentation was kept in file showing the procedures performed by auditor to obtain sufficient appropriate audit evidence that all events up to date of the auditor's report that may require adjustment of, or disclosure in, the financial statements were identified.

What is the issue?	AASB Suggested Guidance	Technical Literature
Whether it is necessary for the auditor to document the procedures performed to obtain sufficient appropriate audit evidence that all events between the date of the financial statements and the date of the auditor's report that may require adjustment of, or disclosure in, the financial statements were identified?	As per SA 560, the auditor should perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements have been identified. If based on audit procedures performed, the auditor identifies such events, the auditor should determine whether each such event is appropriately reflected in those financial statements. As per SA 230, the auditor should keep record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached. As per SA 560, the audit procedures could be as under: • Obtain an understanding of procedures established by management to ensure that subsequent events are identified. • Inquire of management /	**Para 4 of SA 560:** The objectives of the auditor are to: (a) Obtain sufficient appropriate audit evidence about whether events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements are appropriately reflected in those financial statements; and (b) Respond appropriately to facts that become known to the auditor after the date of the auditor's report, that, had they been known to the auditor at that date, may have caused the auditor to amend the auditor's report. **Para 6 of SA 560:** The auditor shall perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements have been identified. The auditor is not, however, expected to perform additional audit procedures on matters to which previously applied audit procedures have provided satisfactory conclusions. (Ref: Para. A6)

	those charged with governance as to whether any subsequent events have occurred which might affect the financial statements. • Read minutes of the meetings, of the shareholders and those charged with governance, that have been held after the date of the financial statements and inquiring about matters discussed at any such meetings for which minutes are not yet available. • Read the entity's latest subsequent interim financial statements, if any.	**Para 7 of SA 560:** The auditor shall perform the procedures required by paragraph 6 so that they cover the period from the date of the financial statements to the date of the auditor's report, or as near as practicable thereto. The auditor shall take into account the auditor's risk assessment in determining the nature and extent of such audit procedures, which shall include the following: (Ref: Para. A7-A8) (a) Obtaining an understanding of any procedures management has established to ensure that subsequent events are identified. (b) Inquiring of management and, where appropriate, those charged with governance as to whether any subsequent events have occurred which might affect the financial statements. (Ref: Para. A9) (c) Reading minutes, if any, of the meetings, of the entity's owners, management and those charged with governance, that have been held after the date of the financial statements and inquiring about matters discussed at any such meetings for which minutes are not yet available. (Ref: Para. A10) (d) Reading the entity's latest subsequent interim financial statements, if any. **Para 8 of SA 560:** When, as a result of the procedures performed as required by paragraphs 6 and 7, the auditor identifies events that require adjustment of, or disclosure in, the financial statements, the auditor shall determine whether each such event is appropriately reflected in those financial statements.

		Para 9 of SA 560: The auditor shall request management and, where appropriate, those charged with governance, to provide a written representation in accordance with SA 580, “Written Representations” that all events occurring subsequent to the date of the financial statements and for which the applicable financial reporting framework requires adjustment or disclosure have been adjusted or disclosed. **Para 5 of SA 230:** The objective of the auditor is to prepare documentation that provides: (a) A sufficient and appropriate record of the basis for the auditor’s report; and (b) Evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements.

Chapter 16

Observations related to SA 600, Using the Work of Another Auditor

Observation 1:

The firm has stated in the independent auditor's report on consolidated financial statements that "we however did not audit the financial statements of certain subsidiaries whose financial statements reflect net total assets of Rs. -----as at March 31, 20XX and total revenue of Rs. ---and net cash inflow of Rs. -----for the year then ended. These financial statements and other financial information have been audited by other auditors whose report have been furnished to us by the management of the group, and our opinion is based solely on the report of other auditors".

It was noted that though the firm has mentioned in its audit report that the financial statements of certain subsidiaries as mentioned above were audited by other auditors; however, the audited accounts of these subsidiary companies were not on record of the firm. However, the copies of financial statements including the converted financial statements of foreign subsidiaries were kept on record. Thus, the assertion of the firm in its audit report is not backed by documentary evidence. It was also observed that the names of auditors of subsidiaries were not found on record and no correspondence has been made/ liasioning done with them to ask for any details/ information. No further work has been carried out to ascertain that the work of the other auditors is adequate in the context of the assignment.

What is the issue?	AASB Suggested Guidance	Technical Literature
What procedures need to be followed by principal auditor for using the work of other auditor?	When planning to use the work of another auditor, the principal auditor should perform the following procedures: **1. Coordinate with the other auditor:** Inform other auditor of how their work will be used, discuss any areas requiring special attention, coordinate on identifying transactions that need disclosure, and agree on the audit timeline. **2. Ensure compliance:** Communicate important accounting, auditing, and reporting requirements to the other auditor and obtain their	**Para 11 of SA 600:** When planning to use the work of another auditor, the principal auditor should consider the professional competence of the other auditor in the context of specific assignment if the other auditor is not a member of the Institute of Chartered Accountants of India. **Para 12 of SA 600:** 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.

	confirmation that they are following these requirements. **3. Assess competence:** Evaluate the other auditor's competence (If they are not a member of ICAI) to ensure they are suitable for the specific audit assignment. **4. Establish clear communication:** Clearly outline the scope, coordination needs, and deadlines, and confirm that the other auditor understands and complies with all relevant standards and requirements. **5. Discuss procedures of other auditor:** • 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.	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 areas 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. **Para 13 of SA 600:** 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. This knowledge may have been enhanced from the review of the previous audit work of the other auditor. **Para 14 of SA 600:** The principal auditor may conclude that it is not necessary to apply

		procedures such as those described in paragraph 13 because sufficient appropriate audit evidence previously obtained that acceptable quality control policies and procedures are complied with in the conduct of other auditor's practice. **Para 15 of SA 600:** The principal auditor should consider the significant findings of the other auditor. **Para 16 of SA 600:** The principal auditor may consider it appropriate to discuss with the other auditor and the management of the component, the audit findings or other matters affecting the financial information of the components. He may also decide that supplemental tests of the records or the financial statements of the component are necessary. Such tests may, depending upon the circumstances, be performed by the principal auditor or the other auditor. **Para 17 of SA 600:** In certain circumstances, the other auditor may happen to be a person other than a professionally qualified auditor. This may happen, for instance, where a component is situated in a foreign country and the applicable laws permit a person other than a professionally qualified auditor to audit the financial statements of such component. In such circumstances, the procedures outlined in paragraphs 10 to 16 assume added importance.
What are principles of SA 600 w.r.t. division of responsibility?	The principal auditor is generally not responsible for the work done by other auditors unless there are indications that raise concerns about the reliability of their work. If the principal auditor relies on reports	**Para 24 of SA 600:** The principal auditor would not be responsible in respect of the work entrusted to the other auditors, except in circumstances which should have aroused his suspicion about the

	of other auditors to form an opinion on the financial statements of the entity as a whole, the principal auditor's report should clearly state how responsibility is shared as per the requirements of SA 600. This is done by indicating the extent to which the financial information of components audited by the other auditors have been included in the financial information of the entity, e.g., the number of divisions/branches/ subsidiaries or other components audited by other auditors.	reliability of the work performed by the other auditors. **Para 25 of SA 600:** When the principal auditor has to base his opinion on the financial information of the entity as a whole relying upon the statements and reports of the other auditors, his report should state clearly the division of responsibility for the financial information of the entity by indicating the extent to which the financial information of components audited by the other auditors have been included in the financial information of the entity, e.g., the number of divisions/branches/subsidiaries or other components audited by other auditors.
What steps should the principal auditor take if they determine that the work of other auditor cannot be used, despite performing additional procedures by the principal auditor? How should the principal auditor address modifications in the other auditor's report in their audit report?	If the principal auditor concludes that they cannot rely on the work of other auditor and cannot perform enough additional procedures on that component's financial information, they should issue a qualified opinion or a disclaimer of opinion due to the audit scope limitation. If the other auditor’s report is modified, the principal auditor should assess whether the modification is of such nature and significance that affects the overall financial statements enough to warrant a change in principal auditors’ report.	**Para 22 of SA 600:** When the principal auditor concludes, based on his procedures, that the work of the other auditor cannot be used and the principal auditor has not been able to perform sufficient additional procedures regarding the financial information of the component audited by the other auditor, the principal auditor should express a qualified opinion or disclaimer of opinion because there is a limitation on the scope of audit. **Para 23 of SA 600:** In all circumstances, if the other auditor issues, or intends to issue, a modified auditor's report, the principal auditor should consider whether the subject of the modification is of such nature and significance, in relation to the financial information of the entity on which the principal auditor is reporting that it requires a modification of the principal auditor's report.

		Extract from Para 17 of Guidance Note on Audit of Consolidated Financial Statements: In carrying out the audit of the standalone financial statements, the computation of materiality for the purpose of issuing an opinion on the standalone financial statements of each component would be done component-wise on a standalone basis. However, with regard to determination of materiality during the audit of consolidated financial statements (CFS), the auditor should consider the following: • While considering the observations (for instance modification and /or emphasis of matter/other matter in accordance with SA 705/706) of the component auditor in his report on the standalone financial statements, the parent auditor should comply with the requirements of SA 600, "Using the Work of Another Auditor".

Chapter 17

Observations related to SA 610(Revised), Using the Work of Internal Auditors

Observation 1:

The effect of the work of internal auditors on the audit procedures of the firm has not been spelt out and documented. The firm reviews the internal audit reports, but the important points / observations / management responses in respect of the same have not been documented.

What is the issue?	AASB Suggested Guidance	Technical Literature
What are the considerations while using the work of an internal auditor?	As per SA 610(Revised), the external auditor can use the work of internal auditor. SA 610(Revised) contains the requirements for external auditor to determine whether, in which areas, and to what extent the work of the internal audit function can be used.	**Para 15 of SA 610 (Revised):** 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; (Ref: Para. A5–A9) (b) The level of competence of the internal audit function; and (Ref: Para. A5–A9) (c) Whether the internal audit function applies a systematic and disciplined approach, including quality control. (Ref: Para. A10–A11) **Para 16 of SA 610(Revised):** 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. (Ref: Para. A12–A14) **Para 17 of SA 610 (Revised):** As a basis for determining the areas and the extent to which the work of the internal audit function can be used, the external auditor shall consider the nature and scope of the work that has been performed, or is planned to be performed, by the internal audit function and its relevance to the external auditor's overall audit strategy and audit plan. (Ref: Para. A15–A17) **Para 18 of SA 610 (Revised):** The external auditor shall make all significant judgments in the audit engagement and, to prevent undue use of the work of the internal audit function, shall plan to use less of the work of the function and perform more of the work directly: (Ref: Para. A15–A17) (a) The more judgment is involved in: (i) Planning and performing relevant audit procedures; and (ii) Evaluating the audit evidence gathered; (Ref: Para. A18–A19) (b) The higher the assessed risk of material misstatement at the assertion level, with special consideration given to risks identified as significant; (Ref: Para. A20–A22) (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.

		Para 19 of SA 610(Revised): The external auditor shall also evaluate whether, in aggregate, using the work of the internal audit function to the extent planned would still result in the external auditor being sufficiently involved in the audit, given the external auditor's sole responsibility for the audit opinion expressed. (Ref: Para. A15–A22) **Para 20 of SA 610 (Revised):** The external auditor shall, in communicating with those charged with governance an overview of the planned scope and timing of the audit in accordance with SA 260(Revised), communicate how the external auditor has planned to use the work of the internal audit function. (Ref: Para. A23)
Why is it essential to assess the adequacy of the internal auditor's work?	SA 610(Revised) provides that if the external auditor decides to use specific work of internal audit function, the external auditor is required to perform certain audit procedures to evaluate the adequacy of that work for purposes of audit. These procedures include reading the internal audit reports.	**Para 21 of SA 610 (Revised):** If the external auditor plans to use the work of the internal audit function, the external auditor shall discuss the planned use of its work with the function as a basis for coordinating their respective activities. (Ref: Para. A24–A26) **Para 22 of SA 610 (Revised)**: The external auditor shall 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. **Para 23 of SA 610 (Revised)**: The external auditor shall 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, including evaluating whether:

		(a) The work of the function had been properly planned, performed, supervised, reviewed and documented; (b) Sufficient appropriate evidence had been obtained to enable the function to draw reasonable conclusions; and (c) Conclusions reached are appropriate in the circumstances and the reports prepared by the function are consistent with the results of the work performed. (Ref: Para. A27–A30) **Para 24 of SA 610 (Revised)**: The nature and extent of the external auditor's audit procedures shall be responsive to the external auditor's evaluation of: (a) The amount of judgment involved; (b) The assessed risk of material misstatement; (c) The extent to which the internal audit function's organizational status and relevant policies and procedures support the objectivity of the internal auditors; and (d) The level of competence of the function; (Ref: Para. A27–A29) and shall include reperformance of some of the work. (Ref: Para. A30) **Para 25 of SA 610 (Revised):** The external auditor shall also evaluate whether the external auditor's conclusions regarding the internal audit function in paragraph 15 of this SA and the determination of the nature and extent of use of the work of the function for purposes of the audit in paragraphs 18–19 of this SA remain appropriate.

Why is it necessary to document the evaluation of the internal auditor's work?	SA 610(Revised) read with SA 230 requires the external auditor to document the audit procedures performed to: (a) Evaluate the objectivity of internal audit function. (b) Evaluate adequacy of work of internal audit function. The external auditor should keep record of audit procedures performed, relevant audit evidence obtained, and conclusions reached.	**Para 36 of SA 610 (Revised):** If the external auditor uses the work of the internal audit function, the external auditor shall include in the audit documentation: (a) The evaluation of: (i) Whether the function's organizational status and relevant policies and procedures adequately support the objectivity of the internal auditors; (ii) The level of competence of the function; and (iii) Whether the function applies a systematic and disciplined approach, including quality control; (b) The nature and extent of the work used and the basis for that decision; and (c) The audit procedures performed by the external auditor to evaluate the adequacy of the work used. **Para 2 of SA 230:** Audit documentation that meets the requirements of this SA and the specific documentation requirements of other relevant SAs provides: (a) Evidence of the auditor's basis for a conclusion about the achievement of the overall objectives of the auditor; and (b) Evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements.

Observation 2:

The assessment and evaluation of internal audit is to be properly documented giving details of scope, reporting authority, frequency of reporting, etc.

What is the issue?	AASB Suggested Guidance	Technical Literature
How can an external auditor determine the nature and extent of work of internal auditor that can be used?	**Evaluating internal audit work:** When deciding how much to rely on the internal audit function, the external auditor should review what the internal audit function has done or plan to do. They need to assess how this work fits into their overall audit strategy and plan. **Limits on using internal audit work:** The external auditor should use his judgment to decide how much of the internal audit work to rely on. They should plan to do more of the audit work themselves if: **1. High judgment required:** The audit involves a lot of judgment, both in planning and performing audit procedures and in evaluating evidence obtained. **2. High risk of misstatement:** There are significant risks of material misstatement, especially if these risks are considered critical. **3. Weak organizational status:** The internal audit function has weak organizational status or inadequate policies and procedures that could affect its objectivity. **4. Low competence:** The internal audit function has lower level of competence. In essence, the external auditor needs	**Para 17 of SA 610 (Revised):** As a basis for determining the areas and the extent to which the work of the internal audit function can be used, the external auditor shall consider the nature and scope of the work that has been performed, or is planned to be performed, by the internal audit function and its relevance to the external auditor's overall audit strategy and audit plan. (Ref: Para. A15–A17) **Para 18 of SA 610 (Revised):** The external auditor shall make all significant judgments in the audit engagement and, to prevent undue use of the work of the internal audit function, shall plan to use less of the work of the function and perform more of the work directly: (Ref: Para. A15–A17) (a) The more judgment is involved in: (i) Planning and performing relevant audit procedures; and (ii) Evaluating the audit evidence gathered; (Ref: Para. A18–A19) (b) The higher the assessed risk of material misstatement at the

	to carefully evaluate how much they can depend on the internal audit function based on its relevance, the risks involved, and its overall quality and support. If there are significant concerns in these areas, the external auditor should do more work themselves.	assertion level, with special consideration given to risks identified as significant; (Ref: Para. A20–A22) (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. **Para 19 of SA 610 (Revised):** The external auditor shall also evaluate whether, in aggregate, using the work of the internal audit function to the extent planned would still result in the external auditor being sufficiently involved in the audit, given the external auditor's sole responsibility for the audit opinion expressed. (Ref: Para. A15–A22)
How does the external auditor ensure that the work of the internal audit function is adequately planned, performed, supervised, and documented?	According to SA 610(Revised), the external auditor should ensure that the work of the internal audit function is adequately planned, performed, supervised, and documented through the following steps: **1. Discussion and coordination:** The external auditor should discuss the planned use of the work of internal audit function with the internal auditors. This helps coordinate their activities and ensures alignment in the audit approach. **2. Review of internal audit reports:** The external auditor should read and review the reports of the internal audit function that are relevant to the work the external auditor plans to use. This	**Para 21 of SA 610 (Revised):** If the external auditor plans to use the work of the internal audit function, the external auditor shall discuss the planned use of its work with the function as a basis for coordinating their respective activities. (Ref: Para. A24–A26) **Para 22 of SA 610 (Revised):** The external auditor shall 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.

	review provides an understanding of the nature and extent of the internal audit procedures performed and their findings. **3. Performing additional audit procedures:** The external auditor should perform sufficient audit procedures on the work of the internal audit function to evaluate its adequacy. This involves: **(a) Planning and execution:** Checking if the internal audit work was properly planned, performed, supervised, reviewed, and documented. **(b) Evidence and conclusions:** Ensuring that sufficient and appropriate evidence was obtained, allowing the internal auditor function to draw reasonable conclusions. **(c) Consistency and appropriateness:** Verifying that the conclusions reached by the internal audit function are appropriate given the circumstances and that the reports of internal audit function are consistent with the work performed.	**Para 23 of SA 610 (Revised):** The external auditor shall 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, including evaluating whether: (a) The work of the function had been properly planned, performed, supervised, reviewed and documented; (b) Sufficient appropriate evidence had been obtained to enable the function to draw reasonable conclusions; and (c) Conclusions reached are appropriate in the circumstances and the reports prepared by the function are consistent with the results of the work performed. (Ref: Para. A27–A30)
How does the external auditor ensure that the audit procedures are appropriately responsive to the amount of judgment, risk of material misstatement, and the internal audit function's competence and objectivity?	To ensure that external auditor's audit procedures are appropriately responsive to the amount of judgment, risk of material misstatement, and the internal audit function's competence and objectivity, and to verify these factors, the external auditor should follow these steps: *<u>Evaluate judgment involvement:</u>* 1. **Assessment:** Determine how much judgment is involved in the internal audit function's work, especially in areas prone to subjective decisions or complex estimates.	**Para 24 of SA 610(Revised):** The nature and extent of the external auditor's audit procedures shall be responsive to the external auditor's evaluation of: (a) The amount of judgment involved; (b) The assessed risk of material misstatement; (c) The extent to which the internal audit function's organizational status and relevant policies and

	2. **Response:** Tailor the audit procedures to address areas with significant judgment by performing detailed testing and ensuring the accuracy of judgments made. *Assess risk of material misstatement:* 1. **Risk analysis:** Analyze and assess the risk of material misstatement in financial statements. Focus on areas with higher assessed risk. 2. **Audit focus:** Adjust audit procedures to provide a higher level of assurance in high-risk areas. This may involve more extensive testing or different audit approaches.	procedures support the objectivity of the internal auditors; and (d) The level of competence of the function; (Ref: Para. A27–A29) and shall include reperformance of some of the work. (Ref: Para. A30) **Para 25 of SA 610(Revised):** The external auditor shall also evaluate whether the external auditor's conclusions regarding the internal audit function in paragraph 15 of this SA and the determination of the nature and extent of use of the work of the function for purposes of the audit in paragraphs 18–19 of this SA remain appropriate.

Chapter 18

Observations related to SA 700(Revised), Forming an Opinion and Reporting on Financial Statements

Observation 1:

The firm did not include below mentioned facts under para "Report on Other Legal and Regulatory Requirements" in audit report issued by them.

With respect to the other matters to be included in the auditor's report in accordance with Rule 11 of the Companies (Audit and Auditors) Rules, 2014, in our opinion and to the best of our information and according to the explanations given to us:

(i) whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statements.

(ii) whether the company has made provision, as required under any law or accounting standards, for material foreseeable losses, if any, on long term contracts including derivative contracts.

(iii) whether there has been any delay in transferring amounts, required to be transferred, to the investor education and protection fund by the company.

The above-mentioned paragraph related to auditor's report in accordance with Rule 11 of the Companies (Audit and Auditors) Rules, 2014 has been missed out from the audit report as well as revised audit report issued by the firm and the firm directly included these points under para "Report on Other Legal and Regulatory Requirements" without mentioning that these points are as per requirements of Rule 11 of the Companies (Audit and Auditors) Rules, 2014.

What is the issue?	AASB Suggested Guidance	Technical Literature
What is the manner of reporting on Rule 11 of the Companies (Audit and Auditors) Rules, 2014 in the audit report?	Reporting on Rule 11 of the Companies (Audit and Auditors) Rules, 2014 is required to be made in audit report under the section "Report on Other Legal and Regulatory Requirements". Further, this reporting is made in a separate bullet point of section "Report on Other Legal and Regulatory Requirements" which gives reference of Rule 11 of the Companies (Audit and Auditors) Rules, 2014.	**Extract from Appendix - illustration 1 given under SA 700(Revised)** *Report on Other Legal and Regulatory Requirements* 2. As required by Section 143(3) of the Act, we report that: (h) With respect to the other matters to be included in the Auditor's Report in accordance with Rule 11 of the Companies (Audit and Auditors) Rules, 2014, in our opinion and to the best of our information and according to the explanations given to us: (i) The Company has disclosed

		the impact of pending litigations on its financial position in its financial statements – Refer Note XX to the financial statements; [or the Company does not have any pending litigations which would impact its financial position]. (ii) The Company has made provision, as required under the applicable law or accounting standards, for material foreseeable losses, if any, on long term contracts including derivative contracts – Refer Note XX to the financial statements; [or the Company did not have any long-term contracts including derivative contracts for which there were any material foreseeable losses]. (iii) There has been no delay in transferring amounts, required to be transferred, to the Investor Education and Protection Fund by the Company {or, following are the instances of delay in transferring amounts, required to be transferred, to the Investor Education and Protection Fund by the Company or there were no amounts which were required to be transferred to the Investor Education and Protection Fund by the Company}.

Observation 2:

The section containing report on audit of financial statements is named as "Report on the Indian Accounting Standards (Ind AS) Financial Statements" instead of "Report on the Audit of the Indian Accounting Standards (Ind AS) Financial Statements". The term 'Audit' has not been specified due to which, it may not be clear on what type of assignment, report has been provided.

In the "Opinion" Section, reference to "notes to the financial statements" has not been made.

OR

Under the section "Report on Other Legal and Regulatory Requirements", the following have been noticed:

Reference has not been made to term "sought". Just the term "obtained" has been referred therein.

No reference has been made in respect of the 'Other Comprehensive Income' and 'Statement of Changes in Equity'.

What is the issue?	AASB Suggested Guidance	Technical Literature
What should the title of an auditor's report indicate?	The auditor's report should have a title that clearly indicates that it is the report of an independent auditor. A title indicating the report is the report of an independent auditor, for example, "Independent Auditor's Report," distinguishes the independent auditor's report from reports issued by others.	**Para 21 of SA 700(Revised):** The auditor's report shall have a title that clearly indicates that it is the report of an independent auditor. (Ref: Para. A15)
What is the objective of the auditor with respect to his opinion in the audit report?	As per SA 700 (Revised), the auditor is required to ensure that an opinion on the financial statements is formed based on an evaluation of the conclusions drawn from the audit evidence obtained; and also ensure that a clear opinion is expressed through a written report which is not ambiguous.	**Para 6 of SA 700(Revised):** The objectives of the auditor are: (a) To form an opinion on the financial statements based on an evaluation of the conclusions drawn from the audit evidence obtained; and (b) To express clearly that opinion through a written report.
What steps should an auditor take to ensure that audit report issued is clear and correct?	As per SQC 1, the engagement quality control reviewer wherever appointed should perform the following procedures: • Discussion with engagement partner.	**Para 64 of SQC 1:** An engagement quality control review ordinarily involves discussion with the engagement partner, a review of the financial statements or other subject

	• Review of financial statements. • Review of audit report. • Review of select working papers.	matter information and the report, and, in particular, consideration of whether the report is appropriate. It also involves a review of selected working papers relating to the significant judgments that the engagement team made and the conclusions they reached. The extent of the review depends on the complexity of the engagement and the risk that the report might not be appropriate in the circumstances. The review does not reduce the responsibilities of the engagement partner.
What should be included in "Opinion" section of the auditor's report?	The auditor should express unmodified opinion when he concludes that financial statements are prepared and presented, in all the required material respects, as per the applicable financial reporting framework. The opinion is expressed in the Opinion section of audit report. As per para 24(d) of SA 700 (Revised), reference to notes, including the summary of significant accounting policies is required in audit report.	**Para 23 of SA 700 (Revised):** The first section of the auditor's report shall include the auditor's opinion, and shall have the heading "Opinion." **Para 24 of SA 700(Revised):** The Opinion Section of the auditor's report shall also: (a) Identify the entity whose financial statements have been audited; (b) State that the financial statements have been audited; (c) Identify the title of each statement comprising the financial statements; (d) Refer to the notes, including the summary of significant accounting policies; and (e) Specify the date of, or period covered by, each financial statement comprising the financial statements. (Ref: Para. A17-A18)
How can the auditor separate "Other Reporting	If the auditor has other reporting responsibilities which are in addition to the auditor's responsibilities under	**Para 43 of SA 700 (Revised)**: If the auditor addresses other reporting responsibilities in the

Responsibilities" from "Auditor's responsibilities under the SAs" in the audit report?	the SAs, these other reporting responsibilities should be separated from auditor's responsibilities under the SAs. It may be noted that correct heading of section which covers auditor's reporting responsibilities under the SAs is "Report on the Audit of the Financial Statements".	auditor's report on the financial statements that are in addition to the auditor's responsibilities under the SAs, these other reporting responsibilities shall be addressed in a separate section in the auditor's report with a heading titled "Report on Other Legal and Regulatory Requirements" or otherwise as appropriate to the content of the section, unless these other reporting responsibilities address the same topics as those presented under the reporting responsibilities required by the SAs in which case the other reporting responsibilities may be presented in the same section as the related report elements required by the SAs. (Ref: Para. A53–A55) **Para 44 of SA 700(Revised):** If other reporting responsibilities are presented in the same section as the related report elements required by the SAs, the auditor's report shall clearly differentiate the other reporting responsibilities from the reporting that is required by the SAs. (Ref: Para. A55) **Para 45 of SA 700 (Revised)** If the auditor's report contains a separate section that addresses other reporting responsibilities, the requirement of paragraphs 20-40 of this SA shall be included under a section with a heading "Report on the Audit of the Financial Statements." The "Report on Other Legal and Regulatory Requirements" shall follow the "Report on the audit of the Financial Statements." (Ref: Para. A55)

Is there any illustrative format of auditor's reporting on Other Legal and Regulatory Requirements?	**Extract from Appendix – Illustration 1 given under SA 700(Revised)** **Report on Other Legal and Regulatory Requirements** 1. As required by the Companies (Auditor's Report) Order, 2020 ("the Order"), issued by the Central Government of India in terms of sub section (11) of section 143 of the Companies Act, 2013, we give in the Annexure a statement on the matters specified in paragraphs 3 and 4 of the Order, to the extent applicable. 2. As required by Section 143(3) of the Act, we report that: (a) We have sought and obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purposes of our audit. (b) In our opinion, proper books of account as required by law have been kept by the Company so far as it appears from our examination of those books [and proper returns adequate for the purposes of our audit have been received from the branches not visited by us.] (c) [The reports on the accounts of the branch offices of the Company audited under Section 143(8) of the Act by branch auditors have been sent to us and have been properly dealt with by us in preparing this report]. (d) The Balance Sheet, the Statement of Profit and Loss, (the Statement of Changes in Equity) and the Cash Flow Statement dealt with by this	Refer illustrative formats of auditor's report given in SA 700(Revised).

	Report are in agreement with the books of account [and with the returns received from the branches not visited by us]. (e) In our opinion, the aforesaid standalone financial statements comply with the Accounting Standards specified under Section 133 of the Act. (f) On the basis of the written representations received from the directors as on 31st March, 20XX taken on record by the Board of Directors, none of the directors is disqualified as on 31st March, 20XX from being appointed as a director in terms of Section 164(2) of the Act. (g) With respect to the adequacy of the internal financial controls over financial reporting of the Company and the operating effectiveness of such controls, refer to our separate Report in "Annexure A". (h) With respect to the other matters to be included in the Auditor's Report in accordance with Rule 11 of the Companies (Audit and Auditors) Rules, 2014, in our opinion and to the best of our information and according to the explanations given to us: i. The Company has disclosed the impact of pending litigations on its financial position in its financial statements – Refer Note XX to the financial statements; [or the Company does not have any pending litigations which would impact its financial position] ii. The Company has made provision, as required under	

	the applicable law or accounting standards, for material foreseeable losses, if any, on long term contracts including derivative contracts – Refer Note XX to the financial statements; [or the Company did not have any long-term contracts including derivative contracts for which there were any material foreseeable losses.] iii. There has been no delay in transferring amounts, required to be transferred, to the Investor Education and Protection Fund by the Company {or, following are the instances of delay in transferring amounts, required to be transferred, to the Investor Education and Protection Fund by the Company or there were no amounts which were required to be transferred to the Investor Education and Protection Fund by the Company}.	

Observation 3:

The comment of the auditor in the auditor's report neither confirms the existence of any foreseeable losses nor quantifies the provisions to be made.

What is the issue?	AASB Suggested Guidance	Technical Literature
Does the auditor need to report on various legal and regulatory requirements as prescribed under a statue e.g., the Companies Act, 2013?	In the case of a company, the requirement to report on legal and regulatory requirements is as per Section 143(3) of the Companies Act, 2013 read with the Companies (Audit and Auditors) Rules, 2014, to the extent applicable. Reporting requirements are also prescribed under other statutes. In accordance with SA 700 (Revised) and the illustrations of auditor's report provided therein, the auditor should include the reporting on these requirements in a separate section of the audit report. This section should be titled "Report on Other Legal and Regulatory Requirements".	**Para 43 of SA 700(Revised):** If the auditor addresses other reporting responsibilities in the auditor's report on the financial statements that are in addition to the auditor's responsibilities under the SAs, these other reporting responsibilities shall be addressed in a separate section in the auditor's report with a heading titled "Report on Other Legal and Regulatory Requirements" or otherwise as appropriate to the content of the section, unless these other reporting responsibilities address the same topics as those presented under the reporting responsibilities required by the SAs in which case the other reporting responsibilities may be presented in the same section as the related report elements required by the SAs. (Ref: Para. A53–A55) **Para 45 of SA 700(Revised):** If the auditor's report contains a separate section that addresses other reporting responsibilities, the requirements of paragraphs 20–40 of this SA shall be included under a section with a heading "Report on the Audit of the Financial Statements." The "Report on Other Legal and Regulatory Requirements" shall follow the "Report on the Audit of the Financial Statements." (Ref: Para. A55)
How should an auditor report if a company does	The auditor is under an obligation to comment on material foreseeable losses as prescribed	**Rule 11(b) of the Companies (Audit and Auditors) Rules, 2014:** Whether the company has made

not have long term contracts or no material foreseeable losses exist on long term contracts?	under Rule 11(b) of the Companies (Audit and Auditors) Rules, 2014 despite that either long term contracts do not exist or material foreseeable losses on long term contracts do not exist. In both instances, the auditor should factually comment that long term contracts or material foreseeable losses on long term contracts do not exist. The auditor should make reference to Appendix (illustration 1) of SA 700(Revised).	provision, as required under any law or accounting standards, for material foreseeable losses, if any, on long term contracts including derivative contracts. **Extract from Appendix - Illustration 1 of SA 700(Revised):** *Report on Other Legal and Regulatory Requirements* 2. As required by Section 143(3) of the Act, we report that: (h) With respect to the other matters to be included in the Auditor's Report in accordance with Rule 11 of the Companies (Audit and Auditors) Rules, 2014, in our opinion and to the best of our information and according to the explanations given to us: ii. The Company has made provision, as required under the applicable law or accounting standards, for material foreseeable losses, if any, on long-term contracts including derivative contracts – Refer Note XX to the financial statements; [or the Company did not have any long-term contracts including derivative contracts for which there were any material foreseeable losses.]

Chapter 19

Observations related to SA 705(Revised), Modifications to the Opinion in the Independent Auditor's Report

Observation 1:

When auditor needs to give "Disclaimer of Opinion "instead of "Qualified Opinion" while issuing audit report.

It was observed that management used certain assumptions while preparing cash flow statement for cash proceeds from sale of tangible assets and same was disclosed in the footnote in the cash flow statement. The management was not able to quantify the amount of misstatement and auditor has issued qualified opinion on this matter.

What is the issue?	AASB Suggested Guidance	Technical Literature
When should the auditor give modified auditor's opinion?	**Implementation Guide on Reporting Standards (Revised SA 700, Revised SA 705 and Revised SA 706)** *Chapter 4 on FAQs on SA 705 (Revised)* **Question 5:** How does the auditor decide the nature of modification that should be made? **Response 5:** An auditor has to evaluate the situation carefully before making his judgment as to the nature of modification. It is very important that the auditor, in terms of the principles laid down in SA 230, "Audit Documentation", also documents in his work papers, how and why he reached this professional judgment. There can be two situations: (a) There is a matter for which the auditor has sufficient appropriate audit evidence to determine that due to such matter, the financial statements are materially misstated, and (b) There is a matter for which the	**Para 6 of SA 705(Revised):** The auditor shall modify the opinion in the auditor's report when: (a) The auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement; or (Ref: Para. A2–A7) (b) The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement. (Ref: Para. A8–A12) **Para 7 of SA 705(Revised):** The auditor shall express a qualified opinion when: (a) The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or

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<td>auditor is unable to obtain sufficient appropriate audit evidence to determine whether due to it, the financial statements may be materially misstated.

In either case, the audit report will be modified, but the nature of modification can be different.

After this, the auditor uses his professional judgment to determine if the effects or possible effects of the matter on the financial statements is/ are pervasive or not pervasive. Again, depending on the extent of pervasiveness, the nature of modification can be different.

The following table summarises the criteria and the nature of modification in different situations:
<table>
<tr><th rowspan="2">Nature of Matter Giving Rise to the Modification</th><th colspan="2">Auditor's Judgment about the materiality and Pervasiveness of the Effects or Possible Effects on the Financial Statements</th></tr>
<tr><th>Material but Not Pervasive</th><th>Material and Pervasive</th></tr>
<tr><td>Financial statements Are materially misstated</td><td>Qualified opinion</td><td>Adverse opinion</td></tr>
<tr><td>Inability to obtain sufficient appropriate audit evidence</td><td>Qualified opinion</td><td>Disclaimer of opinion</td></tr>
</table>
</td>
<td>(b) The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.

Para 8 of SA 705(Revised):

The auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.

Para 9 of SA 705(Revised):

The auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive.</td>
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<tr>
<td>When should the auditor give disclaimer of</td>
<td>An auditor issues a disclaimer of opinion when he is unable to obtain sufficient appropriate audit evidence on which to base an opinion, and he concludes that</td>
<td>Para 9 of SA 705(Revised):

The auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit</td>
</tr>
</table>

opinion instead of qualified opinion while issuing auditor's report?	the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive. A disclaimer of opinion is a form of non-opinion, indicating that the auditor does not express an opinion on the financial statements. Here are some situations when an auditor might issue a disclaimer of opinion instead of a qualified opinion: 1. **Scope Limitation**: When the auditor is unable to obtain all the necessary information and explanations required for the audit, which could be due to restrictions imposed by the client or other circumstances beyond the control of client. 2. **Uncertainty**: When there is an extreme level of uncertainty that affects the entity's ability to continue as a going concern, and the auditor cannot obtain sufficient appropriate audit evidence to conclude whether the going concern assumption is appropriate. 3. **Widespread Discrepancies**: When there are widespread discrepancies or limitations in the financial records that prevent the auditor from conducting an adequate audit and forming an opinion. 4. **Inability to Confirm**: If the auditor is unable to confirm the existence or valuation of key components of the financial statements, and these components are significant to the financial statements as a whole. On the other hand, a qualified opinion is issued when the auditor concludes that misstatements, individually or in the aggregate, are material but not	evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive.

	pervasive to the financial statements. A qualified opinion suggests that except for the effects of the matter to which the qualification relates, the financial statements present a true and fair view in accordance with the applicable financial reporting framework. In summary, a disclaimer of opinion is more severe than a qualified opinion and is used when the auditor cannot form an opinion on the financial statements, whereas a qualified opinion is used when the auditor can form an opinion, but there are certain exceptions.	
When misstatement is to be considered as pervasive?	A pervasive misstatement is one that, due to its nature or size, is likely to influence the economic decisions of users or could potentially mislead users. Pervasiveness is a matter of professional judgment, and auditor should consider the overall impact of misstatements when determining their pervasiveness. Pervasiveness is a key consideration in the context of an audit, as it affects the auditor's opinion. If an auditor concludes that misstatements are both material and pervasive, they may need to issue an adverse opinion or a disclaimer of opinion on the financial statements in accordance with SA 705(Revised).	**Para 5(a) of SA 705(Revised):** **Definition:** **Pervasive –** A term used, in the context of misstatements, to describe the effects on the financial statements of misstatements or the possible effects on the financial statements of misstatements, if any, that are undetected due to an inability to obtain sufficient appropriate audit evidence. Pervasive effects on the financial statements are those that, in the auditor's judgment: (i) Are not confined to specific elements, accounts or items of the financial statements; (ii) If so confined, represent or could represent a substantial proportion of the financial statements; or (iii) In relation to disclosures, are fundamental to users' understanding of the financial statements.

Chapter 20

Observations related to SA 706(Revised), Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report

Observation 1:

The independent auditor's report issued by the firm contains an 'Other Matter' paragraph which draws attention to one specific matter regarding the sanction of the amalgamation petition by the NCLT.

There has been no documentation showing that the matter was communicated to those charged with governance or if any further clarifications were obtained on the matter.

<table>
<tr><th>What is the issue?</th><th>AASB Suggested Guidance</th><th>Technical Literature</th></tr>
<tr><td colspan="3">Note:
This case refers to "Other Matter" paragraph. However, as per the facts of this case, it need not be "Other Matter" paragraph, instead, it should be "Emphasis of Matter" paragraph. Accordingly, the guidance is given below considering it as "Emphasis of Matter" paragraph.</td></tr>
<tr><td>What is the emphasis of matter paragraph and why is it required in auditor's report?

What are the requirements w.r.t. including emphasis of matter paragraph in auditor's report?</td><td>As per SA 706(Revised), if the auditor considers it necessary to draw users' attention to a matter presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements, the auditor should include an Emphasis of Matter paragraph in the auditor's report provided:
(a) The auditor would not be required to modify the opinion in accordance with SA 705 (Revised) as a result of the matter; and
(b) When SA 701 applies, the matter has not been determined to be a key audit matter to be communicated in</td><td>Para 7(a) of SA 706(Revised): Definition
Emphasis of Matter Paragraph:
A paragraph included in the auditor's report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements.
Para 8 of SA 706(Revised):
If the auditor considers it necessary to draw users' attention to a matter presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements, the auditor shall include</td></tr>
</table>

	the auditor's report.	an Emphasis of Matter paragraph in the auditor's report provided: (Ref: Para. A5–A6) (a) The auditor would not be required to modify the opinion in accordance with SA 705 (Revised) as a result of the matter; and (b) When SA 701 applies, the matter has not been determined to be a key audit matter to be communicated in the auditor's report. (Ref: Para. A1–A3) **Para 9 of SA 706(Revised)**: When the auditor includes an Emphasis of Matter paragraph in the auditor's report, the auditor shall: (a) Include the paragraph within a separate section of the auditor's report with an appropriate heading that includes the term "Emphasis of Matter; (b) Include in the paragraph a clear reference to the matter being emphasized and to where relevant disclosures that fully describe the matter can be found in the financial statements. The paragraph shall refer only to information presented or disclosed in the financial statements; and (c) Indicate that the auditor's opinion is not modified in respect of the matter emphasized. (Ref: Para. A7-A8, A16-A17)
What are the circumstances in which an emphasis of matter paragraph may be necessary?	Para A4 of SA 706 (Revised) provides examples of circumstances where emphasis of matter paragraph is required by other Standards on Auditing. Para A5 of SA 706 (Revised) provides examples of	**Para A4 of SA 706(Revised):** Appendix 1 identifies SAs that contain specific requirements for the auditor to include Emphasis of Matter paragraphs in the auditor's report in certain circumstances. These

	circumstances where the auditor may consider it necessary to include an emphasis of matter paragraph.	circumstances include: • When a financial reporting framework prescribed by law or regulation would be unacceptable but for the fact that it is prescribed by law or regulation. • To alert users that the financial statements are prepared in accordance with a special purpose framework. • When facts become known to the auditor after the date of the auditor's report and the auditor provides a new or amended auditor's report (i.e., subsequent events). **Para A5 of SA 706(Revised):** Examples of circumstances where the auditor may consider it necessary to include an Emphasis of Matter paragraph are: • An uncertainty relating to the future outcome of exceptional litigation or regulatory action. • A significant subsequent event that occurs between the date of the financial statements and the date of the auditor's report. • Early application (where permitted) of a new accounting standard that has a material effect on the financial statements. • A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position.
What is the difference between emphasis of matter paragraph and other matter paragraph?	**Implementation Guide on Reporting Standards (Revised SA 700, Revised SA 705 and Revised SA 706)** *Chapter 5 on FAQs on SA 706 (Revised)*	**Para 7 of SA 706(Revised): Definition** *(a) Emphasis of Matter Paragraph*: A paragraph included in the auditor's report that refers to a matter appropriately presented or disclosed in the financial statements that, in the

	Question 9: What is an "Other Matter" paragraph, and how is it different from an Emphasis of Matter paragraph? **Response 9:** An Other Matter Paragraph is defined as "A paragraph included in the auditor's report that refers to a matter other than those presented or disclosed in the financial statements that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report." In other words, the distinction is that while an Emphasis of Matter Paragraph refers to matters that are appropriately presented or disclosed in the financial statements, an Other Matter paragraph refers to matters that are not presented or disclosed in the financial statements but the auditor feels the need to bring them to the users' attention. The other point of difference to note is that while the definition of Emphasis of Matter paragraph uses the word "fundamental" with reference to understanding of the financial statements, the definition of other matter paragraph uses the word "relevant". The reason is that matters of emphasis are mentioned in the financial statements and are therefore already available to the users. By highlighting them in his report, the auditor specifically points the readers' attention to these matters. It is only the	auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements. (b) *Other Matter paragraph:* A paragraph included in the auditor's report that refers to a matter other than those presented or disclosed in the financial statements that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.

	most “fundamentally important” matters that are therefore included in Emphasis of Matter. On the other hand, other matters are those related to the users’ understanding of the audit, the auditor’s responsibility or the auditor’s report, that are not mentioned at all in the financial statements and therefore the users are likely to be unaware of them. So, if the auditor believes that such information is “relevant”, he informs the users through his report. A key point to note is that an Other Matter paragraph is limited to information about the audit, the auditor’s responsibility or the auditor’s report, and does not include matters related to the financial statements, as is the case with the Emphasis of Matter paragraph.	

Observation 2:

The firm has not documented Basis of Emphasis of Matter (EOM) and communication to those charged with governance.

OR

Under the Emphasis of Matter ("EOM") paragraphs, the auditor has reported seven points. Out of these seven points, in five points, the auditor has reported the financial impact of the matters specified. The reporting done by the auditor under the Emphasis of Matter paragraph creates confusion whether the auditor wanted to qualify the given points or wanted to highlight the points through EOM.

What is the issue?	AASB Suggested Guidance	Technical Literature
Whether auditor needs to evaluate misstatements identified during the audit before forming opinion on the financial statements?	The auditor needs to evaluate the misstatements identified during the audit before forming an opinion on the financial statements. The auditor needs to evaluate the effect of uncorrected misstatements on the financial statements. During this evaluation, the auditor needs to determine whether uncorrected misstatements are material to the financial statements, either individually or in aggregate. SA 450 contains relevant requirements for auditors in this regard.	**Para 5 of SA 450:** The auditor shall accumulate misstatements identified during the audit, other than those that are clearly trivial. (Ref: Para. A2- A3) **Para 8 of SA 450:** 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. (Ref: Para. A7-A9) **Para 9 of SA 450:** 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. (Ref: Para. A 10) **Para 10 of SA 450:** Prior to evaluating the effect of uncorrected misstatements, the auditor

		shall reassess materiality determined in accordance with SA 320 to confirm whether it remains appropriate in the context of the entity's actual financial results. (Ref: Para. A11-A12) **Para 11 of SA 450:** 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 (Ref: Para. A13-A17, A19-A20) (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. (Ref: Para. A18) **Para 12 of SA 450:** The auditor shall communicate with those charged with governance 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. (Ref: Para. A21-A23) **Para 13 of SA 450:** The auditor shall also communicate with those charged with governance 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.
What is the emphasis of matter paragraph and why is it required in auditor's report? What are the requirements w.r.t. including emphasis of matter paragraph in auditor's report?	As per SA 706(Revised), if the auditor considers it necessary to draw users' attention to a matter presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements, the auditor should include an Emphasis of Matter paragraph in the auditor's report provided: (a) The auditor would not be required to modify the opinion in accordance with SA 705 (Revised) as a result of the matter; and (b) When SA 701 applies, the matter has not been determined to be a key audit matter to be communicated in the auditor's report. If the required disclosures are not included in financial statements, auditor should evaluate the requirement for expressing a qualified opinion in accordance with requirements of SA 705 (Revised). It is pertinent to note that emphasis of matter cannot be given in respect of a matter which requires auditor to modify the auditor's opinion.	**Para 7(a) of SA 706(Revised): Definition** *Emphasis of Matter Paragraph*: A paragraph included in the auditor's report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements. **Para 8 of SA 706(Revised):** If the auditor considers it necessary to draw users' attention to a matter presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements, the auditor shall include an Emphasis of Matter paragraph in the auditor's report provided: (Ref: Para. A5–A6) (a) The auditor would not be required to modify the opinion in accordance with SA 705 (Revised) as a result of the matter; and (b) When SA 701 applies, the matter has not been determined to be a key audit matter to be communicated in the auditor's report. (Ref: Para. A1–A3) **Para 9 of SA 706(Revised)**: When the auditor includes an Emphasis of Matter paragraph in the auditor's report, the auditor shall: (a) Include the paragraph within a separate section of the auditor's report with an appropriate heading that includes the term "Emphasis of

		Matter”; (b) Include in the paragraph a clear reference to the matter being emphasized and to where relevant disclosures that fully describe the matter can be found in the financial statements. The paragraph shall refer only to information presented or disclosed in the financial statements; and (c) Indicate that the auditor’s opinion is not modified in respect of the matter emphasized. (Ref: Para. A7-A8, A16-A17)
What are the circumstances in which an emphasis of matter paragraph may be necessary?	Para A4 of SA 706 (Revised) provides examples of circumstances where emphasis of matter paragraph is required by other Standards on Auditing. Para A5 of SA 706 (Revised) provides examples of circumstances where the auditor may consider it necessary to include an emphasis of matter paragraph.	**Para A4 of SA 706(Revised):** Appendix 1 identifies SAs that contain specific requirements for the auditor to include Emphasis of Matter paragraphs in the auditor’s report in certain circumstances. These circumstances include: • When a financial reporting framework prescribed by law or regulation would be unacceptable but for the fact that it is prescribed by law or regulation. • To alert users that the financial statements are prepared in accordance with a special purpose framework. • When facts become known to the auditor after the date of the auditor’s report and the auditor provides a new or amended auditor’s report (i.e., subsequent events). **Para A5 of SA 706(Revised):** Examples of circumstances where the auditor may consider it necessary to include an Emphasis of Matter paragraph are: • An uncertainty relating to the future outcome of exceptional litigation or regulatory action. • A significant subsequent event that

		occurs between the date of the financial statements and the date of the auditor's report. • Early application (where permitted) of a new accounting standard that has a material effect on the financial statements. • A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position.
What are the documentation requirements for auditor w.r.t. emphasis of matter paragraph in audit report?	SA 230, which deals with audit documentation, does not specifically address the documentation requirements for an Emphasis of Matter paragraph in the audit report. However, SA 230 provides general guidance on the nature and extent of audit documentation that should be prepared and retained by the auditor. An Emphasis of Matter paragraph is governed by SA 706 (Revised). SA 706 (Revised) provides guidance on when an auditor should include an emphasis of matter paragraph in the audit report and the circumstances under which it is appropriate.	**Para 8 of SA 230:** The auditor shall prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand: (Ref: Para. A2-A5, A16- A17) (a) The nature, timing, and extent of the audit procedures performed to comply with the SAs and applicable legal and regulatory requirements; (Ref: Para. A6-A7) (b) The results of the audit procedures performed, and the audit evidence obtained; and (c) Significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions. (Ref: Para. A8- A11) **Para 9 of SA 230:** In documenting the nature, timing and extent of audit procedures performed, the auditor shall record: (a) The identifying characteristics of the specific items or matters tested; (Ref: Para. A12) (b) Who performed the audit work and the date such work was completed; and (c) Who reviewed the audit work performed and the date and extent of such review. (Ref: Para. A13)

		Para 10 of SA 230: The auditor shall document discussions of significant matters with management, those charged with governance, and others, including the nature of the significant matters discussed and when and with whom the discussions took place. (Ref: Para. A14) **Para 11 of SA 230:** If the auditor identified information that is inconsistent with the auditor's final conclusion regarding a significant matter, the auditor shall document how the auditor addressed the inconsistency. (Ref: Para. A15)
What are the communication requirements for the auditor w.r.t. inclusion of emphasis of matter paragraph in audit report?	As per SA 706 (Revised), if the auditor expects to include an Emphasis of Matter or an Other Matter paragraph in the auditor's report, the auditor is required to communicate with those charged with governance regarding this expectation and the wording of this paragraph. As per SA 260 (Revised), circumstances in which the auditor is required or may otherwise consider it necessary to include additional information in the auditor's report in accordance with the SAs, and for which communication with those charged with governance is required, include when: • The auditor considers it necessary to include an Emphasis of Matter paragraph or Other Matter paragraph in accordance with SA 706 (Revised).	**Para 12 of SA 706 (Revised):** If the auditor expects to include an Emphasis of Matter or an Other Matter paragraph in the auditor's report, the auditor shall communicate with those charged with governance regarding this expectation and the wording of this paragraph. (Ref: Para. A18) **Para 16(d) of SA 260 (Revised):** The auditor shall communicate with those charged with governance: (Ref: Para. A17–A18) (d) Circumstances that affect the form and content of the auditor's report, if any; and (Ref: Para. A23–A25).

Does inclusion of an emphasis of matter paragraph in the auditor's report affect the auditor's opinion?	**Implementation Guide on Reporting Standards (Revised SA 700, Revised SA 705 and Revised SA 706)** *Chapter 5 on FAQs on SA 706 (Revised)* **Question 3:** Does insertion of an Emphasis of Matter paragraph in the auditor's report make the opinion "modified"? **Response 3:** No. SA 705 (Revised) excludes Emphasis of Matter paragraphs and Other Matter paragraphs from being termed as "modifications to the audit opinion". These form the subject-matter of SA 706 (Revised). The point to note is that an Emphasis of Matter is not a part of the audit opinion at all. It is a separate, independent paragraph designed to provide "additional communication" to the users by emphasizing on the subject matter.	**Para 7(a) of SA 706(Revised):** **Definition** *Emphasis of Matter paragraph:* A paragraph included in the auditor's report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements. **Para 5(b) of SA 705 (Revised):** **Definition** *Modified opinion:* A qualified opinion, an adverse opinion or a disclaimer of opinion on the financial statements. **Para A7 of SA 706 (Revised):** The inclusion of an Emphasis of Matter paragraph in the auditor's report does not affect the auditor's opinion. An Emphasis of Matter paragraph is not a substitute for: (a) A modified opinion in accordance with SA 705 (Revised) when required by the circumstances of a specific audit engagement; (b) Disclosures in the financial statements that the applicable financial reporting framework requires management to make, or that are otherwise necessary to achieve fair presentation; or (c) Reporting in accordance with SA 570 (Revised) when a material uncertainty exists relating to events or conditions that may cast significant doubt on an entity's ability to continue as a going concern.

Chapter 21

Observations related to SA 710, Comparative Information – Corresponding Figures and Comparative Financial Statements

Observation 1:

Since the firm was appointed for the first time, the firm should have reported disclosure of audit of previous year done by another audit firm, in accordance with para 13 of SA 710 in the Other Matters Paragraph.

What is the issue?	AASB Suggested Guidance	Technical Literature
What are the reporting requirements for the auditor if the prior period financial statements were audited by a predecessor auditor?	An illustrative example of the auditor's report if the prior period financial statements 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 is contained in Illustration 3 of the Appendix of SA 710. **Extract from illustration 3** *Other Matter paragraph* The financial statements of the Company for the year ended March 31, 20X0, were audited by another auditor who expressed an unmodified opinion on those statements on June 30, 20X0.	**Para 13 of SA 710:** 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. (Ref: Para. A7)

Observation 2:

The company has not mentioned corresponding figures of previous year in Note 30 and 31 to the financial statements. It is suggested to mention corresponding figures in all disclosures.

OR

As per para 2.2 of Master Circular on Disclosure in Financial Statements–Notes to Accounts, at least, the items listed in the circular should be disclosed in the notes to accounts.

However, the bank has not disclosed the figures of comparative period for:

(1) Maturity pattern of certain items of assets and liabilities.

(2) Disclosure of restructured account.

What is the issue?	AASB Suggested Guidance	Technical Literature
What approaches of comparative information are envisaged under SA 710?	The comparative information that is presented in an entity's financial statements depends on the requirements of the applicable financial reporting framework. As per SA 710, comparative information exists in either the form 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. • *Comparative financial statements:* Comparative information where amounts and other disclosures	**Para 1 of SA 710:** This Standard on Auditing (SA) deals with the auditor's responsibilities regarding comparative information in an audit of financial statements. When the financial statements of the prior period have been audited by a predecessor auditor or were not audited, the requirements and guidance in SA 510 regarding opening balances also apply. **Para 6 of SA 710:** **Definitions:** For purposes of the SAs, the following terms have the meanings attributed below: (a) *Comparative information* – The amounts and disclosures included in the financial statements in respect of one or more prior periods in accordance with the applicable financial reporting framework. (b) *Corresponding figures* – Comparative information where amounts and other disclosures for the prior period are included as an

	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.	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. (c) *Comparative financial statements* – Comparative information where amounts and other disclosures for the prior period are included for comparison with the financial statements of the current period but, if audited, are referred to in the auditor's opinion. The level of information included in those comparative financial statements is comparable with that of the financial statements of the current period. For purposes of this SA, references to "prior period" should be read as "prior periods" when the comparative information includes amounts and disclosures for more than one period.
Should an auditor refer to corresponding figures in audit report?	When the current period financial statements include corresponding figures, the auditor should express an opinion only on the current period financial statements, and do not refer to the corresponding figures except in following circumstances: • When the auditor modified the opinion on the prior period and the matter that gave rise to the modified opinion is unresolved. • If the auditor obtains audit evidence that a material misstatement exists in the prior period financial statements on which an unmodified opinion has	**Para 10 of SA 710:** When corresponding figures are presented, the auditor's opinion shall not refer to the corresponding figures except in the circumstances described in paragraphs 11, 12, and 14. (Ref: Para. A2) **Para 11 of SA 710:** 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

	been previously issued, and the misstatement has not been dealt with as required under the applicable financial reporting framework. • If the prior period financial statements were not audited.	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. (Ref: Para. A3-A5) **Para 12 of SA 710:** 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. (Ref: Para. A6) **Para 13 of SA 710:** 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. (Ref: Para. A7) **Para 14 of SA 710:** 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. (Ref: Para. A7a, A8)

Chapter 22

Observations related to SA 720(Revised), The Auditor's Responsibilities Relating to Other Information

Observation 1:

It was observed that the firm has not documented any procedures to demonstrate whether the firm obtained and reviewed the draft annual report to meet the requirements of SA 720(Revised).

OR

There was no evidence available to show that the firm had made appropriate arrangement with the management or those charged with governance to obtain/read the other information before issuing the auditor's report or as soon as possible after issuing the auditor's report to identify material inconsistencies, if any, with the audited financial statements.

OR

The audit firm has not reported and documented matter on other information as per requirements of SA 720(Revised).

What is the issue?	AASB Suggested Guidance	Technical Literature
What is the definition of "Other information" and "Annual Report"?	SA 720(Revised) defines "Other Information" as financial or non-financial information (other than financial statements and the auditor's report thereon) included in an entity's annual report. An entity's annual report may be a single document or a combination of documents that serve the same purpose. The purpose of annual report is to provide owners (or similar stakeholders) with information on the entity's operations and the entity's financial results and financial position as set out in the financial statements (e.g., management report, chairman's statement, corporate governance statement/report, etc.). The below mentioned documents may be considered as "Other Information" but "Other information "is not limited to	**Para 12 of SA 720(Revised):** **Definitions:** *(a) Annual report:* A document, or combination of documents, prepared typically on an annual basis by management or those charged with governance in accordance with law, regulation or custom, the purpose of which is to provide owners (or similar stakeholders) with information on the entity's operations and the entity's financial results and financial position as set out in the financial statements. An annual report contains or accompanies the financial statements and the auditor's report thereon and usually includes information about the entity's developments, its future outlook and risks and

	the following: • Director's Report (with annexures). • Management Discussion & Analysis. • Corporate Governance Report. • Shareholder information. • Any other information/report forming part of the annual report. Also, the auditor should refer to Regulation 34 of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 which specifies contents of the annual report.	uncertainties, a statement by the entity's governing body, and reports covering governance matters. (Ref: Para. A1–A5) *(b) Misstatement of the other information:* A misstatement of the other information exists when the other information is incorrectly stated or otherwise misleading (including because it omits or obscures information necessary for a proper understanding of a matter disclosed in the other information). (Ref: Para. A6–A7) *(c) Other information:* Financial or non-financial information (other than financial statements and the auditor's report thereon) included in an entity's annual report. (Ref: Para. A8–A10).
What are the requirements of SA 720 (Revised) w.r.t. obtaining and reading the other information?	SA 720(Revised) requires the auditor to make arrangements with management to obtain the other information in a timely manner. SA 720(Revised) also requires the auditor to read the other information to consider: • Whether there is any material inconsistency between other information and financial statements. • Whether there is any material inconsistency between other Information and the auditor's knowledge obtained in the audit.	**Para 13 of SA 720(Revised):** The auditor shall: (Ref: Para. A11–A22) (a) Determine, through discussion with management, which document(s) comprises the annual report, and the entity's planned manner and timing of the issuance of such document(s); (b) Make appropriate arrangements with management to obtain in a timely manner and, if possible, prior to the date of the auditor's report, the final version of the document(s) comprising the annual report; and (c) When some or all of the

		document(s) determined in (a) will not be available until after the date of the auditor's report, request management to provide a written representation that the final version of the document(s) will be provided to the auditor when available, and prior to its issuance by the entity, such that the auditor can complete the procedures required by this SA. (Ref: Para. A22) **Para 14 of SA 720(Revised):** The auditor shall read the other information and, in doing so shall: (Ref: Para. A23–A24) (a) Consider whether there is a material inconsistency between the other information and the financial statements. As the basis for this consideration, the auditor shall, to evaluate their consistency, compare selected amounts or other items in the other information (that are intended to be the same as, to summarize, or to provide greater detail about, the amounts or other items in the financial statements) with such amounts or other items in the financial statements; and (Ref: Para. A25–A29) (b) Consider whether there is a material inconsistency between the other information and the auditor's knowledge obtained in the audit, in the context of audit evidence obtained and conclusions reached in the audit. (Ref: Para. A30–A36)

		Para 15 of SA 720(Revised): While reading the other information in accordance with paragraph 14, the auditor shall remain alert for indications that the other information not related to the financial statements or the auditor's knowledge obtained in the audit appears to be materially misstated. (Ref: Para. A24, A37–A38)
What are the documentation requirements pertaining to other information?	The auditor is required to document procedures performed under SA 720 (Revised) and include in audit documentation the final version of the other information on which the auditor has performed the work required under this SA. Audit procedures performed in relation to the "Other Information" should be documented along with the other audit workpapers. However, if the management provides "Other Information" after the date of audit report, audit procedures are performed after the date of audit report, in such situation, these procedures including conclusion and reporting thereof should be documented. Also, the auditor is required to include in audit documentation the final version of the other information on which the auditor has performed the work required under SA 720(Revised). Therefore, the following are the minimum documentation requirements as per SA 720(Revised): • Compliance with SA 230, "Audit Documentation". • Audit procedures performed on other information. • Final version of other information on which procedures were performed.	**Para 25 of SA 720(Revised):** In addressing the requirements of SA 230 as it applies to this SA, the auditor shall include in the audit documentation: (a) Documentation of the procedures performed under this SA; and (b) The final version of the other information on which the auditor has performed the work required under this SA.

	• Management representations w.r.t. other information.	
What are the procedures to be performed when the auditor expects to receive some or all other information after the date of the auditor's report?	**Implementation Guide to Standard on Auditing (SA) 720(Revised) The Auditor's Responsibilities Relating to Other Information** **Chapter 3: Frequently Asked Questions ("FAQs") and Responses** **Question 19:** What are the procedures to be performed when the auditor expects to receive some or all other information after the date of the auditor's report? **Response 19:** Regardless of whether the other information is available prior to or after the date of the auditor's report, the auditor should perform procedures as stated in SA 720(Revised). Further, when some document(s) forming part of other information will not be available until after the date of the auditor's report, written representation will also be required to be taken from the management that the final version of such document(s) will be provided to the auditor when available, and prior to its issuance by the entity, such that the auditor can complete the procedures required by this SA. However, when the other information is obtained after the date of the auditor's report, the auditor is not required to update the procedures performed in accordance with paragraphs 6 and 7 of SA 560, "Subsequent Events". For other information received after the date of the auditor's report, if the auditor concludes that a material misstatement exists in such other information, the outcomes can be as below: • *Other information has been corrected* – no further reporting	**Para 19 of SA 720(Revised):** If the auditor concludes that a material misstatement exists in other information obtained after the date of the auditor's report, the auditor shall: (a) If the other information is corrected, perform the procedures necessary in the circumstances; or (Ref: Para. A48) (b) If the other information is not corrected after communicating with those charged with governance, take appropriate action considering the auditor's legal rights and obligations, to seek to have the uncorrected material misstatement appropriately brought to the attention of users for whom the auditor's report is prepared. (Ref: Para. A49–A50)

	requirement. The auditor needs to perform procedures necessary in circumstances which include determining that the correction has been made and may include reviewing the steps taken by management to communicate with those in receipt of the other information, if previously issued, to inform them of the revision. • *Other information has not been corrected* – the auditor shall firstly communicate with those charged with governance, take necessary action considering the auditor's legal rights and obligations, to seek to have to have the uncorrected material misstatement appropriately brought to the attention of users for whom the auditor's report is prepared, which includes (Ref: para. A49 – A50 of SA 720(Revised)): • Providing a new or amended auditor's report to management including a modified section in accordance with paragraph 22 of SA 720(Revised), and requesting management to provide this new or amended auditor's report to users for whom the auditor's report is prepared; • Bringing the material misstatement of the other information to the attention of the appointing authority; • Communicating with the regulator where required by applicable law or regulation about the uncorrected material misstatement; or • Considering the implications for engagement continuance. Withdrawal from the	

	engagement, where withdrawal is possible under applicable law or regulation, may be appropriate when the circumstances surrounding the refusal to correct the material misstatement of the other information cast such doubt on the integrity of management and those charged with governance as to call into question the reliability of representations obtained from them during the audit. Auditors should sensitize the management that 'other information' received after the date of auditor's report should not be dated before the date of auditor's report. Further, final versions of the documents forming part of annual report and shared with auditor in draft form with written confirmation that the drafts are near final should not be dated before the date of auditor's report.	

Chapter 23

Observations related to Internal Financial Controls

Observation 1:

Based on review of the revenue related working papers it was noted that:

1. High risk is identified only for domestic sales.
2. Write up of control process by engagement team / standard operating procedures / flow charts are not available in the audit work papers.
3. Risks identified are primarily process / procedure level risks.
4. Risks are not identified for cut-off, cash discount, services income, handling charges, etc.
5. Inadequate assessment of controls such as chassis number controls, bill of lading, etc.
6. Assertions not identified.
7. Documentation of control testing does not differentiate between distribution of income and expense evaluation and conclusion and operating effectiveness testing.

Adherence to the guidance in Guidance Note on Audit of Internal Financial Controls Over Financial Reporting issued by ICAI on testing of internal financial controls to be adequately demonstrated in the audit work papers. Revenue being a significant risk area needs to be associated with appropriate assertions and testing procedures tailored accordingly.

OR

It was noted that:

(a) Control testing work papers does not reflect the procedures performed for revenue related controls.

(b) In respect to risk: 'genuinity and correctness of purchase orders from dealers', sample size determined was 14, whereas only 7 samples (screenshots from SAP) available in manual file.

(c) Control testing work papers does not contain the manual working paper references, wherein samples were tested.

The firm needs to strengthen its process of assessing risks and mapping controls in place at the company for such risks. The controls need to be tested for design, implementation and operating effectiveness and conclusions to be drawn on the effectiveness of the controls based on such testing.

OR

In case of internal financial controls w.r.t. sundry sales and processing charges:

There are 3 control weaknesses identified (a) No written customer selection policy (b) segregation of duties for raising invoice (c) risk of invoicing in SAP beyond the approved quantity. There is no audit documentation to suggest that the above control weaknesses were communicated to the management. Further, the representation letter also does not contain a summary of these weaknesses.

Control weaknesses identified need to be communicated to the management in a timely manner and the management response to the said control weaknesses are to be assessed. The firm needs to evaluate if such weaknesses are significant deficiencies and result in an adverse opinion in the auditor's report.

What is the issue?	AASB Suggested Guidance	Technical Literature
Note: ICAI has issued the "Guidance Note on Audit of Internal Financial Controls Over Financial Reporting". The Guidance Note provides detailed guidance on reporting requirement of Section 143(3)(i) of the Companies Act, 2013 including the illustrative formats of auditor's report.		
Whether revenue recognition is a fraud risk by default?	Material misstatements due to fraudulent financial reporting often result from an overstatement or an understatement of revenue. As per SA 240, there is a presumption that a risk of material misstatement due to fraud in revenue recognition exists in every audit. The auditor should evaluate which types of revenue, revenue transactions or assertions give rise to this fraud risk. When the auditor concludes that there is no risk of material misstatement due to improper revenue recognition for each type of revenue transaction, the auditor should document the reasons supporting this conclusion.	**Para 26 of SA 240:** When identifying and assessing the risks of material misstatement due to fraud, the auditor shall, based on a presumption that there are risks of fraud in revenue recognition, evaluate which types of revenue, revenue transactions or assertions give rise to such risks. Paragraph 47 specifies the documentation required when the auditor concludes that the presumption is not applicable in the circumstances of the engagement and, accordingly, has not identified revenue recognition as a risk of material misstatement due to fraud. (Ref: Para. A28-A30)
How should risk associated with a control be identified by an audit firm?	A robust risk assessment is critical to perform a quality audit as it enables the audit firm to develop an audit strategy that is responsive to an entity's risks of material misstatement. Risk assessment underlies the entire audit of internal controls, including the determination of significant accounts and disclosures and relevant assertions, the selection of controls to test, and the	**Guidance Note on Audit of Internal Financial Controls Over Financial Reporting (Guidance Note)** IG 13.9 Factors that affect the risk associated with a control include: • The nature and materiality of misstatements that the control is intended to prevent or detect; • The inherent risk associated

	determination of the evidence necessary for a given control. Paragraph IG 13.9 of the Guidance Note illustrates certain considerations while assessing risk in an audit of internal controls under the Companies Act, 2013. As stated in paragraph IG 13.9 of the Guidance Note, risk associated with a control should be identified on the basis of various factors including history of errors, effectiveness of entity level controls, competence of entity personnel. Further, there is a direct relationship between the degree of risk that could exist in a particular area and the amount of audit attention (i.e., higher the risk higher the auditor's attention). The audit firm should focus more attention on the areas of higher risk. .	with the related account(s) and assertion(s); • Whether there have been changes in the volume or nature of transactions that might adversely affect control design or operating effectiveness; • Whether the account has a history of errors; • The effectiveness of entity-level controls, especially controls that monitor other controls; • The nature of the control and the frequency with which it operates; • The degree to which the control relies on the effectiveness of other controls (e.g., the control environment or information technology general controls); • The competence of the personnel who perform the control or monitor its performance and whether there have been changes in key personnel who perform the control or monitor its performance; • Whether the control relies on performance by an individual or is automated (i.e., an automated control would generally be expected to be lower risk if relevant information technology general controls are effective); and **Note:** A less complex company or business unit with simple business processes and centralized accounting operations might have relatively simple information

		systems that make greater use of off-the-shelf packaged software without modification. In the areas in which off-the-shelf software is used, the auditor's testing of information technology controls might focus on the application controls built into the pre-packaged software that management relies on to achieve its control objectives and the IT general controls that are important to the effective operation of those application controls. • The complexity of the control and the significance of the judgements that must be made in connection with its operation. **Note:** Generally, a conclusion that a control is not operating effectively can be supported by less evidence than is necessary to support a conclusion that a control is operating effectively. Some of these factors relate to the risks of material misstatement that the control addresses, while others relate directly to the characteristics of the control itself. Therefore, it may be helpful to consider the factors in those two groups.
What are the key documentation considerations in an audit of internal controls?	The Guidance Note and SA 230 require the audit firm to appropriately document the work performed. Documentation should be clear and detailed enough for an experienced auditor, with no previous connection to the audit, to understand the work performed, the evidence obtained, and the conclusions reached. An audit firm should include all significant findings or issues, the professional judgments made in reaching conclusions, and how these	**Para 165 of Guidance Note:** The auditor should document the work performed on internal financial controls over financial reporting such that it provides: (a) A sufficient and appropriate record of the basis for the auditor's report; and (b) Evidence that the audit was planned and performed in accordance with this guidance, applicable Standards on Auditing and applicable legal

	judgments were addressed. Documentation should be prepared on a timely basis. This ensures that details are accurately recorded and reduces the risk of omission. By adhering to the Guidance Note and SA 230, audit documentation will be comprehensive, and useful for supporting audit conclusions, to facilitate reviews, and meet regulatory requirements.	and regulatory requirements. In this regard, the auditor should comply with the requirements of SA 230, "Audit Documentation" to the extent applicable.
If a company does not have formal documentation of its processes and controls, how can an audit firm obtain sufficient understanding from other related documentation?	If the company does not have formal documentation of its processes and controls, the auditor may consider whether other related documentation is available for obtaining sufficient understanding. A practical way to identify such other documentation is to look for the information that the company uses to run its business e.g. period closure accounting adjustments circulars/guidelines may specify the period end activities carried out by a company covering some of the aspects.	**Guidance Note:** IG 19.42 Implementing and assessing effective internal financial controls by a company's management generally involves some level of documentation. A smaller, less complex company often has different needs for documentation, and the nature of that documentation might differ from that of a larger or more complex organisation. Differences in the form and extent of control documentation of smaller, less complex companies generally relate to their operating characteristics, particularly to fewer resources and more direct interaction of senior management with controls. The nature and extent of a company's documentation of internal financial controls can have a significant effect on the auditor's strategy regarding the audit of internal financial control. This Section discusses how the auditor could adapt his or her audit strategy to obtain sufficient appropriate evidence in an environment with less formal documentation. IG 19.44 Larger companies with complex operations are more likely

		to have formal documentation of their processes and controls, such as in-depth policy manuals and systems flowcharts of processes. In a smaller, less complex company, documentation of processes and controls might take a variety of forms. For example, information about processes and controls might be found in other documentation, such as memoranda, questionnaires, software manuals, source documents, or job descriptions. This documentation might not cover every process and might not be in a consistent form across all processes. Where walkthroughs are performed, auditors could use those procedures to obtain an understanding of the flow of transactions affecting relevant assertions and to assess the design effectiveness of certain controls, even when documentation is limited.
How should controls be selected for testing?	Selecting controls for testing in an audit of internal controls involves a systematic approach to ensure that the chosen controls are relevant, effective, and provide adequate coverage over financial reporting risks. As per the Guidance Note, selection of controls is affected by the entity and its environment, entity-level controls and process-level controls, risk of material misstatement (focusing on where errors or fraud could have the most significant impact) and other relevant matters.	**Para 105 of Guidance Note:** The auditor should test those controls that are important to the auditor's conclusion about whether the company's controls sufficiently address the assessed risk of misstatement to each relevant assertion. **Para 106 of Guidance Note:** There might be more than one control that addresses the assessed risk of misstatement to a particular relevant assertion; conversely, one control might address the assessed risk of misstatement to more than one relevant assertion. It is neither necessary to test all controls related to a relevant assertion nor

		necessary to test redundant controls, unless redundancy is itself a control objective. **Para 107 of Guidance Note:** The decision as to whether a control should be selected for testing depends on which controls, individually or in combination, sufficiently address the assessed risk of misstatement to a given relevant assertion rather than on how the control is labeled (e.g., entity-level control, transaction-level control, control activity, monitoring control, preventive control, detective control).
How should an audit firm evaluate identified deficiencies?	As per the Guidance Note, an audit firm should evaluate the severity of control deficiency and implications, if any, on the audit opinion on internal financial controls. As defined under the Guidance Note, a deficiency in internal controls exists when a control does not allow management or employees to prevent or detect misstatements in financial statements on a timely basis.	**Para 128 of Guidance Note:** The auditor must evaluate the severity of each control deficiency that comes to his or her attention to determine whether the deficiencies, individually or in combination, are significant deficiencies or material weaknesses as of the balance sheet date. In planning and performing the audit, however, the auditor is not required to search for deficiencies that, individually or in combination, are less severe than a significant deficiency. **Note:** For purpose of this guidance, • A 'deficiency' in internal financial control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. • A 'significant deficiency' is a deficiency, or a combination of deficiencies, in internal financial

		control over financial reporting that is important enough to merit attention of those charged with governance since there is a reasonable possibility that a misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis. - A deficiency in design exists when (a) a control necessary to meet the control objective is missing or (b) an existing control is not properly designed so that, even if the control operates as designed, the control objective would not be met. - A deficiency in operation exists when a properly designed control does not operate as designed, or when the person performing the control does not possess the necessary authority or competence to perform the control effectively. • A 'material weakness' is a deficiency, or a combination of deficiencies, in internal financial control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis. **Para 129 of Guidance Note:** The severity of a deficiency depends on:

		• Whether there is a reasonable possibility that the company's controls will fail to prevent or detect a misstatement of an account balance or disclosure; and • The magnitude of the potential misstatement resulting from the deficiency or deficiencies.
What are the examples of material weakness?	Identification of material weakness implies that there is a reasonable possibility that a material misstatement of the company's annual/ interim financial statements will not be prevented or detected on a timely basis. Examples include restatement of financial statements due to error and identification of fraud.	**Para 135 of Guidance Note:** Indicators of material weaknesses in internal financial controls over financial reporting include: • Identification of fraud, whether or not material, on the part of senior management; • Errors observed in previously issued financial statements in the current financial year; • Identification by the auditor of a material misstatement of financial statements in the current period in circumstances that indicate that the misstatement would not have been detected by the company's internal financial controls over financial reporting; and • Ineffective oversight of the company's external financial reporting and internal financial controls over financial reporting by the company's audit committee.
What communications to management/ those charged with governance are envisaged under the Guidance Note?	The Guidance Note inter alia requires an audit firm to communicate in writing all material weaknesses, any deficiencies (or combinations of deficiencies) irrespective of whether they are significant deficiencies or not, ineffective oversight of the	**Para 137 of Guidance Note:** The auditor must communicate, in writing, to management and those charged with governance all material weaknesses and any deficiencies, or combinations of deficiencies that are significant

	company's external financial reporting and internal financial controls over financial reporting by the Audit Committee. Additionally, the audit firm should comply with SA 260 and SA 265, to the extent applicable.	deficiencies identified during the audit. Where possible, the written communication should be made prior to the issuance of the auditor's report on internal financial controls over financial reporting to provide an opportunity for the company to remediate the material weakness. If such remediation is done before or as at the balance sheet date, the auditor could test the same before forming his/her final opinion. **Para 138 of Guidance Note:** Based on an evaluation of the implementation of the components of internal control which make up the system of internal financial controls over financial reporting established by the company, if the auditor concludes that the oversight of the company's external financial reporting and internal financial controls over financial reporting by the company's audit committee is ineffective, the auditor must communicate that conclusion in writing to the board of directors. **Para 139 of Guidance Note:** The auditor should also communicate to management, in writing, all deficiencies in internal financial controls over financial reporting (i.e., those deficiencies in internal financial controls over financial reporting that are of a lesser magnitude than significant deficiency) identified during the audit and inform the audit committee when such a communication has been made. When making this communication, it is not necessary for the auditor to repeat information about such deficiencies that has been included in previously issued written

		communications, whether those communications were made by the auditor, internal auditors, or others within the organisation. **Para 142 of Guidance Note:** With respect to communications relating to the audit of internal financial controls over financial reporting, the auditor should also consider and suitably adapt the requirements and principles of SA 260 “Communication with Those Charged with Governance” and SA 265 “Communicating Deficiencies in Internal Control to Those Charged with Governance and Management”.

Observation 2:

The following observations in relation to SA 500 and internal financial controls were noticed:

There is no evidence of testing of relevant controls for design and operating effectiveness in respect of:

(i) Physical verification of inventory by the management.

(ii) Valuation of Inventories.

(iii) Control over completeness of raw materials - goods in transit.

(iv) Control over determining overhead allocation.

(v) Accounting of stage of completion of the work-in-progress.

What is the issue?	AASB Suggested Guidance	Technical Literature
Is the auditor required to design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence for internal financial controls over financial reporting (ICFR) testing in accordance with SA 500?	The audit of internal financial controls over financial reporting (ICFR) is primarily governed by the "Guidance Note on Audit of Internal Financial Controls Over Financial Reporting" (the Guidance Note) issued by ICAI, however, the auditor also needs to comply with applicable Standards on Auditing. As per SA 200, in case any applicable laws and regulations require auditors to provide opinion on specific matters, the SAs include requirements and guidance in relation to such matters to the extent that they are relevant to forming an opinion on the financial statements, however, the auditor is required to undertake further work if the auditor has additional responsibilities to provide such opinions. Further, as per the Guidance Note, the auditor needs to consider relevant portions of Standards on Auditing when performing an audit of ICFR.	**Para A1 of SA 200:** The auditor's opinion on the financial statements deals with whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework. Such an opinion is common to all audits of financial statements. The auditor's opinion therefore does not assure, for example, the future viability of the entity nor the efficiency or effectiveness with which management has conducted the affairs of the entity. In some cases, however, the applicable laws and regulations may require auditors to provide opinions on other specific matters, such as the effectiveness of internal control, or the consistency of a separate management report with the financial statements. While the SAs include requirements and guidance in relation to such matters to the extent that they are relevant to forming an opinion on the financial statements, the auditor would be required to undertake further work if the auditor had additional

	Accordingly, in the case of audit of ICFR, the auditor should follow the Standards on Auditing as well as the Guidance Note. Therefore, the auditor should also design and perform audit procedures to obtain sufficient appropriate audit evidence for ICFR testing in accordance with SA 500.	responsibilities to provide such opinions. For example, under section 143(3)(i) of the Companies Act 2013, the independent auditor is required to also report on the adequacy and operating effectiveness of the internal financial controls. For the guidance of the members, the Auditing and Assurance Standards Board has issued the Guidance Note on Audit of Internal Financial Controls over Financial Reporting. **Para 36 of the Guidance Note** Paragraph A1 of SA 200, inter alia, states "In some cases, however, the applicable laws and regulations may require auditors to provide opinions on other specific matters, such as the effectiveness of internal control, or the consistency of a separate management report with the financial statements. While the SAs include requirements and guidance in relation to such matters to the extent that they are relevant to forming an opinion on the financial statements, the auditor would be required to undertake further work if the auditor had additional responsibilities to provide such opinions." Accordingly, the Standards on Auditing do not fully address the auditing requirements for reporting on the system of internal financial controls over financial reporting. However, relevant portions of the Standards on Auditing need to be considered by the auditor when performing an audit of internal financial controls over financial reporting. For example, the auditor should consider the requirements of SA 230, "Audit Documentation" when documenting the work performed on internal financial controls; the auditor should consider and apply the requirements of SA 315 when

		understating internal controls, etc. **Para 37 of the Guidance Note** This guidance aims to provide the supplementary procedures that would need to be considered by the auditor for planning, performing and reporting in an audit of internal financial controls over financial reporting under Clause (i) of Sub-section 3 of Section 143 of the 2013 Act. The applicable standards on auditing which, inter alia, need to be considered by the auditor when performing an audit of internal financial controls is given in the respective paragraphs of this guidance.
Is the auditor required to combine audit of ICFR with audit of the financial statements?	The auditor needs to design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence for ICFR as the auditor is required to specifically report on design and operating effectiveness of ICFR. Without obtaining sufficient appropriate audit evidence, the auditor will not be able to form an opinion on the same. Further, the auditor should also combine the audit of ICFR and audit of financial statements. While combining the audit of ICFR and audit of financial statements, the auditor should design the testing of controls to accomplish the objectives of both the audits simultaneously to obtain sufficient evidence to support the auditor's opinion on ICFR and to support the auditor's control risk assessments for purposes of the audit of financial statements. In case, based on evidence obtained for audit of ICFR, the auditor is able to obtain sufficient	**Para 72 of the Guidance Note** The audit of internal financial controls over financial reporting should be combined with the audit of the financial statements. The objectives of the audits are not identical, however, and the auditor must plan and perform the work to achieve the objectives of both audits. **Para 73 of the Guidance Note** In a combined audit of internal financial controls over financial reporting and financial statements, the auditor should design his or her testing of controls to accomplish the objectives of both audits simultaneously: • To obtain sufficient evidence to support the auditor's opinion on internal financial controls over financial reporting as of year-end, and • To obtain sufficient evidence to support the auditor's control risk assessments for purposes of the audit of financial statements. **Para 74 of the Guidance Note** Obtaining sufficient evidence to

	evidence to support control risk assessment for the purpose of financial statement audit, this will allow the auditor to reduce the amount of work that otherwise would have been necessary to form an opinion on the financial statements.	support control risk assessments for purposes of the financial statement audit ordinarily allows the auditor to reduce the amount of audit work that otherwise would have been necessary to opine on the financial statements.