CA FINAL | PAPER 3 [NEW SCHEME]

ADVANCED AUDITING, ASSURANCE AND PROFESSIONAL ETHICS

[Relevant for May 2024 Exams Onwards]

CA Parth Harsh

MODULE 2 OF 3

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11. STANDARDS ON AUDITING

1.	SA 200	Overall Objectives of an Independent auditor and conduct of an audit in accordance with standards on auditing [CA Inter]
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SA 240 THE AUDITOR'S RESPONSIBILITIES RELATING TO FRAUD IN AN AUDIT OF FINANCIAL STATEMENTS

Q.NO.1. DEFINE THE TERM FRAUD AND DISCUSS THE OBJECTIVES AS PER SA 240?

ANSWER:

A. DEFINITION OF FRAUD:

1. SA - 240 defines the term 'fraud' as "An intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage".

2. Although fraud is a broad legal concept and the auditor is concerned only with the type of fraud that causes a material misstatement in the financial statements.

3. Misstatements in the financial statements can arise from either fraud or error. The distinguishing factor between fraud and error is whether the underlying action that results in the misstatement of the financial statements is intentional or unintentional.

B. OBJECTIVES OF SA 240: The objectives of the auditor in accordance with SA 240 are:

1. To identify and assess the risks of material misstatement in the financial statements due to fraud.

2. To obtain sufficient appropriate audit evidence about the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses and

3. To respond appropriately to identified or suspected fraud.

Q.NO.2. WHAT ARE THE TYPES OF FRAUD AND WHY FRAUDS ARE COMMITTED?

ANSWER:

C. TYPES OF FRAUDS:

1. Fraudulent financial reporting - Intentional Misstatements like Omissions, Misrepresentation

2. Misappropriation of assets - Theft or Unauthorised usage of entity's assets.

D. FRAUD RISK FACTORS: Fraud, whether due to misstatements resulting from fraudulent financial reporting or misappropriation of assets involves:

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1. Incentive or Pressure to commit fraud:
   For Example, When management is under pressure, from sources outside or inside the entity, to achieve an expected (and perhaps unrealistic) earnings target or financial outcome, particularly, since the consequences to management for failing to meet financial goals can be significant.
   Similarly, individuals may have an incentive to misappropriate assets, for example, because the individuals are living beyond their means

2. A perceived opportunity to do so:
   For Example, A perceived opportunity to commit fraud may exist when an individual believes internal control can be overridden, for example, because the individual is in a position of trust or has knowledge of specific deficiencies in internal control.

3. Some rationalization of the act:
   For Example, Individuals may be able to rationalize committing a fraudulent act. Some individuals possess an attitude, character or set of ethical values that allow them knowingly and intentionally to commit a dishonest act. However, even otherwise honest individuals can commit fraud in an environment that imposes sufficient pressure on them.

Q.NO.3. HOW FRAUDULENT FINANCIAL REPORTING MAY BE CAUSED BY ENTITIES?

ANSWER:

WHY: Fraudulent financial reporting involves intentional misstatements including omissions of amounts or disclosures in financial statements to deceive financial statement users.

1. It can be caused by the efforts of management to manage earnings in order to deceive financial statement users by influencing their perceptions as to the entity's performance and profitability.

2. Such earnings manipulation may start out with small actions or inappropriate adjustment of assumptions and changes in judgments by management. Pressures and incentives may lead these actions to increase to the extent that they result in fraudulent financial reporting.

3. Such a situation could occur when, due to pressures to meet market expectations or a desire to maximize compensation based on performance, management intentionally takes positions that lead to fraudulent financial reporting by materially misstating the financial statements.

4. Further in some entities, management may be motivated to reduce earnings by a material amount to minimize tax or to inflate earnings to secure bank financing.

HOW: Fraudulent financial reporting may be accomplished by the following**:**

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1. Manipulation, falsification (including forgery), or alteration of accounting records or supporting documentation from which the financial statements are prepared.

2. Misrepresentation in or intentional omission from, the financial statements of events, transactions or other significant information.

3. Intentional misapplication of accounting principles relating to amounts, classification, manner of presentation, or disclosure.

4. **OVERRIDING INTERNAL CONTROLS:** Fraudulent financial reporting often involves management override of controls that otherwise may appear to be operating effectively. Fraud can be committed by management overriding controls using such techniques as:

    a. Recording fictitious journal entries, particularly close to the end of an accounting period, to manipulate operating results or achieve other objectives.
    b. Inappropriately adjusting assumptions and changing judgments used to estimate account balances.
    c. Omitting, advancing or delaying recognition in the financial statements of events and transactions that have occurred during the reporting period.
    d. Concealing, or not disclosing, facts that could affect the amounts recorded in the financial statements.
    e. Engaging in complex transactions that are structured to misrepresent the financial position or financial performance of the entity.
    f. Altering records and terms related to significant and unusual transactions.

Q.NO.4. HOW MISAPPROPRIATION OF ASSETS MAY BE ACCOMPLISHED BY ENTITIES?

ANSWER:

1. **MEANING:** Misappropriation of assets involves the theft of an entity's assets and is often perpetrated by employees in relatively small and immaterial amounts. However, it can also involve management who are usually more able to disguise or conceal misappropriations in ways that are difficult to detect.

2. **WAYS:** Misappropriation of assets can be accomplished in a variety of ways including:
    a. **MANIPULATION OF CASH:** Embezzling receipts (for example, misappropriating collections on accounts receivable or diverting receipts in respect of written-off accounts to personal bank accounts).
    b. **THEFT OF ASSETS:** Stealing physical assets or intellectual property (for example, stealing inventory for personal use or for sale, stealing scrap for resale, colluding with a competitor by disclosing technological data in return for payment).

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c. **FICTITIOUS TXNS:** Causing an entity to pay for goods and services not received (for example, payments to fictitious vendors, kickbacks paid by vendors to the entity's purchasing agents in return for inflating prices, payments to fictitious employees).

d. **PERSONAL USE:** Using an entity's assets for personal use (for example, using the entity's assets as collateral for a personal loan or a loan to a related party).

3. **MAA WITH SUPPORTING EVIDENCES:** Misappropriation of assets is often accompanied by false or misleading records or documents in order to conceal the fact that the assets are missing or have been pledged without proper authorization.

Note: Although the auditor may suspect or, in rare cases, identify the occurrence of fraud, the auditor does not make legal determinations of whether fraud has actually occurred.

Q.NO.5. WHOSE PRIMARY RESPONSIBILITY IS TO PREVENT AND DETECT FRAUD?

ANSWER:

PRIMARY RESPONSIBILITY:

1. The primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management.
2. It is important that management, with the oversight of those charged with governance, place a strong emphasis on ***fraud prevention***, which may reduce opportunities for fraud to take place, and ***fraud deterrence***, which could persuade individuals not to commit fraud because of the likelihood of detection and punishment.
3. This involves a commitment to creating a culture of honesty and ethical behavior which can be reinforced by an active oversight by those charged with governance.

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RESPONSIBILITIES OF THE AUDITOR IN RELATION TO FRAUD:

1. **OBJECTIVE OF AUDIT:** 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.

2. **INHERENT LIMITATIONS OF AN AUDIT:**
   a. 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.

   b. The potential effects of inherent limitations are particularly significant in the case of misstatement resulting from fraud.

c. The risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting one resulting from error. This is because fraud may involve sophisticated and carefully organized schemes designed to conceal it, such as forgery, deliberate failure to record transactions, or intentional misrepresentations being made to the auditor. Such attempts at concealment may be even more difficult to detect when accompanied by collusion. Collusion may cause the auditor to believe that audit evidence is persuasive when it is, in fact, false.

d. The auditor's ability to detect a fraud depends on factors such as:
   i. the skillfulness of the perpetrator,
   ii. the frequency and extent of manipulation,
   iii. the degree of collusion involved,
   iv. the relative size of individual amounts manipulated, and
   v. the seniority of those individuals involved.

e. While the auditor may be able to identify potential opportunities for fraud to be perpetrated, it is difficult for the auditor to determine whether misstatements in judgment areas such as accounting estimates are caused by fraud or error.

f. Furthermore, the risk of the auditor not detecting a material misstatement resulting from management fraud is greater than for employee fraud, because management is frequently in a position to directly or indirectly manipulate accounting records, present fraudulent financial information or override control procedures designed to prevent similar frauds by other employees.

3. **MAINTAIN PROFESSIONAL SKEPTICISM:** 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.

Q.NO.6. WHAT ARE FRAUD RISK FACTORS?

ASNWER:

Fraud risk factors are events or conditions that indicate an incentive or pressure to commit fraud or provide an opportunity to commit fraud.
For example:

1. The need to meet expectations of third parties to obtain additional equity financing may create pressure to commit fraud.

2. The granting of significant bonuses if unrealistic profit targets are met may create an incentive to commit fraud and

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3. A control environment that is not effective may create an opportunity to commit fraud.

Q.NO.7. WHAT ARE VARIOUS EXAMPLES OF FRAUD RISK FACTORS RELATING TO MMS ARISING FROM FRAUDULENT FINANCIAL REPORTING?

ANSWER:

The following are examples of risk factors relating to misstatements arising from fraudulent financial reporting:

A. INCENTIVES/PRESSURES: Financial stability or profitability is threatened by economic, industry, or entity operating conditions, such as (or as indicated by):

1. High degree of competition or market saturation, accompanied by declining margins.

2. High vulnerability to rapid changes, such as changes in technology, product obsolescence, or interest rates.

3. Significant declines in customer demand and increasing business failures in either the industry or overall economy.

4. Operating losses making the threat of bankruptcy, foreclosure, or hostile takeover imminent.

5. Recurring negative cash flows from operations or an inability to generate cash flows from operations while reporting earnings and earnings growth.

6. Rapid growth or unusual profitability especially compared to that of other companies in the same industry.

7. New accounting, statutory, or regulatory requirements.

8. Excessive pressure exists for management to meet the requirements or expectations of third parties due to the following:
    a. Profitability or trend level expectations of investment analysts, institutional investors, significant creditors, or other external parties (particularly expectations that are unduly aggressive or unrealistic), including expectations created by management in, for example, overly optimistic press releases or annual report messages.

    b. Need to obtain additional debt or equity financing to stay competitive including financing of major research and development or capital expenditures.

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c. Marginal ability to meet exchange listing requirements or debt repayment or other debt covenant requirements.

d. Perceived or real adverse effects of reporting poor financial results on significant pending transactions, such as business combinations or contract awards.

9. Information available indicates that the personal financial situation of management or those charged with governance is threatened by the entity's financial performance arising from the following:
   a. Significant financial interests in the entity.

   b. Significant portions of their compensation (for example, bonuses, stock options, and earn-out arrangements) being contingent upon achieving aggressive targets for stock price, operating results, financial position, or cash flow.

   c. Personal guarantees of debts of the entity.

   d. There is excessive pressure on management or operating personnel to meet financial targets established by those charged with governance, including sales or profitability incentive goals.

B. OPPORTUNITIES: The nature of the industry or the entity's operations provides opportunities to engage in fraudulent financial reporting that can arise from the following:

1. Significant related-party transactions not in the ordinary course of business or with related entities not audited or audited by another firm.

2. A strong financial presence or ability to dominate a certain industry sector that allows the entity to dictate terms or conditions to suppliers or customers that may result in inappropriate or non-arm's-length transactions.

3. Assets, liabilities, revenues, or expenses based on significant estimates that involve subjective judgments or uncertainties that are difficult to corroborate.

4. Significant, unusual, or highly complex transactions, especially those close to period end that pose difficult "substance over form" questions.

5. Significant operations located or conducted across international borders in jurisdictions where differing business environments and cultures exist.

6. Use of business intermediaries for which there appears to be no clear business justification.

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7. Significant bank accounts or subsidiary or branch operations in tax-haven jurisdictions for which there appears to be no clear business justification.

8. The monitoring of management is not effective as a result of:
    a. Domination of management by a single person or small group (in a non-owner-managed business) without compensating controls

    b. Oversight by those charged with governance over the financial reporting process and internal control is not effective.

9. There is a complex or unstable organizational structure, as evidenced by following:
    a. Difficulty in determining the organization or individuals that have controlling interest in the entity.

    b. Overly complex organizational structure involving unusual legal entities or managerial lines of authority.

    c. High turnover of senior management, legal counsel, or those charged with governance.

10. Internal control components are deficient as a result of the following:
    a. Inadequate monitoring of controls, including automated controls and controls over interim financial reporting (where external reporting is required)

    b. High turnover rates or employment of accounting, internal audit, or information technology staff that are not effective.

    c. Accounting and information systems that are not effective, including situations involving significant deficiencies in internal control.

C. ATTITUDES/RATIONALIZATIONS: Communication, implementation, support, or enforcement of the entity's values or ethical standards by management, or the communication of inappropriate values or ethical standards, that are not effective.

1. Non-financial management's excessive participation in or preoccupation with the selection of accounting policies or the determination of significant estimates.

2. Known history of violations of securities laws or other laws and regulations, or claims against the entity, its senior management, or those charged with governance alleging fraud or violations of laws and regulations.

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3. Excessive interest by management in maintaining or increasing the entity's stock price or earnings trend.

4. The practice by management of committing to analysts, creditors, and other third parties to achieve aggressive or unrealistic forecasts.

5. Management failing to remedy known significant deficiencies in internal control on a timely basis.

6. An interest by management in employing inappropriate means to minimize reported earnings for tax-motivated reasons.

7. Low morale among senior management.

8. The owner-manager makes no distinction between personal and business transactions.

9. Dispute between shareholders in a closely held entity.

10. Recurring attempts by management to justify marginal or inappropriate accounting on the basis of materiality.

11. Strained relationship between management and the current or predecessor auditor. The relationship is strained, as exhibited by the following:

    a. Frequent disputes with the current or predecessor auditor on accounting, auditing, or reporting matters.

    b. Unreasonable demands on the auditor, such as unrealistic time constraints regarding the completion of the audit or the issuance of the auditor's report

    c. Restrictions on the auditor that inappropriately limit access to people or information or the ability to communicate effectively with those charged with governance.

    d. Domineering management behavior in dealing with the auditor, especially involving attempts to influence the scope of the auditor's work or the selection or continuance of personnel assigned to or consulted on the audit engagement.

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Q.NO.8. WHAT ARE VARIOUS EXAMPLES OF FRAUD RISK FACTORS RELATING TO MMS ARISING FROM MISAPPROPRIATION OF ASSETS?

ANSWER:

The following are examples of risk factors relating to misstatements arising from misappropriation of assets:

A. INCENTIVES/PRESSURES:

1. Personal financial obligations may create pressure on management or employees with access to cash or other assets susceptible to theft to misappropriate those assets.

2. Adverse relationships between the entity and employees with access to cash or other assets susceptible to theft may motivate those employees to misappropriate those assets. For example, adverse relationships may be created by the following:

    a. Known or anticipated future employee layoffs

    b. Recent or anticipated changes to employee compensation or benefit plans.

    c. Promotions, compensation, or other rewards inconsistent with expectations.

B. OPPORTUNITIES: Certain characteristics or circumstances may increase the susceptibility of assets to misappropriation. For example, opportunities to misappropriate assets increase when there are the following:

1. Large amounts of cash on hand

2. Inventory items that are small in size, of high value, or in high demand.

3. Easily convertible assets, such as bearer bonds, diamonds, or computer chips.

4. Fixed assets which are small in size, marketable, or lacking observable identification of ownership.

5. Inadequate internal control over assets may increase the susceptibility of misappropriation of those assets. For example, misappropriation of assets may occur because there is the following:
    a. Inadequate segregation of duties or independent checks.

    b. Inadequate oversight of senior management expenditures, such as travel and other reimbursements.

    c. Inadequate management oversight of employees responsible for assets, for example, inadequate supervision or monitoring of remote locations.

    d. Inadequate job applicant screening of employees with access to assets.

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e. Inadequate record keeping with respect to assets.

f. Inadequate system of authorization and approval of transactions (for example, in purchasing).

g. Inadequate physical safeguards over cash, investments, inventory, or fixed assets.

h. Lack of complete and timely reconciliations of assets.

i. Lack of timely and appropriate documentation of transactions, for example, credits for merchandise returns.

j. Lack of mandatory vacations for employees performing key control functions.

k. Inadequate management understanding of information technology, which enables information technology employees to perpetrate a misappropriation.

l. Inadequate access controls over automated records, including controls over and review of computer systems event logs.

C. ATTITUDES/RATIONALIZATIONS:

1. Disregard for the need for monitoring or reducing risks related to misappropriations of assets.

2. Disregard for internal control over misappropriation of assets by overriding existing controls or by failing to take appropriate remedial action on known deficiencies in internal control.

3. Behaviour indicating displeasure or dissatisfaction with the entity or its treatment of the employee.

4. Changes in behaviour or lifestyle that may indicate assets have been misappropriated.

5. Tolerance of petty theft.

Q.NO.9. WHY EVALUATION OF FRAUD RISK FACTORS IS AN IMPORTANT TASK TO AN AUDITOR?

ANSWER:

1. The auditor shall evaluate whether 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

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circumstances where frauds have occurred and therefore may indicate risks of material misstatement due to fraud.

2. The fact that fraud is usually concealed can make it very difficult to detect. Nevertheless, the auditor may identify fraud risk factors. Fraud risk factors cannot easily be ranked in order of importance. The significance of fraud risk factors varies widely. Some of these factors will be present in entities where the specific conditions do not present risks of material misstatement.

3. Accordingly, the determination of whether a fraud risk factor is present and whether it is to be considered in assessing the risks of material misstatement of the financial statements due to fraud requires the exercise of professional judgment.

4. Maintaining Professional Skepticism:

a. 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.

b. Unless the auditor has reason to believe the contrary, the auditor may accept records and documents as genuine. If conditions identified during the audit cause the auditor to believe that a document may not be authentic or that terms in a document have been modified but not disclosed to the auditor, the auditor shall investigate further.

c. Where responses to inquiries of management or those charged with governance are inconsistent, the auditor shall investigate the inconsistencies.

5. Discussion among the engagement team:

a. The discussion among the engagement team 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.

b. The discussion shall occur notwithstanding the engagement team members' beliefs that management and those charged with governance are honest and have integrity.

Q.NO.10. WRITE ABOUT RISK ASSESSMENT PROCEDURES AND RELATED ACTIVITIES BE GEARED TOWARDS OBTAINING INFORMATION FOR USE IN IDENTIFYING RISK OF MATERIAL MISSTATEMENT DUE TO FRAUD?

ANSWER:

When performing risk assessment procedures and related activities to obtain an understanding of the entity and its environment, including the entity's internal control, the auditor shall perform the

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procedures to obtain information for use in identifying the risks of material misstatement due to fraud like:

1. Inquiries of management and others within the entity,

2. Obtaining understanding as to how those charged with governance exercise oversight of management's processes for identifying and responding to the risks of fraud in the entity and

3. The internal control that management has established to mitigate these risks and evaluation of unexpected relationships identified in performing analytical procedures which may indicate risks of material misstatement due to fraud.

4. Besides, 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.

Q.NO.11. WRITE ABOUT RESPONSES TO THE ASSESSED RISKS OF MATERIAL MISSTATEMENT DUE TO FRAUD?

ANSWER:

A. AT FINANCIAL STATEMENT LEVEL:

In determining overall responses to address the assessed risks of material misstatement due to fraud at the financial statement level, the auditor shall:

1. 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
2. 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
3. Incorporate an element of unpredictability in the selection of the nature, timing and extent of audit procedures.

B. AT ASSERTION STATEMENT LEVEL:

1. 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.

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2. In doing so the auditor may change nature, timing and extent of audit procedures to obtain audit evidence that is more reliable and relevant or to obtain additional corroborative information.

3. For example, if the auditor identifies that management is under pressure to meet earnings expectations, there may be a related risk that management is inflating sales by entering into sales agreements that include terms that preclude revenue recognition or by invoicing sales before delivery. In these circumstances, the auditor may, for example:
    a. Design External Confirmations 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.
    b. In addition, the auditor might find it effective to supplement such external confirmations with inquiries of non-financial personnel in the entity regarding any changes in sales agreements and delivery terms.

C. AUDIT PROCEDURES RESPONSIVE TO RISKS RELATED TO MANAGEMENT OVERRIDE OF CONTROLS:

1. 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.

2. This risk is 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.

3. 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.

    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.

    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.

4. 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.

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Q.NO.12. WRITE ABOUT EVALUATION OF AUDIT EVIDENCE?

ANSWER:

1. The auditor shall evaluate whether analytical procedures that are performed when forming an overall conclusion as to whether the financial statements as a whole are consistent with the auditor's understanding of the entity and its environment indicate a previously unrecognized risk of material misstatement due to fraud.

2. When the auditor identifies a misstatement, the auditor shall evaluate whether such a misstatement is indicative of fraud. If there is such an indication, the auditor shall evaluate the implications of the misstatement in relation to other aspects of the audit, particularly the reliability of management representations, recognizing that an instance of fraud is unlikely to be an isolated occurrence.

3. If the auditor identifies a misstatement, whether material or not, and the auditor has reason to believe that it is or may be the result of fraud and that management (in particular, senior management) is involved, the auditor shall re- evaluate the assessment of the risks of material misstatement due to fraud and its resulting impact on the nature, timing and extent of audit procedures to respond to the assessed risks.

4. The auditor shall also consider whether circumstances or conditions indicate possible collusion involving employees, management or third parties when reconsidering the reliability of evidence previously obtained.

5. When the auditor confirms that, or is unable to conclude whether, the financial statements are materially misstated as a result of fraud, the auditor shall evaluate the implications for the audit.

Q.NO.13. WRITE ABOUT CIRCUMSTANCES IN WHICH AUDITOR IS UNABLE TO CONTINUE THE ENGAGEMENT?

ANSWER:

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

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

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2. Consider whether it is appropriate to withdraw from the engagement, where withdrawal from the engagement is legally permitted and

3. If the auditor withdraws:
    a. Discuss with the appropriate level of management and those charged with governance, the auditor's withdrawal from the engagement and the reasons for the withdrawal and

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

Q.NO.14. WRITE ABOUT OBTAINING MANAGEMENT REPRESENTATION IN THE CONTEXT OF FRAUD BY AUDITOR?

ANSWER:

The auditor shall obtain written representations from management and, where applicable, those charged with governance that:

1. **MANAGEMENT RESPONSIBILITY FOR ICS:** They acknowledge their responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud

2. **DISLOSED ENTITIES RISK ASSESSSMENT RESULTS:** 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.

3. **DISCLOSED INFO ABOUT FRAUDS:** They have disclosed to the auditor their knowledge of fraud or suspected fraud affecting the entity involving management, employees who have significant roles in internal control or others where the fraud could have a material effect on the financial statements.

4. **DISCLOSED ALLEGATIONS:** 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.

Q.NO.15. WRITE ABOUT COMMUNICATIONS TO MANAGEMENT AND WITH THOSE CHARGED WITH GOVERNANCE ABOUT FRAUDS IDENTIFIED BY THE AUDITOR?

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ANSWER:

1. **COMMUNICATE TO MANAGEMENT:** If the auditor has identified a fraud or has obtained information that indicates that a fraud may exist, the auditor shall communicate these matters on a timely basis to the appropriate level of management in order to inform those with primary responsibility for the prevention and detection of fraud of matters relevant to their responsibilities.

2. **COMMUNICATE TO TCWG:** Unless all of those charged with governance are involved in managing the entity, if the auditor has identified or suspects fraud involving management, employees who have significant roles in internal control or others where the fraud results in a material misstatement in the financial statements, the auditor shall communicate these matters to those charged with governance on a timely basis.

3. **COMMUNICATE TO TCWG:** If the auditor suspects fraud involving management, the auditor shall communicate these suspicions to those charged with governance and discuss with them the nature, timing and extent of audit procedures necessary to complete the audit.

4. The auditor shall communicate with those charged with governance any other matters related to fraud that are, in the auditor's judgment, relevant to their responsibilities.

Q.NO.16. WRITE ABOUT COMMUNICATIONS TO REGULATORY AND ENFORCEMENT AUTHORITIES OF FRAUD IDENTIFIED BY THE AUDITOR?

ANSWER:

1. If the auditor has identified or suspects a fraud, the auditor shall determine whether there is a responsibility to report the occurrence or suspicion to a party outside the entity.

2. Although the auditor's professional duty to maintain the confidentiality of client information may preclude such reporting, the auditor's legal responsibilities may override the duty of confidentiality in some circumstances. For example, in case of audit of banks, the auditor has a statutory duty to report the occurrence of fraud to the supervisory authorities, i.e., RBI.

3. Also, in some entities the auditor may have a duty to report misstatements to authorities in those cases where management and those charged with governance fail to take corrective action.

4. In some clients, requirements for reporting fraud, whether or not discovered through the audit process, may be subject to specific provisions of the audit mandate or related legislation or regulation.

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Q.NO.17. WRITE ABOUT DOCUMENTATION OF THE UNDERSTANDING OF THE ENTITY AND ITS ENVIRONMENT AND THE ASSESSMENT OF THE RISKS OF MATERIAL MISSTATEMENT RELATED TO FRAUD?

ANSWER:

1. The auditor's documentation of the understanding of the entity and its environment and the assessment of the risks of material misstatement required 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.

2. The auditor's documentation of the responses to the assessed risks of material misstatement required 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.

3. The auditor shall document communications about fraud made to management, those charged with governance, regulators and others.

4. 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.

ILLUSTRATION 1.

My Décor Limited, presently engaged in manufacturing of fabrics, wants to set up a new plant for manufacturing of special kind of fabric providing an altogether different texture and feel. This kind of fabric has become a hit with retail customers. The company needs to set up plant for manufacturing the above kind of fabric involving huge capital outlays to stay competitive in the market.

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You are auditor of the company and find that company's revenue has increased in financial year 2022-23 to ₹ 1000 crore from ₹ 750 crore in last year. By the time, you started the audit, there was no change in plant capacity and information regarding need to set up new plant has become known to you during inquiry of company's personnel.
Discuss, how you should proceed to deal with above situation, as auditor of the company, paying special attention to risk of material misstatement due to fraudulent financial reporting?

ANSWER:

The given situation highlights need for the company to set up new plant for manufacturing of special kind of fabric to stay competitive in the market. Setting up of such plant involves huge capital outlays which could entail financing arrangements.

Therefore, excessive pressure exists for management to be involved in fraudulent financial reporting. In such a situation, management may be tempted to inflate its revenues to show rosy picture. It is a fraud risk factor and needs to be evaluated by the auditor.

The revenues of company have jumped from ₹ 750 crore in last year to ₹ 1000 crore in year 2022-23 without any change in plant capacity. The auditor may consider abovesaid fraud risk factor for assessing risk of material misstatement due to fraud.

In case of auditor assessing risk of material misstatement due to fraudulent financial reporting, audit procedures to address such risk like performing substantive analytical procedures relating to revenue, use of computer assisted audit techniques to identify unusual revenue transactions and testing controls pertaining to revenue transactions need to be performed.

ILLUSTRATION 2.

CA. Ridhima, internal auditor of Track Store Limited, has pointed out following deficiencies in internal control of the company, in her reports: -

i. **Receivables are not reconciled at stipulated intervals.**
ii. **Customers are provided a credit limit based upon their track record. However, no review of customer credit limits is undertaken at required intervals.**

The statutory auditor of the company finds that no action has been taken by the company on the said deficiencies pointed out in reports of internal auditor.
What does above situation allude to statutory auditor of company?

ANSWER:

1. Management failing to remedy known significant deficiencies in internal control on a timely basis is a fraud risk factor for misstatements arising from fraudulent financial reporting.

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2. When management does not correct significant deficiencies in internal control on a timely basis, it reflects an attitude, character or set of ethical values that allow them knowingly and intentionally to commit a dishonest act.
3. Failure to rectify known control deficiencies pertaining to reconciliation of receivables and review of customer credit limits has the potential to fraud. Lack of timely reconciliation of receivables may lead to intentional misstatements.
4. Further, non-reviewing customer limit may lead to grant of credit beyond creditworthiness of customers. It may result in intentional tying up of company's funds with risky customers due to collusion.
5. The above situation is a fraud risk factor for fraudulent financial reporting.

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

SCOPE: SA 250 deals with auditor's responsibility to consider laws and regulations when performing an audit of financial statements. However, it does not apply to other assurance engagements in which the auditor is specifically engaged to test and report separately on compliance with specific laws or regulations.

The requirements in this SA are designed to assist the auditor in identifying material misstatement of the financial statements due to non-compliance with laws and regulations.

Q.NO.1. WRITE ABOUT EFFECT OF LAWS AND REGULATIONS ON FINANCIAL STATEMENTS OF AN ENTITY?

ANSWER:

LEGAL AND REGULATORY FRAMEWORK: Those laws and regulations to which an entity is subject constitute the legal and regulatory framework. The effect on the financial statements of laws and regulations varies considerably.

1. **TYPE 1 LAWS AND REGULATIONS:** The provisions of some laws or regulations have a direct effect on the financial statements in that they determine the reported amounts and disclosures in an entity's financial statements.

2. **TYPE 2 LAWS & REGULATIONS:** Other laws or regulations are to be complied with by management or set the provisions under which the entity is allowed to conduct its business but do not have a direct effect on an entity's financial statements.

   Some entities operate in heavily regulated industries (such as banks and chemical companies). Others are subject only to the many laws and regulations that relate generally to the operating aspects of the business (such as those related to occupational safety and health). Non-compliance with laws and regulations may result in fines, litigation or other consequences for the entity that may have a material effect on the financial statements.

Q.NO.2. WRITE ABOUT OBJECTIVES OF AUDITOR IN ACCORDANCE WITH SA 250?

ANSWER:

The objectives of the auditor in accordance with SA 250 are:

1. To obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations generally recognised to have a direct effect on the determination of material amounts and disclosures in the financial statements.

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2. To perform specified audit procedures to help identify instances of non-compliance with other laws and regulations that may have a material effect on the financial statements and

3. To respond appropriately to non-compliance or suspected non-compliance with laws and regulations identified during the audit.

Q.NO.3. WRITE ABOUT RESPONSIBILITY OF MANAGEMENT FOR COMPLIANCE WITH LAWS AND REGULATIONS?

ANSWER:

1. It is the responsibility of management, with the oversight of those charged with governance, to ensure that the entity's operations are conducted in accordance with the provisions of laws and regulations, including compliance with the provisions of laws and regulations that determine the reported amounts and disclosures in an entity's financial statements.

2. The following are examples of the types of policies and procedures an entity may implement to assist in the prevention and detection of non-compliance with laws and regulations: -

    a. Monitoring legal requirements and ensuring that operating procedures are designed to meet these requirements.

    b. Instituting and operating appropriate systems of internal control.

    c. Developing, publicising and following a code of conduct.

    d. Ensuring employees are properly trained and understand the code of conduct.

    e. Monitoring compliance with the code of conduct and acting appropriately to discipline employees who fail to comply with it.

    f. Engaging legal advisors to assist in monitoring legal requirements.

    g. Maintaining a register of significant laws and regulations with which the entity has to comply within its particular industry and a record of complaints.

3. In larger entities, these policies and procedures may be supplemented by assigning appropriate responsibilities to an internal audit function, an audit committee, a compliance function.

Q.NO.4. WHAT ARE THE RESPONSIBILITIES OF THE AUDITOR IN RELATION TO LAWS AND REGULATIONS IN AN AUDIT OF FINANCIAL STATEMENTS?

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ANSWER:

1. The auditor is not responsible for preventing non-compliance and cannot be expected to detect non- compliance with all laws and regulations.

2. The auditor is responsible for obtaining reasonable assurance that the financial statements, taken as a whole, are free from material misstatement, whether caused by fraud or error.
3. In conducting an audit of financial statements, the auditor takes into account the applicable legal and regulatory framework.

4. Owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements in the financial statements may not be detected, even though the audit is properly planned and performed in accordance with the SAs. In the context of laws and regulations, the potential effects of inherent limitations on the auditor's ability to detect material misstatements are greater for such reasons as the following:

    a. There are many laws and regulations, relating principally to the operating aspects of an entity that typically do not affect the financial statements and are not captured by the entity's information systems relevant to financial reporting.

    b. Non-compliance may involve conduct designed to conceal it, such as collusion, forgery, deliberate failure to record transactions, management override of controls or intentional misrepresentations being made to the auditor.

    c. Whether an act constitutes non-compliance is ultimately a matter for legal determination by a court of law.

    d. Ordinarily, the further removed non-compliance is from the events and transactions reflected in the financial statements, the less likely the auditor is to become aware of it or to recognize the non- compliance.

5. SA 250 distinguishes the auditor's responsibilities in relation to compliance with 2 different categories of laws and regulations as follows:

    a. **TYPE 1:**
        i. The provisions of those laws and regulations generally recognised to have a direct effect on the determination of material amounts and disclosures in the financial statements such as tax and labour laws and

        ii. The auditor's responsibility is to obtain sufficient appropriate audit evidence about compliance with the provisions of those laws and regulations.

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b. **TYPE 2:**

i. Other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the financial statements, but compliance with which may be fundamental to the operating aspects of the business, to an entity's ability to continue its business, or to avoid material penalties (for example, compliance with the terms of an operating license, compliance with regulatory solvency requirements, or compliance with environmental regulations). Non-compliance with such laws and regulations may, therefore, have a material effect on the financial statements.

ii. The auditor's responsibility is limited to undertaking specified audit procedures to help identify non-compliance with those laws and regulations that may have a material effect on the financial statements.

6. The auditor is to remain alert to the possibility that other audit procedures applied for the purpose of forming an opinion on financial statements may bring instances of identified or suspected non- compliance to the auditor's attention.

7. Maintaining professional skepticism throughout the audit, is important in this context, given the extent of laws and regulations that affect the entity.

Q.NO.5. WRITE ABOUT THE AUDITOR'S CONSIDERATION OF COMPLIANCE WITH LAWS AND REGULATIONS and PROCEDURES TO OBTAIN SUFFICIENT AND APPROPRIATE AUDIT EVIDENCE?

ANSWER:

1. As part of obtaining an understanding of the entity and its environment, the auditor shall obtain a general understanding of:

   a. The legal and regulatory framework applicable to the entity and the industry or sector in which the entity operates and

   b. How the entity is complying with that framework.

2. The auditor shall obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations generally recognised to have a direct effect on the determination of material amounts and disclosures in the financial statements. Such laws, for example, could relate to form and content of financial statements or industry- specific financial reporting issues.

3. **SPECIFIED AUDIT PROCEDURES FOR TYPE 2 LAWS:** The auditor shall perform the following specified audit procedures to help identify instances of non- compliance with other laws and regulations that may have a material effect on the financial statements:

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a. Inquiring of management and, where appropriate, those charged with governance, as to whether the entity is in compliance with such laws and regulations; and

b. Inspecting correspondence, if any, with the relevant licensing or regulatory authorities.

4. Certain other laws and regulations may need particular attention by the auditor because they have a fundamental effect on the operations of the entity. Non-compliance with laws and regulations that have a fundamental effect on the operations of the entity may cause the entity to cease operations, or call into question the entity's continuance as a going concern.

   For example: Non-compliance with the requirements of the entity's license or other entitlement to perform its operations could have such an impact (for example, for a bank, non-compliance with capital or investment requirements). An NBFC might have to cease to carry on the business of a non-banking financial institution if it fails to obtain a certificate of registration issued under RBI Act and if its Net Owned Funds are less than the amount specified by the RBI in this regard.

5. There are also many laws and regulations relating principally to the operating aspects of the entity that typically do not affect the financial statements and are not captured by the entity's information systems relevant to financial reporting.

6. As the financial reporting consequences of other laws and regulations can vary depending on the entity's operations, the audit procedures as stated above are directed to bringing to the auditor's attention instances of non-compliance with laws and regulations that may have a material effect on the financial statements.

7. Audit procedures applied to form an opinion on the financial statements may bring instances of non- compliance or suspected non-compliance with laws and regulations to the auditor's attention.

8. During the audit, the auditor shall remain alert to the possibility that other audit procedures applied may bring instances of non-compliance or suspected non-compliance with laws and regulations to the auditor's attention.

9. **WRITTEN REPRESENTATION:** The auditor shall request management and, where appropriate, those charged with governance to provide written representations that all known instances of non-compliance or suspected non- compliance with laws and regulations whose effects should be considered when preparing financial statements have been disclosed to the auditor.

Q.NO.6. WRITE ABOUT AUDIT PROCEDURES WHEN NON-COMPLIANCE IS IDENTIFIED OR SUSPECTED?

ANSWER:

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1. If the auditor becomes aware of information concerning an instance of non-compliance or suspected non-compliance with laws and regulations, the auditor shall obtain:

    a. An understanding of the nature of the act and the circumstances in which it has occurred and

    b. Further information to evaluate the possible effect on the financial statements.

2. If the auditor suspects there may be non-compliance, the auditor shall discuss the matter with management and, where appropriate, those charged with governance.

    a. If management or, as appropriate, those charged with governance do not provide sufficient information that supports that the entity is in compliance with laws and regulations and, in the auditor's judgment, the effect of the suspected non-compliance may be material to the financial statements, the auditor shall consider the need to obtain legal advice.

    b. If sufficient information about suspected non-compliance cannot be obtained, the auditor shall evaluate the effect of the lack of sufficient appropriate audit evidence on the auditor's opinion.

    c. The auditor shall evaluate the implications of non-compliance in relation to other aspects of the audit, including the auditor's risk assessment and the reliability of written representations, and take appropriate action.

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Q.NO.7. WRITE ABOUT REPORTING OF IDENTIFIED OR SUSPECTED NON-COMPLIANCE?

ANSWER:

A. REPORTING NON-COMPLIANCE TO THOSE CHARGED WITH GOVERNANCE:

1. Unless all of those charged with governance are involved in management of the entity, and therefore are aware of matters involving identified or suspected non-compliance already communicated by the auditor, the auditor shall communicate with those charged with governance matters involving non- compliance with laws and regulations that come to the auditor's attention during the course of the audit, other than when the matters are clearly inconsequential.

2. If, in the auditor's judgment, the non-compliance referred to above is believed to be intentional and material, the auditor shall communicate the matter to those charged with governance as soon as practicable.

3. If the auditor suspects that management or those charged with governance are involved in non- compliance, the auditor shall communicate the matter to the next higher level of authority at the entity, if it exists, such as an audit committee or supervisory board.

4. Where no higher authority exists, or if the auditor believes that the communication may not be acted upon or is unsure as to the person to whom to report, the auditor shall consider the need to obtain legal advice.

B. REPORTING NON-COMPLIANCE IN THE AUDITOR'S REPORT ON THE FINANCIAL STATEMENTS:

1. **MMS IN F/S – Q.O / A.O:** If the auditor concludes that the non-compliance has a material effect on the financial statements, and has not been adequately reflected in the financial statements, the auditor shall, in accordance with SA 705, express a qualified or adverse opinion on the financial statements.

2. **UNABLE TO GET EVIDENCE – Q.O / D.O.O:** If the auditor is precluded by management or those charged with governance from obtaining sufficient appropriate audit evidence to evaluate whether non-compliance that may be material to the financial statements has, or is likely to have, occurred, the auditor shall express a qualified opinion or disclaim an opinion on the financial statements on the basis of a limitation on the scope of the audit in accordance with SA 705.

3. **UNABLE TO DETERMINE NON-COMPLIANCE – Q.O / D.O.O:** If the auditor is unable to determine whether non-compliance has occurred because of limitations imposed by the circumstances rather than by management or those charged with governance, the auditor shall evaluate the effect on the auditor's opinion in accordance with SA 705.

C. REPORTING NON-COMPLIANCE TO REGULATORY AND ENFORCEMENT AUTHORITIES:

If the auditor has identified or suspects non-compliance with laws and regulations, the auditor shall determine whether the auditor has a responsibility to report the identified or suspected non-compliance to parties outside the entity.

D. DOCUMENTATION: The auditor shall document identified or suspected non-compliance with laws and regulations and the results of discussion with management and, where applicable, those charged with governance and other parties outside the entity.

Q.NO.8. WHAT ARE THE INDICATORS OF NON-COMPLIANCES WITH LAWS AND REGULATIONS ?

ANSWER:

The following are few indicators of Non compliances with various laws and regulation. This list is only illustrative and not exhaustive.

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Further an indicator doesn't mean that there is a severe Non-compliance. It only provides the auditor the guidance to identify non compliances if any exists.

1. Investigations by regulatory organisations and government departments.
2. Payment of fines or penalties.
3. Payments for unspecified services or loans to consultants, related parties, employees or government employees.
4. Purchasing at prices significantly above or below market price.
5. Unusual payments in cash or payments in form of bearer cheques,
6. Unusual payments towards legal and retainership fees.
7. Unusual transactions with companies registered in tax havens.
8. Unauthorised transactions or improperly recorded transactions.
9. Adverse media comment.

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ILLUSTRATION 3.

FAS Insurance Brokers Limited is a leading online insurance intermediary. During the year, Director General of GST Intelligence (DGGI) has issued notice to the company for allegedly creating fictitious invoices for "marketing and sales services" amounting to ₹ 50 crores in favour of non-life insurance companies. The premises of company were also searched during the year by DGGI officials. The matter was also informed to IRDAI by DGGI for violation of norms and regulations in this regard.
Does above situation has any bearing on your responsibilities as statutory auditor of the company? Outline briefly in context of possible non-compliance with laws by the company.

ANSWER:

When the auditor becomes aware of the existence of or has information about investigations by government departments and regulatory organizations, it may be an indication of non-compliance with laws and regulations.

In the instant case, notice has been served upon the company by DGGI for allegedly creating fictitious invoices in guise of providing *"marketing and sales services"* for ₹ 50 crores. Issuing an invoice without supply of services is a serious offence under GST laws and it could involve

penalties and imprisonment. Such suspected non-compliance may have a direct effect on financial statements.

The matter has also been informed to regulator i.e., IRDAI. Violation of IRDAI regulations may result in fines, litigation or other consequences for the entity that may have a material effect on the financial statements.

1. If the auditor becomes aware of information concerning an instance of non-compliance or suspected non-compliance with laws and regulations, the auditor shall obtain:
    a. An understanding of the nature of the act and the circumstances in which it has occurred and
    b. Further information to evaluate the possible effect on the financial statements.
2. If the auditor suspects there may be non-compliance, the auditor shall discuss the matter with management and, where appropriate, those charged with governance.
3. If management or, as appropriate, those charged with governance do not provide sufficient information that supports that the entity is in compliance with laws and regulations and, in the auditor's judgment, the effect of the suspected non-compliance may be material to the financial statements, the auditor shall consider the need to obtain legal advice.
4. If sufficient information about suspected non-compliance cannot be obtained, the auditor shall evaluate the effect of the lack of sufficient appropriate audit evidence on the auditor's opinion.

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SA 260 COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE

Q.NO.1. WHO ARE "THOSE CHARGED WITH GOVERNANCE"?

ANSWER:

1. The person(s) or organization(s) (e.g., a corporate trustee) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity.

2. This includes those overseeing the financial reporting process.

3. For some entities, those charged with governance may include management personnel, for example, executive members of a governance board of a private or public sector entity, or an owner-manager.

4. Governance structures vary by entities, reflecting influences such as different cultural and legal backgrounds, size and ownership characteristics.

   For example, in some entities, a supervisory board exists that is separate from executive board. In other entities, both supervisory and executive functions are performed by a single board. In some entities, those charged with governance hold positions that are an integral part of the entity's legal structure. For example, company directors.

5. In some cases, some or all of those charged with governance are involved in managing the entity. In others, those charged with governance and management comprise different persons.

6. In most entities, governance is the collective responsibility of a governing body, such as a board of directors, a supervisory board, partners, proprietors, a committee of management, trustees, or equivalent persons.

7. In some smaller entities, however, one person may be charged with governance, for example, the owner-manager where there are no other owners, or a sole trustee.

8. It is not possible to specify for all audits the persons with whom the auditor is to communicate particular matters.

9. Also, in some cases, the appropriate persons with whom to communicate may not be clearly identifiable from the applicable legal framework or other engagement circumstances, for example, entities where the governance structure is not formally defined, such as some family-owned entities and some not-for-profit organizations.

10. In such cases, the auditor may need to discuss and agree with the engaging party the relevant persons with whom to communicate.

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11. In deciding with whom to communicate, the auditor's understanding of an entity's governance structure and processes obtained in accordance with SA 315 is relevant. The appropriate persons with whom to communicate may vary depending on the matter to be communicated.

Q.NO.2. WRITE ABOUT SIGNIFICANCE OF COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE?

ANSWER:

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

1. The auditor and those charged with governance in understanding matters related to the audit in context, and in developing a constructive working relationship. This relationship is developed while maintaining the auditor's independence and objectivity.

2. The auditor in obtaining from those charged with governance information relevant to the audit. For example, those charged with governance may assist the auditor in understanding the entity and its environment, in identifying appropriate sources of audit evidence, and in providing information about specific transactions or events and

3. Those charged with governance in fulfilling their responsibility to oversee the financial reporting process, thereby reducing the risks of material misstatement of the financial statements.

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Q.NO.3. WRITE ABOUT OBJECTIVES OF AUDITOR IN ACCORDANCE WITH SA 260?

ANSWER:

The objectives of the auditor are:

1. To communicate clearly with those charged with governance responsibilities of the auditor in relation to the financial statement audit, and an overview of the planned scope and timing of the audit;

2. To obtain from those charged with governance information relevant to the audit.

3. To provide those charged with governance with timely observations arising from the audit that are significant and relevant to their responsibility to oversee the financial reporting process; and

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

Q.NO.4. WHAT ARE THE MATTERS TO BE COMMUNICATED BY THE AUDITOR?

ANSWER:

Following matters are required to be communicated by auditor with those charged with governance:

A. THE AUDITOR'S RESPONSIBILITIES IN RELATION TO THE FINANCIAL STATEMENT AUDIT: The auditor shall communicate with those charged with governance the responsibilities of the auditor in relation to the financial statement audit, including that:

1. The auditor is responsible for forming and expressing an opinion on the financial statements that have been prepared by management with the oversight of those charged with governance and

2. The audit of the financial statements does not relieve management or those charged with governance of their responsibilities.

Note: The auditor's responsibilities in relation to the financial statement audit are often included in the engagement letter or other suitable form of written agreement that records the agreed terms of the engagement. Law, regulation or the governance structure of the entity may require those charged with governance to agree the terms of the engagement with the auditor. When this is not the case, providing those charged with governance with a copy of that engagement letter or other suitable form of written agreement may be an appropriate way to communicate with them.

B. PLANNED SCOPE AND TIMING OF THE AUDIT: Communication regarding the planned scope and timing of the audit may:

1. Assist those charged with governance to understand better the consequences of the auditor's work, to discuss issues of risk and the concept of materiality with the auditor, and to identify any areas in which they may request the auditor to undertake additional procedures and

2. Assist the auditor to understand better the entity and its environment.

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

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4. Communicating significant risks identified by the auditor helps those charged with governance understand those matters and why they require special audit consideration. The communication about significant risks may assist those charged with governance in fulfilling their responsibility to oversee the financial reporting process.

5. While communication with those charged with governance may assist the auditor to plan the scope and timing of the audit, it does not change the auditor's sole responsibility to establish the overall audit strategy and the audit plan, including the nature, timing and extent of procedures necessary to obtain sufficient appropriate audit evidence.

6. Care is necessary when communicating with those charged with governance about the planned scope and timing of the audit so as not to compromise the effectiveness of the audit, particularly where some or all of those charged with governance are involved in managing the entity.
   For example, communicating the nature and timing of detailed audit procedures may reduce the effectiveness of those procedures by making them too predictable.

C. SIGNIFICANT FINDINGS FROM THE AUDIT: The auditor shall communicate with those charged with governance:

1. The auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures. When applicable, the auditor shall explain to those charged with governance why the auditor considers a significant accounting practice, that is acceptable under the applicable financial reporting framework, not to be most appropriate to the particular circumstances of the entity.

2. Significant difficulties, if any, encountered during the audit:

   a. Significant delays by management, the unavailability of entity personnel, or an unwillingness by management to provide information necessary for the auditor to perform the auditor's procedures.
   b. An unreasonably brief time within which to complete the audit.
   c. Extensive unexpected effort required to obtain sufficient appropriate audit evidence.
   d. The unavailability of expected information.
   e. Restrictions imposed on the auditor by management.
   f. Management's unwillingness to make or extend its assessment of the entity's ability to continue as a going concern when requested.

   In some circumstances, such difficulties may constitute a scope limitation that leads to a modification of the auditor's opinion.

3. Significant matters arising during the audit that were discussed, or subject to

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correspondence, with management:

a. Significant events or transactions that occurred during the year.

b. Business conditions affecting the entity, and business plans and strategies that may affect the risks of material misstatement.

c. Concerns about management's consultations with other accountants on accounting or auditing matters.

d. Discussions or correspondence in connection with the initial or recurring appointment of the auditor regarding accounting practices, the application of auditing standards, or fees for audit or other services.

e. Significant matters on which there was disagreement with management, except for initial differences of opinion because of incomplete facts or preliminary information that are later resolved by the auditor obtaining additional relevant facts or information.

4. Written representations the auditor is requesting.

5. Circumstances that affect the form and content of the auditor's report, if any and

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

Note: The communication of findings from the audit may include requesting further information from those charged with governance in order to complete the audit evidence obtained.
For example, the auditor may confirm that those charged with governance have the same understanding of the facts and circumstances relevant to specific transactions or events.

D. COMMUNICATION OF AUDITOR'S INDEPENDENCE IN CASE OF LISTED ENTITIES: In the case of listed entities, the auditor shall communicate with those charged with governance:

1. A statement that the engagement team and others in the firm as appropriate, the firm and, when applicable, network firms have complied with relevant ethical requirements regarding independence and

2. All relationships and other matters between the firm, network firms, and the entity that, in the auditor's professional judgment, may reasonably be thought to bear on independence.

3. This shall include total fees charged during the period covered by the financial statements for audit and non-audit services provided by the firm and network firms to the entity and components controlled by the entity.

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4. These fees shall be allocated to categories that are appropriate to assist those charged with governance in assessing the effect of services on the independence of the auditor; and

5. The related safeguards that have been applied to eliminate identified threats to independence or reduce them to an acceptable level.

E. TERMS OF AUDIT ENGAGEMENT: The agreed terms of the audit engagement are required to be recorded in an audit engagement letter or other suitable form of written agreement and include, among other things, reference to the expected form and content of the auditor's report. Communication in this respect is intended to inform those charged with governance about circumstances in which the auditor's report may differ from its expected form and content or may include additional information about the audit that was performed.

F. REPORTING AS PER REQUIREMENT UNDER SA 700 SERIES:

1. 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:
   a. The auditor expects to modify the opinion in the auditor's report in accordance with SA 705.

   b. A material uncertainty related to going concern is reported in accordance with SA 570.

   c. Key audit matters are communicated in accordance with SA 701.

   d. The auditor considers it necessary to include an Emphasis of Matter paragraph or Other Matter paragraph in accordance with SA 706 or is required to do so by other SAs.

   e. The auditor has concluded that there is an uncorrected material misstatement of the other information in accordance with SA 720.

2. In such circumstances, the auditor may consider it useful to provide those charged with governance with a draft of the auditor's report to facilitate a discussion of how such matters will be addressed in the auditor's report.

CA Pam Harsha

Q.NO.5. WRITE ABOUT THE COMMUNICATION PROCESS AND DOCUMENTATION AS PER SA 260?

ANSWER:

1. The auditor shall communicate with those charged with governance the form, timing and expected general content of communications.

2. The auditor shall communicate in writing with those charged with governance regarding significant findings from the audit if, in the auditor's professional judgment, oral communication would not be adequate.

3. Written communications need not include all matters that arose during the course of the audit. The auditor shall communicate in writing with those charged with governance regarding auditor independence when required in case of listed entities.

4. The auditor shall communicate with those charged with governance on a timely basis.

5. ADEQUACY OF THE COMMUNICATION PROCESS:

   a. The auditor shall evaluate whether the two-way communication between the auditor and those charged with governance has been adequate for the purpose of the audit.

   b. If it has not, the auditor shall evaluate the effect, if any, on the auditor's assessment of the risks of material misstatement and ability to obtain sufficient appropriate audit evidence, and shall take appropriate action.

6. DOCUMENTATION:

   a. Where matters required by SA 260 to be communicated are communicated orally, the auditor shall include them in the audit documentation, and when and to whom they were communicated.

   b. Where matters have been communicated in writing, the auditor shall retain a copy of the communication as part of the audit documentation.

CA Ram Parsha

ILLUSTRATION 4.

CA. Vallabh Sundar is auditor of a leading private sector bank. "IT Systems and controls" is under his consideration to be reported as "Key audit matter" in audit report of the bank due to high level of automation and complexity of the IT architecture and its impact on the financial reporting system.
At what time he should communicate such identified "Key audit matter"? What are relevant considerations in this regard and their usefulness?

ANSWER:

1. SA 260 requires the auditor to communicate with those charged with governance on a timely basis. SA 701 states that the appropriate timing for communications about key audit matters will vary with the circumstances of the engagement.

2. However, the auditor may communicate preliminary views about key audit matters when discussing the planned scope and timing of the audit, and may further discuss such matters when communicating about audit findings.

3. Doing so may help to alleviate the practical challenges of attempting to have a robust two-way dialogue about key audit matters at the time the financial statements are being finalized for issuance.

4. Communication with those charged with governance enables them to be made aware of the key audit matters that the auditor intends to communicate in the auditor's report, and provides them with an opportunity to obtain further clarification where necessary.

5. The auditor may consider it useful to provide those charged with governance with a draft of the auditor's report to facilitate this discussion.

6. Communication with those charged with governance recognizes their important role in overseeing the financial reporting process, and provides the opportunity for those charged with governance to understand the basis for the auditor's decisions in relation to key audit matters and how these matters will be described in the auditor's report.

7. It also enables those charged with governance to consider whether new or enhanced disclosures may be useful in light of the fact that these matters will be communicated in the auditor's report.

CA Ram Harsha

SA 402 AUDIT CONSIDERATIONS RELATING TO AN ENTITY USING A SERVICE ORGANISATION

SERVICE ORGANIZATION [S/O]: Service organisation is a third-party organisation (or segment of a third-party organisation) that provides services to user entities that are part of those entities' information systems relevant to financial reporting.

USER ENTITY [U/E]: User entity is an entity that uses a service organisation and whose financial statements are being audited.

SERVICE AUDITOR [S/A]: Service auditor is an auditor who, at the request of the service organisation, provides an assurance report **[type 1 or type 2]** on the controls of a service organisation.

USER AUDITOR [U/A]: User auditor is an auditor who audits and reports on the financial statements of a user entity.

Q NO 1. WHEN SERVICES PROVIDED BY A SERVICE ORGANIZATION ARE RELEVANT TO THE AUDIT OF A USER ENTITY'S FINANCIAL STATEMENTS?

ANSWER:

1. Services provided by a service organisation are relevant to the audit of a user entity's financial statements when those services, and the controls over them, are part of the user entity's information system, including related business processes, relevant to financial reporting. Although most controls at the service organisation are likely to relate to financial reporting, there may be other controls that may also be relevant to the audit, such as controls over the safeguarding of assets.

2. A service organisation's services are part of a user entity's information system, including related business processes, relevant to financial reporting if these services affect any of the following:

    a. The classes of transactions in the user entity's operations that are significant to the user entity's financial statements.

    b. The procedures, within both information technology (IT) and manual systems, by which the user entity's transactions are initiated, recorded, processed, corrected as necessary, transferred to the general ledger and reported in the financial statements.

    c. The related accounting records, either in electronic or manual form, supporting information and specific accounts in the user entity's financial statements that are used to initiate, record, process and report the user entity's transactions

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d. How the user entity's 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 user entity's financial statements, including significant accounting estimates and disclosures and

f. Controls surrounding journal entries, including non-standard journal entries used to record non- recurring, unusual transactions or adjustments

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

Q NO 2. WRITE ABOUT THE OBJECTIVES OF USER AUDITOR IN ACCORDANCE WITH SA 402?

ANSWER:

The objectives of the user auditor, when the user entity uses the services of a service organisation, are:

1. To obtain an understanding of the nature and significance of the services provided by the service organisation and their effect on the user entity's internal control relevant to the audit, sufficient to identify and assess the risks of material misstatement; and

2. To design and perform audit procedures responsive to those risks.

CA Ram Harsha

Q NO 3. WHAT IS TYPE 1 AND TYPE 2 REPORTS AS REFERRED UNDER SA 402?

ANSWER:

TYPE 1 REPORT	TYPE 2 REPORT
A description, prepared by management of the service organisation, of the service organisation's system, control objectives and related controls that have been designed and implemented as at a specified date and	A description, prepared by management of the service organisation, of the service organisation's system, control objectives and related controls, their design and implementation as at a specified date or throughout a specified period and, in some cases, their operating effectiveness throughout a specified period and
A report by the service auditor with the objective of conveying reasonable assurance that includes the service auditor's opinion on	A report by the service auditor with the objective of conveying reasonable assurance that includes:

the description of the service organisation's system, control objectives and related controls and the suitability of the design of the controls to achieve the specified control objectives.	a. The service auditor's opinion on the description of the service organisation's system, control objectives and related controls, the suitability of the design of the controls to achieve the specified control objectives, and the operating effectiveness of the controls **AND** b. A description of the service auditor's tests of the controls and the results thereof.

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Q NO 4. WRITE ABOUT OBTAINING AN UNDERSTANDING OF THE SERVICES PROVIDED BY S/O?

ANSWER:

When obtaining an understanding of the user entity in accordance with SA 315, the user auditor shall obtain an understanding of how a user entity uses the services of a service organisation in the user entity's operations, including:

1. **NATURE OF SERVICES BY S/O:** The nature of the services provided by the service organisation and the significance of those services to the user entity, including the effect thereof on the user entity's internal control.

   Information on nature of services provided by a user organization may be available from sources such as user manuals, contract between the user entity and service organization, reports by service auditors etc.

2. **MATERIALITY OF TXNS PROCESSED BY S/O:** The nature and materiality of the transactions processed or accounts or financial reporting processes affected by the service organisation. In certain situations, the transactions processed and the accounts affected by the service organisation may not appear to be material to the user entity's financial statements, but the nature of the transactions processed may be significant and the user auditor may determine that an understanding of those controls is necessary in the circumstances.

3. **DEGREE OF INTERACTION BETWEEN U/E AND S/O:** The degree of interaction between the activities of the service organisation and those of the user entity. The degree of interaction

refers to the extent to which a user entity is able to and elects to implement effective controls over the processing performed by the service organisation.

For example, a high degree of interaction exists between the activities of the user entity and those at the service organisation when the user entity authorises transactions and the service organisation processes and does the accounting for those transactions

4. **RELATIONSHIP BETWEEN U/E AND S/O:** The nature of the relationship between the user entity and the service organisation, including the relevant contractual terms for the activities undertaken by the service organisation.

Q NO 5. WRITE ABOUT OBTAINING AN UNDERSTANDING OF INTERNAL CONTROL RELEVANT TO THE AUDIT IN ACCORDANCE WITH SA 315 WHEN THE U/E IS USING SERVICES OF S/O?

ANSWER:

1. **EVALUATE IC:** The user auditor shall evaluate the design and implementation of relevant controls at the user entity that relate to the services provided by the service organisation, including those that are applied to the transactions processed by the service organisation.

2. **UNDERSTAND SERVICES BY S/O FROM U/E:** The user auditor shall determine whether a sufficient understanding of the nature and significance of the services provided by the service organisation and their effect on the user entity's internal control relevant to the audit has been obtained to provide a basis for the identification and assessment of risks of material misstatement.

3. **UNABLE TO OBTAIN UNDERSTANDING OF SERVICES BY S/O FROM U/E:** If the user auditor is unable to obtain a sufficient understanding from the user entity, the user auditor shall obtain that understanding from one or more of the following procedures:

    a. Obtaining a Type 1 or Type 2 report, if available

    b. Contacting the service organisation, through the user entity, to obtain specific information. [Follow SA 505 Procedures]

    c. Visiting the service organisation and performing procedures that will provide the necessary information about the relevant controls at the service organisation or

    d. Using another auditor to perform procedures that will provide the necessary information about the relevant controls at the service organization.

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Q NO 6. WRITE ABOUT USING OF TYPE 1 OR TYPE 2 REPORTS BY U/A OF U/E W.R.T SERVICES PROVIDED BY S/O?

ANSWER:

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

    a. The service auditor's professional competence (except where the service auditor is a member of the Institute of Chartered Accountants of India) and independence from the service organisation and

    b. The adequacy of the standards under which the Type 1 or Type 2 report was issued.

2. If the user auditor plans to use a Type 1 or Type 2 report as audit evidence to support the user auditor's understanding about the design and implementation of controls at the service organisation, the user auditor shall:

    a. Evaluate whether the description and design of controls at the service organisation is at a date or for a period that is appropriate for the user auditor's purposes.

    b. Evaluate the sufficiency and appropriateness of the evidence provided by the report for the understanding of the user entity's internal control relevant to the audit and

3. Determine whether complementary user entity controls identified by service organisation are relevant to the user entity and, if so, obtain an understanding of whether the user entity has designed and implemented such controls.

    CUEC: Complementary user entity controls refer to controls that the service organisation assumes, in the design of its service, will be implemented by user entities, and which, if necessary to achieve control objectives, are identified in the description of its system.

Q NO 7. WRITE ABOUT RESPONDING TO THE ASSESSED RISKS OF MATERIAL MISSTATEMENT IN RELATION TO SERVICES PROVIDED BY S/O?

ANSWER:

1. In responding to assessed risks in accordance with SA 330, the user auditor shall:
2. Determine whether sufficient appropriate audit evidence concerning the relevant financial statement assertions is available from records held at the user entity and, if not,

3. Perform further audit procedures to obtain sufficient appropriate audit evidence or use another

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auditor to perform those procedures at the service organisation on the user auditor's behalf.

4. **TESTS OF CONTROLS:** When the user auditor's risk assessment includes an expectation that controls at the service organisation are operating effectively, the user auditor shall obtain audit evidence about the operating effectiveness of those controls from one or more of the following procedures:

    a. Obtaining a Type 2 report, if available

    b. Performing appropriate tests of controls at the service organisation.

    c. Using another auditor to perform tests of controls at the service organisation on behalf of the user auditor.

Q NO 8. WRITE ABOUT USING A TYPE 2 REPORT AS AUDIT EVIDENCE THAT CONTROLS AT THE SERVICE ORGANISATION ARE OPERATING EFFECTIVELY?

ANSWER:

If, the user auditor plans to use a Type 2 report as audit evidence that controls at the service organisation are operating effectively, the user auditor shall determine whether the service auditor's report provides sufficient appropriate audit evidence about the effectiveness of the controls to support the user auditor's risk assessment by:

1. Evaluating whether the description, design and operating effectiveness of controls at the service organisation is at a date or for a period that is appropriate for the user auditor's purposes.

2. Determining whether complementary user entity controls identified by the service organisation are relevant to the user entity and, if so, obtaining an understanding of whether the user entity has designed and implemented such controls and, if so, testing their operating effectiveness.

3. Evaluating the adequacy of the time period covered by the tests of controls and the time elapsed since the performance of the tests of controls and

4. Evaluating whether the tests of controls performed by the service auditor and the results thereof, as described in the service auditor's report, are relevant to the assertions in the user entity's financial statements and provide sufficient appropriate audit evidence to support the user auditor's risk assessment.

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Q NO 9. WRITE ABOUT FRAUD, NON-COMPLIANCE WITH LAWS AND REGULATIONS AND UNCORRECTED MISSTATEMENTS IN RELATION TO ACTIVITIES AT THE SERVICE ORGANISATION AND REPORTING THERE OF IN THE AUDITORS REPORT BY USER AUDITOR?

ANSWER:

A. MMS IN F/S RELATED TO S/O SERVICES:

1. The user auditor shall inquire of management of the user entity whether the service organisation has reported to the user entity, or whether the user entity is otherwise aware of, any fraud, non- compliance with laws and regulations or uncorrected misstatements affecting the financial statements of the user entity.

2. The user auditor shall evaluate how such matters affect the nature, timing and extent of the user auditor's further audit procedures, including the effect on the user auditor's conclusions and user auditor's report.

B. REFERENCE IN AUDIT REPORT THE USER AUDITOR:

1. **UNMODIFIED OPINION:** The user auditor shall not refer to the work of a service auditor in the user auditor's report containing an unmodified opinion unless required by law or regulation to do so. If such reference is required by law or regulation, the user auditor's report shall indicate that the reference does not diminish the user auditor's responsibility for the audit opinion.

2. **NO S & A EVIDENCE – MODIFID OPINION:**

    a. The user auditor shall modify the opinion in the user auditor's report in accordance with SA 705 if the user auditor is unable to obtain sufficient appropriate audit evidence regarding the services provided by the service organisation relevant to the audit of the user entity's financial statements.

    b. If reference to the work of a service auditor is relevant to an understanding of a modification to the user auditor's opinion, the user auditor's report shall indicate that such reference does not diminish the user auditor's responsibility for that opinion.

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TEST YOUR KNOWLEDGE

Q.NO.1. CA. Shelly Goel is offered appointment as auditor of RUTE Limited, a listed company. The audit committee of the company wants her to justify independence in relation to company through proper communication. Although she has ensured that there are no threats to her independence, she feels requirement of audit committee to be beyond its purview. What is your opinion in this regard?

ANSWER:

REFER ANSWER IN THE SA 260 DISCUSSION.

[Hint: Matters to be communicated to TCWG in case of Listed Entities]

Q.NO.2. You are auditor of a social media company. Of late, government has tightened noose around companies operating in this segment by bringing in a maze of regulatory legislations to protect interests of users. How you can proceed to verify that company is compliant with new regulatory requirements? Besides, what does above situation underscore to you as an auditor?

ANSWER:

It needs to be verified that the company has put in place systems and procedures to meet with new regulatory requirements. The same can be verified by examining policies and procedures developed by company in this regard like devising appropriate system of internal control, sensitizing employees regarding new rules, engaging legal advisors etc.

Further, financial stability of the company may be threatened due to new regulatory requirements. The management may be under pressure.

It is also a fraud risk factor and may need to be evaluated by auditor.

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Q.NO.3. Discuss why the potential effects of inherent limitations of an auditor's ability to detect material misstatements described in SA 200 are far greater in respect of non-compliance with laws and regulations?

ANSWER:

REFER ANSWER IN THE SA 250 DISCUSSION.

[Hint: Inherent Limitations w.r.t Laws and Regulations]

Q.NO.4. MN & Associates are the statutory auditors of ABC Ltd. for the FY 2021-22. During the course of audit, the engagement partner, Mr. Manohar notices a misstatement resulting from a suspected fraud that brings into question the audit team's ability to continue performing the audit. How should the audit team deal with the situation?

ANSWER:

During the course of audit, the engagement partner, Mr. Manohar notices a misstatement resulting from a suspected fraud that brings into question the audit team's ability to continue performing the audit. In such a situation the audit team should:

REFER ANSWER IN THE SA 240 DISCUSSION.

[Hint: Auditor unable to continue the enagagement]

Q.NO.5. CA Anand is the engagement partner for the audit assignment of NHT Ltd. engaged in manufacture of Iron and Steel bars. The company has its plants in the state of Sikkim. While verifying the wages record of the company, CA Anand found that maximum of the labour employed in the plants of the company was child labour. He questioned the management of the company about the same to which the management replied that looking into the compliance of such law is outside his scope of financial audit. Give your comments with respect to such situation.

ANSWER:

Write Responsibility of auditor In the context of SA 250 [Refer SA 250 Discussion on the same]

In the instant case, maximum of the labour employed in the plants of the company was child labour. When CA Anand questioned the management of the company about the same, the management replied that looking into the compliance of such law is outside his scope of financial audit.
Such reply by the management is not acceptable as such situation may have a material effect on the financial statements.

Therefore, CA Anand should ensure as to whether any penal provisions will be there for non-compliance of such law and also whether the same has been duly disclosed by the company.

If CA Anand concludes that such non- compliance has a material effect on the financial statements and the same has not been adequately reflected in the financial statements by the company, he shall express an adverse or a qualified opinion on the financial statements.

Q.NO.6. MNO Ltd. gets its accounting data processed by a service organisation. CA Riya is the

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statutory auditor of MNO Ltd. CA Riya wants to obtain an understanding as to how MNO Ltd. is using the services of the service organisation. What all understanding should she obtain?

ANSWER:

When obtaining an understanding of MNO Ltd. (user entity) in accordance with SA 315, CA Riya shall obtain an understanding of how MNO Ltd. uses the services of a service organisation in its operations, including:

REFER ANSWER IN THE SA 402 DISCUSSION.

[Hint: Obtaining an understanding of Services provided by S/O]

Q.NO.7. UVW & Associates are the statutory auditors of Moon Ltd., a listed company, for the financial year 2022-23. CA Udhav is the engagement partner for the audit assignment. He was of the understanding that as per the requirement of one of the SAs he has a responsibility to communicate following matters to those charged with governance:

a. The auditor's responsibilities in relation to the financial statement audit.
b. Planned scope and timing of the audit.
c. Auditor independence

Which of the matters is not included in the list prepared by CA Udhav. Discuss such matter in detail.

ANSWER:

SA 260 "Communication with Those Charged with Governance" deals with auditor's responsibility to communicate with those charged with governance in relation to an audit of financial statements. Among various matters as included by CA Udhav in his list, one of the matters that is not mentioned in the list is Significant findings from the audit.

REFER ANSWER IN THE SA 260 DISCUSSION.

[Hint: Significant findings to be communicated with TCQG as per SA 260]

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SA 500 AUDIT EVIDENCE

A. AUDIT EVIDENCE: Audit evidence is the information used by the auditor in arriving at the conclusions on which the auditor's opinion is based. Audit evidence includes both information contained in the accounting records underlying the financial statements and other information.

B. SCOPE OF THE SA 500:

1. This SA deals with the auditor's responsibility to design and perform audit procedures to obtain sufficient and appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion.

2. This SA is applicable to all the audit evidence obtained during the course of audit.

C. OBJECTIVE OF THE AUDITOR: To design and perform audit procedures in such a way as to enable the auditor to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base auditor's opinion.

D. INFORMATION TO BE USED AS AUDIT EVIDENCE:

1. The auditor shall consider the relevance and reliability of the information to be used as audit evidence.
2. When information from management expert is used, the auditor shall evaluate the competence, objectivity of the expert, appropriateness of the expert's work.
3. When using information produced by the entity, the auditor shall evaluate the reliability, completeness, accuracy of the information.

E. AUDIT PROCEDURES TO OBTAIN AUDIT EVIDENCE: Audit evidence to draw reasonable conclusions on which to base the auditor's opinion is obtained by performing:

1. Risk Assessment procedures
    a. Inquiries
    b. Inspection and Observation
    c. Analytical Procedures
2. Further audit procedures comprising of:
    a. Test of controls and
    b. Substantive procedures:
        i. Test of Details
        ii. Substantive Analytical Procedures

F. INCONSISTENCY IN OR DOUBTS OVER RELIABILITY OF AUDIT EVIDENCE:

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

ILLUSTRATION 5.

During the course of the audit of TK Home Private Limited, a recognized export house engaged in manufacturing of T-shirts under brand name of "TK". CA Tripti is verifying export revenues of the company for the year 2022-23. She has verified transactions entered in "Export Sales" account maintained in accounting software from relevant export invoices. The export sales are being made on payment of IGST, for which a refund is automatically credited in the account of the company after the goods are shipped.

On enquiring from internal audit staff regarding the recognition of export revenues, she is told that export sales are recognised for the year on the basis of "Bills of Lading". However, she is not convinced with such a response and feels that the same does not appear to be proper.

She finds that three export invoices bearing dates in the month of March 2023 having a value of Rs.75.00 lacs have not been recognized in export revenue on the ground that bills of lading for these invoices were issued in the month of April 2023.
Discuss from what sources she can obtain reliable audit evidence in this regard. How can she challenge management's assertion regarding the completeness of export revenues for the year 2022-23?

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ANSWER:

She can obtain reliable audit evidence by going through GST returns filed by the company on GST portal and correlating the same with e-way bills.

She can obtain audit evidence about how company has reflected its export sales in its GST returns and whether export sales pertaining to three invoices having value of Rs. 75.00 lacs are reflected in such returns.

Further, e-way bills generated on the portal would provide evidence that goods have moved out of the company's premises. The export revenue should have been booked at the time the goods moved out of the company's premises. The company is claiming an IGST refund. The refund is linked to the monthly sales return. This aspect can also be verified.

"Bill of Lading" is only a document issued by the carrier to the shipper of goods that goods have been taken on board. She should challenge and counter management's assertion on the above

grounds and point out violations of relevant accounting standards and principles. In this way, she can obtain reliable audit evidence.

Highlighting such digital and other evidence, she can challenge management's assertion regarding the completeness of export revenues and point out that export revenues are understated.

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SA 501 AUDIT EVIDENCE - SPECIFIC CONSIDERATIONS FOR SELECTED ITEMS

A. OBJECTIVE OF THE AUDITOR: The objective of the auditor is to obtain sufficient appropriate audit evidence regarding the:

1. Existence and condition of Inventory.
2. Completeness of litigation and claims involving the entity. and
3. Presentation and disclosure of segment information in accordance with the applicable financial reporting framework.

B. EXISTENCE AND CONDITION OF INVENTORY:

1. ATTEND MANAGEMENT INVENTORY COUNTING:

a. The auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of inventory as at year end i.e., Date of financial statements by:
b. Attendance at physical inventory counting performed by management to:
   i. Evaluate management's instructions and procedures for recording and controlling the results of the entity's physical inventory counting.
   ii. Observe Management Count
   iii. Inspect the inventory. and
   iv. Perform test counts and
c. Reconcile the physical inventory with the inventory records to identify any discrepancies.
d. If inventory counting is carried at other than balance sheet date then the auditor shall identify the changes occurred between balance sheet date and count date and shall ensure whether the changes are properly recorded.

2. PHYSICAL INSPECTION BY AUDITOR DIRECTLY: If the auditor is unable to attend physical inventory counting by management due to unforeseen circumstances, the auditor shall make or observe some physical counts on an alternative date and perform audit procedures on intervening transactions.

3. **PHYSICAL INSPECTION IMPRACTICABILITY:**

a. 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.
b. The alternative procedure includes inspection of documentation of subsequent sale of specific items of inventory purchased on or before balance sheet date. This will ensure the auditor to confirm about existence and condition of inventory as on reporting date.
c. If alternative procedures are not possible to do so, the auditor shall modify the opinion in the auditor's report in accordance with SA 705.

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Note: 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.

4. **INVENTORY IN THE CUSTODY OF THIRD PARTY:**
    a. When inventory under the custody and control of a third party the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of that inventory by performing one or both of the following:
    b. Request confirmation from the third party as to the quantities and condition of inventory held on behalf of the entity. (SA 505)
    c. If there exist doubts as to reliability of confirmation provided by third parties then the auditor may perform the below procedures:
        i. Attending or arranging another auditor for physical count procedures of third parties, if practicable.
        ii. Obtaining another auditor report on adequacy of third party count procedures.
        iii. Inspecting documentation regarding inventory held by third party eg: warehouse receipts.
        iv. Requesting confirmation from other parties where the inventory is pledged as collateral.

C. LITIGATION AND CLAIMS:

1. The auditor shall design and perform audit procedures in order to identify litigation and claims involving the entity which may give rise to a risk of material misstatement, including:
    a. Inquiry of management and, where applicable, others within the entity, including in-house legal counsel.
    b. Reviewing minutes of meetings of those charged with governance and correspondence between the entity and its external legal counsel and
    c. Reviewing legal expense accounts.

    d. **CONFIRMATION FROM EXTERNAL LEGAL COUNCIL:** the auditor shall, in addition to the procedures required by other SAs, seek direct communication with the entity's external legal counsel in the following cases:
        i. If the auditor assesses a risk of material misstatement regarding litigation or claims that have been identified, or
        ii. When audit procedures performed indicate that other material litigation or claims may exist,
        iii. For obtaining more clear understanding of existing litigations and claims.

    The auditor shall do so through a letter of inquiry, prepared by management and sent by the auditor, requesting the entity's external legal counsel to communicate directly with the auditor.

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2. If management refuses to give the auditor permission to communicate or meet with the entity's external legal counsel, or the entity's external legal counsel refuses to respond appropriately to the letter of inquiry, or is prohibited from responding; and

3. If the auditor is unable to obtain sufficient appropriate audit evidence by performing alternative audit procedures, then the auditor shall modify the opinion in the auditor's report in accordance with SA 705.

4. **WRITTEN REPRESENTATIONS:** The auditor shall request management and, where appropriate, those charged with governance to provide written representations that all known actual or possible litigation and claims whose effects should be considered when preparing the financial statements have been disclosed to the auditor and appropriately accounted for and disclosed in accordance with the applicable financial reporting framework.

D. SEGMENT INFORMATION: The auditor shall obtain sufficient appropriate audit evidence regarding the presentation and disclosure of segment information in accordance with the applicable financial reporting framework by:

1. Obtaining an understanding of the methods used by management in determining segment information, and:
   a. Evaluating whether such methods are likely to result in disclosure in accordance with the applicable financial reporting framework:
      i. Sales, transfers and charges between segments, and elimination of intersegment amounts.
      ii. Comparisons with budgets and other expected results, for example, operating profits as a percentage of sales.
      iii. The allocation of assets and costs among segments.
      iv. Consistency with prior periods, and the adequacy of the disclosures with
      v. respect to inconsistencies
   b. Where appropriate, testing the application of such methods and

2. Performing analytical procedures or other audit procedures appropriate in the circumstances.

ILLUSTRATION 6.

CA Prabhjot has planned observing the physical count of inventories at the plant of a company located in remote area in the state of Uttarakhand as part of a statutory audit exercise as at close of year ending 31st March 2023. He has already informed the management of his intention to reach the plant site by evening of 29th March 2023. He plans to inspect inventories, observe the counting process and perform test counts among other matters.
The management has made all necessary arrangements to facilitate the above exercise.

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However, an agitation in Himalayan hills has started on 28th March 2023 for the promulgation of a strict law relating to the conversion of agricultural land for commercial use. Many civil society groups are participating in the agitation. NH-7 leading to the plant site is blocked by protestors. The plant is not accessible through any other mode. The blockade is lifted after one month when state government announced the formation of a committee to look into protestors' demands.

Does the above case highlight to a situation of "impracticability of attendance" at inventory counting in terms of requirements of SA 501?

How should the auditor proceed in above situation?

ANSWER:

The above situation does not highlight the impracticability of attendance at inventory counting. It only shows that the auditor is unable to attend physical inventory counting due to unforeseen circumstances arising out of agitation by protestors. It has led to the inaccessibility of the plant site for a month. The blockade is lifted after a month.

SA 501 states that if the auditor is unable to attend physical inventory counting due to unforeseen circumstances, the auditor shall make or observe some physical counts on an alternative date and perform audit procedures on intervening transactions.

Therefore, the auditor should attend to the physical inventory count after the blockade is lifted and perform audit procedures on intervening transactions.

ILLUSTRATION 7.

On reviewing legal expenses account of Zed Ltd., CA. Sunitha, auditor of company, finds that legal fees amounting to Rs. 10 lac was paid to B. George, a reputed lawyer, during the year 2022- 23. On inquiry with management regarding the purpose of such expenditure, evasive reply was received from management stating that a lot of work is performed by the said lawyer on behalf of the company. However, no specific details were provided.

She finds it proper to correspond directly with the lawyer. She obtains the address and mail id of the lawyer from his professional services bill. She shoots off an inquiry letter asking for the nature and status of litigation claims against the company on her letterhead.

Is her approach proper? Irrespective of the merits of the approach followed by her, what she is trying to achieve by corresponding with lawyer of the company?

CA Ram Harsha

ANSWER:

SA 501 states that when audit procedures performed indicate that material litigation or claims may exist, the auditor shall seek direct communication with the entity's external legal counsel.

The auditor shall do so through a letter of inquiry prepared by management and sent by the auditor, requesting the entity's external legal counsel to communicate directly with the auditor.

Therefore, her approach in communicating with an external lawyer is wrong. She has to make management aware of her intention to communicate directly with the lawyer. The letter of enquiry has to be prepared by management and sent by her.

Her purpose in corresponding with the lawyer of the company is to identify litigation and claims involving the entity which may give rise to a risk of material misstatement. It is due to the reason that litigation and claims involving the entity may have a material effect on the financial statements and thus may be required to be disclosed or accounted for in the financial statements.

ILLUSTRATION 8.

On going through financial statements and records of "TS Ltd.," during the course of statutory audit, CA Tanmaya finds that substantial inventories of the company consisting of mast lighting poles remain with "Super Industries" for certain finishing works. While planning audit procedures, he had planned about seeking confirmation from "Super Industries" regarding existence and condition of such mast lighting poles belonging to TS Ltd. lying with them as on 31st March, 2023.
However, the premises of "Super Industries" were raided by DGGI officials (Director General of GST Intelligence) in connection with the busting of a fake billing scam. The proprietor of the firm was arrested in November 2022 and came out on bail in the month of March 2023. The details of proprietor and his firm were flashed prominently in local newspapers of the city where company is located. CA. Tanmaya also belongs to the same place. Discuss how he should proceed in the above matter as auditor of TS Ltd.

ANSWER:

501 states that 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:

1. Request confirmation from the third party as to the quantities and condition of inventory held on behalf of the entity.
2. Perform inspection or other audit procedures appropriate in the circumstances.

CA Rani Harsha

It further states that 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.

Examples of other audit procedures include:

1. Attending, or arranging for another auditor to attend, the third party's physical counting of inventory, if practicable.
2. 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.
3. Inspecting documentation regarding inventory held by third parties.

In the given case, the integrity of the third party appears to be doubtful in view of DGGI raids and his possible involvement in a fake billing scam. He has already been behind bars.

Keeping in view above, besides obtaining confirmation from such party, he may attend a third party's physical counting or ask some other auditor to attend physical counting as on reporting date, depending upon practical considerations.

He can also inspect the record of goods sent and received back from such party by tracing it to challans, e-ways bills etc. and correlate the above information.

ILLUSTRATION 9.

Briefly mention the matters that are relevant in planning attendance at physical inventory counting?

ANSWER:

The auditor shall consider the following:

1. Nature of Inventory
2. Stages of completion of WIP
3. Internal Controls related to Inventory
4. Whether adequate instructions are given for physical inventory counting
5. Timing of physical inventory counting
6. Whether the entity is maintaining perpetual inventory system
7. Whether assistance of auditor's expert is needed

The location at which inventory is held and related risks.

CA Ram Harsha

SA 505 EXTERNAL CONFIRMATIONS

A. DEFINITIONS:

1. **EXTERNAL CONFIRMATION:**
   Audit evidence obtained as a direct written response to the auditor from a third party (AKA the confirming party), in paper form, or by electronic or other medium.

2. **POSITIVE CONFIRMATION REQUEST:**
   A request that the confirming party respond directly to the auditor indicating whether the confirming party agrees or disagrees with the information in the request, or providing the requested information.

3. **NEGATIVE CONFIRMATION REQUEST:**
   A request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request.

4. **EXCEPTION:**
   A response indicates a difference between information requested to be confirmed, or contained in the entity's records, and information provided by the confirming party.

CA Ram Harsha

B. EXTERNAL CONFIRMATION PROCEDURES: When using external confirmation procedures, the auditor shall maintain control over external confirmation requests, including:

STEP 1: DETERMINING THE INFORMATION TO BE CONFIRMED OR REQUESTED:

External confirmation procedures frequently are performed to confirm or request information regarding account balances and their elements. They may also be used:

1. To confirm terms of agreements,
2. Contracts, or
3. Transactions between an entity and other parties, or
4. To confirm the absence of certain conditions, such as a "side agreement".
5. Amounts due to lenders.
6. Property title deeds held by lawyers or financiers for safe custody or as security.
7. Investments held for safekeeping by third parties, or purchased from stockbrokers but not delivered at the balance sheet date.

STEP 2: SELECTING THE APPROPRIATE CONFIRMING PARTY:

1. Responses to confirmation requests provide more relevant and reliable audit evidence when confirmation requests are sent to a confirming party the auditor believes is knowledgeable about the information to be confirmed.
2. For example, a financial institution official who is knowledgeable about the transactions or arrangements for which confirmation is requested may be the most appropriate person at the financial institution from whom to request confirmation.

STEP 3: DESIGNING THE CONFIRMATION REQUESTS:

1. The design of a confirmation request may directly affect the confirmation response rate, and the reliability and the nature of the audit evidence obtained from responses.
2. The following are the factors when designing the confirmation request:
    a. Specific identified risks of material misstatement, including fraud risks.
    b. The layout and presentation of the confirmation request.
    c. Prior experience on the audit or similar engagements.
    d. The assertions being addressed.
    e. The method of communication [for example, in paper form, or by electronic mode (like e-mail) or other medium].
    f. Management's authorisation or encouragement to the confirming parties to respond to the auditor. *Confirming parties may only be willing to respond to a confirmation request containing management's authorisation*.
    g. The ability of the intended confirming party to confirm or provide the requested information (for example, individual invoice amount versus total balance).

STEP 4: Sending the requests, including follow-up requests when applicable, to the confirming party.

Example: The auditor may, having re-verified the accuracy of the original address, send an additional or follow-up request.

C. MANAGEMENT'S REFUSAL TO ALLOW THE AUDITOR TO SEND A CONFIRMATION REQUEST: If management refuses to allow the auditor to send a confirmation request, the auditor shall:

1. Inquire as to management's reasons for the refusal, and seek audit evidence as to their validity and reasonableness.
2. Evaluate the implications of management's refusal on the auditor's assessment of the relevant risks of material misstatement, including the risk of fraud, and on the nature, timing and extent of other audit procedures and
3. Perform alternative audit procedures designed to obtain relevant and reliable audit evidence.
4. If the auditor concludes that management's refusal to allow the auditor to send a confirmation request is unreasonable, or the auditor is unable to obtain relevant and reliable audit evidence from alternative audit procedures, the auditor shall communicate with those charged with governance in accordance with SA 260.
5. The auditor also shall determine the implications for the audit and the auditor's opinion in accordance with SA 705.

D. DOUBTS ABOUT RELIABILITY OF RESPONSES TO CONFIRMATION REQUESTS

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

CA Ram Harsha

2. If the auditor determines that a response to a confirmation request is not reliable, the auditor shall evaluate the implications on the assessment of the relevant risks of material misstatement, including the risk of fraud, and on the related nature, timing and extent of other audit procedures.

E. NEGATIVE CONFIRMATIONS:

Negative confirmations provide less persuasive audit evidence than positive confirmations. Accordingly, the auditor shall not use negative confirmation requests as the sole substantive audit procedure to address an assessed risk of material misstatement at the assertion level **UNLESS ALL** of the following are present:

a. The auditor has assessed the risk of material misstatement as low and has obtained sufficient appropriate audit evidence regarding the operating effectiveness of controls relevant to the assertion
b. The population of items subject to negative confirmation procedures comprises a large number of small, homogeneous, account balances, transactions or conditions;
c. A very low exception rate is expected; and
d. Very low chances of non-response from third party. [Auditors are not aware of circumstances or conditions that would cause recipients of negative confirmation requests to disregard such requests].

CA Ram Harsha

ILLUSTRATION 10.

Write about factors that assist in determining External Confirmation procedures as Substantive audit Procedures?

ANSWER:

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

1. Although external confirmations may provide relevant audit evidence relating to certain assertions, there are some assertions for which external confirmations provide less relevant audit evidence.
   Example: External confirmations provide less relevant audit evidence relating to the recoverability of accounts receivable balances, than they do of their existence.

2. The auditor may determine that external confirmation procedures performed for one purpose provide an opportunity to obtain audit evidence about other matters.
   Example: Confirmation requests for bank balances often include requests for information relevant to other financial statement assertions.

3. The confirming party's knowledge of the subject matter – responses may be more reliable if provided by a person at the confirming party who has the requisite knowledge about the information being confirmed.

4. The ability or willingness of the intended confirming party to respond – For example, the confirming party:
    a. may not accept responsibility for responding to a confirmation request.
    b. may consider responding too costly or time consuming.
    c. may have concerns about the potential legal liability resulting from responding.
    d. may account for transactions in different currencies; or
    e. may operate in an environment were responding to confirmation requests is not a significant aspect of day-to-day operations.
    f. In such situations, confirming parties may not respond, may respond in a casual manner or may attempt to restrict the reliance placed on the response.

5. The objectivity of the intended confirming party – if the confirming party is a related party of the entity, responses to confirmation requests may be less reliable.

ILLUSTRATION 11.

During the financial year 2020-21, the auditor of Delicious and Healthy Limited asked a Trade Receivable to respond directly to the auditor whether or not the amount they were required to pay to Delicious and Healthy Limited was Rs. 79,000. That trade receivable confirmed to the auditor of Delicious and Healthy Limited, that they were required to pay an amount of Rs. 79,000 to Delicious and Healthy Limited. State and explain the type of Confirmation Request as required by the auditor.

ANSWER:

The above-mentioned situation is an example of Positive Confirmation Request because in Positive Confirmation Request the party confirms the auditor of a company whether such party agrees or whether such party disagrees with the information for which the confirmation is required by auditor of that company

ILLUSTRATION 12.

As auditor of Groom Limited, you have sent positive confirmation requests to 30 creditors of the company in March 2023. All of the creditors in informal sector are small concerns. You choose to send positive confirmation requests to all the above parties at their business addresses stated on respective bills after discussing the matter with CFO of the company. The CFO is cooperative and does not raise any hassles in the matter.

CA Ram Harsha

Responses to confirmation requests are received within a week's time. Your articled clerk informs you that out of above 30 creditors, GST registrations of 25 concerns have been cancelled during financial year 2022-23 itself by collating information from GST portal.

He further informs you that there are no fresh registrations pertaining to PANs of these parties. How you would proceed to deal with the situation as auditor of the company?

ANSWER:

SA SA 505 states that if the auditor determines that a response to a confirmation request is not reliable, the auditor shall evaluate the implications on the assessment of the relevant risks of material misstatement, including the risk of fraud, and on the related nature, timing and extent of other audit procedures.

In the instant case, GST registrations of 25 concerns have been cancelled in the year 2022-23. It indicates that businesses on those addresses were closed. Further, there are no fresh registrations pertaining to the PANs of these parties. However, the auditor sent external confirmation requests in March 2023, which were duly responded. It raises questions on the reliability of responses received.

SA 500 indicates that even when audit evidence is obtained from sources external to the entity, circumstances may exist that affect its reliability. All responses carry some risk of interception, alteration or fraud. Such risk exists regardless of whether a response is obtained in paper form or by electronic or other medium. Factors that may indicate doubts about the reliability of a response include:

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

Keeping in view the circumstances described in the case situation, there is a risk that the response has not come from the originally intended confirming party.

Unreliable responses may indicate a fraud risk factor that requires evaluation.

CA Ram Harsha

SA 510 INTITIAL AUDIT ENGAGEMENTS - OPENING BALANCES

A. OBJECTIVE OF THE AUDITOR: 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:

1. Opening balances contain misstatements that materially affect the current period's financial statements; and
2. 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.

B. DEFINITIONS:

1. **INITIAL AUDIT ENGAGEMENT:** An engagement in which either:
    a. The financial statements for the prior period were not audited; or
    b. The financial statements for the prior period were audited by a predecessor auditor.

2. **OPENING BALANCES:** Those account balances that exist at the beginning of the period.
    a. Opening balances are based upon the closing balances of the prior period and reflect the effects of transactions and events of prior periods and accounting policies applied in the prior period.
    b. Opening balances also include matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments.

3. **PREDECESSOR AUDITOR:** Predecessor auditor means the auditor from a different audit firm, who audited the financial statements of an entity in the prior period and who has been replaced by the current auditor.

C. AUDIT PROCEDURES FOR AUDIT OF OPENING BALANCES:

1. 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:
    d. Whether audit procedures performed in the current period provide evidence relevant to the opening balances; or
    e. Performing specific audit procedures to obtain evidence regarding the opening balances. (Opening Balance verification: Opening TB comparing with Previous year Approved Balance sheet)

CA Ram Harsha

2. 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.

D. CONSISTENCY OF ACCOUNTING POLICIES:

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.

E. AUDIT CONCLUSIONS AND REPORTING - OPENING BALANCES:

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

F. AUDIT CONCLUSIONS AND REPORTING - CONSISTENCY OF ACCOUNTING POLICIES:

1. If the auditor concludes that:
    a. The current period's accounting policies are not consistently applied in relation to opening balances in accordance with the applicable financial reporting framework; or
    b. Changes in accounting policies is not properly accounted for or not adequately presented or disclosed in accordance with the applicable financial reporting framework.
2. Then the auditor shall express a qualified opinion or an adverse opinion as appropriate in accordance with SA 705.

G. MODIFICATIONS IN THE PREDECESSOR AUDITOR'S REPORT:

If there exist a modification in the predecessor audit report and the modification is remain relevant and material for the current period under audit then the current auditor shall also modify the opinion in accordance with SA 705.

CA Rani Parsha

ILLUSTRATION 13.

CA M. Hussain is appointed auditor of a firm for year 2022-23 on 31st July, 2022. The accounts of firm were unaudited in year 2021-22. The firm had material inventories reflected in its financial statements even as on close of 31st March, 2022.
He is performing audit procedures, including attending physical inventory count as on 31st March, 2023. However, there is a lingering doubt in his mind regarding opening inventories reflected in financial statements.

Does there exist any responsibility on his part in such a situation?

ANSWER:

SA 510 states that in conducting an initial audit engagement, one of the objectives of the auditor with respect to opening balances is to obtain sufficient appropriate audit evidence about whether opening balances contain misstatements that materially affect the current period's financial statements. The auditor has to evaluate whether audit procedures performed in the current period provide evidence relevant to the opening balances or specific audit procedures are required to be performed to obtain evidence regarding the opening balances.

In the case of inventories, however, the current period's audit procedures on the closing inventory balance provide little audit evidence regarding inventory on hand at the beginning of the period.

Therefore, additional audit procedures may be necessary, and one or more of the following may provide sufficient appropriate audit evidence:

1. Observing a current physical inventory count and reconciling it to the opening inventory quantities.
2. Performing audit procedures on the valuation of the opening inventory items.
3. Performing audit procedures on gross profit and cut-off.

CA Ram Harsha

SA 530 AUDIT SAMPLING

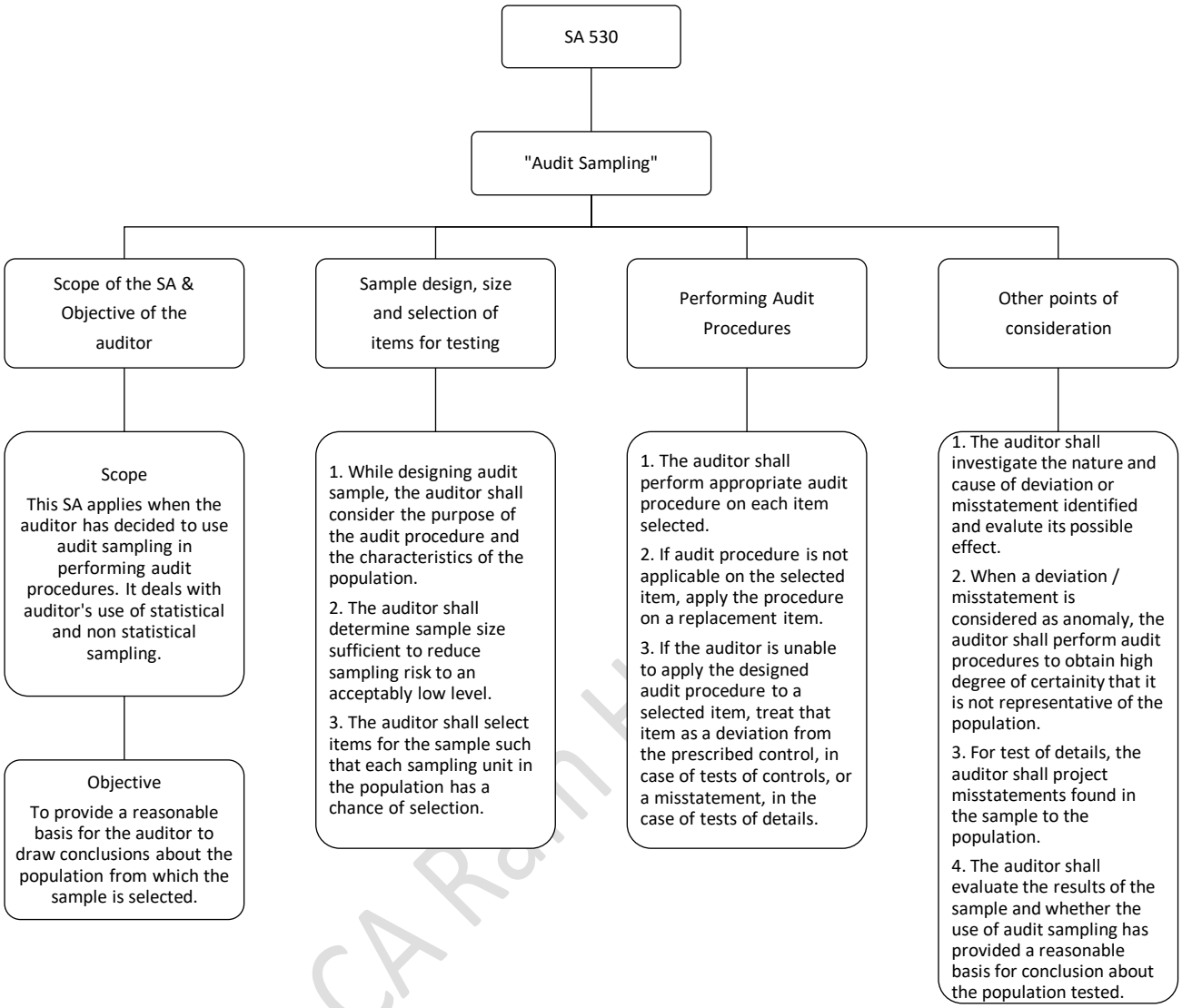

ILLUSTRATION 14.

CA. Ritesh Deshpande has drawn some samples during the course of audit of a manufacturing company for testing controls as well as for tests of details. On the basis of the samples selected, he reaches an erroneous conclusion that access controls on applications are less effective. Further, on the basis of samples selected, he concludes erroneously that work-in progress inventories amounting to Rs. 5 crore in financial statements are materially misstated. Outlining the above risk involved, discuss how it is going to affect his audit of the company.

ANSWER:

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

In the given case, the auditor has arrived at erroneous conclusions on the basis of the samples selected. In the case of a test of controls, he has concluded that access controls are less effective than they actually are. In the case of a test of details, he has concluded erroneously that a material misstatement exists when in fact, it does not.

This type of erroneous conclusion affects audit efficiency as it would usually lead to additional work to establish that initial conclusions were incorrect.

CA Ram Harsha

SA 550 RELATED PARTIES

Scope of the SA	Objectives of the auditor	Requirements of the SA	Identification of previously unidentified or undisclosed related part transactions.	Identified significant related party transactions outside the entity's normal course of business	Other important points
This SA deals with the auditor's responsibilities regarding related party relationships and transactions. It expands on how SA 315, SA 330, SA 240 are to be applied in relation to related party relationships and transactions.	To obtain an understanding of the related party transactions to: 1. recognize fraud risk factors arising from such transactions. 2. conclude whether financial statements in so far as they are affected by such transactions a) achieve a true and fair presentation. b) are not misleading. To obtain audit evidence as to whether the related party transactions are properly identified, accounted for, and disclosed in the financial statements.	1. Risk Assessment procedures and related activities. 2. Understanding the Entity's related party relationships and transactions. 3. Maintaining alertness for related party information when reviewing records or documents. 4. Sharing related party information with the Engagement team. 5. Identification and assessment of the risk of material misstatement associated with related party transactions and relationships. 6. Responses to the Risks of Material Misstatement associated with related party relationships and transactions.	1. Auditor shall determine whether the underlying circumstances confirm the existence of such transactions. 2. Communicate within the team. 3. Request managment to identify all transactions with newly identified related parties. 4. Perform more substantive procedures. 5. Reconsider risks with respect to other related parties. 5. If non disclosure by the management appears intentional, evaluate the implications for the audit.	1. Inspect the underlying contracts and evaluate: a) the business rationale of the transactions. b) whether the terms of transactions are consistent with managment's explanations. c) whether such transactions have been properly accounted for. 2. Obtain audit evidence that the transactions have been appropriately authorised and approved.	**The auditor shall obatin Written Representation that:** a) all the related parties and related party transactions have been disclosed to the auditor and b) all such transactions have been properly accounted for and disclosed. **Communication with TCWG** The auditor shall communicate with TCWG significant matters arising during the audit in connection with the entity's related parties. **Documentation:** The auditor shall include in audit documentation names of the related parties and the nature of the related party transactions.

ILLUSTRATION 15.

"Living Well Private Limited" is engaged in the manufacturing and export of floor coverings. Such products are labour-intensive and do not require much of capital investment in machinery. The company has no plans to diversify in other product lines. Its directors are also holding significant interest in another company "My Living Private Limited" engaged in manufacturing of blankets using capital intensive machinery.

During the course of the audit of "My Living Private Limited", it was noticed by you that the company has sold machinery of Rs.1 crore to "Living Well Private Limited" during the year. The transaction has been done at normal market rates applicable to such used machinery. How do you view the above transaction as auditor of "My Living Private Limited"?

ANSWER:

In respect of significantly related party transactions outside the normal course of business of an entity, it is the responsibility of the auditor, in accordance with SA 550, to evaluate the business rationale or lack thereof of transactions that may have been entered to indulge in fraudulent financial reporting or conceal misappropriation of assets.

The auditor has to seek to understand the business rationale of such a transaction from a related party's perspective. It would help him understand the economic reality of such a transaction and why it was carried out.

In the given situation, there is no primary rationale for such a transaction. Living Well Private Limited does not manufacture blankets, and the purchase of part of old machinery pertaining to blanket manufacturing has no rationale for it primarily.

A business rationale from the related party's perspective that appears inconsistent with the nature of its business may represent a fraud risk factor.

CA Ram Harsha

TEST YOUR KNOWLEDGE

Q.NO.1. Coccyx Ltd. supplies navy uniforms across the country. The company has 3 warehouses at different locations throughout the India and 5 warehouses at the borders. The major stocks are generally supplied from the borders. Coccyx Ltd. appointed M/s OPAQE & Co. to conduct its audit for the financial year 2022-23. Mr. P, partner of M/s OPAQE & Co., attended all the physical inventory counting conducted throughout the India but could not attend the same at borders due to some unavoidable reason.

You are required to advise M/s OPAQE & Co.,

i. **How sufficient appropriate audit evidence regarding the existence and condition of inventory may be obtained?**
ii. **How is an auditor supposed to deal when attendance at physical inventory counting is impracticable?**

ANSWER:

I. **Special Consideration with Regard to Inventory:** As per SA 501 "Audit Evidence- Specific Considerations for Selected Items", when inventory is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by:
   1. Attendance at physical inventory counting, unless impracticable, to:
      i. Evaluate management's instructions and procedures for recording and controlling the results of the entity's physical inventory counting
      ii. Observe the performance of management's count procedures
      iii. Inspect the inventory and
      iv. Perform test counts and
   2. Performing audit procedures over the entity's final inventory records to determine whether they accurately reflect actual inventory count results.

II. **Attendance at Physical Inventory Counting Not Practicable:** 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 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", 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.

Further, 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.

CA Ram Harsha

In some cases, though, 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 on Modifications to the Opinion in the Independent Auditor's Report, requires the auditor to modify the opinion in the auditor's report as a result of the scope limitation.

Q.NO.2. GHK Associates, Chartered Accountants, conducting the audit of PBS Ltd., a listed company for the year ended 31.03.2023 is concerned with the presentation and disclosure of segment information included in Company's Annual Report. GHK Associates want to ensure that methods adopted by management for determining segment information have resulted in disclosure in accordance with the applicable financial reporting framework. Guide GHK Associates with 'Examples of Matters' that may be relevant when obtaining an understanding of the methods used by the management with reference to the relevant Standards on Auditing.

ANSWER:

The auditors, GHK Associates wanted to ensure and obtain sufficient appropriate audit evidence regarding the presentation and disclosure of segment information in accordance with the applicable financial reporting framework by obtaining an understanding of the methods used by management in determining segment information.

SA 501 guides in this regard. As per SA 501- "Audit Evidence—Specific Considerations for Selected Items", example of matters that may be relevant when obtaining an understanding of the methods used by management in determining segment information and whether such methods are likely to result in disclosure in accordance with the applicable financial reporting framework include:

1. Sales, transfers and charges between segments, and elimination of inter-segment amounts.

2. Comparisons with budgets and other expected results, for example, operating profits as a percentage of sales.

3. The allocation of assets and costs among segments.

4. Consistency with prior periods, and the adequacy of the disclosures with respect to inconsistencies.

Q.NO.3. Chintamani Ltd appoints Chintan & Mani as statutory auditors for the financial year 2022-2023. Chintan & Mani seem to have different opinions on Audit approach to be adopted for audit of Chintamani Ltd. Mani is of the opinion that 100% checking is not required and they can rely on Audit Sampling techniques in order to provide them a reasonable basis on which they can draw

CA Ram Harsha

conclusions about the entire population.
Chintan is concerned that whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested.
You are required to guide Chintan about his role if audit sampling has not provided a reasonable basis for conclusions about the population that has been tested in accordance with SA 530.

ANSWER:

As per SA 530, "Audit Sampling", the auditor shall evaluate:

a. The results of the sample and
b. Whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested.

If the auditor concludes that audit sampling has not provided a reasonable basis for conclusions about the population that has been tested, the auditor may:

i. Request management to investigate misstatements that have been identified and the potential for further misstatements and to make any necessary adjustments; or
ii. Tailor the nature, timing and extent of those further audit procedures to best achieve the required assurance.
   For example, in the case of tests of controls, the auditor might extend the sample size, test an alternative control or modify related substantive procedures.

Q.NO.4. During the audit of Star Ltd. a company engaged in the production of paper, the auditor received certain confirmation for the balances of trade payables outstanding in the balance sheet through external confirmation by "Negative Confirmation Request". In the list of trade payables, there are number of small balances except one which is an old outstanding of
Rs. 20 lakhs for which no confirmation was received. Comment with respect to Standards of Auditing relating to the confirmation process and how to deal the non-receipt of confirmation.

ANSWER:

As per SA 505, "External Confirmation", negative confirmation is a request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request. Negative confirmations provide less persuasive audit evidence than positive confirmations.

The failure to receive a response to a negative confirmation request does not explicitly indicate receipt by the intended confirming party of the confirmation request or verification of the accuracy of the information contained in the request.
Accordingly, a failure of a confirming party to respond to a negative confirmation request provides significantly less persuasive audit evidence than does a response to a positive confirmation request.

CA Ram Harsha

Confirming parties also may be more likely to respond indicating their disagreement with a confirmation request when the information in the request is not in their favour, and less likely to respond otherwise.

In the instant case, the auditor sent the negative confirmation requesting the trade payables having outstanding balances in the balance sheet while doing audit of Star Limited.

One of the old outstanding of Rs. 20 lakh has not sent the confirmation on the credit balance. In case of non-response, the auditor may examine subsequent cash disbursements or correspondence from third parties, and other records, such as goods received notes.

Further non-response for negative confirmation request does not means that there is some misstatement as negative confirmation request itself is to respond to the auditor only if the confirming party disagrees with the information provided in the request.

CA Ram Harsha

SA 560 SUBSEQUENT EVENTS

A. OBJECTIVES:

The objectives of the auditor are to:

1. 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 in the financial statements are appropriately reflected in those financial statements; and
2. Respond appropriately to facts that become known to the auditor after the date of the auditor's report that may have caused the auditor to amend the auditor's report

B. DEFINITIONS:

1. **SUBSEQUENT EVENTS**: the events occurring between the date of the financial statements and the date of the auditor's report, and facts that become known to the auditor after the date of the auditor's report.

2. **DATE OF THE FINANCIAL STATEMENTS:** The date of the end of the latest period covered by the financial statements.

3. **DATE OF APPROVAL OF THE FINANCIAL STATEMENTS:** The date on which all the statements that comprise the financial statements, including the related notes, have been prepared and those with the recognised authority have asserted that they have taken responsibility for those financial statements.

4. **DATE OF THE AUDITOR'S REPORT:** The date the auditor dates the report on the financial statements in accordance with SA 700.

5. **DATE THE FINANCIAL STATEMENTS ARE ISSUED**: The date that the auditor's report and audited financial statements are made available to third parties.

C. AUDIT PROCEDURE FOR IDENTIFICATION OF SUBSEQUENT EVENTS:

1. The auditor shall perform the procedures to identify subsequent events which shall include the following:
2. Obtaining an understanding of any management procedures established to ensure that subsequent events are identified.
3. Inquiring of management and those charged with governance as to whether any subsequent events have occurred. Specifically, the auditor shall evaluate the following:
    a. Whether new commitments, borrowings or guarantees have been entered into.
    b. Whether sales or acquisitions of assets have occurred or are planned.
    c. Whether any assets have been appropriated by government or destroyed, for example, by fire or flood

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d. Whether there have been any developments regarding contingencies.
e. Whether any unusual accounting adjustments have been made or are Contemplated
f. Whether any events have occurred or are likely to occur which will bring into question the appropriateness of accounting policies used in the financial statements as would be the case, for example, if such events call into question the validity of the going concern assumption.

4. Reading minutes 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.
5. Reading the entity's latest subsequent interim financial statements, if any.

CASE – I – FACTS WHICH BECOME KNOWN TO THE AUDITOR AFTER THE DATE OF THE AUDITOR'S REPORT BUT BEFORE THE DATE THE FINANCIAL STATEMENTS ARE ISSUED:

1. Generally, the auditor has no obligation to perform any audit procedures regarding the financial statements after the date of the auditor's report.
2. However, when, after the date of the auditor's report but before the date the financial statements are issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report, the auditor shall:
    a. Discuss the matter with management and those charged with governance.
    b. Determine whether the financial statements need amendment and, if so,
    c. Inquire how management intends to address the matter in the financial statements.
    d. **IF MANAGEMENT AMENDS THE FINANCIAL STATEMENTS**: the auditor shall:
        i. Carry out the audit procedures necessary in the circumstances on the amendment.
        ii. Obtain sufficient and appropriate evidence regarding the amendment such subsequent events.
    e. **IF MANAGEMENT DOES NOT AMEND THE FINANCIAL STATEMENTS:**
        i. Where the auditor concludes that the financial statements are not amended and If the auditor's report has not yet been provided to the entity, the auditor shall modify the opinion as required by SA 705 and then provide the auditor's report; or
        ii. If the auditor's report has already been provided to the entity, the auditor shall notify management and those charged with governance not to issue the financial statements to third parties before the necessary amendments have been made.
        iii. If the financial statements are nevertheless subsequently issued without the necessary amendments, the auditor shall take appropriate action, to seek to prevent reliance on the auditor's report.

CASE – II – FACTS WHICH BECOME KNOWN TO THE AUDITOR AFTER THE FINANCIAL STATEMENTS HAVE BEEN ISSUED:

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1. After the financial statements have been issued, the auditor has no obligation to perform any audit procedures regarding such financial statements.
2. However, when, after the financial statements have been issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report, the auditor shall:
    - **a.** Discuss the matter with management and, where appropriate, those charged with governance.
    - **b.** Determine whether the financial statements need amendment and, if so,
    - **c.** Inquire how management intends to address the matter in the financial statements.
        - i. **IF THE MANAGEMENT AMENDS THE FINANCIAL STATEMENTS:** The auditor shall:
            1. Carry out the audit procedures necessary in the circumstances on the amendment.
            2. Review the steps taken by management to ensure that anyone in receipt of the previously issued financial statements together with the auditor's report thereon is informed of the situation.
            3. Provide a new auditor's report on the amended financial statements. The report shall include an emphasis of matter or other matter paragraph describing the effect of amendment of financial statements on the earlier issued F/S and earlier issued audit report.

        - ii. **IF MANAGEMENT DOES NOT TAKE NECESSARY STEPS:**
          The auditor shall take appropriate action to seek prevent reliance on the audit report and financial statements that are already issued to third parties.

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ILLUSTRATION 16.

"Move Fast Limited" is engaged in the manufacturing of shoes and slippers located in Bahadurgarh in Haryana. Due to unprecedented rains in the area in the month of September 2022, many areas of the town got inundated due to the choking of sewer systems. As a result of the above, the company's premises located in town were also affected, resulting in damage of stocks.
The company has lodged a claim with the insurance company for Rs.1 crore, and the same is shown as a claim receivable as of 31st March 2023, as the claim was not settled at year end.
The insurance surveyor appointed in the case submitted a report to the insurance company recommending a claim of Rs.45 lacs in the month of April 2023. The company has also given its consent for the same, and the settled amount of Rs.45 lacs was transferred to the bank account of the company on 15th May 2023.
You have just finished performing substantive procedures of the company by the end of May 2023.
Is there any responsibility cast upon you as auditor of the company in the above situation?

ANSWER:

The given situation provides evidence of conditions that existed at the date of financial statements. Initially, the company had lodged claim of Rs.1 crore and the same is reflected as claim receivable in financial statements as on 31st March, 2023.

However, subsequent events occurring have provided evidence that claim was settled for Rs. 45 lacs only. Such settled amount has already been accepted by the company by providing its consent. Therefore, such events have provided fresh information about items included in financial statements.

Further, performance of substantive procedures has been finished implying that audit report is not yet issued.

Therefore, financial statements as on 31st March, 2023 should be adjusted to reflect fresh information emanating from described events and management should be asked to take appropriate action in this regard so that adjustment pertaining to above is properly reflected in financial statements in accordance with applicable financial reporting framework.

ILLUSTRATION 17.

CA Anuj is the auditor of a listed company, and he is in the midst of conducting an audit of the said company for the financial year ending 31St March 2023. At a meeting of the Board of Directors held on 17th April 2023, a dividend of Rs.1 crore is proposed to equity shareholders @ Rs.10/- per share, and such a proposal has a good chance of being approved in the AGM of the company to be held after few months. His audit procedures are near completion.

He is contemplating finalizing the audit report by 31st July 2023. Is there any responsibility thrust upon him as auditor of the company?

ANSWER:

In the given situation, dividend has been proposed by Board of Directors on 17th April, 2023. It is an example of condition that arose after the reporting period. No liability exists for the company on reporting date because there is no obligation to pay at the reporting date in accordance with Ind AS 1.

Therefore, above situation does not require recognition of above proposed dividend in financial statements.

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It is an example of events which does not require adjustments. However, it should be disclosed in financial statements in notes to accounts. Therefore, it should be ensured that it is disclosed in notes to accounts in financial statements.

He should verify in accordance with SA 560 that it is so disclosed in notes to accounts.

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SA 580 WRITTEN REPRESENTATION

A. DEFINITION OF WRITTEN REPRESENTATION: A written statement by provided by management to the auditor to confirm certain matters or to support other audit evidence. Written representations in this context do not include financial statements, the assertions therein, or supporting books and records.

B. WRITTEN REPRESENTATIONS AS AUDIT EVIDENCE:

1. Written representations are necessary information that the auditor requires in connection with the audit of the entity's financial statements. Accordingly, similar to responses to inquiries, written representations are audit evidence.
2. Although written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own.

C. OBJECTIVES: The objectives of the auditor are:

1. To obtain written representations from management that they believe that they have **fulfilled** their responsibility for the preparation of the financial statements and for the **completeness** of the information provided to the auditor.
2. To support other audit evidence relevant to the financial statements or specific assertions in the financial statements by means of written representations, if determined necessary by the auditor or required by other SAs and
3. To respond appropriately to written representations provided by management.

D. DATE OF AND PERIOD COVERED BY WRITTEN REPRESENTATIONS:

1. The date shall be as near as practicable to, but not later than the date of the auditor's report on the financial statements.
2. The written representations shall be for all financial statements and period referred to in the auditor's report.

E. WRITTEN REPRESENTATION FROM WHOM:

1. The auditor shall request written representations from management with appropriate responsibilities for the financial statements and knowledge of the matters concerned.
2. Written representations are requested from those responsible for the preparation and presentation of the financial statements. Those individuals may vary depending on the governance structure of the entity, and relevant law or regulation. However, management (rather than those charged with governance) is often the responsible party.
3. Written representations may therefore be requested from the entity's chief executive officer and chief financial officer, or other equivalent persons in entities that do not use such titles.
4. In some circumstances, however, other parties, such as those charged with governance, are also responsible for the preparation and presentation of the financial statements. [E.g., Accountants under the direction of Audit Committee]
5. Due to its responsibility for the preparation and presentation of the financial statements, and its responsibilities for the conduct of the entity's business, management would be

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expected to have sufficient knowledge of the process followed by the entity in preparing and presenting the financial statements and the assertions therein on which to base the written representations.

6. In some cases, however, management may decide to make inquiries of others who participate in preparing and presenting the financial statements and assertions therein, including individuals who have specialized knowledge relating to the matters about which written representations are requested. Such individuals may include:
    a. An actuary responsible for actuarially determined accounting measurements.
    b. Staff engineers who may have responsibility for and specialized knowledge about environmental liability measurements.
    c. Internal counsel who may provide information essential to provisions for legal claims.
7. **QUALIFYING LANGUAGE:** In some cases, management may include in the written representations qualifying language to the effect that representations are made to the **best of its knowledge and belief**. It is reasonable for the auditor to accept such wording if the auditor is satisfied that the representations are being made by those with appropriate responsibilities and knowledge of the matters included in the representations.

F. DOUBT AS TO THE RELIABILITY OF WRITTEN REPRESENTATIONS:

1. If the auditor has concerns about the competence, integrity of management, the auditor shall determine the effect that may have on the reliability of representations and audit evidence in general.
2. In particular, if written representations are inconsistent with other audit evidence, the auditor shall perform audit procedures to attempt to resolve the matter.
3. If the auditor concludes that the written representations are not reliable, the auditor shall take appropriate actions, including determining the possible effect on the opinion in the auditor's report in accordance with SA 705. (Usually expresses a disclaimer of opinion)

G. WRITTEN REPRESENTATIONS NOT PROVIDED: If management does not provide one or more of the requested written representations, the auditor shall:

1. Discuss the matter with management;
2. Re-evaluate the integrity of management and evaluate the effect that may have on the reliability of representations; and
3. Take appropriate actions in accordance with SA 705. (Expresses a disclaimer of opinion)

ILLUSTRATION 18.

Following is a written representation given by RES Limited to its statutory auditors i.e., M/s CTK & Associates for audit of financial year 2022-23. The audit was completed and report dated 31.7.23 was issued.
Point out, if there is any, anomaly in written representation reproduced below. 15th April, 2023 To

CA Ram Harsha

CTK & Associates

Chartered Accountants

Dear Sir,

This representation letter is provided in connection with your audit of the financial statements of RES Limited for the year ended March 31, 2023 for the purpose of expressing an opinion as to whether the financial statements give a true and fair view in accordance with the applicable accounting standards in India.

We confirm that (to the best of our knowledge and belief, having made such inquiries as we considered necessary for the purpose of appropriately informing ourselves):

Financial Statements

- **We have fulfilled our responsibilities, as set out in the terms of the audit engagement dated 17th August 2022 for the preparation of the financial statements in accordance with financial reporting Standards, in particular, the financial statements give a true and fair view in accordance with the applicable accounting standards in India.**
- **Significant assumptions used by us in making accounting estimates, including those measured at fair value, are reasonable.**
- **Related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the requirements of applicable accounting standards in India. (SA 550)**
- **All events subsequent to the date of the financial statements and for which applicable accounting standards in India require adjustment or disclosure have been adjusted or disclosed. (SA 560)**
- **The effects of uncorrected misstatements are immaterial, both individually and in the aggregate, to the financial statements as a whole. A list of the uncorrected misstatements is attached to the representation letter. (SA 450)**

Information provided

- **We have provided you with: -**
  - **Access to all information of which we are aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;**
  - **Additional information that you have requested from us for the purpose of the audit; and**
  - **Unrestricted access to persons within the entity from whom you determined it necessary to obtain audit evidence.**
- **All transactions have been recorded in the accounting records and are reflected in the financial statements.**
- **We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.**
- **We have disclosed to you all information in relation to fraud or suspected fraud that we are aware of and that affects the entity and involves: -**
  - **Management;**
  - **Employees who have significant roles in internal control; or**
  - **Others where the fraud could have a material effect on the financial statements.**
- **We have disclosed to you all information in relation to allegations of fraud, or suspected**

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fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators or others.

- **We have disclosed to you all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing financial statements.**
- **We have disclosed to you the identity of the entity's related parties and all the related party relationships and transactions of which we are aware. (SA 550) Chief Financial Officer**

ANSWER:

The date of the written representations shall be as near as practicable to, but not after, the date of the auditor's report on the financial statements. As the auditor is concerned with events occurring up to the date of the auditor's report that may require adjustment to or disclosure in the financial statements.

In the given situation, written representation is dated 15th April 2023. The audit report is dated 31st July 2023. There is a considerable lag between date of written representations and date of audit report.

It could signify that all subsequent events after date of financial statements requiring adjustments or disclosure may not have been adjusted or disclosed in the financial statements by management.

As audit report is dated 31St July, 2023, it reflects that auditor has considered subsequent events occurring between date of financial statements and date of auditor's report. However, written representations pertain to 15th April 2023.

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TEST YOUR KNOWLEDGE

Q.NO.1. Ramadhan & Co., are the Auditors of XYZ Company Ltd., for the year ended on 31/03/2023. The Audit Report for that year was signed by the Auditors on 04/05/2023. The Annual General Meeting was decided to be held during the month of August 2023. On 06/05/2023, the Company had received a communication from the Central Government that an amount of Rs. 5800 crore kept pending on account of incentives pertaining to Financial Year 2022-23 had been approved and the amount would be paid to the Company before the end of May 2023. To a query to Chief Financial officer of the Company by the Board, it was informed that this amount had not been recognised in the Audited Financial Statements in view of the same not being released before the close of the Financial Year and due to uncertainty of receipt. Now, having received the amount, the Board of Directors wished to include this amount in the Financial Statements of the Company for the Financial Year ended on 31/03/2023. On 08/05/2023, the Board amended the accounts, approved the same and requested the Auditor to consider this event and issue a fresh Audit Report on the Financial Statements for the year ended on 31/03/2023. Analyse the issues involved and give your views as to whether or not the Auditors could accede to the request of the Board of Directors.

ANSWER:

Facts Which Become Known to the Auditor After the Date of the Auditor's Report but Before the Date the Financial Statements are Issued: As per SA 560, "Subsequent Events", the auditor has no obligation to perform any audit procedures regarding the financial statements after the date of the auditor's report. However, when, after the date of the auditor's report but before the date the financial statements are issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report, the auditor shall

i. Discuss the matter with management and, where appropriate, those charged with governance.
ii. Determine whether the financial statements need amendment and, if so,
iii. Inquire how management intends to address the matter in the financial statements.

If management amends the financial statements, the auditor shall carry out the audit procedures necessary in the circumstances on the amendment. Further, the auditor shall extend the audit procedures and provide a new auditor's report on the amended financial statements. However, the new auditor's report shall not be dated earlier than the date of approval of the amended financial statements.

In the instant case, XYZ Company Ltd. received an amount of rupees 5800 crore on account of incentives pertaining to year 2022-23 in the month of May 2023 i.e., after finalisation of financial statements and signing of audit report. Board of Directors of XYZ Ltd. amended the accounts, approved the same and requested the Ramadhan & Co. (auditor) to consider this event and issue a fresh audit report on the financial statements for the year ended on 31.03.2023.

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After applying the conditions given in SA 560, Ramadhan & Co. can issue new audit report subject to date of audit report which should not be earlier than the date of approval of the amended financial statements.

Q.NO.2. PRSH & Co is the statutory auditor of Make My Journey Ltd. The company is in the business of tours and travels. Annual turnover of the company is INR 2000 crores and profits are INR 190 crores. During the planning meeting of the management and the auditors, it was discussed that the management needs to provide written representation letter to the auditors for the preparation of the financial statements and for the completeness of the information provided to the auditor. At the time of closure of the audit, there has been some confusion about the requirements of the written representation letter. Management argued that representation need not be written, it can also be verbal which has been provided to the audit team during the course of their audit. Auditors have completed their documentation and hence in a way, representation based on verbal discussions with the auditors has also got documented. Auditors explained that this is mandatory to obtain written representation in accordance with the requirements of SA 580. However, still some confusion remains regarding the date and period covered by the written representation. You are required to advise about the date of and period covered by written representation in view of SA 580.

ANSWER:

As per SA 580, "Written Representations", as written representations are necessary audit evidence, the auditor's opinion cannot be expressed, and the auditor's report cannot be dated, before the date of the written representations.

Furthermore, because the auditor is concerned with events occurring up to the date of the auditor's report that may require adjustment to or disclosure in the financial statements, the written representations are dated as near as practicable to, but not after, the date of the auditor's report on the financial statements.
In some circumstances it may be appropriate for the auditor to obtain a written representation about a specific assertion in the financial statements during the course of the audit. Where this is the case, it may be necessary to request an updated written representation.

The written representations are for all periods referred to in the auditor's report because management needs to reaffirm that the written representations it previously made with respect to the prior periods remain appropriate. The auditor and management may agree to a form of written representation that updates written representations relating to the prior periods by addressing whether there are any changes to such written representations and, if so, what they are.

Situations may arise where current management were not present during all periods referred to in the auditor's report. Such persons may assert that they are not in a position to provide some or all of the written representations because they were not in place during the period. This fact, however,

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does not diminish such persons' responsibilities for the financial statements as a whole. Accordingly, the requirement for the auditor to request from them written representations that cover the whole of the relevant period(s) still applies.

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SA 320 MATERIALITY IN PLANNING AND PERFORMANCE OF AN AUDIT

Q.NO.1 WRITE ABOUT THE CONCEPT OF MATERIALITY?

ANSWER:

1. Financial statements should disclose all 'material items, i.e., the items the knowledge of which might influence the decisions of the user of the financial statement.

2. Materiality is not always a matter of relative size.
   For example, a small amount lost by fraudulent practices of certain employees can indicate a serious flaw in the enterprise's internal control system requiring immediate attention to avoid greater losses in future.

3. In certain cases, quantitative limits of materiality is specified. A few of such cases are given below:
   a. A company should disclose by way of notes additional information regarding any item of income or expenditure which exceeds 1% of the revenue from operations or Rs.1,00,000 whichever is higher (Schedule III to the Companies Act, 2013).
   b. A company should disclose in Notes to Accounts, shares in the company held by each shareholder holding more than 5 % shares specifying the number of shares held.

4. Standard on Auditing (SA) -320 on "Materiality in Planning and Performing an Audit" deals with the auditor's responsibility to apply the concept of materiality in planning and performing an audit of financial statements. SA 450 explains how materiality is applied in evaluating the effect of identified misstatements on the audit and of uncorrected misstatements on the financial statements.

5. **MATERIALITY IF FRFW DO NOT CONTAIN ANY REFERENCE THERETO:** Financial reporting frameworks often discuss the concept of materiality in the context of the preparation and presentation of financial statements. Although financial reporting frameworks may discuss materiality in different terms, they generally explain that:
   a. Misstatements are material if expected to influence the economic decisions of users taken on the basis of the financial statements.
   b. Judgments about materiality are affected by the size or nature of a misstatement or combination of both.
   c. Judgments about matters that are material are based on a consideration of the common financial information needs of users as a group. The possible effect of misstatements on specific individual users, whose needs may vary widely, is not considered.

   If the applicable financial reporting framework does not include a discussion of the concept of materiality, the characteristics referred above provide the auditor with such a frame of reference.

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Q.NO.2 DETERMINATION OF MATERIALITY IS A MATTER OF PROFESSIONAL JUDGMENT OF AUDITOR. COMMENT.

ANSWER:

The auditor's determination of materiality is a matter of professional judgment, and is affected by the auditor's perception of the financial information needs of users of the financial statements. In this context, it is reasonable for the auditor to assume that users:

1. Have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information in the financial statements with reasonable diligence.
2. Understand that financial statements are prepared, presented and audited to levels of materiality.
3. Recognize the uncertainties inherent in the measurement of amounts based on the use of estimates, judgment and the consideration of future events and
4. Make reasonable economic decisions on the basis of the information in the financial statements.

Q.NO.3 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. COMMENT.

ANSWER:

1. Materiality is an important consideration for an auditor to evaluate whether the financial statements reflect a true and fair view or not.
2. SA 320 on "Materiality in Planning and Performing an Audit" requires that an auditor should consider materiality and its relationship with audit risk while conducting an audit.
3. When planning the audit, the auditor considers what would make the financial information materially misstated.
4. The auditor's preliminary assessment of materiality related to specific account balances and classes of transactions helps the auditor decide such questions as what items to examine and whether to use sampling and analytical procedures.
5. This enables the auditor to select audit procedures that, in combination, can be expected to support the audit opinion at an acceptably low degree of audit risk.
6. It may be noted that the auditor's assessment of materiality and audit risk may be different at the time of initially planning of the audit as against at the time of evaluating the results of audit procedures.

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7. At the planning stage, the auditor needs to consider the materiality for the financial statements as a whole. The auditor has to carry out a preliminary identification of significant components and material classes of transactions, account balances and disclosure which he plans to examine.
8. What could be considered material for all situations cannot be defined precisely and an amount or transaction material in one situation may not be material in other situation.
9. For example, Rs. 5,000 may be material for a small entity, but even Rs. 100,000 may not be material for a large entity.
10. The auditor has to apply his professional judgement in determining materiality, choosing appropriate benchmark and determining level of benchmark.
11. Materiality forms the basis for determination of audit scope and the levels of testing the transactions.
12. If there is any statutory requirement of disclosure, it is to be considered material irrespective of the value of amount.

Example:
As per new Division I schedule III of Companies Act, 2013, any item of income or expenditure which exceeds one percent of the revenue from operations or Rs. 1,00,000, whichever is higher, needs to be disclosed separately.

Q.NO.4 WRITE ABOUT PERFORMANCE MATERIALITY?

ANSWER:

1. When establishing the overall audit strategy, the auditor shall determine materiality for the financial statements as a whole.
2. If, in the specific circumstances of the entity, there is one or more particular classes of transactions, account balances or disclosures for which misstatements of lesser amounts than the materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements, the auditor shall also determine the materiality level or levels to be applied to those particular classes of transactions, account balances or disclosures.

3. **PERFORMANCE MATERIALITY:** Performance materiality means the amount or amounts set by the auditor at less than materiality for the financial statements as a whole to *reduce to an appropriately low level* the probability that the aggregate of uncorrected and undetected misstatements *exceeds materiality for the financial statements as a whole*.
   If applicable, performance materiality also refers to the amount or amounts set by the auditor at less than the materiality level or levels for particular classes of transactions, account balances or disclosures.

Q.NO.5 WRITE ABOUT USE OF BENCHMARKS IN DETERMINING MATERIALITY FOR THE FINANCIAL STATEMENTS AS A WHOLE?

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ANSWER:

Determining materiality involves the exercise of professional judgment. A percentage is often applied to a chosen benchmark as a starting point in determining materiality for the financial statements as a whole.

Factors that may affect the identification of an appropriate benchmark include the following:

1. The elements of the financial statements.
   Example: Assets, liabilities, equity, revenue, expenses;

2. Whether there are items on which the attention of the users of the particular entity's financial statements tends to be focused
   Example: For the purpose of evaluating financial performance users may tend to focus on profit, revenue or net assets

3. The nature of the entity, where the entity is at in its life cycle, and the industry and economic environment in which the entity operates

4. The entity's ownership structure and the way it is financed
   Example: If an entity is financed solely by debt rather than equity, users may put more emphasis on assets, and claims on them, than on the entity's earnings;

5. The relative volatility of the benchmark.
   Example: Profit before tax from continuing operations is often used for profit-oriented entities. When profit before tax from continuing operations is volatile, other benchmarks may be more appropriate, such as gross profit or total revenues.

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Q.NO.6 WRITE ABOUT EXAMPLES OF BENCHMARKS THAT HELPS IN DETERMINGING MATERIALITY?

ANSWER:

Examples of benchmarks that may be appropriate, depending on the circumstances of the entity, include categories of reported income such as:

1. Profit before tax,
2. Total revenue,
3. Gross profit and total expenses,
4. Total equity or net asset value.

SELECTION OF CHOOSEN BENCHMARK: In relation to the chosen benchmark, relevant financial data ordinarily includes:

1. Prior periods' financial results and financial positions,
2. The period to-date financial results and financial position, and
3. Budgets or forecasts for the current period,

Adjusted for significant changes in the circumstances of the entity (for example, a significant business acquisition) and relevant changes of conditions in the industry or economic environment in which the entity operates.

EXAMPLE:

When, as a starting point, the materiality for the financial statements as a whole is determined for a particular entity based on a percentage of profit before tax from continuing operations, circumstances that give rise to an exceptional decrease or increase in such profit may lead the auditor to conclude that the materiality for the financial statements as a whole is more appropriately determined using a normalized profit before tax from continuing operations figure based on past results.

APPLY A PERCENTAGE ON CHOOSEN BENCHMARK: Determining a percentage to be applied to a chosen benchmark involves the exercise of professional judgment. There is a relationship between the percentage and the chosen benchmark, such that a percentage applied to profit before tax from continuing operations will normally be higher than a percentage applied to total revenue.

Q.NO.7 WRITE ABOUT MATERIALITY LEVEL OR LEVELS FOR PARTICULAR CLASSES OF TRANSACTIONS, ACCOUNT BALANCES OR DISCLOSURES?

ANSWER:

Factors that may indicate the existence of one or more particular classes of transactions, account balances or disclosures for which misstatements of lesser amounts than materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements include the following:

1. Whether law, regulations or the applicable financial reporting framework affect users' expectations regarding the measurement or disclosure of certain items.
   Example: Related party transactions, and the remuneration of management and those charged with governance.

2. The key disclosures in relation to the industry in which the entity operates.
   Example: Research and development costs for a pharmaceutical company.

3. Whether attention is focused on a particular aspect of the entity's business that is separately disclosed in the financial statements.
   Example: A newly acquired business.

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Q.NO.8 WRITE ABOUT REVISION AND DOCUMENTATION OF MATERIALITY?

ANSWER:

REVISION IN MATERIALITY LEVEL:

The overall materiality and performance materiality may need to be changed as the audit progresses in the following cases:

1. A change in circumstances that occurred during the audit.
2. Availability of additional information.
3. A change in actual financial results than the anticipated results at the beginning of the audit.
4. Increase in estimated risk than the original prediction resulting in revision of materiality level.
5. A change in auditor's knowledge of client's business and understanding of the same.

DOCUMENTATION OF MATERIALITY:

The auditor shall document the following:

1. Materiality for the financial statements as a whole (Overall materiality);
2. If applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures;
3. General Performance materiality; and
4. Any revision of the above.

EXAMPLE:

If during the audit it appears as though actual financial results are likely to be substantially different from the anticipated period end financial results that were used initially to determine materiality for the financial statements as a whole, the auditor revises that materiality.

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

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

A. SCOPE AND OBJECTIVE:

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

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

3. This quality control standard applies to all firms irrespective of their constitution.

4. Quality control policies and procedures should be documented and communicated to the firm's personnel. By communicating, the firm recognizes the importance of obtaining feedback on its quality control system from its personnel. Therefore, the firm encourages its personnel to communicate their views or concerns on quality control matters.

B. ELEMENTS OF SYSTEM OF QUALITY CONTROL: The firm's system of quality control should include policies and procedures addressing each of the following elements: -

1. Leadership responsibilities for quality within the firm
2. Ethical requirements
3. Acceptance and continuance of client relationships and specific engagements
4. Human resources
5. Engagement performance
6. Monitoring

C. LEADERSHIP RESPONSIBILITIES FOR QUALITY WITHIN THE FIRM:

1. SQC 1 requires firms to establish policies and procedures designed to promote an internal culture based on the recognition that quality is essential in performing engagements.

2. Such policies and procedures should require the firm's chief executive officer or the firm's managing partners to assume ultimate responsibility for the firm's system of quality control. The example set by firm's leadership encourages an inner culture that recognizes high quality audit work.

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3. Further, persons assigned operational responsibilities for the firm's quality control system by the firm's chief executive officer or managing partners should have sufficient and appropriate experience, ability, and the necessary authority to assume that responsibility.

4. It has been laid down clearly that firm's business strategy is subject to the overriding requirement for the firm to achieve quality in all the engagements that the firm performs. Essentially, it implies that audit quality is paramount in all engagements. It is non-negotiable. In this regard, it should be ensured that:

    a. The firm assigns its management responsibilities so that commercial considerations do not override the quality of work performed.

    b. The firm's policies and procedures addressing performance evaluation, compensation, and promotion (including incentive systems) with regard to its personnel are designed to demonstrate the firm's overriding commitment to quality and

    c. The firm devotes sufficient resources for the development, documentation and support of its quality control policies and procedures.

ILLUSTRATION 19.

ABC & Associates, Chartered Accountants has a policy to accept the clients wherein the risk evaluation is conducted with respect to the Company and the promoter. XYZ Limited approached ABC & Associates. Promoter of XYZ Limited is a close associate and family friend of Mr. A, Managing Partner of ABC & Associates. XYZ Limited is in news in the previous year for certain inquiries from the regulatory authorities in relation to certain matters. The existing auditor of XYZ Limited has resigned and has created a casual vacancy. XYZ Limited is ready to offer 25% more than the existing fees and has approached ABC & Associates for appointment as Auditor. Mr. A has strong recommendation to the Firm to accept the audit.
What is your understanding of the functioning of the tone at the top of the Firm ABC & Associates, Chartered Accountants? What are the considerations one should exercise to uphold Firm?

ANSWER:

The given situation indicates that proposed client is a new one whose promoter is close associate and family friend of managing partner of M/s ABC & Associates. However, previous auditor of proposed client has resigned and company is offering hike in audit fees in comparison to audit fees paid to previous auditor.

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Besides, there are also regulatory inquires against the company. In spite of all this, managing partner of firm Mr. A has recommended for acceptance of offered audit of the company.

It reflects poorly regarding functioning at top of the firm as regards to quality control.

SQC 1 requires that firm should establish a system of quality control designed to provide it with reasonable assurance that firm and its personnel comply with professional standards and legal and regulatory requirements.

The managing partner of firm is close associate and family friend of promoter. The matter should have been brought to knowledge of firm in accordance with requirements of SQC 1 as it involves issue of independence of managing partner of the firm with respect to proposed audit engagement. Further, matters of inquiries from regulators and resignation of previous auditor raise question about integrity of the proposed client. SQC 1 further requires firm to consider before acceptance of an engagement that client does not lack integrity. All these factors need to be taken into consideration before accepting engagement.

Overall, such a situation reflects lack of proper establishment of quality control framework at top of the firm.

Following considerations should be taken into account while upholding quality of firm: -

1. The firm assigns its management responsibilities so that commercial considerations do not override quality of work performed
2. The firm's policies and procedures in relation to its personnel are designed to demonstrate its overriding commitment to quality.
3. The firm devotes sufficient resources for development and documentation of its quality control policies and procedures
4. A firm before accepting an engagement should acquire vital information about the client. Such an information should help firm to decide about integrity of Client, promoters and key managerial personnel, competence (including capabilities, time and resources) to perform engagement and compliance with ethical requirements.

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D. ETHICAL REQUIREMENTS:

1. The firm should establish policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with relevant ethical requirements contained in the Code of ethics issued by ICAI. The Code establishes the fundamental principles of professional ethics which include integrity, objectivity, professional competence and due care, confidentiality and professional behaviour. Fundamental principles should be emphasized by:
    a. Actions of the leadership of the firm

b. Spreading awareness and training

c. Monitoring

d. A process for dealing with non-compliance.

2. Observance of "Independence" in all engagements is the founding requirement. The firm should establish policies and procedures designed to provide it with reasonable assurance that the firm, its personnel and (including experts contracted by the firm and network firm personnel) maintain independence where required by the Code. Such policies and procedures should enable the firm to:
   a. Communicate its independence requirements to its personnel

   b. Identify and evaluate circumstances and relationships that create threats to independence, and to take appropriate action to eliminate those threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the engagement.

3. There should exist a mechanism in the firm by which engagement partners provide the firm with relevant information about client engagements and personnel of firm promptly notify firm of circumstances and relationships that create a threat to independence. All breaches of independence should be promptly notified to firm for appropriate action. Its objective is to ensure that independence requirements are satisfied.

4. At least annually, the firm should obtain written confirmation of compliance with its policies and procedures on independence from all firm personnel required to be independent in terms of the requirements of the Code.

5. SQC 1 lays special emphasis on familiarity threat. Using the same senior personnel on assurance engagements over a prolonged period may impair the quality of performance of the engagement. Therefore, the firm should establish criteria for determining the need for safeguards to address this threat. In determining appropriate criteria, the firm considers such matters as
   a. The nature of the engagement, including the extent to which it involves a matter of public interest and

   b. The length of service of the senior personnel on the engagement.

   c. Examples of safeguards include rotating the senior personnel or requiring an engagement quality control review.

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d. The familiarity threat is particularly relevant in the context of financial statement audits of listed entities. For these audits, the engagement partner should be rotated after a pre- defined period, normally **not more than 7 years** (except in cases where audit of listed entities is conducted by a sole practitioner). However, to ensure quality control exists in such firms and appropriate reports are issued, there is a process for mandatory peer review of such firms.

ILLUSTRATION 20.

MNP & Co., a firm of auditors, is appointed by a bank to conduct stock audit of a borrower. It deputes one of its paid Chartered accountant employees, Sudhanshu, to conduct above said stock audit. He leverages it as an opportunity to prevail upon the client to get the accounts audited from their firm. He also assures the client of a clean stock audit report without adverse comments as a quid pro quo. Is approach of Sudhanshu proper? How does it reflect upon quality control system of firm?

ANSWER:

Approach of Sudhanshu is not proper. Such practices blatantly violate code of ethics and its spirit. It reflects poorly upon quality control system of firm envisaged in SQC 1 which requires that quality control policies and procedures should be documented and communicated to the firm's personnel.

It shows that firm's personnel are not properly sensitized regarding requirements of SQC 1.

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E. ACCEPTANCE AND CONTINUANCE OF CLIENT RELATIONSHIPS AND SPECIFIC ENGAGEMENTS:

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

   a. Integrity of Client, promoters and key managerial personnel:

      i. The identity and business reputation of the client's principal owners, key management, related parties and those charged with its governance.

      ii. The nature of the client's operations, including its business practices.

      iii. Information concerning the attitude of the client's principal owners, key management and those charged with its governance towards such matters as aggressive interpretation of accounting standards and the internal control

environment.

iv. Whether the client is aggressively concerned with maintaining the firm's fees as low as possible.

v. Indications of an inappropriate limitation in the scope of work.

vi. Indications that the client might be involved in money laundering or other criminal activities.

vii. The reasons for the proposed appointment of the firm and non-reappointment of the previous firm.

The extent of knowledge a firm will have regarding the integrity of a client will generally grow within the context of an ongoing relationship with that client.

b. Competence (including capabilities, time and resources) to perform engagement:

i. Firm personnel have knowledge of relevant industries or subject matters;

ii. Firm personnel have experience with relevant regulatory or reporting requirements, or the ability to gain the necessary skills and knowledge effectively;

iii. The firm has sufficient personnel with the necessary capabilities and competence;

iv. Experts are available, if needed;

v. Individuals meeting the criteria and eligibility requirements to perform engagement quality control review are available, where applicable; and

vi. The firm would be able to complete the engagement within the reporting deadline.

c. Compliance with ethical requirements.

2. The firm should obtain such information as it considers necessary in the circumstances:
   a. Before accepting an engagement with a new client,

   b. When deciding whether to continue an existing engagement, and

   c. When considering acceptance of a new engagement with an existing client.

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3. If there is any conflict of interest between the firm and client, it should be properly resolved before accepting the engagement. Where the firm obtains information that would have caused it to decline an engagement if that information had been obtainable earlier, policies and procedures on the continuance of the engagement and the client relationship should include consideration of:
   a. The professional and legal responsibilities that apply to the circumstances, including whether there is a requirement for the firm to report to the person or persons who made the appointment or, in some cases, to regulatory authorities; and

   b. The possibility of withdrawing from the engagement or from both the engagement and the client relationship:

4. Policies and procedures on withdrawal from an engagement or from both the engagement and the client relationship address issues that include the following:

   a. Discussing with the appropriate level of the client's management and those charged with its governance regarding the appropriate action that the firm might take based on the relevant facts and circumstances.

   b. If the firm determines that it is appropriate to withdraw, discussing with the appropriate level of the client's management and those charged with its governance withdrawal from the engagement or from both the engagement and the client relationship, and the reasons for the withdrawal.

   c. Considering whether there is a professional, regulatory or legal requirement for the firm to remain in place, or for the firm to report the withdrawal from the engagement, or from both the engagement and the client relationship, together with the reasons for the withdrawal, to regulatory authorities.

   d. Documenting significant issues, consultations, conclusions and the basis for the conclusions.

ILLUSTRATION 21.

CA M is introduced to a prospective client in a social function. He assures to visit office of CA M very soon in relation to professional work. During discussions over a cup of coffee next week, it transpires that there was a search by Enforcement Directorate in his premises about a month back resulting in recovery of huge sum of cash. The income tax department had also searched his premises in relation to bogus capital gains on penny stocks. Lamenting poor quality of services provided by his present auditor, he offers appointment as tax auditor of his five family-

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owned firms to CA M in lieu of handsome fees. What are the factors to be evaluated by CA M if he wants to take up the engagement?

ANSWER:

As per SQC 1, before accepting a new engagement, integrity of client should be considered including matters that indicate involvement in money laundering or criminal activities. There has been search of ED on the said party leading to recovery of huge amount of cash. The above coupled with actions of income tax department relating to bogus capital gains on penny stocks indicates that client might be involved in money laundering activities.

Therefore, offer should not be accepted.

F. HUMAN RESOURCES:

1. The firm should establish policies and procedures designed to provide it with reasonable assurance that it has sufficient personnel with the capabilities, competence, and commitment to ethical principles necessary to perform its engagements in accordance with professional standards and regulatory and legal requirements and to enable the firm or engagement partners to issue reports that are appropriate in the circumstances.

2. Such policies and procedures should address relevant HR issues including:
    a. Recruitment,
    b. Compensation,
    c. Training,
    d. Career development,
    e. Performance evaluation etc.

    There should be emphasis on the continuing professional development of firm's personnel.

3. The firm should assign responsibility for each engagement to an engagement partner.

4. The firm should establish policies and procedures requiring that:
    a. The responsibilities of the engagement partner are clearly defined and communicated to that partner

    b. The identity and role of the engagement partner are communicated to key members of the client's management and those charged with governance.

    c. The engagement partner has the appropriate capabilities, competence, authority and time to perform the role and

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5. Each engagement team should be able to carry out its responsibilities with necessary competence and skill. Therefore, the firm should ensure suitable people are available and also groom them for their role.

6. The firm should assess performance of their partners and team members keeping in mind their commitment towards quality.

G. ENGAGEMENT PERFORMANCE:

1. Consistency in quality of engagement performance is achieved through briefing of engagement teams of their objectives, processes for complying with engagement standards, processes of engagement supervision and training, methods of reviewing performance of work, appropriate documentation of work performed.

2. **CONSULTATION IN DIFFICULT OR CONTENTIOUS MATTERS:** Consultation should take place in difficult or contentious matters pertaining to an engagement.

    a. **CONCEPT:** Consultation includes discussion, at the appropriate professional level, with individuals within or outside the firm who have specialized expertise, to resolve a difficult or contentious matter. It helps to promote quality and improves the application of professional judgment.

    b. **INTERNAL CONSULTATION:** Consultation procedures require consultation with those having appropriate knowledge, seniority and experience within the firm (or outside the firm) on significant technical, ethical and other matters and appropriate documentation and implementation of conclusions resulting from consultations.

    c. **EXTERNAL CONSULTATION:** A firm needing to consult externally, for example, a firm without appropriate internal resources, may take advantage of advisory services provided by other firms or professional and regulatory bodies.

    d. **DOCUMENTATION OF RESULTS:** Complete and proper documentation should be maintained on issues involved and results of consultation.

3. **ENGAGEMENT QUALITY CONTROL REVIEW [EQC]:**
    a. Significant judgments made in an engagement should be reviewed by an engagement quality control reviewer [EQCR] for taking an objective view BEFORE the report is issued.

    b. 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.

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c. Engagement quality control review is mandatory for all audits of financial statements of listed entities. In respect of other engagements, firm should devise criteria to determine cases requiring performance of engagement quality control review.

d. An engagement quality control review for audits of financial statements of listed entities includes considering the following:

i. The engagement team's evaluation of the firm's independence in relation to the specific engagement.

ii. Significant risks identified during the engagement and the responses to those risks.

iii. Judgments made, particularly with respect to materiality and significant risks.

iv. Whether appropriate consultation has taken place on matters involving differences of opinion or other difficult or contentious matters, and the conclusions arising from those consultations.

v. The significance and disposition of corrected and uncorrected misstatements identified during the engagement.

vi. The matters to be communicated to management and those charged with governance and, where applicable, other parties such as regulatory bodies.

vii. Whether working papers selected for review reflect the work performed in relation to the significant judgments and support the conclusions reached.

viii. The appropriateness of the report to be issued.

4. **EQCR:**

a. **Engagement quality control reviewer** is a partner, other person in the firm (who should be member of ICAI), suitably qualified external person, or a team made up of such individuals. In this regard, suitably qualified external person refers to an individual outside the firm with the capabilities and competence to act as an engagement partner, for example a partner or an employee (with appropriate experience) of another firm.

b. In addition, the engagement quality control reviewer for an audit of the financial statements of a listed entity is an individual with sufficient and appropriate experience and authority to act as an audit engagement partner on audits of financial statements of listed entities.

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c. It is necessary to maintain objectivity of such reviewer. Therefore, participation in engagement or making decisions for engagement team is to be avoided at all costs. However, engagement partner may consult engagement quality control reviewer during the engagement so as not to compromise his objectivity and eligibility to perform the role.

d. Where the nature and extent of the consultations become significant, however, care is taken by both the engagement team and the reviewer to maintain the reviewer's objectivity. Where this is not possible, another individual within the firm or a suitably qualified external person is appointed to take on the role of either the engagement quality control reviewer or the person to be consulted on the engagement.

e. The firm's policies should provide for the replacement of the engagement quality control reviewer where the ability to perform an objective review may be impaired.

f. **Differences of Opinion:**
   i. There might be difference of opinion within engagement team, with those consulted and between engagement partner and engagement quality control reviewer.

   ii. The report should only be issued after resolution of such differences.

   iii. In case, recommendations of engagement quality control reviewer are not accepted by engagement partner and matter is not resolved to reviewer's satisfaction, the matter should be resolved by following established procedures of firm like by consulting with another practitioner or firm, or a professional or regulatory body.

5. **ENGAGEMENT DOCUMENTATION:**
   a. The firm should establish policies and procedures for engagement teams to complete the assembly of final engagement files on a timely basis after the engagement reports have been finalized.

   b. Engagement files should be completed in not more than 60 days after date of auditor's report in case of audit engagements and in other cases within the limits appropriate to engagements.

   c. Where 2 or more different reports are issued in respect of the same subject matter information of an entity, the firm's policies and procedures relating to time limits for the assembly of final engagement files should be considered for each report as if it were for a separate engagement. This may, for example, be the case when the firm

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issues an auditor's report on a component's financial information for group consolidation purposes and, at a subsequent date, an auditor's report on the same financial information for statutory purposes.

d. Policies and procedures should be designed to maintain the confidentiality, safe custody, integrity, accessibility and retrievability of engagement documentation.

e. Care should be taken that policies and procedures on documentation of the engagement quality control review should require documentation that:

   i. The procedures required by the firm's policies on engagement quality control review have been performed.

   ii. The engagement quality control review has been completed before the report is issued and

   iii. The reviewer is not aware of any unresolved matters that would cause the reviewer to believe that the significant judgments the engagement team made and the conclusions they reached were not appropriate.

f. Unless otherwise specified by law or regulation, engagement documentation is the property of the firm. The firm may, at its discretion, make portions of, or extracts from, engagement documentation available to clients, provided such disclosure does not undermine the validity of the work performed, or, in the case of assurance engagements, the independence of the firm or its personnel.

g. Engagement documentation has to be retained for a period of time sufficient to permit those performing monitoring procedures to evaluate the firm's compliance with its system of quality control, or for a longer period if required by law or regulation.

h. In the specific case of audit engagements, the retention period ordinarily is no shorter than 7 years from the date of the auditor's report, or, if later, the date of the group auditor's report.

H. MONITORING:

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

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2. Quality control of engagements has to be monitored taking into account following factors:
    a. Deciding whether quality control system of the firm has been appropriately designed and effectively implemented.

    b. Examining whether new developments in the professional standards, legal and regulatory requirements have been reflected in the quality control policies.

    c. Conducting monitoring by entrusting responsibility of monitoring process to a partner or other persons with sufficient and appropriate experience and authority in the firm.

    d. Dealing with complaints and allegations against the firm or any employees of it of non – compliance with professional standards or appropriate regulatory requirements by a person within or outside the firm.

    e. Taking appropriate remedial actions against the personnel who did not conform to quality control policies.

    f. Taking action when deficiencies in the design or operation of the firm's quality control policies and procedures, or non-compliance with the firm's system of quality control are identified.

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SA 220 QUALITY CONTROL FOR AN AUDIT OF FINANCIAL STATEMENTS

A. INTRODUCTION:

1. Engagement partner of a team is responsible for quality control procedures of a particular audit engagement in accordance with SA-220. Therefore, SA-220 is premised on the basis that the firm is subject to SQC 1.

2. Within the context of the firm's system of quality control, engagement teams have a responsibility to implement quality control procedures that are applicable to the audit engagement and provide the firm with relevant information to enable the functioning of that part of the firm's system of quality control relating to independence.

3. Engagement teams are entitled to rely on the firm's system of quality control, unless information provided by the firm or other parties suggests otherwise.

B. OBJECTIVE OF AUDITOR AS PER SA 220: The objective of the auditor is to implement quality control procedures at the engagement level that provide the auditor with reasonable assurance that:

1. The audit complies with professional standards and regulatory and legal requirements and

2. The auditor's report issued is appropriate in the circumstances.

C. ELEMENTS COVERED UNDER SA-220: This standard is modelled on lines of SQC 1. It describes responsibilities of engagement partner in relation to following matters:

1. Leadership responsibilities for quality on audits.
2. Relevant ethical requirements.
3. Acceptance and continuance of client relationships and audit engagements.
4. Assignment of engagement teams.
5. Engagement performance.
6. Monitoring.

D. LEADERSHIP RESPONSIBILITIES FOR QUALITY ON AUDITS:

1. Leadership responsibility of an engagement partner is to take responsibility for the overall quality on each audit engagement. The actions of the engagement partner and appropriate messages to the other members of the engagement team, in taking responsibility for the overall quality on each audit engagement, emphasis:

2. The importance to audit quality of:
    a. Performing work that complies with professional standards and regulatory and legal requirements.

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b. Complying with the firm's quality control policies and procedures as applicable.

c. Issuing auditor's reports that are appropriate in the circumstances and

d. The engagement team's ability to raise concerns without fear of reprisals.

3. The fact that quality is essential in performing audit engagements.

E. RELEVANT ETHICAL REQUIREMENTS: The responsibilities of an engagement partner in relation to ethical requirements in an audit engagement are as under:

1. Identifying a threat to independence regarding the audit engagement that safeguards may not be able to eliminate or reduce to an acceptable level.

2. Reporting by engagement partner to the relevant persons within the firm to determine appropriate action, which may include eliminating the activity or interest that creates the threat, or withdrawing from the audit engagement, where withdrawal is legally permitted.

F. ACCEPTANCE AND CONTINUANCE OF CLIENT RELATIONSHIPS AND AUDIT ENGAGEMENTS: The responsibility of an engagement partner in this regard in an audit engagement is on lines of SQC which requires the firm should obtain such information as it considers necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client:

1. Information like integrity of principal owners,

2. Competence of engagement team and consideration of necessary capabilities including time and resources,

3. Compliance with relevant ethical requirements and

4. Significant matters arisen during current or previous audit engagement and their implications assist the engagement partner in determining whether the conclusions reached regarding the acceptance and continuance of client relationships and audit engagements are appropriate.

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

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H. ENGAGEMENT PERFORMANCE:

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

2. He is responsible for auditor's report being appropriate in circumstances.

3. Further, review of audit documentation before issue of audit report is his responsibility. It has to be ensured that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for issuance of auditor's report.

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

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

1. Determine that an engagement quality control reviewer has been appointed.

2. Discuss significant matters arising during the audit engagement, including those identified during the engagement quality control review, with the engagement quality control reviewer

3. Not date the auditor's report until the completion of the engagement quality control review.

4. The engagement quality control reviewer shall perform an objective evaluation of the significant judgments made by the engagement team, and the conclusions reached in formulating the auditor's report. This evaluation shall involve:

    a. Discussion of significant matters with the engagement partner.

    b. Review of the financial statements and the proposed auditor's report.

    c. Review of selected audit documentation relating to the significant judgments the engagement team made and the conclusions it reached and

    d. Evaluation of the conclusions reached in formulating the auditor's report and consideration of whether the proposed auditor's report is appropriate.

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e. For audits of financial statements of listed entities, the engagement quality control reviewer, on performing an engagement quality control review, shall also consider the following:

i. The engagement team's evaluation of the firm's independence in relation to the audit engagement.

ii. Whether appropriate consultation has taken place on matters involving differences of opinion or other difficult or contentious matters, and the conclusions arising from those consultations.

iii. Whether audit documentation selected for review reflects the work performed in relation to the significant judgments made and supports the conclusions reached.

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

ILLUSTRATION 22.

GVN & Associates are auditors of a listed company involved in "fin-tech" sector. The engagement team is stuck up with some issue pertaining to a particular Ind AS applicable to the company. They have framed a query and sent to ICAI for expert opinion on the matter. The issue was resolved upon receipt of expert opinion. Since expert opinion was provided by ICAI, engagement team was of the view that appointment of engagement quality control reviewer has lost its relevance. Do you agree?

ANSWER:

Engagement quality control review in listed entities is a mandatory requirement. Expert opinion of ICAI pertains to issue of interpretation. The appointment of reviewer is a separate and mandatory requirement in audits of listed companies.

J. MONITORING: An effective system of quality control includes a monitoring process designed to provide the firm with reasonable assurance that its policies and procedures relating to the system of quality control are relevant, adequate, and operating effectively. The engagement partner shall consider the results of the firm's monitoring process as evidenced in the latest

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information circulated by the firm and, if applicable, other network firms and whether deficiencies noted in that information may affect the audit engagement.

K. DOCUMENTATION:

1. **BY ENGAGEMENT PARTNER:** The engagement partner should document following matters pertaining to an audit engagement:

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

    b. Conclusions on compliance with independence requirements that apply to the audit engagement, and any relevant discussions with the firm that support these conclusions.

    c. Conclusions reached regarding the acceptance and continuance of client relationships and audit engagements.

    d. The nature and scope of, and conclusions resulting from, consultations undertaken during the course of the audit engagement.

2. **BY EQC REVIEWER:** Besides, the engagement quality control reviewer shall document, for the audit engagement reviewed, that:

    a. The procedures required by the firm's policies on engagement quality control review have been performed.

    b. The engagement quality control review has been completed on or before the date of the auditor's report.

    c. The reviewer is not aware of any unresolved matters that would cause the reviewer to believe that the significant judgments the engagement team made and the conclusions they reached were not appropriate.

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S.N.	SQC 1	SA 220
1	It applies to entire firm and fixes the responsibility of firm to be assumed by CEO or managing partners.	It applies to a particular audit engagement and engagement partner takes responsibility of the same.
2	It is applicable to audits, reviews of historical financial Information, and other assurance and related services engagements.	It is applicable to audit engagements only.
3	It relates to setting up of a quality control system consisting of policies and procedures for firm as a whole.	It deals with responsibilities of engagement teams to implement quality control procedures that are applicable to audit engagements.
4	It pertains to establishing a system of quality control designed to provide firm with a reasonable assurance that a firm and its personnel comply with professional standards and regulatory and legal requirements so that reports issued by firm or engagement partners are appropriate in circumstances.	It is premised on the basis that firm is subject to SQC 1. Therefore, SQC 1 is a sine qua non for applicability of SA 220. It is within overall context of a firm's system of quality control, engagement teams implement quality control procedures applicable to audit engagements.

ILLUSTRATION 23.

RST & Co., a firm of Chartered accountants, are auditors of a listed company engaged in manufacturing of heavy machinery components. The audit report for year 2021-22 also included report on matters listed in CARO,2020. While reporting under clause vii(a) of the said order relating to regularity of undisputed statutory dues by the company, the auditors have commented that company is "generally regular" in depositing statutory dues to appropriate authorities. Is above reporting qualitative and in line with requirements of SA-220?

ANSWER:

Such type of reporting is not qualitative. It is not in accordance with SA 220. One of the objectives of the auditor, as per SA 220, is to implement quality control procedures at the engagement level that provide the auditor with reasonable assurance that the audit complies with professional standards and regulatory and legal requirements. The reporting under CARO, 2020 is not proper. Hence, the audit does not comply with regulatory and legal requirements.

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MECHANISMS FOR REVIEW OF QUALITY CONTROL

PEER REVIEW BOARD:

1. Peer review Board is constituted by Council of ICAI. The main objective of Peer review Board is to ensure that, in carrying out assurance assignments:
    a. Technical, professional and ethical standards including regulatory requirements are complied with by members of ICAI.

    b. Proper systems are in place including documentation thereof which amply demonstrate quality of assurance services provided by members.

2. The peer review is meant for purpose of enhancing quality of professional work resulting in more reliable and useful audit reports.

3. Peer review means an examination and review of the systems and procedures to determine whether the same have been put in place by the Practice Unit for ensuring the quality of assurance services as envisaged by the technical, professional and ethical Standards or any other regulatory requirements.

4. Once a Practice Unit is subjected to Peer review, its assurance engagement records pertaining to the Peer review period are subject to examination and review by the Peer Reviewer.

5. On completion of this exercise, a "peer review certificate" is issued in case of unqualified report issued by Peer Reviewer. In case of a qualified report, it is informed to the Practice Unit that same cannot be issued along with the reasons therefor as well as inform about the due date for conducting a follow-on review as may be decided by the Board.

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QUALITY REVIEW BOARD:

1. Quality review Board has been set up by Central government. It consists of members nominated by Central govt and Council of ICAI. The functions of QRB are:

    a. To make recommendations to the Council regarding 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 and

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

2. The statutory auditors in respect of the companies are identified for their audit quality review based upon risk-based approach. The review is carried out by technical reviewers who are empanelled by QRB on engagement basis from across the country.

3. **National Financial Reporting Authority (NFRA):** NFRA has been constituted in terms of Section 132(1) of Companies Act,2013. Duties of NFRA also include the following:

    a. Monitor and enforce compliance with accounting standards and auditing standards.

    b. Oversee the quality of service of the professions associated with ensuring compliance with such standards and suggest measures for improvement in the quality of service.

    c. It has power to monitor and enforce compliance with accounting standards and auditing standards and oversee the quality of service under section 132(2) or undertake investigation under section 132(4) of the auditors of certain class of companies. Such companies include listed companies, insurance companies, banking companies and other companies as provided for in rule 3 of NFRA Rules,2018.

    d. Therefore, overseeing quality of audit services of listed companies falls under the purview of NFRA.

    e. QRB can review quality of audit services provided by the members of the Institute only in respect of entities other than those specified under Rule 3 of NFRA Rules, 2018 and those referred to QRB by NFRA under relevant rules.

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TEST YOUR KNOWLEDGE

Q.NO.1. PQR & Associates are statutory auditors of a listed company. There arose an issue during the course of audit relating to related party transactions. The engagement partner wants to consult engagement quality control reviewer on this matter during the course of audit process itself. Can he consult with engagement quality control reviewer? Discuss.

ANSWER:

It is necessary to maintain objectivity of reviewer. Therefore, participation in engagement or making decisions for engagement team is to be avoided at all costs. However, engagement partner may consult engagement quality control reviewer during the engagement so as not to compromise his objectivity and eligibility to perform the role.

Q.NO.2. Beta Private Limited has approached a firm of Chartered accountants to assist them in preparation of financial statements and issue a compilation report in this regard. Does CA firm have responsibility in relation to quality control for above said engagement? Discuss with reasons.

ANSWER:

Such kind of services fall in category of "related services". SQC 1 is applicable to all type of engagements including engagement pertaining to "related services".

Q.NO.3. Ramanujan, a CA final student, feels that engagement file in audit engagement should be ready prior to issue of audit report. Discuss whether Ramanujan's view is in order.

ANSWER:

The firm should establish policies and procedures for engagement teams to complete the assembly of final engagement files on a timely basis after the engagement reports have been finalized. Engagement files should be completed in not more than 60 days after date of auditor's report in case of audit engagements.

Thus, view of Ramanujam is not in order.

Q.NO.4. BNE & Co. are in midst of audit process of a listed company. During the course of audit, an issue arose relating to revenues from contracts with customers in terms of Ind AS 115. The engagement partner took a certain stand. However, engagement quality control reviewer recommended otherwise after review. The engagement partner is not willing to accept recommendations of reviewer. How can the stalemate be ended?

ANSWER:

In case, recommendations of engagement quality control reviewer are not accepted by engagement

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partner and matter is not resolved to reviewer's satisfaction, the matter should be resolved by following established procedures of firm like by consulting with another practitioner or firm, or a professional or regulatory body. The audit report should be issued only after resolution of matter.

Q.NO.5. MB & Associates is a partnership firm of Chartered Accountants which was established seven years back. The firm is getting new clients and has also, been offered new engagement services with existing clients. The firm is concerned about obtaining such information as it considers necessary in the circumstances before accepting an engagement with a new client and acceptance of a new engagement with an existing client. The firm is looking to work with only select clients to adhere to the Quality Control Standards. Guide MB & Associates about the matters to be considered with regard to the integrity of a client, as per the requirements of SQC 1.

ANSWER:

Refer SQC Discussion and write points on Integrity of principal owners related points.

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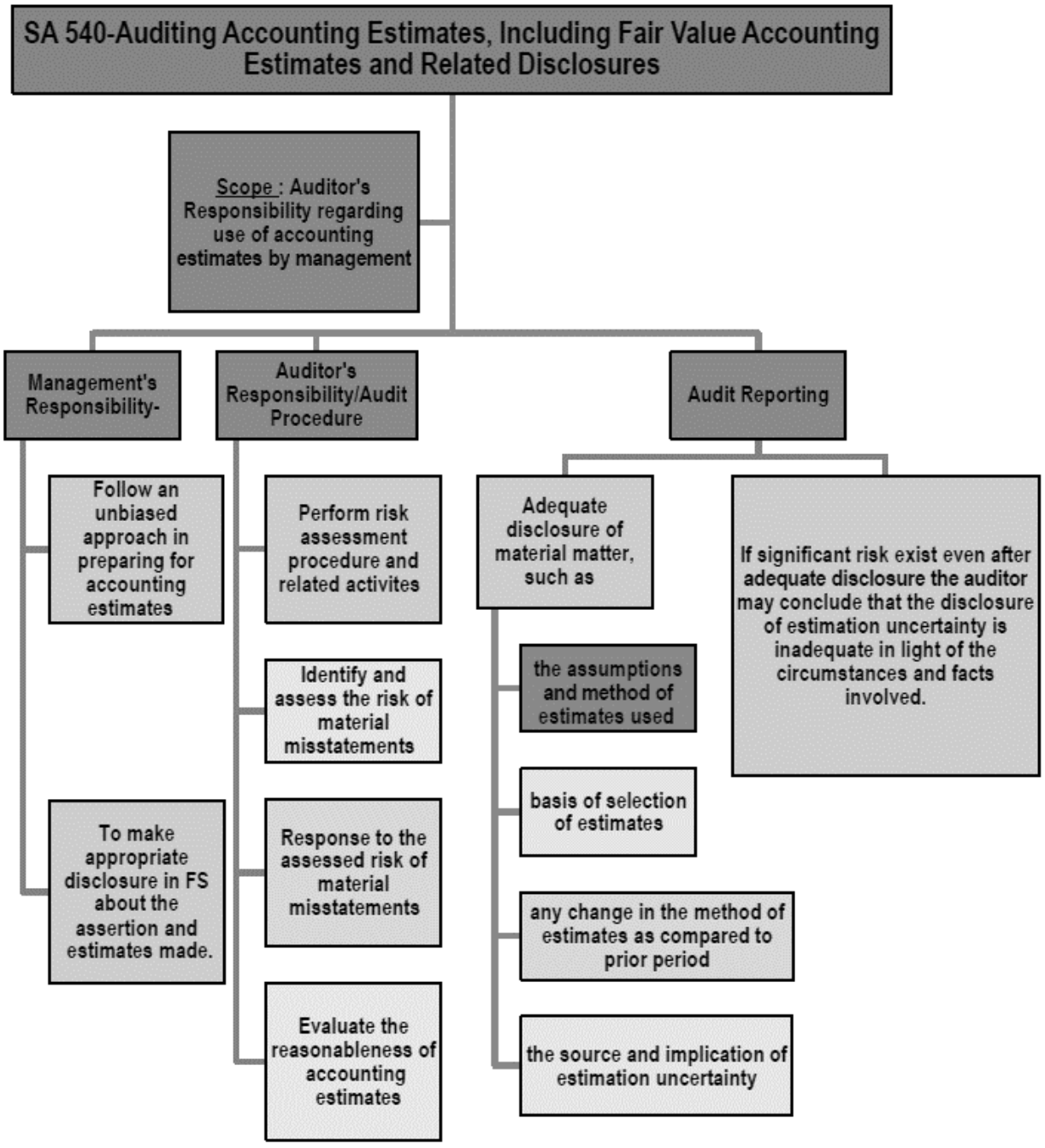
SA 540 AUDITING ACCOOUNTING ESTIMATES, INCLUDING FAIR VALUE ACCOUNTING ESTIMATES AND RELATED DISCLOSURES



A. OBJECTIVE OF SA 540:

The objective of the auditor is to obtain sufficient appropriate audit evidence whether in the context of the applicable financial reporting framework:

1. Accounting estimates, including fair value accounting estimates, in the financial statements, whether recognised or disclosed, are reasonable and
2. Related disclosures in the financial statements are adequate.

B. DEFINITIONS:

ACCOUNTING ESTIMATE: An approximation of a monetary amount in the **absence of a precise means of measurement**.
This term is used for an amount measured at fair value where there is estimation uncertainty, as well as for other amounts that require estimation. Where ever this SA addresses accounting estimates involving measurement at fair value, the term "fair value accounting estimates" is used.

AUDITOR'S POINT ESTIMATE OR AUDITOR'S RANGE: The amount, or range of amounts, respectively, derived from audit evidence for **use in evaluating management's point estimate**.

MANAGEMENT'S POINT ESTIMATE: The amount selected by management for recognition or disclosure in the financial statements as an accounting estimate.

MANAGEMENT BIAS: A lack of neutrality by management in the preparation and presentation of information.

ESTIMATION UNCERTAINTY: The susceptibility of an accounting estimate and related disclosures to an inherent lack of precision in its measurement.

OUTCOME OF AN ACCOUNTING ESTIMATE: The actual monetary amount which results from the resolution of the underlying transaction(s), event(s) or condition(s) addressed by the accounting estimate.

C. AUDITOR'S RESPONSIBILITY /AUDIT PROCEDURES:

1. **RISK ASSESSMENT PROCEDURES AND RELATED ACTIVITIES FOR ACCOUNTING ESTIMATES:**
   The auditor shall obtain an understanding of the following in order to provide a basis for the identification and assessment of the risks of material misstatement for accounting estimates:
   a. The requirements of the applicable financial reporting framework relevant to accounting estimates, including related disclosures.
   b. How management identifies those transactions, events and conditions that may give rise to the need for accounting estimates to be recognised or disclosed in the financial statements.
   c. In obtaining this understanding, the auditor shall make inquiries of management about changes in circumstances that may give rise to new, or the need to revise existing, accounting estimates.

2. **OBTAINING AN UNDERSTANDING OF HOW MANAGEMENT IDENTIFIES THE NEED FOR ACCOUNTING ESTIMATES:**

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a. Management has the responsibility to determine whether a transaction, event or condition requires to make an accounting estimate, and ensure that they are in accordance with the applicable financial reporting framework.
b. The auditors risk assessment procedures assist the auditor in identifying circumstances, or changes in circumstances, that may indicate a requirement for an accounting estimate.
c. Inquiries of management about changes in circumstances may include, for example, inquiries about whether:
    a) The entity has engaged in new types of transactions that may give rise to accounting estimates.
    b) Terms of transactions that gave rise to accounting estimates that have changed.
    c) Accounting policies relating to accounting estimates have changed.
    d) Regulatory or other changes outside the control of management have occurred that may require management to revise, or make new, accounting estimates.
    e) New conditions or events have occurred that may give rise to the need for new or revised accounting estimates.
d. **MANAGEMENT FAILED TO IDENTIFY AN ESTIMATE:** During the audit, the auditor may identify transactions, events and conditions that give rise to the need for accounting estimates that management failed to identify. Determining whether there is a significant deficiency in internal control with regard to the entity's risk assessment processes.

3. **HOW MANAGEMENT MAKES THE ACCOUNTING ESTIMATES:** How management makes the accounting estimates, and an understanding of the data on which they are based, including:
a) The method, including where applicable the model, used in making the accounting estimate.
b) Relevant controls.
c) Whether management has used an expert.
d) The assumptions underlying the accounting estimates;
e) Whether there are any changes in the methods for making the accounting estimates, and if so, why and
f) Whether and, if so, how management has assessed the effect of estimation uncertainty.

The auditor shall review the outcome of accounting estimates included in the prior period financial statements, or, where applicable, their subsequent re-estimation for the purpose of the current period.

4. **ESTIMATION UNCERTAINTY:** For accounting estimates that give rise to significant risks, in addition to other substantive procedures performed to meet the requirements of SA 330, the auditor shall evaluate the following:
    a. How management has considered alternative assumptions or outcomes, and why it has rejected them, or how management has otherwise addressed estimation uncertainty in making the accounting estimate.
    b. Whether the significant assumptions used by management are reasonable.

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c. The appropriate application of the applicable financial reporting framework, management's intent to carry out specific courses of action and its ability to do so.

ESTIMATION UNCERTAINTY - UNADDRESSED: If, in the auditor's judgment, management has not adequately addressed the effects of estimation uncertainty on the accounting estimates that give rise to significant risks, the auditor shall, if considered necessary, develop a range with which to evaluate the reasonableness of the accounting estimate.

5. RECOGNITION AND MEASUREMENT CRITERIA – SIGNIFICANT RISK:

For accounting estimates that give rise to significant risks, the auditor shall obtain sufficient appropriate audit evidence whether the following are in accordance with the requirements of the applicable financial reporting framework:

a. Management's decision to recognise, or to not recognise, the accounting estimates in the financial statements; and
b. The selected measurement basis for the accounting estimates.

IDENTIFYING AND ASSESSING THE RISKS OF MATERIAL MISSTATEMENTS:

1. The auditor shall evaluate the degree of estimation uncertainty associated with accounting estimates.
2. The auditor shall determine whether any of those accounting estimate have high estimation uncertainty give rise to significant risk.

RESPONSES TO THE ASSESSED RISKS OF MATERIAL MISSTATEMENT:

1. Based on Risk assessment the auditor shall determine:
   a) Whether management has appropriately applied the applicable financial reporting framework relevant to the accounting estimate and
   b) Whether the methods for making the accounting estimates are appropriate and have been applied consistently
   c) If there are changes in accounting estimates or in the method used for making those from prior period, are those appropriate in the present circumstances.

2. The auditor shall undertake one or more of the following, taking in account the nature of the accounting estimates:
   a. **SUBSEQUENT EVIDENCE:** Determine whether events occurring up to the date of the auditor's report provide sufficient audit **evidence regarding** the accounting estimate.
   b. Test checks the data used by the management for making accounting estimate.
   c. The auditor shall also evaluate whether the method used for measurement is appropriate in the circumstances and assumptions made by the management are reasonable. This can be achieved by:

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i. Testing the extent to which data on which accounting estimate is based is accurate, complete and relevant and whether the accounting estimate has been properly determined using such data and management assumptions.
ii. Considering the source, relevance and reliability of external data.
iii. Recalculating the accounting estimate and reviewing information about an accounting estimate for internal consistency.
iv. Test checks the effectiveness of the controls over the estimates used by the management together with appropriate substantive procedure.

3. The auditor shall consider whether specialized skills or knowledge in relation to one or more aspects of the accounting estimates are required in order to obtain sufficient appropriate audit evidence. [Whether Expert assistance is needed]

6. EVALUATING THE REASONABLENESS OF THE ACCOUNTING ESTIMATES, AND DETERMINING MISSTATEMENTS:

The auditor shall evaluate, based on the audit evidence, whether the accounting estimates in the financial statements are either reasonable in the context of the applicable financial reporting framework, or are misstated.

D. AUDIT REPORTING & DISCLOSURE:

DISCLOSURES RELATED TO ACCOUNTING ESTIMATES:

a. **AFRFW:** The auditor shall obtain sufficient appropriate audit evidence about whether the disclosures in the financial statements related to accounting estimates are in accordance with the requirements of the applicable financial reporting framework.
b. **ESTIMATION UNCERTAINTY:** For accounting estimates that give rise to significant risks, the auditor shall also evaluate the adequacy of the disclosure of their estimation uncertainty in the financial statements in the context of the applicable financial reporting framework

WRITTEN REPRESENTATIONS:

The auditor shall obtain written representations from management and, where appropriate, those charged with governance whether they believe significant assumptions used in making accounting estimates are reasonable.

E. DOCUMENTATION OF ACCOUNTING ESTIMATES:

The audit documentation shall include:

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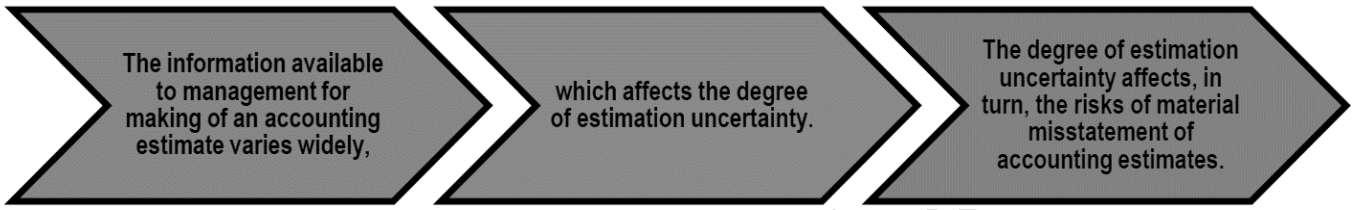
a) The basis for the auditor's conclusions about the reasonableness of accounting estimates and their disclosure that give rise to significant risks and
b) Indicators of possible management bias, if any.

ACCOUNTING RELATED CONTENT W.R.T ACCOUNTING ESTIMATES

NATURE OF ACCOUNTING ESTIMATES:

1. 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.
2.



3. Because of the uncertainties involve in business activities, some financial statement items can only be estimated. Further, the specific characteristics of an asset, liability or component of equity, or the basis of or method of measurement prescribed by the financial reporting framework, may give rise to the need to estimate a financial statement item.

4. **LOW ESTIMATION UNCERTAINTY:** Some accounting estimates involve relatively low estimation uncertainty and may give rise to lower risks of material misstatements:
    a. Activities that are **not complex**.
    b. Frequently used estimates related to **routine transactions**.
    c. Accounting estimates derived from data that is **readily available**. Such data may be referred to as "**observable" in the context of a fair value** accounting estimate.
    d. Fair value accounting estimates where the method of measurement prescribed by the **applicable financial reporting framework** is simple and can be applied easily.
    e. Model used to measure the accounting estimate is **well-known** or generally accepted.

5. **HIGH ESTIMATION UNCERTAINTY:** For some accounting estimates, however, there may be relatively high estimation uncertainty, particularly where they are based on significant assumptions, for example:
    a. Accounting estimates relating to the **outcome of litigation**.
    b. Fair value accounting estimates for derivative financial instruments **not publicly traded**. [E.g., Un Quoted Shares]
    c. Fair value accounting estimates for which a highly specialised entity-developed model is used or for which, there are assumptions or inputs that cannot be observed in the marketplace. *[E.g., Accounting estimates in cases of Wage Revision Agreements*

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wherein negotiations with the Trade Unions are on the way or Government's sanction is awaited leading to uncertainty.]

6. **DEGREE OF ESTIMATION UNCERTAINTY:** The Degree of estimation uncertainty varies based on:
    a. The nature of the accounting estimate,
    b. The extent to which there is a generally accepted method used to make the accounting estimate and
    c. The subjectivity of the assumptions used to make the accounting estimate.

NOTES:

a) Not all financial statement items requiring measurement at fair value, involve estimation uncertainty. [E.g., Open Market Data is available for Unquoted shares which require to be measured at Fair value].
b) Estimation uncertainty may exist even when the valuation method and data are well defined. [For example, valuation of securities quoted on an active and open market at the listed market price may require adjustment if the holding is **significant** in relation to the market or is subject to restrictions in marketability.]

7. **Examples** of situations where accounting estimates, **other than fair value** accounting estimates, may be required include:
    a. Allowance for doubtful accounts.
    b. Inventory obsolescence.
    c. Warranty obligations.
    d. Depreciation method or asset useful life.
    e. Provision against the carrying amount of an investment where there is uncertainty regarding its recoverability.
    f. Outcome of long-term contracts.
    g. Financial Obligations / Costs arising from litigation settlements and judgments.

8. **Examples** of situations where **fair value accounting estimates** may be required include:
    a. Complex financial instruments, which are not traded in an active and open market.
    b. Share-based payments.
    c. Property or equipment held for disposal.
    d. Certain assets or liabilities acquired in a business combination, including goodwill and intangible assets.
    e. Transactions involving the exchange of assets or liabilities between independent parties without monetary consideration, for example, a non-monetary exchange of plant facilities in different lines of business.

9. **ESTIMATION INVOLVES JUDGMENTS:**

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a. Estimation involves judgments based on information available when the financial statements are prepared.
b. For many accounting estimates, these include making assumptions about matters that are uncertain at the time of estimation.
c. The auditor is not responsible for predicting future conditions, transactions or events.

10. MANAGEMENT BIAS:

a. Financial reporting frameworks often call for neutrality, that is, freedom from bias.
b. Accounting estimates are imprecise, however, and can be influenced by management judgment. Such judgment may involve unintentional or intentional management bias (for example, as a result of motivation to achieve a desired result).
c. The susceptibility of an accounting estimate to management bias increases with the subjectivity involved in making it.
d. Unintentional management bias and the potential for intentional management bias are inherent in subjective decisions.
e. For continuing audits, indicators of possible management bias identified during the audit of the preceding periods influence the planning and risk identification and assessment activities of the auditor in the current period.
f. Management bias can be difficult to detect at an account level:
    i. It may only be identified when considered in the aggregate of groups of accounting estimates or
    ii. all accounting estimates, or
    iii. when observed over a number of accounting periods.
g. If Management Bias is **intention to mislead**, then it is **considered as Fraudulent.**

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While auditing Z Ltd., you observe certain material financial statement assertions have been based on estimates made by the management. As the auditor how do you minimize the risk of material misstatements?

ANSWER:

The auditor shall obtain an understanding of the following in order to provide a basis for the identification and assessment of the risks of material misstatements for accounting estimates:

1. The requirements of the applicable financial reporting framework relevant to the accounting estimates, including related disclosures.
2. How management makes the accounting estimates, and an understanding of the data on which they are based, including:
    a. The method, including where applicable the model, used in making the accounting estimate.
    b. Relevant controls.
    c. Whether management has used an expert.

d. The assumptions underlying the accounting estimates;
e. Whether there are any changes in the methods for making the accounting estimates, and if so, why and
f. Whether and, if so, how management has assessed the effect of estimation uncertainty.

A Pvt Ltd is engaged in the business of real estate. The auditor of the company requested the information from the management to review the outcome of accounting estimates (like estimated costs considered for percentage completion etc) included in the prior period financial statements and their subsequent re-estimation for the purpose of the current period.

The management has refused the information to the auditor saying that the review of prior period information should not be done by the auditor. Please advise.

ANSWER:

As per SA 540, "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures", the auditor shall review the outcome of accounting estimates included in the prior period financial statements, or, where applicable, their **subsequent re-estimation for the purpose of the current period**.

The nature and extent of the auditor's review takes account of the nature of the accounting estimates, and whether the information obtained from the review would be relevant to identifying and assessing risks of material misstatement of accounting estimates made in the current period financial statements.

The **outcome of an accounting estimate will often differ from the accounting estimate recognised in the prior period** financial statements. By performing risk assessment procedures to identify and understand the reasons for such differences, the auditor may obtain:

- Information regarding the effectiveness of management's prior period estimation process, from which the auditor can judge the likely effectiveness of management's current process.
- Audit evidence that is pertinent to the re-estimation, in the current period, of prior period accounting estimates.
- Audit evidence of matters, such as estimation uncertainty, that may be required to be disclosed in the financial statements.

However, **the review is not intended to call into question the judgments** made in the prior periods that were based on information available at that time.

In the given case, the **management is not correct** in refusing the relevant information to the auditor.

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12. FORENSIC ACCOUNTING

INTRODUCTION:

Forensic Accounting has established itself as dynamic and strategic tool in combating corruption, financial crimes and frauds through investigations and resolving allegations of fraud and embezzlement. Thus, a new area, known as Forensic Accounting, was needed to detect the frauds in companies that suspected fraudulent transactions.

"Forensic" means "suitable for use in the court of law". Bologna said that it is the application of financial skills and investigative mentality to unresolved issues, conducted within the context of the rules of evidence.

As an emerging discipline, it encompasses financial expertise, fraud knowledge and a sound knowledge and understanding of business reality and the working of legal system.

However, the definition of Forensic Accounting keeps on changing in response to the growing needs of corporations. Simply stated, Forensic Accounting includes the use of accounting, accounting and investigative skills to assist in legal matters.

Forensic Accounting can be conducted in order to prosecute a party for fraud, embezzlement or other financial claims. In addition, an audit may be conducted to determine negligence in addition, an audit may be conducted to determine negligence.

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IMPORTANT DEFINITIONS:

FORENSIC: The word forensic comes from the Latin word forensis, meaning "of or before the forum." It is:

1. Relating to, used in, or appropriate for courts of law or for public discussion or argumentation.

2. Relating to the use of science or technology in the investigation and establishment of facts or evidence in a court of law.

FORENSIC ACCOUNTING: The integration of accounting, auditing and investigative skills yields the specialty known as Forensic Accounting. It is the study and interpretation of accounting evidence.

It is the application of accounting methods to the tracking and collection of forensic evidence, usually for investigation and prosecution of criminal acts such as embezzlement or fraud.

BOOK DEFINITION:

1. Forensic accounting is the application of investigative and analytical skills for the purpose of resolving financial issues in a manner that meets standards required by courts of law.
2. Forensic accountants apply special skills in accounting, auditing, finance, quantitative methods, certain areas of the law, research and investigative skills to collect, analyse and evaluate evidential matter and to interpret and communicate findings.

RED FLAG:

1. Red flags are indicators or warning of any impending danger or inappropriate behavior.

2. Red flag does not necessarily indicate the existence of fraud however are indicators that caution needs to be exercised while investigating the situations.

3. Red flags are classified in categories such as financial performance red flag, accounting system red flags, operational red flags and behavioral red flags.

Example of Forensics:

The Company received an anonymous handwritten letter through the mail in which there were serious death threats against the CEO and his family. The letter alluded to the fact that bodily harm may be inflicted on the Children of the CEO unless he took some specific action to send a specific amount of cash in currency notes within a specified time period in such a manner where the identity of the receiver was to remain unknown. The CEO immediately informed the police who took the letter, and the envelope it came in, for "forensic analysis".

The lab undertaking the forensic work examined the paper used, the possibility of capturing some fingerprints on the letter and envelope, scrutinise the manner in which the writing was done, such as the ink used to find out the nature of the writing implement, deployed the expertise of a handwriting expert to decipher the possibility of the writer etc. The police also undertook an investigation of the possible suspects and collected various samples of hand - writings of there suspects to allow the forensic experts to match the handwritings and shortlist the most likely suspect.

All the above-mentioned techniques deployed to analyse the only clue available (letter and envelope) are generally referred to as forensic work.

Example of Forensic Accounting:

The Accounting Officer in the pharma company performs a regular reconciliation between the physical inventory counted in the factory and the inventory as calculated by the books and accounts. He takes the opening physical inventory as reconciled last month and adjusting for purchases and sales during the month along with any production wastage/shrinkage etc. he calculates the theoretical inventory at the close of the last day of the month. This time he noticed a large discrepancy and after double checking the figures could not understand why he had a large reconciliation variance.

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To identify the reason of the variance, he undertook a review of the quantities of some of the large inventory items to see if he could identify the variance in kilogram weight terms. He noticed that some large expensive raw inventory items receipts during the month could neither be located in the storeroom or the factory production floor. He tried to trace these receipts to specific production runs to see if they had been used for making the medicines sold during the month. Finally, he reviewed the wastage records to see if these had been discarded due to quality control purposes. When he received no plausible explanation, he came to the conclusion that there is a serious possibility of pilferage of these expensive raw materials and asked the security head to investigate the matter during and after the time of receipt. This investigation led the security people to review the CCTV footage and records during delivery to identify a few instances of short delivery by the inward people.

This detailed analysis by the Accounting Officer was an example of some Forensic Accounting techniques to identify a case of accounting fraud.

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Q NO 1. HOW IS A FORENSIC ACCOUNTING ANALYSIS DIFFERENT FROM AN STATUTORY AUDIT?

ANSWER:

The general public believes that a financial auditor would detect a fraud if one were being perpetrated during the financial auditor's audit. The truth, however, is that the procedures for financial audits are designed to detect material misstatements, not immaterial frauds.

While it is true that many of the financial statements and frauds could have, perhaps should have, been detected by financial auditors, the vast majority of frauds could not be detected with the use of financial audits. Reasons include the dependence of financial auditors on a sample and the auditors' reliance on examining the audit trail versus examining the events and activities behind the documents. The latter is simply resource prohibitive in terms of costs and time.

There are some basic differences today between the procedures of Forensic Accounting and those of financial auditors. In comparison, forensic accounting and audit differ in specific ways, as shown below:

	STATUTORY AUDIT	**FORENSIC ACCOUNTING**
Basic Overview	1. It's a legal mandate 2. Conducted only by a chartered accountant 3. Measures compliance with reporting standards 4. Obtains reasonable assurance 5. Expression of an independent opinion 6. On financial statements 7. As per ICAI auditing standards	1. To support legal cases a. In response to an event. b. Financial investigation c. Finding used as evidence in court or to resolve disputes 2. Non – CAs permitted 3. Report findings of evidence discovered 4. Primarily financials 5. ICAI standards
Objective	True and fair picture	Discover facts and evidence
Focus	Very general – an overall review of the books of account	Narrow – validate transactions and Balances
Approach	Control tests of transactions and substantive tests of balances	Focused testing to confirm Suspicion / allegation
Target	Identify material mis – statements in financial statements	Identify / confirm nature of violation
Skills	Testing & checking, analysis, inquiry & observation	Scrutiny & analysis, fact – finding, interviews
Presumption	Professional skepticism, due professional care	Neutrality
Outcome	Audit report opinion (qualification – subject to/except for)	Present evidence to a court of law – they shall judge)!

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Q NO 2. HOW FORENSIC ACCOUNTING IS DIFFERENT FROM OTHER AUDITS ?

ANSWER:

A forensic accountant professional will often look for indications of fraud that are not subject to the scope of a financial statement audit. Forensic Accounting has Investigative mentality" however auditing is done with "professional scepticism".

A forensic accountant professional will often require more extensive corroboration. A forensic accountant professional may focus more on seemingly immaterial transactions.

Sr.No.	Particulars	Other Audits	Forensic Accounting
1.	Objectives	Express an opinion as to 'True & Fair' presentation	Whether fraud has actually taken place in books
2.	Techniques	Substantive & Compliance. Sample based	Investigative, substantive or in-depth checking
3.	Period	Normally for a particulars accounting period.	No such limitations
4.	Verification of stock, Estimation realisable value of assets, provisions, liability etc.	Relies on the management certificate/Management Representation	Independent/verification of suspected/selected items where misappropriation in suspected
5.	Off balance sheet items (like contracts etc.)	Used to vouch the arithmetic accuracy & compliance with procedures.	Regulatory & propriety of these transactions/contracts are examined.
6.	Adverse findings if any	Negative opinion or qualified opinion expressed with/without quantification	Legal determination of fraud impact and identification of perpetrators depending on scope.

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Q NO 3. WHO IS A FORENSIC ACCOUNTANT PROFESSIONAL AND LIST OF SERVICES THAT THEY CAN PROVIDE?

ANSWER:

1. A Forensic Accountant Professional is often retained to analyze, interpret, summarize and present complex financial and business-related issues in a manner which is both understandable and properly supported.

2. Forensic Accountants Professional are trained to look beyond the numbers and deal with the business reality of the situation.

3. A Forensic Accountant Professional must initially consider whether his/her firm has the necessary skills and experience to accept the work.

4. Forensic Accounting is highly specialized, and the work requires detailed knowledge of fraud investigation techniques and the legal framework.

5. Forensic Accountant Professional needs to have an understanding on various frauds that can be carried off and how evidence need to be collected.

6. Forensic Accountant Professional can be engaged in public practice or employed by insurance companies, banks, police forces, government agencies and other organizations.

7. **FORENSIC ACCOUNTING SERVICES:** An indicative list of services that can be provided by the Professional in this area are as follows:
    a. Financial Statement manipulations
    b. Fund diversions/Asset tracing
    c. Anti-Money laundering
    d. Licence Fees/Dues/Tax Evasion
    e. Related party transactions/valuations
    f. Valuations/Estimations of loss/damage
    g. Suspicious transactions under IBC (Insolvency and Bankruptcy Code)

8. AREAS OF SERVICES PERFORMED:
    a. **Fraud Detection:** Investigating and analyzing financial evidence, detecting financial frauds and tracing misappropriated funds
    b. **Computer Forensics:** Developing computerized applications to assist in the recovery, analysis and presentation of financial evidence.
    c. **Fraud Prevention:** Either reviewing internal controls to verify their adequacy or providing consultation in the development and implementation of an internal control framework aligned to an organization's risk profile.
    d. **Providing Expert Testimony:** Assisting in legal proceedings, including testifying in court as an expert witness and preparing visual aids to support trial evidence.

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ILLUSTRATION 1.

X Limited engaged in manufacturing of floor coverings has taken a Product Liability Insurance policy (PLI). Such a policy covers risk of liabilities for damages for bodily injury resulting from sale and distribution of floor coverings by vendors of X Limited's products. The policy is also subject to "claim series" clause. A Claims Series event is a series of two or more claims arising from one specific common cause which are attributable to the same fault in design or manufacture of products or to the supply of the same products showing the same defect. A claim series event is deemed to be one claim under the terms & conditions of PLI policy.
The company has been asked to shell out damages of `5 crore due to supply of faulty products to one of its vendors. The vendor had sold floor coverings to a 5-star hotel which has alleged that harmful chemicals used in dyeing of floor coverings have resulted in skin ailments to some of its guests.
Being in capacity of forensic accountant Professional appointed by insurance company, what special issues you would keep in mind while dealing with claims involving PLI policy covering such matters?

ANSWER:

1. In claims involving product liability insurance policies, many documents are required from third parties. The third party may be unwilling to provide relevant documents to forensic accountant concerning the very organization responsible for causing damages.
2. Independence of forensic accountant become paramount in such types of assignments because it involves engagement with parties who are not directly claiming from insurance company. Forensic accountant needs to resist any pressure or interference in establishing the scope of the assignments or the manner in which the work is conducted and reported.
3. The company might be willing to negotiate it to salvage its reputation. It can lead to additional complexities.
4. Quantification of legal liability under the policy can prove to be a challenging task and it has to be determined in accordance with policy terms & conditions.
5. Careful analysis of date of loss when first claim occurred in accordance with "claim series" clause and whether the same falls under the policy

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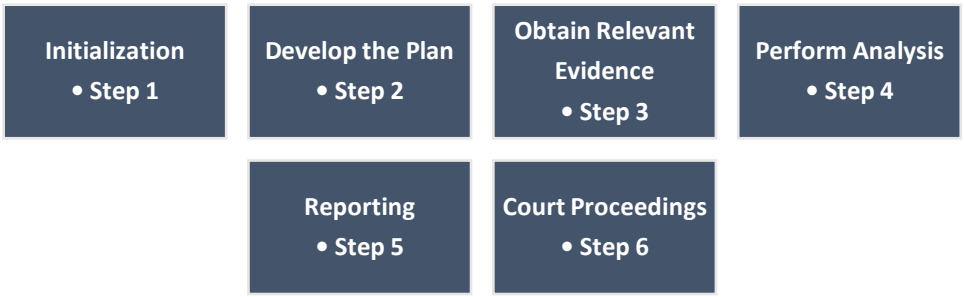
Q NO 4. WRITE ABOUT GENERAL STEPS INVOLVED IN THE PROCESS OF FORENSIC ACCOUNTING?

ANSWER:



STEP 1: INITIALIZATION

1. It is vital to clarify and remove all doubts as to the real motive, purpose and utility of the assignment. It is helpful to meet the client to obtain an understanding of the important facts, players and issues at hand.

2. A conflict check should be carried out as soon as the relevant parties are established. It is often useful to carry out a preliminary investigation prior to the development of a detailed plan of action. This will allow subsequent planning to be based upon a more complete understanding of the issues.

STEP 2: DEVELOP PLAN

This plan will take into account the knowledge gained by meeting with the client and carrying out the initial investigation and will set out the objectives to be achieved and the methodology to be utilized to accomplish them.

STEP 3: OBTAIN RELEVANT EVIDENCE

1. Depending on the nature of the case, this may involve locating documents, economic information, assets, a person or company, another expert or proof of the occurrence of an event.

2. In order to gather detailed evidence, the investigator must understand the specific type of fraud that has been carried out, and how the fraud has been committed.

3. The evidence should be sufficient to ultimately prove the identity of the fraudster(s), the mechanics of the fraud scheme, and the amount of financial loss suffered.

4. It is important that the investigating team is skilled in collecting evidence that can be used in a court case within the stipulated time period, and in keeping a clear chain of custody until the evidence is presented in court.

5. If any evidence is inconclusive or there are gaps in the chain of custody, then the evidence may be challenged in court, or even become inadmissible.

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6. Investigators must be alert to documents being falsified, damaged or destroyed by the suspect(s).

STEP 4. PERFORM THE ANALYSIS

The actual analysis performed will be dependent upon the nature of the assignment and may involve:

1. Calculating economic damages.
2. Summarizing a large number of transactions.
3. Performing a tracing of assets.
4. Performing present value calculations utilizing appropriate discount rates.
5. Performing a regression or sensitivity analysis.
6. Utilizing a computerized application such as a spread sheet, data base or computer model; and
7. Utilizing charts and graphics to explain the analysis.

STEP 5: REPORTING

1. Issuing a report is the final step of a forensic accounting. Accountant / Investigators will include information detailing the fraudulent activity, if any has been found.

2. The client will expect a report containing the findings of the investigation, including a summary of evidence, a conclusion as to the amount of loss suffered as a result of the fraud and to identify those involved in fraud.

3. The report may include sections on the nature of the assignment, scope of the investigation, approach utilized, limitations of scope and findings and/or opinions.

4. The report will include schedules and graphics necessary to properly support and explain the findings.

5. The report will also discuss how the fraudster set up the fraud scheme, and which controls, if any, were circumvented.

6. It is also likely that the investigative team will recommend improvements to controls within the organization to prevent any similar frauds occurring in the future.

STEP 6: COURT PROCEEDINGS

The investigation is likely to lead to legal proceedings against the suspect, and members of the investigative team will probably be involved in any resultant court case. The evidence gathered during the investigation will need to be presented at court, and team members may be called to court to describe the evidence they have gathered and to explain how the suspect was identified.

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Q NO 5. WRITE ABOUT FORENSIC ACCOUNTING AND INVESTIGATION REPORT REFERRED UNDER FAIS 510?

ANSWER:

This Forensic Accounting and Investigation Standard (FAIS or "Standard") 510 deals with the responsibility of the Professional to issue a written report to the stakeholders at the conclusion of the assignment.
Reporting results of the work procedures completed and the findings from those procedures, is the concluding part of the assignment. Since one engagement may include multiple assignments, multiple reports may have to be issued, one for each assignment.

1. **WRITTEN REPORT:** The Professional shall issue a written report which conveys the results of the assignment clearly and accurately. The findings reported shall be based on evidence gathered which are reliable and relevant. Thus, the Professional shall issue a written report which is precise and unambiguous.

2. **REPORT ADDRESSEE AND DISTRIBUTION:** The report shall be addressed to the Primary Stakeholders and shared with other stakeholder(s) if required or otherwise permissible

3. **FORMAT OR CONTENT OF REPORT:**

   a. While no fixed form or content of the report is mandated by this Standard, the report shall include certain key elements to enable the recipient to understand the purpose of the assignment, the extent and scope of work performed by the Professional, any limitations, assumptions or disclaimers, the facts and evidence gathered and the conclusions drawn.

   b. Where the form and content of the report is mandated by the stakeholders, or specified by the statutory or regulatory requirements, the Professional shall report in line with those requirements, while keeping in mind the key elements.

4. **KEY ELEMENTS OF THE REPORT:** The Professional shall consider the inclusion of the following key elements in the report (indicative list):
   a. Title, addressee and distribution list (if any)
   b. Scope and objectives of the assignment
   c. Approach and broad work procedures undertaken
   d. An Executive Summary of the results, covering all important aspects and the essence of the findings
   e. Reference to use of an expert, where applicable
   f. The fact that the assignment has been conducted in accordance with FAIS, or any material departures therefrom
   g. List of findings supported by key evidences, sources of evidences, and other relevant matter;

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h. Assumptions, limitations and disclaimers of the assignment
i. Conclusions (if any) drawn from the assessment undertaken.

5. DISCUSSION OF DRAFT REPORT:

a. Where the mandate of the engagement requires a discussion of the findings with the subject party prior to finalisation, a summary of the responses received from them shall be included in the report.

b. Further, the Principles of Natural Justice requires a discussion of the observations with the subject party. In some cases, this is done by the Primary Stakeholders through their own internal processes (e.g., disciplinary committee, show-cause notice, etc.).

c. At times, the Professional is requested to incorporate the discussion of draft findings as part of the interview process with the subject. Any response received from them shall be included in the written report issued by the Professional.

6. ASSUMPTIONS AND LIMITATIONS:

a. The Professional shall list any relevant assumptions made during the assignment having a significant bearing on the subject matter.

b. In addition, the Professional may encounter limitations that restrict the methodologies or procedures applied in carrying out the assignment. Such limitations can be in the form of lack of (or limited) management support, restricted (or denied) access to required records, information or people, due to any reason such as court orders, short timelines, etc. These disclaimers would be covered in the report as a key element of the report.

c. The report shall not express an opinion or pass any judgement on the guilt or innocence. Determination of culpability is either a disciplinary process internal to the organization under review, or a judicial process depending on the specific situation under review.

d. The report can, at best, highlight the circumstances and facts that may aid a stakeholder decision or further a civil or criminal investigation.

7. REPORTING TIMELINES: The report shall be issued within reasonable time frame as per the engagement terms. The Professional may be required to provide interim reports as per the engagement terms which can be given to the extent practicable without compromising the progress of the investigation. Such interim reports are also subject to this Standard.

Q NO 6. WRITE ABOUT OVERVIEW OF FORENSIC ACCOUNTING AND INVESTIGATION STANDARDS (FAIS) ?

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ANSWER:

1. The Institute of Chartered Accountants of India (ICAI) was formed with many mandates, one of which places a responsibility of "Ensuring Standards of Performance of its Members".

2. In keeping with this obligation, the ICAI has recently published a full set of standards in the area of forensic science. These are referred to as the "Forensic Accounting and Investigation Standards (FAIS for short):

    a. The FAIS are issued to ensure that the ICAI members deliver high quality output in the area of Forensic Accounting and Investigations.

    b. The Framework Governing Forensic Accounting and Investigations (the "Framework") lays down the underlying principles and boundaries for undertaking such services. It aims to preserve and enhance the quality of practice of a member of the Institute of Chartered Accountants (ICAI) performing forensic accounting and investigation services.

    c. This Framework needs to be read in conjunction with the Preface to the Forensic Accounting and Investigation Standards (FAIS).

3. The main objectives of the Framework are to:
    a. Provide an overall understanding of Forensic Accounting and Investigations and its key components.

    b. Outline the manner in which these components come together in an inter-related cohesive manner when providing such services.

    c. Maintain and improve the quality of forensic accounting and investigation services.

4. The Framework establishes the structure which governs the professions of Forensic Accounting and Investigations. It is based on the "Definition of forensic accounting and investigation" and the Code of Ethics forms the foundation of the Framework. It comprises of 4 components inherent to the process of forensic accounting and investigations.

    These components implicitly form part of the FAIS, even though they may not be mentioned explicitly in the particular Standards. Hence, as explained in the Preface, they all are mandatory in nature, except the Guidance which is recommendatory.

5. The 4 key components (forming the pillars) of the Framework are:

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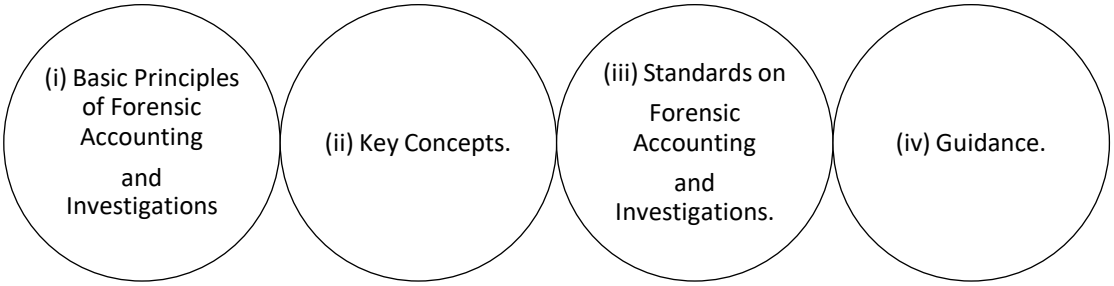

6. The Forensic Accounting and Investigation Standards (referred to as "FAIS" or the "Standards") at a broad level seek to provide:
    a. The Professionals with the minimum standards for undertaking forensic accounting and investigation (FAI) assignments.

    b. The Users of FAI services with an indication of the quality of service that can be expected from such engagements.

    c. The Regulators and Governmental agencies with an appreciation of what can be expected from FAI services and

    d. To everyone, guidance on matters of implementation and related practical issues.

7. The Standards are intended to be principle-based, rather than rule based, thereby providing ample room for professional judgment when applying such principles to unique situations and under specific circumstances. The unique nature of forensic assignments would necessitate that the application of forensic accounting and investigative skills, together with the use of digital forensic tools, may vary depending on the nature of specific engagements.

8. If, for any reason, a member is unable to comply with any of the requirements of the FAIS, or if there is a conflict between the Standards and other mandates, such as a statutory or regulatory requirement, the FAI report (or such similar communication) should draw attention to the material departures therefrom along with appropriate explanation.

9. The FAIS, as and when issued, will be classified, and numbered in a series format, as follows:

Forensic Accounting and Investigation Standards (FAIS)
100 Series: **Standards on Key Concepts** FAIS 110: Nature of Engagement FAIS 120: Fraud Risk FAIS 130: Laws and Regulations FAIS 140: Applying Hypotheses
200 Series: Standards on Engagement Management FAIS 210: Engagement Objectives

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FAIS 220: Engagement Acceptance and Appointment
FAIS 230: Using the Work of An Expert
FAIS 240: Engaging with Agencies
FAIS 250: Communication with Stakeholders
300 Series: Standards on Executing Assignments
FAIS 310: Planning the Assignment
FAIS 320: Evidence and Documentation
FAIS 330: Conducting Work Procedures
FAIS 340: Conducting Interviews
FAIS 350: Review and Supervision
FAIS 360: Testifying Before a Competent Authority
400 Series: Standards on Specialised Areas
FAIS 410: Applying Data Analysis
FAIS 420: Evidence Gathering in Digital Domain
FAIS 430: Loans Or Borrowings
500 Series: Standards on Reporting
FAIS 510: Reporting Results
600 Series: Standards on Quality Control
FAIS 610: Quality Control

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TEST YOUR KNOWLEDGE

Q.NO.1. Enumerate the steps to be undertaken in case of forensic accounting process.

ANSWER:

General Steps in Forensic audit. [6 Steps process in Q No 4]

Q.NO.2. Briefly discuss the key content of Forensic Accounting and Investigation Report.

ANSWER:

Contents of Forensic audit report as per FAIS [Point 3 & 4 of Q No 5]

Q.NO.3. ABC Ltd. is a listed company having turnover of ₹ 50 crores & plans expansion by installation of new machines at new building-having total additional project cost of ₹ 20 crore.

Rupees (In crore)	Purpose
10.0	**- for Building**
8.5	**- for Machinery**
1.5	**- for Working Capital**
20 Crore	**Total**

Project gets implemented in 2022-23 and one of the accountants report to the Managing Director that some suspicious transactions are noticed in the purchase of building material. But the Management is confused as to whether they should get an audit or Forensic Accounting done for the same. Advise Management about the difference in forensic accounting and audit.

ANSWER:

Refer Q No 1

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13. DIGITAL AUDITING AND ASSURANCE

Q NO 1. WHAT IS DIGITAL AUDIT AND POINT OUT THE FEATURES OF DIGITAL AUDIT?

ANSWER:

MEANING: Digital Audit is placing assurance on the effectiveness of the IT systems implemented in an organization. Technology is becoming an integral part of day-to-day business operations. It is essential that organizations review their technology-related controls to identify gaps and risks for continuous improvement and to ensure regulatory compliance. A strong controls and security position will allow organizations to build trust with their stakeholders.

KEY FEATURES OF A DIGITAL AUDIT:

1. Digital audit encourages the auditee to embrace the latest technological advancements and provides confidence to auditee to stay updated in a constantly evolving environment.

2. A digital audit improves the quality of opinion. This consequently leads to a more reliable audit report

3. Digital Audit leads to savings in time, cost and human effort which can be utilized towards more productive tasks. Many of today's digitally enabled processes can be orchestrated to operate autonomously 24x7, driving real-time transactions.

4. Digital Audit allows to standardize processes and allow controls to be implemented to mitigate risk.

5. The digital audit will help organization gain a more comprehensive overview of end-to- end processes and how technologies are utilized, controlled and optimized against standards set.

6. The digital audit will help create a future for a digital strategy and paves way for adopting new technologies such as AI and Robotic, usage of analytics and automation.

7. It can help auditee to make informed decisions.

ADVANTAGES OF DIGITAL AUDIT:

1. **ENHANCED EFFECTIVENESS & EFFICIENCY:** Increased efficiency is one of the key benefits of digital audit. With the use of tools and automation techniques, auditee can standardize the processes and routine tasks can be automated like automating a reconciliation process that previously involved hours increase efficiency and saves time and costs.

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2. **BETTER AUDIT QUALITY:** Technology can correctly evaluate massive volumes of data quickly. This can assist auditors in determining the areas that require more testing, lowering the chance that serious misstatements or other problems would go unnoticed.

3. **LOWER COSTS:** By automating processes that were previously done manually, technology can assist with the cost of auditing. This may shorten the time needed to complete an audit, which may lower the audit's overall cost.

4. **BETTER ANALYTICS:** Improved analytics capabilities can aid management and auditors in seeing trends and patterns that may be challenging to spot manually. For instance, AI can examine a lot of financial data to spot possible fraud, which is hard for auditors to spot manually.

5. **IMPROVED RISK ASSESSMENT:** Creating a number of automations to assist with the audit process and streamlined testing improves the risk assessment procedure. Management and auditors put their testing efforts on sites with a higher risk of material misstatement and make informed decisions.

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Q NO 2. WHAT ARE THE CONSIDERATIONS THAT ORGANISATIONS SHALL KEEP IN MIND WHILE USING DIGITAL TECHNIQUES AND AUTOMATION?

ANSWER:

1. Some considerations that organization should keep in mind while using digital techniques & automation:
    a. Know what business benefits the organization wants to achieve with automation

    b. Think people first and do not underestimate change is difficult.

    c. Target the right processes – this is a key for successful automation.

    d. Automation is not a standalone solution and should be part of a broader digitalization strategy.

    e. Ensure the process works and it is standardised before automating. Bots do not easily adapt to process change.

    f. Automation introduces new challenges for organization. Don't forget about governance and data security in the risk framework.

2. As auditors will obtain an understanding of management's implementation and oversight of new technologies, they also will perform procedures to understand the changes to the company's

business, including any changes to the information technology environment. Areas of focus could include understanding of the following:

a. New activities or changes to existing processes due to new technology (e.g., new revenue streams, changes in the roles and responsibilities of entity personnel, automation of manual tasks, changes in staffing levels that affect an entity's internal control environment)

b. Changes in the way the entity's systems are developed and maintained and whether these changes introduce new risks and require new controls to respond to those risks

c. The impact the new technology as how the organization obtains or generates and uses relevant, quality information to support the functioning of internal control.

Q NO 3. WHAT IS THE CONCEPT OF AUDITING DIGITALLY AND ADVANTAGES THERE OF?

ANSWER:

1. Auditing Digitally is using advancements in technology for conducting an effective and efficient audit. With a rapidly growing IT environment it is essential to adapt technology in auditing practices.

   For Example, Using Sampling Tools for selection of a sample size from a population based on materiality or using BOTs for analysis of statutory payments compliance as part of an audit assignment.

2. It is time to digitize the way an audit is delivered through automation and innovation. There are new technologies to help capture data, automate procedures, analyse information and focus on the real risks of the client.

3. The opportunity is in understanding how technology can help and then applying it to the auditing challenges.

4. **Expectations from an Auditor:**
   a. Audit teams need to involve the experts on different software applications and technologies. Having the right level of expertise of new technology (such as RPA, AI, blockchain technology) allows auditors to provide the highest quality of audit.

   b. Investment in digitally upskilling the people is the real secret to quality technology audit.

   c. Investment in technology across the profession has largely been focused on developing and using tools to automate and enhance existing processes, such as data

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analytics and collaboration and sharing tools, which help to drive quality in audits today. While this will remain core to the role of technology in the audit, there are many opportunities where more advanced technologies such as AI and drones could have an even bigger impact. Such technologies may also play a role in evolving the scope of the audit (e.g., in using data analytics and machine learning to help identify fraud).

For Example, A manager on a weekly basis performs a manual control to review if vendor master additions and changes in the system are done post appropriate approvals.

d. This control can be tested and reperformed by the auditor using RPA technology – BOTs can login into the system and generate the report and write the output to an Excel file. Based on the population the BOT will select the samples of changes to be tested. Further BOT will pull the correct file with approved changes from SharePoint. Then it will perform the testing wherein it will populate the details of approvals (date, approved by) and identify if changes made without approvals. Lastly BOT will summarise the results for all the selected samples in an excel file.

e. The auditor will then review the final results file to check if there are any exceptions (changes made without approvals) noted in the selected samples.

f. Due to the usage of BOT manual intervention has been reduced, more accurate results are populated, it results in saving auditors time as well and exceptions highlighted can be readily reviewed.

5. **KEY FEATURES OR ADVANTAGES OF AUDITING DIGITALLY:**

a. **IMPROVED QUALITY OF AUDITS:** The impact on quality is evident, through automation, data analytics techniques we can easily move from sample auditing to full population of transactions being reviewed or re-performed. This ultimately free up time for audit teams to analyses the information and better understand the business they audit. Technology requires an element of upfront investment, and it can be challenging to implement with regards to resources and people, but the value once it is up and running is undeniable.

b. **DECREASING HUMAN DEPENDENCY**: Using technology minimizes the manual intervention which ultimately results in reducing the risk of manual errors. Technology helps in streamlining the process of testing for auditors which decreases the errors which occur from the judgement of different individuals.

c. **INCREASES TRANSPARENCY**: With the technological advancement transparency has been increased. New ERPs and tools have audit trail feature available to trace the

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transaction end to end. It helps the management or auditors to review the details like the date on which any change is made, who made the change, what has been changed, all such details are captured and can be used while performing audit.

d. **AUTOMATION AND EASE:** Automating tasks like recording work in repositories, extracting data and sampling have improved the quality of audit and reduced the manual error. Using dashboards (e.g., Power BI) for reporting helps in understanding the position and helps the auditor to form his opinion.

e. **IMPROVED EFFICIENCY:** What used to take weeks to learn and programme using deep experts, is now easily available to auditors after some simple training and digital upskilling. The result may be increased efficiency and fewer errors, but the benefits are wider reaching and personal. This also results in improved retention of talent and confidence.

f. **BETTER RISK ASSESSMENT:** With usage of automation and technology in audit, auditor may focus on the real challenges and assess the potential risk precisely. It gives time to auditors to focus on the bigger picture rather than being involved with repetitive tasks. Dashboards, visual presentations and other tools helps in understanding where the risk lies and what all areas need more attention.

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Q NO 4. WHAT ARE THE CONSIDERATIONS IN AUDITING DIGITALLY?

ANSWER:

While all industry sectors are affected by the emergence of new technologies it is important to remember that the auditor's needs are unique. There are few questions it is important to ask and answer – at all stages of tech journey:

1. **What problems are you trying to solve?**
   Continuously evaluate the emerging technologies and latest tools to see what can benefit the audit. Think about what would make your audit easier or better and how you will measure return on your investment.

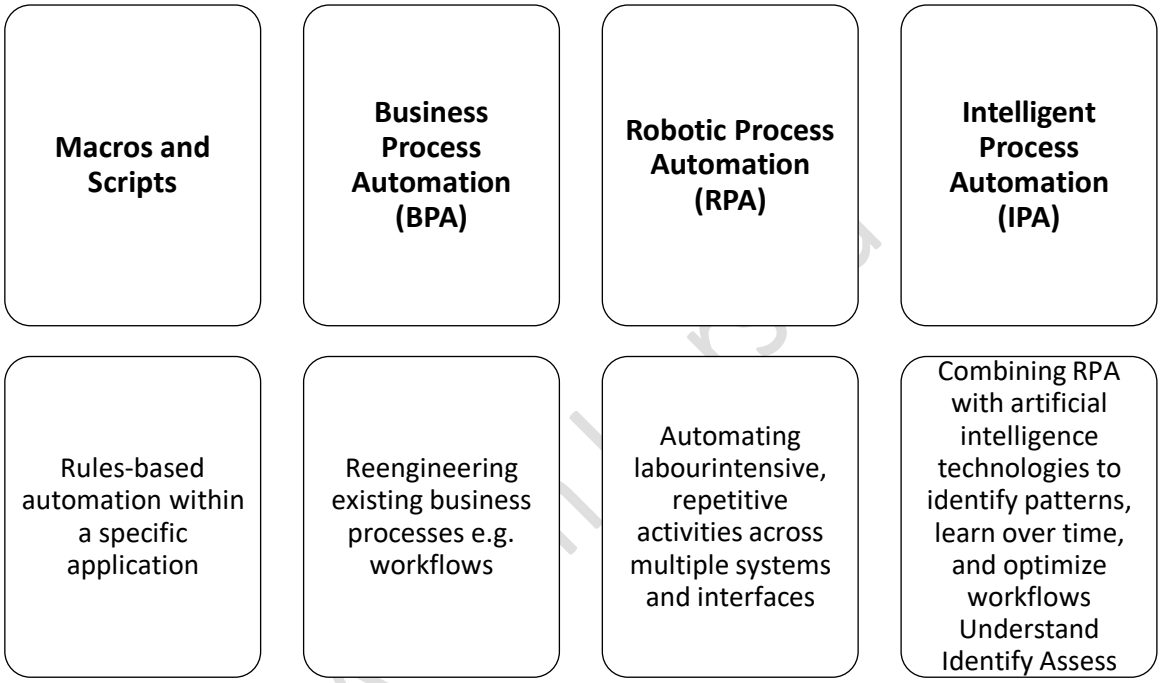
2. **Which technology can help you?**
   There are a number of tools available and many vendors and start-ups using data acquisition, manipulation and visualization tools. Consider how comfortably these solutions will integrate into your current processes and flag any potential implementation issues early on.

3. **How will you upskill your people to make best use of the technology available?**

Technology is only as good as the people using it. Training and development are critical to ensure teams understand how and why they are using the technology. Reluctance to change is obvious, however continuous training help them to get better.

4. **Range of automated solutions:**
   There is a range of automation solutions, from low to high sophistication, which helps to standardize the repeatable tasks and optimize the efforts resulting in doing better.

   Some of the techinques are using robotics and automation for data gathering activities, use of data analytics for planning and budgetting and reporting by dashboards.



Q NO 5. WRITE ABOUT UNDERSTANDING OF THE IT ENVIRONMENT?

ANSWER:

1. Understanding the ways in which the entity relies upon IT and how the IT environment is set up to support the business. This allows the auditor to better understand where risks might arise from the entity's use of IT (required as per SA 315).

2. Understanding how IT is used by the entity helps in identifying controls over the entity's IT processes.

3. Assessing the complexity of the IT environment helps the teams consider whether to involve IT specialists or experts in the planning and/or execution of the audit, including initial consideration of whether to include specialists in the complexity assessment.

4. The auditor's understanding of the automated environment should include the following:
   a. The applications that are being used by the company.
   b. Details of the IT infrastructure components for each of the application.
   c. The organization structure and governance.
   d. The policies, procedures and processes followed.
   e. Extent of IT integration, use of service organizations.
   f. IT risks and controls.

The illustration below is an example of how an auditor can document details of an automated environment:

Application	Used for	Database	Operating System	Network	Server and Storage
SAP ECC/ HANA	Integrated application software	Oracle 19c	HP-UX	LAN, WAN	HP Server and NAS
REVS	Front Desk, Guest Reservations	MS-SQL Server 2018	Windows 2016 Server	In-house developed	HP Server Internal HDD
KOTS	Restaurant and Kitchen Orders	MS-SQL Server 2018	Windows 2016 Server	In-house developed	HP Server Internal HDD
BILLSYS	Billing	Oracle 12c	Windows 2016 Server	Packaged Software	HP Server Internal HDD

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Q NO 6. WHAT ARE THE KEY AREAS FOR AN AUDITOR TO UNDERSTAND IT ENVIRONMENT ?

ANSWER:

Key Areas for an Auditor to Understand IT Environment are as follows:

1. **UNDERSTAND THE FLOW OF TRANSACTION:** The auditor's understanding of the IT environment may focus on identifying and understanding the nature and number of the specific IT applications and other aspects of the IT environment that are relevant to the flows of transactions and processing of information in the information system. Changes in the flow of transactions, or information within the information system may result from program changes to IT applications, or direct changes to data in databases involved in processing or storing those transactions or information.

2. **IDENTIFICATION OF SIGNIFICANT SYSTEMS:** The auditor may identify the IT applications and supporting IT infrastructure concurrently with the auditor's understanding of how information relating to significant classes of transactions, account balances and disclosures flows into, through and out the entity's information system.

3. **IDENTIFICATION OF MANUAL AND AUTOMATED CONTROLS:** An entity's system of internal control contains manual elements and automated elements (i.e., manual and automated controls and other resources used in the entity's system of internal control). An entity's mix of manual and automated elements varies with the nature and complexity of the entity's use of IT. The characteristics of manual or automated elements are relevant to the auditor's identification and assessment of the risks of material misstatement.

4. **IDENTIFICATION OF THE TECHNOLOGIES USED:** The need to understand the emerging technologies implemented and the role they play in the entity's information processing or other financial reporting activities and consider whether there are risks arising from their use.
Given the potential complexities of these technologies, there is an increased likelihood that the engagement team may decide to engage specialists and/or auditor's experts to help understand whether and how their use impacts the entity's financial reporting processes and may give rise to risks from the use of IT. Some examples of emerging technologies are:
   - Blockchain, including cryptocurrency businesses (e.g., token issuers, custodial services, exchanges, miners, investors)
   - Robotics
   - Artificial Intelligence
   - Internet of Things
   - Biometrics
   - Drone

5. **ASSESSING THE COMPLEXITY OF THE IT ENVIRONMENT:** Not all applications of the IT environment have the same level of complexity. The level of complexity for individual characteristics differs across applications. Complexity of IT Environment is assessed based on the following factors:
   a. Automation used in the organization,
   b. Entity's reliance on system generated reports,
   c. Customization in IT applications,
   d. Business model of the entity,
   e. Any significant changes done during the year and
   f. Implementation of emerging technologies.

Q NO 7. WRITE ABOUT IDENTIFYING THE RISKS ARISING FROM USAGE OF IT?

ANSWER:

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1. **UNAUTHORISED ACCESS TO DATA:** Unauthorized access to data that may result in destruction of data or improper changes to data, including the recording of unauthorized or non-existent transactions, or inaccurate recording of transactions. Particular risks may arise where multiple users access a common database.

2. **RISK OF PRIVILAGED ACCESS:** The possibility of IT personnel gaining access privileges beyond those necessary to perform their assigned duties thereby breaking down segregation of duties. Unauthorized changes to data in master files.

3. **CHANGES TO DATA:** Unauthorized changes to IT applications or other aspects of the IT environment.

4. **UPDATE FAILURES:** Failure to make necessary update IT applications or other aspects of the IT environment.

5. Inappropriate manual intervention.

6. **DATA LOST:** Data loss or data corruption is a major risk which arises from use of IT. If appropriate cybersecurity controls and protocols not followed it may lead to loss of sensitive data, hackers might encrypt your system or illegally break into your system. Risk of fraud can arise if users alter the information or there is a case of physical security breach or theft of sensitive information.

7. **DOWNTIME:** There is a risk of system downtime which is caused by hardware failures, faulty configurations, cyberattacks or power outage. It means the IT systems will not be operational or will be unavailable/offline which may hamper the business.

8. **INTEGRATION ISSUES:**

    a. Since companies uses more than one IT systems to support their business system integration (means integrating one or more systems) and system compatibility comes in place. However, system integration and compatibility have some risks. In case of system failure in one system may also lead to widespread failure in integrated systems. Or if the integration between two systems is not appropriate the end result would be incorrect.

    b. System compatibility means sharing compatible hardware, software and operating system while performing the integration. Compatibility risks arises if different versions of same software are used, if the patches are not upgraded which may lead to bugs.

9. **COMPLIANCE RISKS:** With advancement in usage of IT the risk of regulatory compliances increases. Any change in the law, order, guidelines or agreements will impact the business, its related costs, investments etc. A FMCG sector will be subject to different regulatory requirements than a financial company, however both businesses will need to manage their

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respective compliance risks.

10. **PERFORMANCE ISSUES:** Performance Issues arises with the way requests are processed in the IT systems. Heavy data load, network usage impacts the application performance and its responsiveness. To overcome the performance issues of IT systems, resources or hardware can be added to an existing node, which is known as scaling. However, scaling can be expensive therefore an informed decision should be made in case of adding a hardware or changing the architecture.

Q NO 8. WHILE AUDITING IN AN IT ENVIRONMENT IT IS IMPORTANT KNOW HOW TO IDENTIFY THE IT DEPENDENCIES IMPACTING THE AUDIT. DESCRIBE?

ANSWER:

Identifying and documenting the entity's IT dependencies in a consistent, clear manner helps to identify the entity's reliance upon IT, understand how IT is integrated into the entity's business model, identify potential risks arising from the use of IT, identify related IT General Controls and enables us to develop an effective and efficient audit approach.

How IT dependencies arise?

IT Dependencies are created when IT is used to initiate, authorize, record, process, or report transactions or other financial data for inclusion in financial statements.

There are five types of IT dependencies as described below:

TYPE	DESCRIPTION
AUTOMATED CONTROLS	Automated controls are designed into the IT environment to enforce business rules. For example: a. Purchase order approval via workflow or format checks (e.g., only a particular date format is accepted), b. Existence checks (e.g., Duplicate customer number cannot exist), c. Reasonableness checks (e.g., maximum payment amount) when a transaction is entered.
REPORTS	System generated reports are information generated by IT systems. These reports are often used in an entity's execution of a manual control, including business performance reviews, or may be the source of entity information used by us when selecting items for testing, performing substantive tests of details or performing a substantive analytical procedure. E.g. (Vendor master report, customer ageing report)
CALCULATIONS	Calculations are accounting procedures that are performed by an IT system

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	instead of a person. For example, the system will apply the 'straight-line' depreciation formula to calculate depreciation of an asset (i.e., cost of the asset, less the residual value of the asset at the end of its useful life divided by the useful life of the asset) or the system will calculate the value of the amount invoiced to a customer by multiplying the item price times the quantity shipped.
SECURITY	Security including segregation of duties is enabled by the IT environment to restrict access to information and to determine the separation of roles and responsibilities that could allow an employee to perpetrate and conceal errors or fraud, or to process errors that go undetected.
INTERFACES	Interfaces are programmed logic that transfer data from one IT system to another. For example, an interface may be programmed to transfer data from a payroll sub- ledger to the general ledger.

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Q NO 9. AUDITORS UNDERSTANDING OF RESPONDING TO RISKS ARISING FROM IT DEPENDENCIES BY MANAGEMENT OF THE ENTITY. DESCRIBE?

ANSWER:

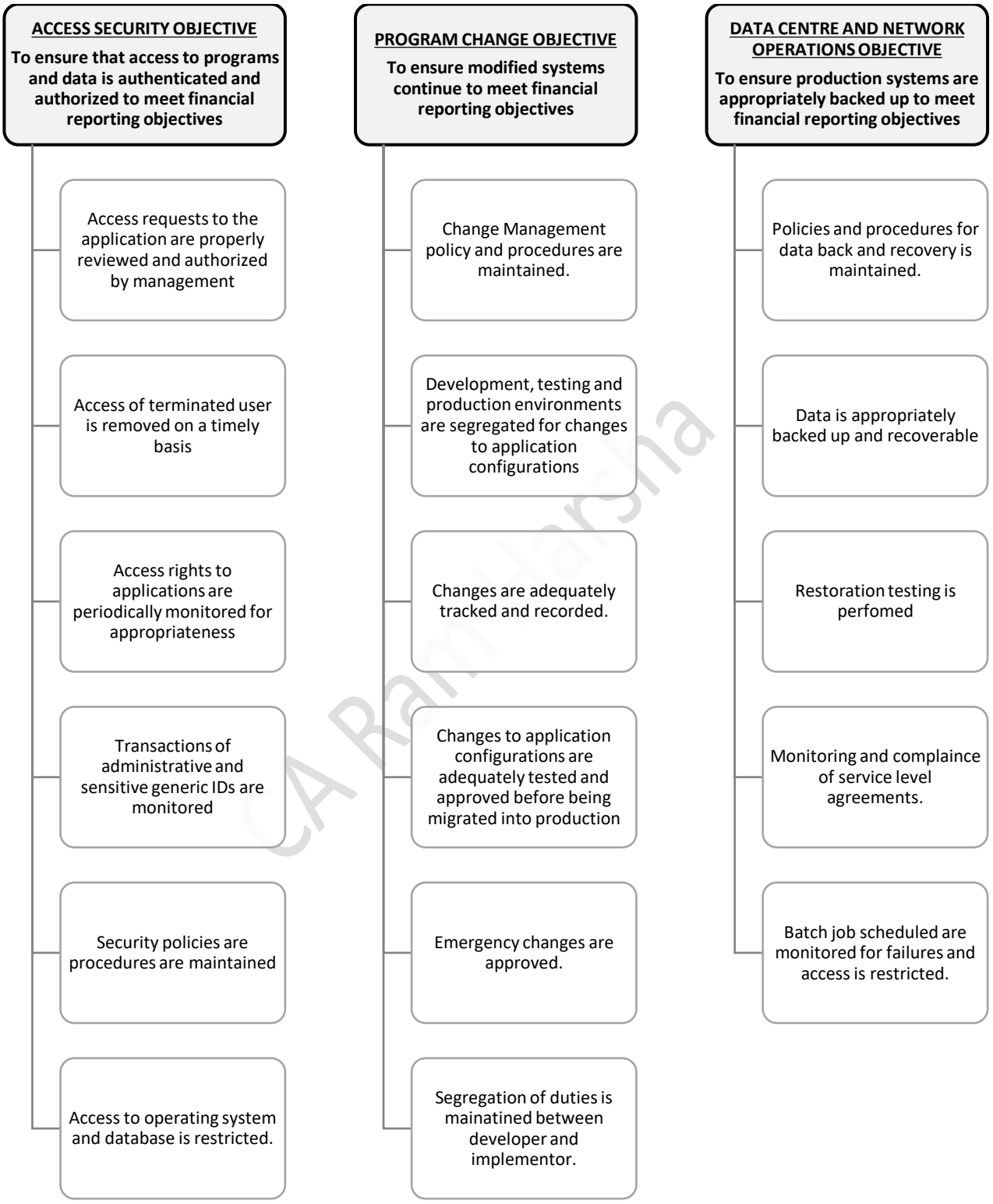
1. When auditors identify IT dependencies that are relevant to the entity's flow of transactions and processing of financial information, they need to understand how management responds to the associated risks that may arise from them.

2. Management may implement information technology general controls (ITGCs) to address risks related to IT dependencies.

3. IT dependencies may also affect the design of the entity's controls and how they are implemented.

   Therefore, auditors consider IT dependencies relevant to audit and evaluate the related risks. Auditor should scope in ITGCs to tests when there are IT dependencies identified in the system. If the controls around IT environment are not implemented or operating effectively it will result in not relying on ITGCs which means the IT dependencies could not be relied upon.

The illustration below is an overview of the Control Objectives and controls for each area of General IT Controls:



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Q NO 10. WRITEA ABOUT ASSESSING CYBER RISKS (INCLUDING REMOTE AUDIT)?

ANSWER:

1. **MEANING:** A cyber-attack is an attempt to gain unauthorized access to a computing system or network with the intent to cause damage, steal, expose, alter, disable, or destroy data.

2. Regulators across the globe have placed the topic of cyber risk management under increasing scrutiny, requiring financial institutions to assess the maturity of their cybersecurity program, manage cyber risks, and enhance resiliency against cyber-attacks.

3. Most common types of cyber- attacks are:

    a. **MALWARE** : Malware or malicious software is any program or code that is created with the intent to do harm to a computer, network or server. Malware is the most common type of cyberattack, its subsets are ransomware, fileless Malware trojans, viruses etc.

Type	Description
Ransomware	1. In a ransomware attack, an adversary encrypts a victim's data and offers to provide a decryption key in exchange for a payment. 2. Ransomware attacks are usually launched through malicious links delivered via phishing emails, but unpatched vulnerabilities and policy misconfigurations are used as well.
Fileless Malware	Fileless malware is a type of malicious activity that uses native, legitimate tools built into a system to execute a cyber-attack. Unlike traditional malware, fileless malware does not require an attacker to install any code on a target's system, making it hard to detect.
Trojan	1. A trojan is malware that appears to be legitimate software disguised as native operating system programs or harmless files like free downloads. 2. Trojans are installed through social engineering techniques such as phishing or bait websites.
Mobile Malware	Mobile malware is any type of malware designed to target mobile devices. Mobile malware is delivered through malicious downloads, operating system vulnerabilities, phishing, smishing, and the use of unsecured Wi-Fi.

    b. **DENIAL-OF-SERVICE (DoS) ATTACKS** :

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i. A Denial-of-Service (DoS) attack is a malicious, targeted attack that floods a network with false requests in order to disrupt business operations.

ii. In a DoS attack, users are unable to perform routine and necessary tasks, such as accessing email, websites, online accounts or other resources that are operated by a compromised computer or network.

iii. While most DoS attacks do not result in lost data and are typically resolved without paying a ransom, they cost the organization time, money and other resources in order to restore critical business operations.

c. **PHISHING**: Phishing is a type of cyberattack that uses email, SMS, phone, social media, and social engineering techniques to entice a victim to share sensitive information — such as passwords or account numbers — or to download a malicious file that will install viruses on their computer or phone.

Type	Description
Spear Phishing	Spear-phishing is a type of phishing attack that targets specific individuals or organizations typically through malicious emails. The goal of spear phishing is to steal sensitive information such as login credentials or infect the targets' device with malware.
Whaling	A whaling attack is a type of social engineering attack specifically targeting senior or C-level executive employees with the purpose of stealing money or information or gaining access to the person's computer in order to execute further cyberattacks.
Smishing	Smishing is a type of fraudulent practice of sending text messages purporting to be from reputable companies in order to induce individuals to reveal personal information, such as passwords or credit card numbers.
Vishing	Vishing, a voice phishing attack, is the fraudulent use of phone calls and voice messages pretending to be from a reputable organization to convince individuals to reveal private information such as bank details and passwords.

d. **SPOOFING**: Spoofing is a technique through which a cybercriminal disguises themselves as a known or trusted source. In so doing, the adversary is able to engage with the target and access their systems or devices with the ultimate goal of stealing information, extorting money or installing malware or other harmful software on the device.

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Type	Description
Domain Spoofing	Domain spoofing is a form of phishing where an attacker impersonates a known business or person with fake website or email domain to fool people into the trusting them. Typically, the domain appears to be legitimate at first glance, but a closer look will reveal subtle differences.
Email Spoofing	Email spoofing is a type of cyberattack that targets the businesses by using emails with forged sender addresses. Because the recipient trusts the alleged sender, they are more likely to open the email and interact with its contents, such as a malicious link or attachment.

e. **IDENTITY-BASED ATTACKS**: When a valid user's credentials have been compromised and an adversary is pretend to be that user. For e.g., people often use the same user ID and password across multiple accounts. Therefore, possessing the credentials for one account may be able to grant access to other, unrelated account.

f. **INSIDER THREATS**: When current or former employees that pose danger to an organization because they have direct access to the company network, sensitive data, and intellectual property (IP), as well as knowledge of business processes, company policies or other information that would help carry out such an attack.

g. **DNS TUNNELING:** DNS Tunneling is a type of cyberattack that leverages domain name system (DNS) queries and responses to bypass traditional security measures and transmit data and code within the network. This tunnel gives the hacker a route to unleash malware and/or to extract data, IP or other sensitive information by encoding it bit by bit in a series of DNS responses.

h. **IoT-BASED ATTACKS:** An IoT attack is any cyberattack that targets an Internet of Things (IoT) device or network. Once compromised, the hacker can assume control of the device, steal data, or join a group of infected devices.

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Q NO 11. WHAT ARE THE STAGES OF CYBER RISKS?

ANSWER:

1. **STAGE 1 - ASSESSING THE CYBER RISK:** No organization is completely immune to a cyber risk. Different clients will have different levels of risks, even with the same industry. Every organization should consider at least the common threats**:**
   a. Ransomware disabling their organization (including their plants and manufacturing facilities)
   b. Common criminals using email phishing and hacks for fraud and theft.
   c. Insiders committing malicious activities or accidental activities resulting in unintended

discourse of information theft and frauds.

2. **STAGE 2 - IMPACT OF CYBER RISK:** Cyber-attack can impact one, two or more types of risks. The impact of the attack would vary from organization to organization and most importantly from an attack to attack. Some of the indicative areas can be:
   a. Regulatory costs
   b. Business interruptions causing an operational challenge for an organization.
   c. Data loss, reputational loss and litigation.
   d. Ransomware - more common these days where entire systems are encrypted
   e. Intellectual property theft which may not only take the competitive advantage, but we may also result in any impairment/impediment charge because of the loss of IP.
   f. Incident response cost which could be for investigations & remediations
   g. Breach of Privacy, if personal data of a consumer is hacked it could have a significant impact on the organization.
   h. Fines and penalties

3. **STAGE 3 - MANAGING THE CYBER RISK**: A strategic approach to cyber risk management can help an organization to:
   i. Gain a holistic understanding of the cyber risks, threats facing their organization and other financial institutions
   j. Assess existing IT and cybersecurity program and capabilities against the relevant regulatory requirements
   k. Align cybersecurity and IT transformation initiatives with strategic objectives and critical risks
   l. Understand accepted risks & documented compensating controls

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Q NO 12. WRITE ABOUT CYBER SECURITY FRAMEWORK?

ANSWER:

Cybersecurity framework includes how management is identifying the risk, protecting and safeguarding its assets (including electronic assets) from the risk. Management preparedness to detect the attacks, anomalies and responsiveness to the adverse event.

A. IDENTIFY THE RISK:

1. Auditor has to determine whether the entity's risk assessment process considers cybersecurity risks.

2. Entity should conduct a periodic risk assessment & develop a management strategy which identifies cybersecurity risks around IT system failure affecting the entity's primary business or potential loss of data or inability to access data as required, Risk of unauthorized access to the IT network.

3. The entity should maintain and periodically reviews an inventory of their information assets- i.e., Asset Management (e.g., intellectual property, patents, copyrighted material, trade secrets and other intangibles).

4. The entity should classify and prioritize protection of their information assets based on sensitivity and business value and periodically reviews the systems connected to the network on which digital assets reside.

5. From the governance perspective management should review how cybersecurity risks affect internal controls over financial reporting. In case of adverse attack how management is going to assess the impact on the recoverability of financial data and impact on revenue recognition.

6. Management needs to identify if any established a risk-based cybersecurity program can be leveraged e.g. (NIST, ISO etc.)

7. To determine overall responsibility for cybersecurity in the business environment entity should establish roles and responsibilities over cybersecurity (CISO, CIO).

8. Further the risk assessment should be discussed with those charged with governance (e.g., the Audit Committee or Board of Directors).

B. PROTECT THE RISK:

1. Obtained an understanding of the entity's processes for safeguarding of assets subject to cybersecurity. Entity monitors whether there has been unauthorized access to electronic assets and any related impact on financial reporting.

2. Formal training should be conducted to make the teams aware of the risk associated with cyber- attacks.

3. Entity should implement effective controls for data security.

4. Entity should have a process & procedures in place for identifying material digital/electronic assets on the balance sheet subject to cybersecurity risk (e.g., intellectual property, patents, copyrighted material, trade secrets) and prioritizing their protection based on criticality.

C. DETECT THE RISK:

1. Entity should have controls and procedures that enable it to identify cybersecurity risks and incidents and to assess and analyse their impact on the entity's business, evaluate the significance associated with such risks and incidents, and consider timely disclosures**.**

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2. Review entity's processes to monitor and detect security breaches or incidents. If management has implemented anti-virus in the system to secure it from anomalies or if firewall logs are being continuously monitored to detect any repetitive attacks.

3. A monitoring process should be established to review how many such events have been denied by the firewall. Monitoring process should also include if any upgrades or updates are required to safeguard the systems from vulnerabilities.

D. RESPOND TO THE RISK:

1. In case of material cybersecurity or data breach has been identified management should capture the details of nature of incident and how the incident or data breach was identified.

2. Entity should have a response planning in place to capture the details of nature of incident and the same needs to be communicated with those who are ultimately responsible for this framework and with those charge with governance.

3. The security incident response plan helps in analysing the impact and severity of the attack and helps the organisation in taking the appropriate actions.

4. Management should assess Litigation costs, Regulatory investigation costs and Remediation costs as a part of mitigation process and improvement management should assess the future action plans that needs to be taken to safeguard the organisation from such attacks.

E. RECOVER FROM RISK:

1. Entity should undertake appropriate actions to recover from the attack and make sure the business is up and running.

2. Once the impact evaluated and communicated with the regulators the recovery plan needs to be implemented to overcome the impact.

3. Necessary improvements – like patch upgrades, better controls, improved technology in terms of firewall, anti-virus, tools etc. needs to be implemented to safeguard the entity.

ILLUSTRATION 1.

Sukanya, a CA final student, is of the view that cyber risks are issues of IT and result only in information loss to an entity. She also feels that many cyber-attacks are not directly targeted at financial systems and do not pose risk of material misstatements to financial statements of an entity.
Is her view proper?

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ANSWER:

The cyber risks are not an issue of IT alone. Rather, it is a business risk and has an effect on whole business organization. It affects entity's reputation and can lead to many other consequences. They are:

a. Regulatory costs
b. Business interruptions causing an operational challenge for an organization.
c. Data loss, reputational loss and litigation.
d. Ransomware - more common these days where entire systems are encrypted
e. Intellectual property theft which may not only take the competitive advantage, but we may also result in any impairment/impediment charge because of the loss of IP.
f. Incident response cost which could be for investigations & remediations
g. Breach of Privacy, if personal data of a consumer is hacked it could have a significant impact on the organization.
h. Fines and penalties

It may happen that many cyber attacks are not directly targeted at financial systems. However, the access gained by the attackers may provide them the ability to:

1. Manipulate or modify financial records
2. Modify key automated business rules
3. Modify automated controls relied upon by the management.

Further, auditor should consider whether cyber risk (like other business risks) represents a risk of material misstatement to the financial statement as part of the audit risk assessment activities.

Focus should be on understanding the cyber risks affecting the entity and the actions being taken to address these risks.

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DETAILED EXAMPLE OF A CYBER ATTACK:

WHAT HAS HAPPENED:

The CEO of a hotel realized their business had become the victim of wire fraud when the accounts payable executive began to receive insufficient fund notifications for regularly recurring bills.
A review of the accounting records exposed a serious problem. Upon investigating it was noted that the CEO had clicked on a link in an email that he thought was from the trusted source. However, it wasn't and when he clicked the link and entered his credentials, the cyber criminals captured the CEO's login information, giving them full access to intimate business and personal details.

TYPE OF ATTACK: Social engineering, phishing attack.

A phishing attack is a form of social engineering by which cyber criminals attempt to trick individuals by creating and sending fake emails that appear to be from an authentic source, such as a business or colleague. The email might ask you to confirm personal account information such as a password or prompt you to open a malicious attachment that infects your computer with malware.

RESULT: The hotel's cash reserves were depleted. The fraudulent transfers amounted to more than ₹1 million. The hotel also contacted a cybersecurity firm to help them mitigate the risk of a repeat attack.

IMPACT: The business lost ₹1 million, and the funds were not recovered. Further there was loss of business reputation too.

LESSONS LEARNED:

1. Train the staff about the dangers of clicking on unsolicited email links and attachments, and the need to stay alert for warning signs of fraudulent emails. Engage in regular email security training.

2. Implement stringent wire transfer protocols and include a secondary form of validation (Multi Factor Authentication)

3. Have a cyber incident response plan ready to implement.

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Q NO 13. WHAT ARE THE CONTROL CONSIDERATIONS FOR CYBER RISKS?

ANSWER:

Apart from having the cyber security policies, procedures, framework and regular assessment in place, management should have a strong and updated internal controls to ensure they are covered from cyber risks:

1. CONTROLS AROUND VENDOR SETUP AND MODIFICATIONS:

a. Certain cyber schemes exist in which changes to bank account or other critical vendor information are requested through email phishing scams by individuals purporting to be authorized vendor personnel.

b. Entities have inappropriately dispersed funds to these individuals and therefore inappropriately reduced the liability owed to the actual vendor, resulting in an impact to the financial statements (i.e., loss of cash and related expense)

   i. Who is responsible for making changes to vendor master data? Is the process centralized or decentralized?

ii. Are other communication channels, such as email, used to request changes to vendor master data? (If yes, consider if multi-factor authentication is enabled for email).

iii. What systems and technologies are used to initiate, authorize and process requests related to changes to vendor master data?

iv. Are authentication protocols defined to verify modifications to vendor master data (e.g., call back procedures, multi-factor authentication)?

2. CONTROLS AROUND ELECTRONIC TRANSFER OF FUNDS:

Wire transfers or electronic funds transfers, similar to vendor changes noted above, cyber schemes pertaining to fraudulent requests for wire transfers are made relating to business transactions and vendor payments, as well as fraudulent requests appearing to come from financial institutions requesting disbursement from customer asset accounts.

a. Are personnel responsible for wire transfers educated on the relevant threats and information related to common phishing scams associated with fraudulent requests for wire transfers?

b. Are authentication protocols defined to verify wire transfer requests (e.g., call back procedures, dual-authentication procedures)?

c. What systems and technologies are used to facilitate the request/initiation, authorization and release of wire transfers?

3. CONTROLS AROUND PATCH MANAGEMENT:

Cyber and ransomware attacks exploit known security vulnerabilities resulting in the manipulation or the destruction of data. Exploitations of known security vulnerabilities are often caused by unapplied patches or upgrades.

a. Does the entity have a patch management program?

b. Does the entity run periodic vulnerability scans to identify missing/unapplied patches?

c. How is the entity notified of patches by external vendors (e.g., Microsoft for Windows patches)?

Q NO 14. WHAT IS THE CONCEPT OF REMOTE AUDIT AND WHAT ARE THE CONSIDERATIONS FOR REMOTE AUDIT?

ANSWER:

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Remote audit or virtual audit is when the auditor uses the online or electronic means to conduct the audit. It could be partially or completely virtual, auditor engages using technology to obtain the audit evidence or to perform documentation review with the participation of the auditee.

Audit planning and scoping is crucial in every audit. This includes a discussion of the scope and schedule, and the ways to conduct audit.

Remote auditing plays a vital part, and provide assurance when unprecedented circumstances, like COVID. It provides an opportunity for organisations and auditors to leverage communication technology tools. In addition, management perception about remote audits is changing as it provides flexibility in terms of time ensuring that day-to-day business activities are not impacted, along with the reductions in cost.

CONSIDERATIONS FOR REMOTE AUDIT: Auditors must develop tailored strategies to ensure the remote audit meets the requirements and deliver results equivalent to traditional onsite audits.

1. **FEASIBILITY AND PLANNING:**
   a. Planning should involve agreeing on audit timelines, meeting platform (Zoom calls/ Microsoft Teams/Google Meet) to be used for audit sessions, data exchange mechanisms, any access authorization requests.

   b. Ensure feasibility is determining what technology may be used, if auditors and auditees have competencies and that resources are available.

   c. The execution phases of a remote audit involve video/tele conferencing with auditees. The documentation for audit evidence should be transferred through a document sharing platform.

2. **CONFIDENTIALITY, SECURITY AND DATA PROTECTION:**
   a. To ensure data security and confidentiality, access to document sharing platform should be sufficiently restricted and secured by encrypting the data that is sent across the network.

   b. The information, once reviewed and documented by auditor, is removed from the platform, and stored according to applicable archiving standards and data protection requirements.

   c. Auditors should take into consideration legislation and regulations, which may require additional agreements from both sides (e.g., there will be no recording of sound and images, or authorizations to using people's images).

   d. Auditors should not take screenshots of auditees as audit evidence. Any screenshots of documents or records or other kind of evidence should be previously authorized by the audited organization.

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e. In case of accessing the auditee's IT system auditor should use VPN (Virtual private network). VPN is a service which creates safe and encrypted online connection. It prevents unauthorized users to enter into network and allows the users to perform work remotely.

3. **RISK ASSESSMENT:** The communication from auditor as well as auditees need to clear and consistent, and this becomes crucial during remote audit. The risks for achieving the audit objectives are identified, assessed and managed. The assessment if remote audit would be sufficient to achieve the audit objectives should be done and documented for each audit involving all members of the audit team and the audited organization representative.

ADVANTAGES AND DISADVANTAGES OF REMOTE AUDIT:

ADVANTAGES	DISADVANTAGES
Cost and time effective: No travel time and travel costs involved.	Due to network issues, interviews and meetings can be interrupted.
Comfort and flexibility to the audit team as they would be working from home environment,	Limited or no ability to visualize facility culture of the organization, and the body language of the auditees. Time zone issues could also affect the efficiency of remote audit session
Time required to gather evidence can spread over several weeks, instead of concentrated into a small period that takes personnel from their daily activities.	The opportunity to present doctored documents and to omit relevant information is increased. This may call for additional planning, some additional/different audit procedures, Security and confidentiality violation.
Auditor can get first-hand evidence directly from the IT system as direct access may be provided.	Remote access to sensitive IT systems may not be allowed. Security aspects related to remote access and privacy needs to be assessed
Widens the selection of auditors from global network of experts.	Cultural challenges for the auditor. Lack of knowledge for local laws and regulations could impact audit. Audit procedures like physical verification of assets and stock taking cannot be performed.

Q NO 15. WHAT ARE THE EMERGING TECHNOLOGIES IN AUDIT?

ANSWER:

1. Emerging technologies are altering the financial reporting environment substantially, and this change is accelerating. Some examples of emerging technologies are – Data analytics (CAATs (ACL, Alteryx, Power BI, CaseWare), Artificial Intelligence (AI), Robotic Process Automation, and

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Blockchain). These are changing the way business gets done, and auditors are leading by transforming their own processes.

2. As the use of emerging technologies in the financial reporting process increases, it becomes important for auditor and the client to upskill on the emerging technologies.

3. Some important considerations for auditors are to assess the impact of emerging technologies on business and evaluate whether management is properly assessing the impact of emerging technologies on internal control over financial reporting.

4. DATA ANALYTIC TECHNIQUES:

a. Generating and preparing meaningful information from raw system data using processes, tools, and techniques is known as Data Analytics.

b. Audit analytics or audit data analytics involves analyzing large sets of data to find actionable insights, trends, draw conclusions and for informed decision making. The use of audit analytics enables greater efficiencies and more accurate findings from the review process.

c. As a result, businesses will be able to create strategies based on verifiable data and professional assumptions and auditors can improve the audit quality. It allows auditors to more effectively audit the large amounts of data held and processed in IT systems in larger clients.

d. Audit analytics helps:
   i. To discover and analyze patterns
   ii. Identifying anomalies
   iii. Extract other useful information in data

Q NO 16. WHAT DO YOU MEAN BY CAAT's AND EXAMPLES OF VARIOUS TOOLS OF CAAT's?

ANSWER:

The data analytics methods used in an audit are known as Computer Assisted Auditing Techniques or CAATs. It involves use of multiple data analytical tool or visualization tools that can help the auditor to deep dive into the problem statement and hence increase the audit quality. This also minimizes the scope of missing out on key attributes that might be of a higher risk to the organization and its respective business.

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Auditor performing audit analytics can make use of various applications and tools that help them to analyse large data sets and obtain insights that help them to make the quality of the audit better. Some of the popular tools used across the industry as part of CAATs are listed below:

1. **ACL:** Audit Command Language (ACL) Analytics is a data extraction and analysis software used for fraud detection and prevention, and risk management. It samples large data sets to find irregularities or patterns in transactions that could indicate control weaknesses or fraud.

> **Example:** ACL (Audit Command Language) is used to analyse and check complete data sets to perform Trial Balance reconciliations during the Audits.
>
> In such case scenarios, the entity provided the General Ledger dump and system Trial Balance. Using ACL, the completeness of the data can be ensured as the data set exceeded beyond the capacity of the excel and basic functions like record count, sum, pivoting can be performed within ACL where excel could not perform such actions.

2. **ALTERYX**:
   a. Alteryx is used to consolidate financial or operational data to assess controls. A fully transparent audit trail of every action is performed in Alteryx in form of a workflow which makes it easier for the user to learn as no prior knowledge of coding or scripting is required.

   b. Alteryx can also be leveraged to automate analytics and perform Machine Learning to search for patterns indicative of fraud or irregularities speed up your processes like accounting close, tax filings, regulatory reporting, forecast creation etc.

   c. It can also be used to automate set procedures that are performed periodically like reconciliations, consolidations, marketing workflows, system integrations, continuous audits etc.

> **Example:** Alteryx used for logistics organization to recompute the revenue entries recorded by the system to match with the financials that showcased the expected revenue turnover. Due to Alteryx's processing speed and ease to implement functions, auditors could perform re-computation for all the transactions entry and noted that the revenue was being understated as the expected revenue was more than the actual calculated. This was due the fact that the addendum between the logistic company and the client was not revised in the system and old versions of rates were used to compute the revenue. Alteryx helped in analysing and recomputing the huge data set and to focus on actual risk.

3. **Power BI**: Power Bi is a business intelligence (BI) platform that provides nontechnical business users with tools for aggregating, analyzing, visualizing and sharing data. From audit perspective, such visualization tools can be used to find the outliers in the population, it can also be used for

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reporting purpose (audit reports) in an interactive dashboard to the higher management.

Example: Power BI dashboard used for checking the outliers of the apparel company. Auditors were required to analyse the trends of the sales during the year. By the use of Power BI, the sales data provided by the client was further converted into dashboard to analyse the trends and patterns as per the market standards.

In analysis performed on untimely sales, it was noted that sales transactions were performed during non-business hours.

4. **CaseWare**: CaseWare is a data analysis software & provide tools that helps in conducting audit and assurance engagements quickly, accurately and consistently. It shares analytical insights which help in taking better informed decisions. It helps in streamlining processes and eliminating the routine tasks. Used by accounting firms, governments and corporations worldwide, this trusted platform integrates everything you need to conduct assurance and reporting engagements.

Example: CaseWare provides the solutions to build accounting software which turns any document, including financial statements into cost effective client ready report.
It automatically links to client data and securely communicate with the client in real time. Regardless of location, all authorized users have access to the same documents. Consistency of data is ensured. Refer screenshot below to illustrate audit, review and compilation process maintained on-screen.

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ILLUSTRATION 2.

CA Y is planning to use CAATs extensively in audit of a company-be it for compliance tests or substantive tests. Can you list out examples of few situations (in brief) of tests performed by him using CAATs?

ANSWER:

1. **Identify exceptions:** Identify exceptional transactions based on set criteria. For example, cash transactions above Rs. 10,000.
2. **Identify errors:** Identify data, which is inconsistent or erroneous. For e.g.: account number which is not numeric.
3. **Verify calculations:** Re-perform various computations in audit software to confirm the results from application software confirm with the audit software. For e.g.: TDS rate applied as per criteria.

4. **Existence of records:** Identify fields, which have null values. For example: invoices which do not have vendor name.
5. **Data completeness:** Identify whether all fields have valid data. For example: null values in any key field such as date, invoice number or value or name.
6. **Data consistency:** Identify data, which are not consistent with the regular format. For example: invoices which are not in the required sequence.
7. **Duplicate payments:** Establish relationship between two or more tables as required. For example, duplicate payment for same invoice.
8. **Accounts exceeding authorized limit:** Identify data beyond specified limit. For example, transactions entered by user beyond their authorized limit or payment to vendor beyond amount due or overdraft allowed beyond limit.

Q NO 17. WRITE ABOUT AUTOMATED TOOLS IN AUDIT?

ANSWER:

Enterprises are adopting emerging technologies at a rapid pace to create synergies and harness the latest technologies. Robotic process automation (RPA), blockchain, machine learning, Internet of Things (IOT) and artificial intelligence (AI) are some prime examples of automation.

Automation and use of technology often requiring auditors to understand and perform procedures on a larger group of systems that produce information relevant to the production of financial statements.

Based on managements and auditors' independent risk assessment procedures, the audit's scope may need to include peripheral systems, as well as testing general IT and application controls relative to those systems due to the increased use of technology that is relevant to financial reporting.

A. INTERNET OF THINGS [IoT]:

1. IoT is the concept of connecting any device (cell phones, coffee makers, washing machines, and so on) to the internet. Key components of IoT are data collection, analytics, connectivity, and people and process.

2. IoT not only changes the business model, but also affects the strategic objectives of the organization. The risk profile of the entity changes with exposure to new laws and regulations.

Example: Connected Cars, connected manufacturing equipment's, smart home security, (The options for home security from doorbell cameras or outdoor cameras - users can view video feeds

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when they are away from home) or Data from machines can be used to predict whether equipment will break down, giving manufacturers advance warning to prevent long stretches of downtime. Or a refrigerator placing an order with a grocery store whenever the supply of eggs falls below a certain number. Or smart oven works by scanning QR or bar codes and connecting to Wi-Fi, which it then uses to determine the best temperature and time to cook the food to avoid undercooking or burning. Researchers uses IoT devices to gather data about customer preferences and behavior, though that can have serious implications for privacy and security.

3. **AUDIT IMPLICATIONS:**
    a. A shift to connected devices and systems may result in auditors not being able to rely only on manual controls. Instead, auditors may need to scope new systems into their audit. Audit firms may need to train and upskill auditors to evaluate the design and operating effectiveness of automated controls.

    b. Consumer-facing tools that connect to business environments in new ways can impact the flow of transactions and introduce new risks for management and auditors to consider.

    c. Consider payment processing tools that allow users to pay via credit card at a retail location through a mobile device.

    d. This could create a new path for incoming payments that may rely, in part, on a new service provider supplying and routing information correctly. Auditors would need to consider the volume of those transactions and the processes and controls related to it.

4. **COMMON RISKS OF IoT:** The key risks associated with IoT, including, device hijacking, data siphoning, denial of service attacks, data breaches and device theft.

B. AI (Artificial intelligence):

1. Artificial intelligence (AI) refers to a system or a machine that can think and learn. AI systems utilize data analysis and algorithms to make decisions based on predictive methods. Complex algorithms are developed to propose decisions based on a pattern or behavior learned over time.

Example: Self-driving cars, manufacturing robots, smart assistants, marketing chatbots, virtual travel booking agent. The self-deploying robots can determine how much vacuuming there is to do based on a room's size, uses AI to scan room size, identify obstacles and remember the most efficient routes for cleaning.

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Siri to help find your Air Pods or told Amazon Alexa to turn off the lights, quick commands to open a phone camera or start a particular playlist, AI to predict when to book the lowest prices for flights, hotels, car and vacation home rentals. Using historical flight and hotel data, AI will also recommend to the user whether the booking has reached its lowest price point or if the user should hold out a bit longer for the price to drop.

2. **AUDITOR IMPLICATIONS:**
    a. Given the invisible nature of algorithms, audits must focus on the logical flow of processes. A review of AI should ascertain whether unintended bias has been added to the algorithms.

    b. Auditors should assess the effectiveness of algorithms and whether their output is appropriately reviewed and approved.

    c. Because AI is built on software modules, auditors must also consider cybersecurity and search for possible bugs and vulnerabilities that can be exploited to impact AI functionality.

    d. Auditors should confirm their understanding of how the use of AI affects the entity's flows of transactions, including the generation of reports or analytics used by management. Auditors also should consider whether the AI is making decisions—or being utilized by management as part of the decision-making process.

    e. If management shifts its focus on oversight by relying on AI, auditors should understand what shift occurred, how new risks might be addressed, and whether existing risks may not be getting the same level of attention. Understanding these changes could drive changes in the audit approach.

3. **Common risks for AI:** AI comes with list of risks:
    a. Security is one of the key risks – the more data the system uses, from more sources, the more entry points and connections are formed and the greater the potential risks.

    b. Inappropriate configuration - AI may also be used to diagnose medical conditions. If it is badly configured or malfunctions, it could harm people before the problem is spotted.

    c. Data privacy - The data used and shared should have the necessary explicit consent from data providers.

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C. BLOCKCHAIN:

1. Blockchain is based on a decentralized and distributed ledger that is secured through encryption. Each transaction is validated by the blockchain participants, creating a block of information that is replicated and distributed to all participants.

2. All blocks are sequenced so that any modification or deletion of a block disqualifies the information.

3. Despite resistance, the benefits associated with blockchain technology are being recognized across a variety of other industries.

Example: Bitcoin, cryptocurrency transfer application - Blockchain in money transfer, blockchain smart contracts.

4. **AUDIT IMPLICATIONS:**
    a. Auditors should consider the appropriate governance and security transactions around the transactions.

    b. Although blockchain's core security premise rests on cryptography, there are risk factors associated with it. As blockchain interacts with legacy systems and business partners, concerns related to insecure application programming interfaces (APIs), data confidentiality and privacy cannot be ignored.

    c. Weak blockchain application development protocols are something auditors cannot overlook.

    d. Similarly, data privacy laws and regulations may be area of concern as data are communicated across geographic boundaries.

    e. Auditors must be able to determine whether the data put on blockchain will expose the enterprise to liability for noncompliance with applicable laws and regulations.

5. **COMMON RISKS FOR BLOCKCHAIN TECHNOLOGY:**
    a. The strengths of blockchain can also be its weaknesses. The inability to reverse transactions and to access data without the required keys make the system secure, but also mean that organisations need specific protocols and management processes to ensure that they are not locked out and have clear contingency plans.

    b. Operating through network nodes could also expose the organisation to cyber-attacks and data hacks, so security issues are important.

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c. Auditors should also ensure that the organisation has the necessary data management processes and complies with regulations. The regulatory landscape is still evolving for blockchain, so audit teams should check that compliance managers are following developments constantly and adapting processes accordingly.

D. NFT (Non-Fungible Token):

1. NFTs are digital assets, e.g., photos, videos, artwork, sports collectibles etc. NFT means something is unique and cannot be replaced. Unlike physical money and cryptocurrencies are fungible (means they can be traded or exchanged for one another) NFTs are non-fungible tokens.

2. NFTs contains the digital signature which make them unique.

3. NFTs are tokens used to represent ownership of unique items.

4. NFTs allow their creators to tokenize things like art, collectibles, or even real estate. They are secured by the blockchain and can only have one official owner at a time.

5. No one can change the record of ownership or copy/paste a new NFT into existence.

6. **Key Features of NFT:**
   a. Digital Asset - NFT is a digital asset that represents Internet collectibles like art, music, and games with an authentic certificate created by blockchain technology that underlies Cryptocurrency.
   b. Unique - It cannot be forged or otherwise manipulated.
   c. Exchange - NFT exchanges take place with cryptocurrencies such as Bitcoin on specialist sites.

7. **Challenges of NFT:** NFTs has its own challenges like ownership and copyright concerns, security risks, market is not that wide, online frauds etc. NFT audit considerations includes comprehensive code review for verifying the safety of a token, valid contract, data privacy and potential cyber threat.

Case Study

XY Bank, headquartered in New York, offers a broad range of financial services including asset management, commercial banking, investment banking, and treasury and securities services.
The Five Indian banks in partnership with XY bank, provide a comprehensive range of banking services and products encompassing retail banking, corporate banking, international banking, and other financial services. All these banks have been significant contributors to the digitalization of banking services in India.
Under the pilot programme, the Indian banks will open on-chain Nostro accounts with XY Bank branch in Gift City. The blockchain-based system is expected to facilitate instant, 24×7 settlement

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between the accounts held at the US bank. Essentially, it will create a private intra-correspondent banking network, redefining the traditional banking hours and enabling seamless money transfer.

Following are the illustrative steps for performing audit of above said block chain:

a. Obtain a comprehensive understanding of the blockchain-based pilot program, including its objectives, scope, and key processes involved.
b. Review the partnership agreements, contracts, and legal documentation governing the relationship between the Indian banks and XY Bank.
c. Identify the specific blockchain technology used, its functionalities, and the underlying smart contracts.
d. **Assess Internal Controls:**
   Review policies and procedures related to the on-chain Nostro accounts, settlement processes, and money transfer mechanisms.
   Assess the governance framework, risk management practices, and compliance procedures established by the Indian banks and XY Bank.
e. **Review Security Measures:**
   Assess encryption methods, cryptographic key management, and secure transmission protocols used for data protection.
   Review measures taken to prevent unauthorized access, cyber threats, and potential vulnerabilities in the blockchain network.
f. **Test Transaction Validity and Accuracy:**
   Validate that transactions are recorded and settled accurately on the blockchain, ensuring adherence to relevant regulations and contractual obligations.
   Perform reconciliations between on-chain Nostro accounts and the corresponding accounts held at XY Bank to confirm the accuracy of balances and transactions.
g. **Evaluate Compliance and Regulatory Requirements:**
   Review documentation and procedures related to customer due diligence, transaction monitoring, and reporting obligations.
   Ensure that the pilot program adheres to industry-specific standards and best practices.
h. **Assess Business Continuity and Disaster Recovery:**
   Evaluate the adequacy of backup and recovery procedures, redundancy measures, and failover mechanisms to ensure uninterrupted operations.
   Test the effectiveness of these plans by conducting simulations or examining historical incidents and response procedures.
i. **Report Findings and Recommendations:**
   Provide recommendations for improving internal controls, security measures, compliance procedures, and overall efficiency and effectiveness of the pilot program.
   Communicate the audit results to the relevant stakeholders, highlighting areas of concern and suggesting remedial actions.

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E. ROBOTIC PROCESS AUTOMATION:

1. RPA is the automation of the repetitive processes performed by users. It is a software technology that emulate humans' actions interacting with digital systems and software. Process efficiency, customer experience and control effectiveness contributed to RPA.

2. Robotic Process Automation software bots can interact with any application or system the same way people do—except that RPA bots can operate around the clock, nonstop, much faster and with 100% reliability and precision.

Case Study

A large passenger carrier is having an AI bot for passenger ticket booking with following processes:

User Interaction: The bot interacts with passengers through various channels such as a website, mobile app, or messaging platforms. Passengers can initiate a conversation with the bot by providing their travel details, preferences, and other required information.

Natural Language Processing (NLP): The bot utilizes natural language processing techniques to understand and interpret the passenger's queries and requests. It can process text or voice inputs and extract relevant information to facilitate ticket booking.

Query Handling: The bot responds to passenger queries related to ticket availability, fares, train schedules, seat preferences, and other relevant information. It can provide real-time updates and answers to common passenger questions.

Booking Process: Upon receiving a booking request, the bot collects the necessary details from the passenger, including travel dates, destinations, class preferences, and passenger information. It validates the inputs, checks seat availability, and calculates fares based on the carrier's pricing structure.

Integration with Booking Systems: The bot interfaces with the carrier's booking systems to check seat availability, reserve seats, and process payment transactions. It securely communicates with the backend systems to initiate the booking process.

Payment Processing: The bot facilitates secure payment transactions, allowing passengers to provide payment details and complete the booking. It may integrate with various payment gateways or services to process credit card payments, net banking, or other payment methods.

Confirmation and Ticket Generation: Once the booking is successfully processed, the bot generates a booking confirmation along with a unique ticket number. It provides the passenger with the necessary information, including the ticket details, train information, and any other relevant instructions.

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Ancillary Services: The bot may offer additional services such as seat upgrades, meal selection, travel insurance, or other ancillary offerings. It can provide information and assist passengers in availing these services during the booking process.

Post-Booking Support: The bot can assist passengers with post-booking support, including itinerary changes, cancellations, or ticket modifications. It handles these requests, checks the carrier's policies, and processes the necessary changes as per the passenger's requirements.

Integration with Customer Support: The bot may be integrated with customer support systems to escalate complex queries or issues to human agents when necessary. It can provide a seamless transition from automated assistance to human interaction, ensuring a high level of customer service.

Following are the illustrative STEPS TO AUDIT TICKET BOOKING "BOT "SYSTEM:

a. Identify the objectives and goals of auditing the IRCTC ticket booking bot.
b. Determine the scope of the audit, including the specific aspects of the bot's functionality and operations to be evaluated.
c. Review relevant regulatory and compliance standards applicable to the ticket booking process, such as data protection and privacy regulations, payment card industry standards, and any specific industry guidelines.
d. Identify and assess potential risks associated with the ticket booking bot, such as unauthorized access to customer data, system failures, or inaccurate booking information.
e. Develop a comprehensive set of audit procedures to assess the effectiveness, efficiency, and compliance of the ticket booking bot. This may include:
f. Reviewing the system architecture, design, and documentation.
g. Evaluating the security measures in place, including authentication, access controls, and encryption.
h. Testing the bot's functionality by simulating booking scenarios and verifying the accuracy of the results.
i. Assessing the performance of the bot, such as response times and scalability.
j. Analyzing logs and audit trails to detect any unusual or suspicious activities.
k. Examining the data handling processes, ensuring proper encryption, storage, and protection of customer data.
l. Verifying compliance with relevant regulations, policies, and procedures.
m. Conducting penetration testing or vulnerability assessments to identify potential weaknesses in the bot's security.
n. Decide on the appropriate sampling methodology to evaluate the bot's performance and compliance. This may involve selecting a representative sample of booking transactions or data for analysis.
o. Conduct the audit based on the defined procedures, following best practices and professional audit standards.
p. Document your findings, including any issues or areas of improvement identified

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during the audit.

q. Compile the audit findings into a comprehensive report, detailing the audit objectives, scope, procedures performed, and results.
r. Provide recommendations for addressing any identified weaknesses, risks, or noncompliance issues.
s. Present the report to relevant stakeholders, such as management, IT teams, and compliance officers.
t. Track the implementation of recommended actions and ensure appropriate measures are taken to address any identified weaknesses.
u. Periodically review and monitor the bot's performance, security, and compliance to ensure ongoing effectiveness.

3. **Audit Implications:**
    a. It is of utmost importance for auditors to understand RPA processes, which include data extraction, aggregation, sanitization and cleansing. Unless auditors understand these processes, they will not be in a position to initiate an audit.

    b. A comprehensive assurance process might demand review of the source code. To perform substantive testing, auditors must have an understanding of the tools used to develop and maintain RPA. This will be helpful when auditors review logs, configuration controls, privileged access controls and the like. General IT controls are applicable as always.

4. **Common Risks of RPA:**
    a. **Operational and execution risks**: Robots are deployed without proper operating model. Buying the wrong tool, making wrong assumptions, taking shortcuts, and jeopardizing security and compliance. Assigning proper responsibilities, training and clearly stating about changing roles also can help you reduce operational risk to a great extent.

    b. **Change management risks:** Not following the change management implementation lifecycle, improper and incomplete testing (not covering all scenarios) leads to inaccurate results.

    c. **RPA Strategy Risk:** Setting wrong expectations, improper KPIs, and unrealistic business goals creates an environment of uncertainty. Management should discuss, and analyse the complete working characteristics, potential, and limitations of RPA before drafting a robotic process automation.

5. **RPA to check IND AS, IFCoFR and Standards on Auditing:** Incorporating Standards on Auditing, IFCoFR, IND AS (para-wise details of | Para reference | Accounting policy | Relevant data to be captured | Relevant calculation to be made | Presentation in financial statements | IFCoFR | Audit procedures as per Standards on auditing |) in audit practices ensures

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accurate financial reporting, effective internal controls, and reliable audit procedures. Leveraging RPA in conjunction with these frameworks can significantly enhance audit efficiency, accuracy, and compliance. RPA developers and auditors should collaborate to align RPA workflows with relevant standards and guidelines, ultimately improving the effectiveness of audits and enhancing client assurance given below:

Columnar Presentation of IND AS 16 - Property, Plant & Equipment with IFCoFR and Audit Procedures						
Para ref.	**Accounting policy**	**Relevant data to be captured**	**Relevant calculation to be made**	**Presentation in financial statements**	**IFCoFR**	**Audit procedures as per Standards on auditing**
6	Define PPE as tangible assets that are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and are expected to be used during more than one period.	Identify PPE items and their cost components.	Apply recognition criteria and measurement principles.	Disclose PPE items and their carrying amounts, depreciation methods and rates, useful lives, impairment losses, etc.	Establish internal controls over the identification, recognition, measurement, depreciation, impairment, and disclosure of PPE.	Verify the existence, ownership, valuation, and disclosure of PPE by inspection, confirmation, vouching, analytical procedures, etc.
7	Recognize an item of PPE as an asset if it is probable that future economic benefits associated with the item will flow to the entity; and the cost of the item	Assess the probability and reliability of future economic benefits and cost of PPE items.	Apply cost model or revaluation model for subsequent measurement of PPE items.	Disclose the basis of recognition and measurement of PPE items.	Establish internal controls over the assessment of probability and reliability of future economic benefits and cost of PPE items.	Verify the recognition criteria and measurement basis of PPE items by inspection, confirmation, vouching, analytical procedures, etc.

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	can be measured reliably.					
8	Measure the cost of an item of PPE as the cash price equivalent at the recognition date. If payment is deferred beyond normal credit terms, measure the cost at the present value of all future payments.	Identify the cash price equivalent and the present value of deferred payments for PPE items.	Calculate the present value of deferred payments using an appropriate discount rate.	Disclose the cash price equivalent and the present value of deferred payments for PPE items.	Establish internal controls over the identification and calculation of cash price equivalent and present value of deferred payments for PPE items.	Verify the cash price equivalent and present value of deferred payments for PPE items by inspection, confirmation, vouching, analytical procedures, etc.
8	Measure the cost of an item of PPE as the cash price equivalent at the recognition date. If payment is deferred beyond normal credit terms, measure the cost at the present value of all future payments.	Identify the cash price equivalent and the present value of deferred payments for PPE items.	Calculate the present value of deferred payments using an appropriate discount rate.	Disclose the cash price equivalent and the present value of deferred payments for PPE items.	Establish internal controls over the identification and calculation of cash price equivalent and present value of deferred payments for PPE items.	Verify the cash price equivalent and present value of deferred payments for PPE items by inspection, confirmation, vouching, analytical procedures, etc.
9	Include in the cost of an item of PPE any costs	Identify the directly attributable costs and	Allocate the directly attributable costs to PPE	Disclose the directly attributable costs and the	Establish internal controls over the	Verify the directly attributable costs and

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	directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. Exclude any costs that are not directly attributable to bringing the asset to that location and condition.	the non-attributable costs for PPE items.	items based on a rational and consistent basis. Exclude any non-attributable costs from PPE items.	non-attributable costs for PPE items.	identification and allocation of directly attributable costs and non-attributable costs for PPE items.	non-attributable costs for PPE items by inspection, confirmation, vouching, analytical procedures, etc.

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Q NO 18. WRITE ABOUT CONTROL CONSIDERATIONS OR OBJECTIVES OF AUDITING DIGITALLY?

ANSWER:

Emerging technologies can bring great benefits, but they also come with a varied set of substantial risks. The strength of the auditing profession is the assessment of risks and controls. As they address the challenge of assessing technology risk, auditors can and should focus on the following control considerations:

1. Auditors should gain a holistic understanding of changes in the industry and the information technology environment to effectively evaluate management's process for initiating, processing, and recording transactions and then design appropriate auditing procedures.

2. Auditors, as appropriate, should consider risks resulting from the implementation of new technologies and how those risks may differ from those that arise from more traditional, legacy systems.

3. Auditors should consider whether digital upskilling or specialists are necessary to determine the impact of new technologies and to assist in the risk assessment and understanding of the design, implementation, and operating effectiveness of controls. E.g., cybersecurity control experts, IT

specialists in the team etc.

4. Some examples of technology risks where auditors should test the appropriate controls for relying on the digital systems:

    a. Reliance on systems or programs that are inaccurately processing data, processing inaccurate data, or both

    b. Unauthorized access to data that might result in destruction of data or improper changes to data, including the recording of unauthorized or non-existent transactions or inaccurate recording of transactions (specific risks might arise when multiple users access a common database)

    c. The possibility of information technology personnel gaining access privileges beyond those necessary to perform their assigned duties, thereby leading to insufficient segregation of duties

    d. Unauthorized or erroneous changes to data in master files

    e. Unauthorized changes to systems or programs

    f. Failure to make necessary or appropriate changes to systems or programs

    g. Inappropriate manual intervention

    h. Potential loss of data or inability to access data as required

    i. Risks introduced when using third-party service providers

    j. Cybersecurity risks

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Q NO 19. WHAT ARE THE KEY STEPS FOR AUDITORS IN A CHANGING TECHNOLOGY ENVIRONMENT?

ANSWER:

As auditors obtain an understanding of the impact of technology on a company's business, its systems of internal control, and its financial reporting, some important reminders include the following:

1. Maintain sufficient professional skepticism when reviewing management's risk assessment for new systems.

2. Understand the direct and indirect effects of new technology and determine how its use by the entity impacts the auditor's overall risk assessment.

3. Understand how the technologies impact the flow of transactions, assess the completeness of the in-scope ICFR systems, and design a sufficient and appropriate audit response.

4. Assess the appropriateness of management's processes to select, develop, operate, and maintain controls related to the organization's technology based on the extent the technology is used.

ILLUSTRATION 3.

A company is planning to use Robotics process automation (RPA) to streamline its hiring process.
Earlier, the company used to hire from campuses of various management institutes leading to high recruitment costs, inefficient hire yield and resultant lack of diversity. How RPA can be used to automate the hiring process? List out tentative few such steps. What could be likely benefits of using RPA in hiring process?

Answer:
RPA can be used to streamline hiring process in a company. The tentative steps could include: -
1. Place advertisements on social media/career advice sites.
2. Link redirects candidate to a career site.
3. Career site pulls information of candidate.
4. An algorithm scans applicants for desired and suitable roles.
5. Selected candidates may be asked to play online games to assess their skills.
6. A certain percentage of those applicants are called for a video interview using an interview software.
7. The automated hiring process will reduce full time effort involvement, provide with a wider assessment range, reduce the impact of recruiter biases, increase the efficiency of mapping of interested candidates, reduce recruiting costs, increase hire yield, reduce time to hire, increase diversity.

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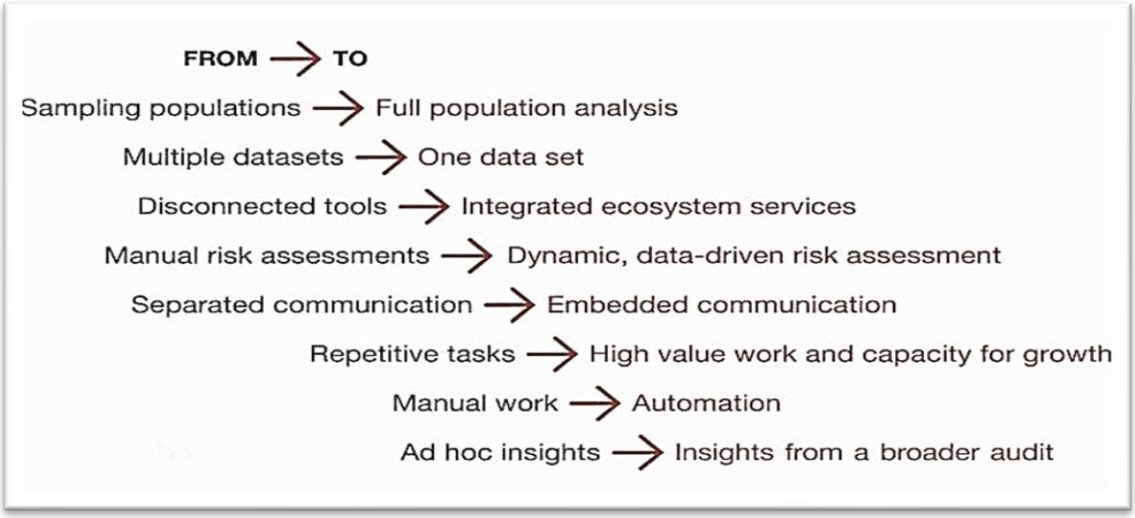
Q NO 20. WHAT IS NEXT GENERATION AUDIT?

ANSWER:

1. The Next Generation Audit is human-led, tech-powered and data-driven. It is based on combining emerging technologies to redefine how audits are performed.

2. Next Generation Audit aims to the following:



3. We live in an era of fast technological progress, with new digital devices, applications, and tools being developed almost on a daily basis. 3D printing, augmented reality (AR) and virtual reality (VR), biotechnology, auditing through drones (also known as an 'Unmanned Aerial Vehicle' (UAV) and quantum technology are some of the most rapidly advancing areas, with many implications for society.

Example of Drone Technology: Using drone technology in the remote locations for stock counts. Drones have great payload capacity for carrying sensors and cameras, thus they can photograph and physically examine the count of large quantities of fixed assets and inventory.
Drone captured audit information can be combined with various alternative sources of information such as QR code readers, handheld bar scanners, manual counts etc. to optimise quality of deliverables, consolidate audit information and enhance the execution speed while ensuring correctness and completeness of data.

4. **COMMON RISKS:**
    a. Beyond their potential, these technologies also come with challenges such as public safety, cybersecurity, data privacy, data protection, lack of standards and technical challenges. Since they often track movements and data, massive amounts of data are generated about the whereabouts of users.

    b. It also raises questions about taxation, jurisdiction, and customer protection.

    c. Regulators and auditors have to think of the controls around privacy, data security, governance to make it more regulated.

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NEW TECHNOLOGIES

1. **AUGMENTED REALITY:** The technology allows users to view the real-world environment with augmented (added) elements, generated by digital devices. One famous example was Pokémon Go, a game for mobile devices in which players chase imaginary digital creatures (visible on their mobile phones) around physical locations.

2. **VIRTUAL REALITY:** VR goes a step forward and replaces the real world entirely with a simulated environment, created through digitally generated images, sounds, and even touch and smell. Using special equipment, such as a custom headset, the user can explore a simulated world or simulate experiences such as flying or skydiving.

   Examples of augmented and virtual reality? In architecture and engineering businesses, AR and VR allow architects to see their building plans come to life before being built. In the business sector, these technologies allow products to be previewed or customised, thus improving productivity and offering new marketing possibilities. In the health sector, AR can provide surgeons with additional information when operating on a patient, such as heartbeat and blood pressure monitoring and virtual x-rays. Vision Pro is essentially an augmented-reality (AR) headset that "seamlessly" blends the real and digital worlds. The device can switch between augmented and full virtual reality (VR) using a dial.

3. **METAVERSE:** The metaverse is the emerging 3-D digital space that uses virtual reality, augmented reality, and other advanced internet technology to allow people to have lifelike personal and business experiences online. It represents a convergence of digital technology to combine and extend the reach and use of Cryptocurrency, Artificial Intelligence (AI), Augmented Reality (AR) and Virtual Reality (VR)

   Some considerations for future:

   a. Beyond cryptocurrencies, coins, and exchanges, players in the Metaverse will need to consider how to build digital monetary systems and apply economic principles to things like digital land.

   b. Governance models will become ever more difficult to balance openness and user contribution with strategic direction and innovation.

   c. Identity in the digital world has historically been different based on the platform utilized. The practical challenge of identity will also have to be considered in the Metaverse (e.g., KYC)

   d. Synchronicity is the ability for aspects of the Metaverse to be multiplayer, simultaneous, and real-time. This includes transactions and actions happening in the Metaverse and are dependent on the infrastructure of digital economies, networking and computing power

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required to operate a digital world.

4. **VIRTUAL BANKING AND TRANSACTIONS**: A forward-thinking financial institution, establishes a presence in the metaverse to offer virtual banking services. Users can create virtual bank accounts, access personalized financial dashboards, and perform transactions using virtual currencies. Customers can seamlessly transfer funds, make virtual purchases, and engage in virtual commerce, all within the immersive environment of the metaverse. XYZ Bank leverages the metaverse to provide a convenient and interactive banking experience, attracting tech-savvy customers who value digital innovation.

5. **DIGITAL ASSET MANAGEMENT**: A digital asset management company, recognizes the growing popularity of virtual assets in the metaverse. They launch a virtual asset trading platform within the metaverse, allowing users to buy, sell, and trade NFTs and other digital assets. Investors can diversify their portfolios, participate in virtual auctions, and even showcase their virtual art collections in virtual galleries. Crypto Investments Ltd. leverages the metaverse's decentralized and secure infrastructure to facilitate transparent and efficient transactions of virtual assets.

6. **VIRTUAL FINANCIAL EDUCATION AND TRAINING**: A Financial Learning Academy aims to enhance financial literacy using the metaverse. They create a virtual classroom environment where participants can attend interactive financial education sessions. Students can engage in simulated investment activities, learn about budgeting and financial planning, and gain hands-on experience through virtual trading simulations. Financial Learning Academy leverages the immersive nature of the metaverse to provide an engaging and practical financial education platform, preparing individuals for real-world financial challenges.

7. **VIRTUAL MEETINGS AND CONFERENCES**: For a leading industry even an organisation hosts a virtual conference within the metaverse. Participants from around the world can access the conference through their virtual avatars. They can attend keynote speeches, panel discussions, and networking events in virtual conference halls. Attendees can interact with industry experts, explore virtual exhibition booths, and establish valuable connections in the financial sector. Global Finance Summit leverages the metaverse to create a global and inclusive conference experience, fostering collaboration and knowledge sharing.

8. **DATA VISUALIZATION AND ANALYTICS**: A company utilizes the metaverse to offer advanced data visualization and analytics tools to financial professionals. Their virtual analytics platform allows users to visualize complex financial data in interactive and immersive 3D environments. Users can explore data trends, conduct simulations, and analyze financial performance through intuitive interfaces within the metaverse. Analytics Solutions Inc. leverages the metaverse's immersive capabilities to enhance data-driven decision-making, enabling financial professionals to gain deeper insights into market trends and make informed investment decisions.

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TEST YOUR KNOWLEDGE

Q.NO.1. Briefly describe the advantages and challenges of Auditing digitally.

ANSWER:

Advantages: Improved efficiency, better quality, lower costs, improved risk assessment.

Challenges: Reluctance to change, challenges with data security and governance, choosing the right tool and automating the right process, ensuring standardisation and correct configurations to avoid error and bias, evaluating business benefits the organization wants to achieve with automation and the roadmap for digital strategy.
For details refer Para 2.

Q.NO.2. What are the stages involved in understanding the IT environment and what key considerations auditor should consider?

ANSWER:

The stages involved in understanding of IT environment are: Understand – Identify – Assess.

Key considerations - Understand the flow of transaction, Identification of Significant Systems, Identification of Manual and Automated Controls, Identification of the technologies used and. Assessing the complexity of the IT environment.

Refer Discussion on Key considerations about IT Environment.

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Q.NO.3. In an automated environment, the data stored and processed in systems can be used to get various insights into the way business operates. This data can be useful for preparation of management information system (MIS) reports and electronic dashboards that give a high- level snapshot of business performance. In view of above you are required to briefly discuss the meaning of data analytics and example of such data analytics techniques.

ANSWER:

Refer Discussion on Data Analytics

Q.NO.4. Enterprises are adopting emerging technologies at a rapid pace to create synergies and harness the latest technologies. Give 3 examples of automated tools used as a part of emerging

technologies along with the risk and audit considerations associated with these tools.
Answer:

Refer Discussion on Q No. 17

Q.NO.5. Emerging technologies can bring great benefits, but they also come with a varied set of substantial risks. Give some examples of technology risks of digital system and the control considerations to consider while assessing technology risk.

ANSWER:

Refer Q No. 18

Q.NO.6. Give example of emerging technologies available for Next Generation Audit along with the risks associated with it.

ANSWER:

Refer Q No. 20

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NOTES FOR ADDITIONAL CONTENTS OR REFERENCES IN LECTURES

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