Standards on Auditing

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Agenda

Particulars
<u>Risk Assessment and Responses to Assessed Risks</u>
SA 300 Planning an Audit of Financial Statements
SA 315 Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment
SA 320 Materiality in Planning and Performing an Audit
SA 330 The Auditor's Responses to Assessed Risks
SA 402 Audit Considerations Relating to an Entity Using a Service Organization
SA 450 Evaluation of Misstatements Identified During the Audit

SA 300 : Planning audit of financial statements

Overview of the requirements of the Standard

300-499 Risk Assessment and Response to Assessed Risks

Standard on Auditing 300 : Planning the audit of financial statements

Lays down the requirements on audit planning

Implementation guide on the standard

Explains the implementation aspects (Published in Feb 2016)

The standard was issued in December 2007 and is effective for accounting period beginning on or after from 1 April 2008

Considerations while establishing overall audit strategy

- Financial reporting framework
- Industry-specific reporting requirements
- Consideration of audit evidence obtained in PY audit including IFC
- Interim audit or final audit

- Multi location audit / business segments
- Developing understanding about internal audit
- Entity's use of Service Organisation
- Impact of information technology on audit
- The availability of client personnel and data

Preliminary engagement activities

Risk and planning considerations

- Performance of the initial risk assessment activities and identification of risk of material misstatements
- Planned audit approach on areas where significant risks of error or fraud identified
- Results of previous audits that involved evaluating the operating effectiveness of internal control, including the nature of identified deficiencies and action taken to address them. - Example IT audit

Other qualitative aspects

- Determination of materiality - SA 320
- Volume of business transactions
- Group reporting engagements - identification of components, materiality allocations to them etc. SA 600
- Significant changes in financial reporting framework
- Changes in laws and regulations affecting the entity
- Significant business developments affecting the entity, including changes in information technology and business processes, changes in key management, and acquisitions, mergers and divestments.

Administrative aspects

- The resources to deploy for specific audit areas, such as the use of appropriately experienced team members for high-risk areas involvement of experts on complex matters;
- The amount of resources to allocate to specific audit areas, such as the number of team members assigned to observe the inventory count at material locations, the extent of review of other auditors' work in the case of group audits, or the audit budget in hours to allocate to high-risk areas;
- When these resources are to be deployed, such as whether at an interim audit stage or at key cut-off dates; and
- When and how the engagement reviews are planned

Interplay with other SA

Planning an audit in compliance with the standard on auditing will enable the auditor to form an appropriate audit opinion

SA 200 'Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards of Auditing'

SA 330 'The Auditor's Responses to Assessed Risks'

SA 501 Audit Evidence – Specific Considerations for Selected Items

SA 505 'External Confirmations'

SA 540 'Auditing Accounting Estimates including Fair Value Accounting Estimates and Related Disclosures'

SA 570 'Going Concern'

SA 620 'Using the Work of an Auditor's Expert'

SA 600 'Using the Work of Another Auditor'

SA 250 'Consideration of Laws and Regulations in an Audit of financial statements'

SA 210 'Agreeing the Terms of Audit Engagements'

SA 230 'Audit Documentation'

SA 315 'Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment'

SA 320 'Materiality in Planning and Performing an Audit'

SA 260 'Communications with Those Charged with Governance'

SA 402 'Audit Considerations Relating to an Entity Using a Service Organisation'

Documentation – Key Consideration

The overall audit strategy :
The auditor may summarize the overall audit **strategy in the form of a memorandum that contains key decisions** i.e. overall scope, timing and conduct of audit .
Illustrative format of the audit memorandum provided in Appendix 2 to implementation guide

The audit plan :

- Documentation **covers records of planned nature, timing and extent of risk assessment procedures** and further **audit procedures at the assertion level** in response to the assessed risks.
- Illustrative format of the audit memorandum provided in Appendix 4 to implementation guide
- It also **serves as a record of the proper planning of the audit procedures that can be reviewed and approved prior to their performance.**
- A **record of the significant changes to the overall audit strategy and the audit plan and the reasons for such changes**, and resulting changes to the planned nature, timing and extent of audit procedures, explains why the significant changes were made, and the overall strategy and audit plan finally adopted for the audit.

SA 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment

Scope:

- deals with the **auditor's responsibility** to identify and assess the ROMM in the financial statements,

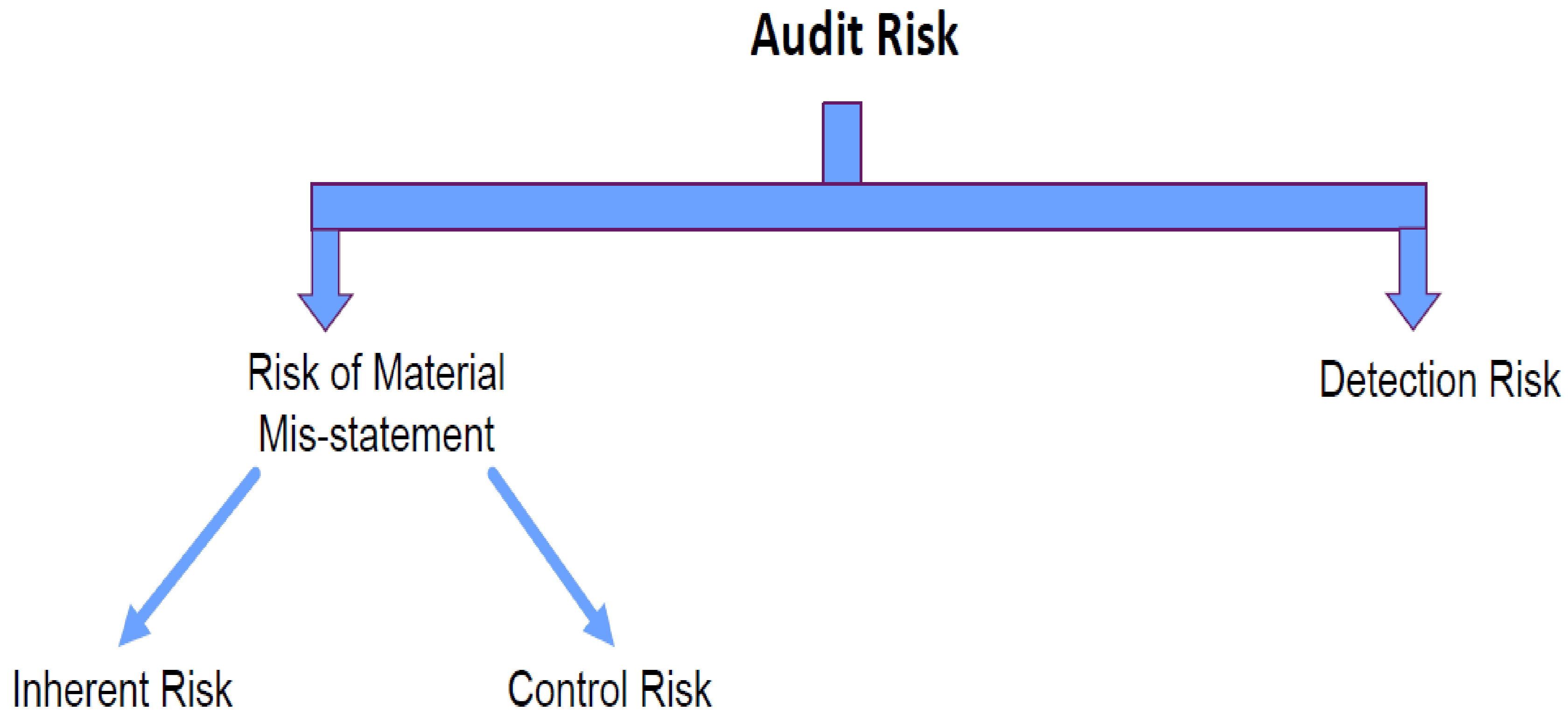
- through understanding:

the entity
its environment,
entity's internal control.

Objective :

- To identify and assess RoMM, due to fraud or error, at the financial statement and assertion levels.
- To provide basis for designing and implementing responses to the assessed RoMM .
- To reduce the RoMM to an acceptably low level.

SA 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment



SA 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment

Audit Risk
Risk of **expressing an inappropriate audit opinion** on financial statements **that are materially misstated.**

The objective of the audit is to reduce this audit risk to an acceptably low level.

'TO REDUCE AUDIT RISK TO AN ACCEPTABLY LOW LEVEL'

- Assess the risks of material misstatement; and
- Limit the detection risk.

This may be achieved by performing procedures that respond to the assessed risks at the financial statement, class of transactions, account balance and assertion levels .

Inherent Risk: Susceptibility of an assertion to a misstatement that could be material, individually or when aggregated with other misstatements, **assuming that there are no related controls.**

Control Risk: Risk that the entity's **internal control system will not prevent or detect and correct** a material misstatement on a timely basis.

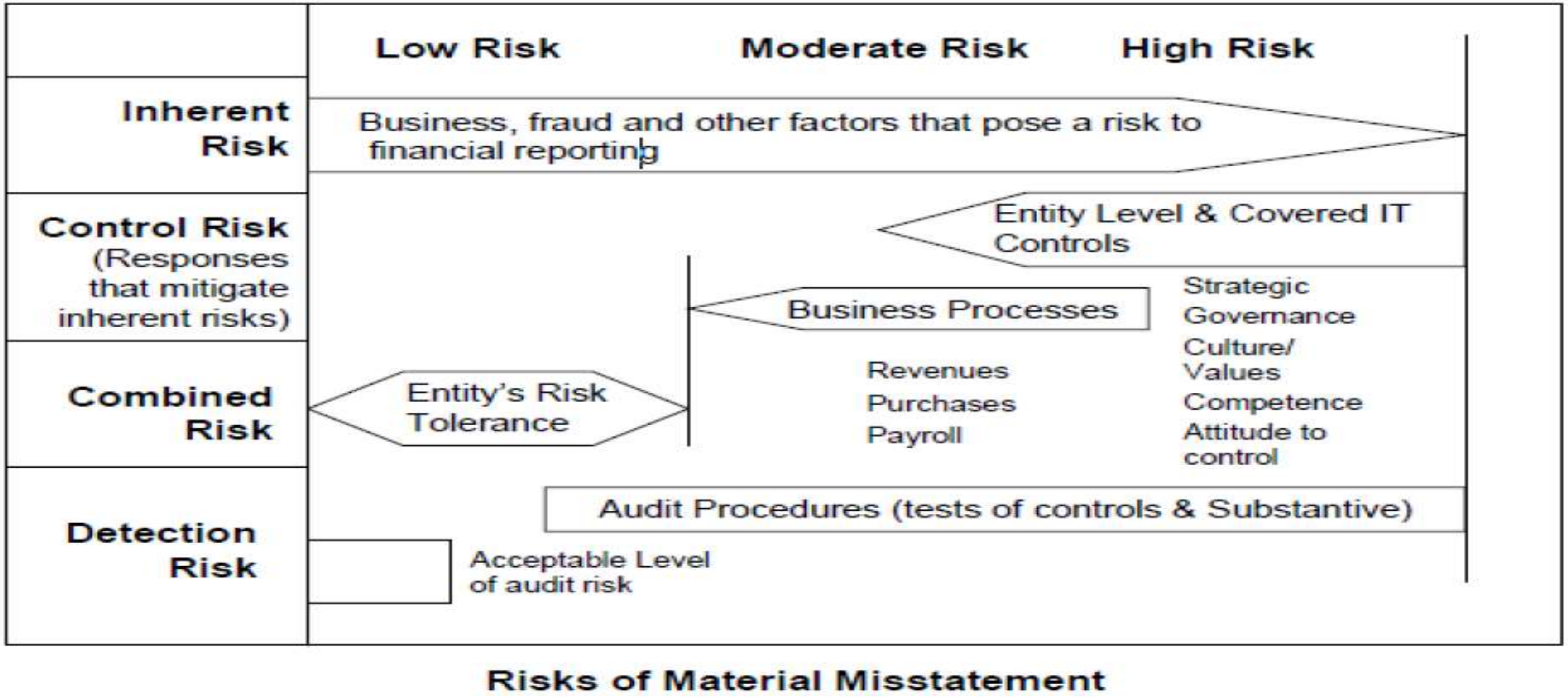
SA 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment

Fraud Risk: The **risk of 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.
There are **two types of intentional misstatement** that are relevant to the auditor:
- Misstatements resulting from **fraudulent financial reporting**; and
- Misstatements resulting from **misappropriation of assets**.

Detection Risk: Risk that the auditor will not detect a material misstatement **at assertion level.**

To reduce the detection risk at acceptably low level
- Identify assertions (areas) where there are risk of material misstatement
- Concentrate audit procedures on such areas
- Carefully design and evaluate results of procedures performed.

Interrelationship of audit risk components



Identifying and Assessing the Risks of Material Misstatement

Auditor need to identify Risk of Material Misstatements (RoMM) at

- the financial statement level; and
- the assertion level for classes of transactions, account balances, and disclosures;

RoMM at Financial Statements Level

- Relate pervasively to the financial statements as a whole and potentially affect multiple assertions
- Not necessarily identifiable at specific assertion (management override of controls)
- deficient control environment (management's lack of competence)
- Concerns about the integrity of the entity's management
- Concerns about the condition and reliability of an entity's records

Identifying and Assessing the Risks of Material Misstatement

- Identify risks throughout the process of **obtaining an understanding of the entity and its environment, including relevant controls** and by considering the classes of transactions, account balances, and disclosures in the financial statements; **(Risk Identification at FS level and assertion level);**
- Assess the identified risks, and evaluate whether they relate more pervasively to the financial statements as a whole and potentially affect many assertions. **(Financial Statement level assessment)**;
- Relate the identified risks to what can go wrong at the assertion level considering relevant controls **(Assertion level assessment)** and
- Consider the **likelihood** of misstatement, including the possibility of multiple misstatements, and whether the potential misstatement is of a **magnitude** that could result in a material misstatement. **(Assessing RoMM)**

Understanding entity and its Environment

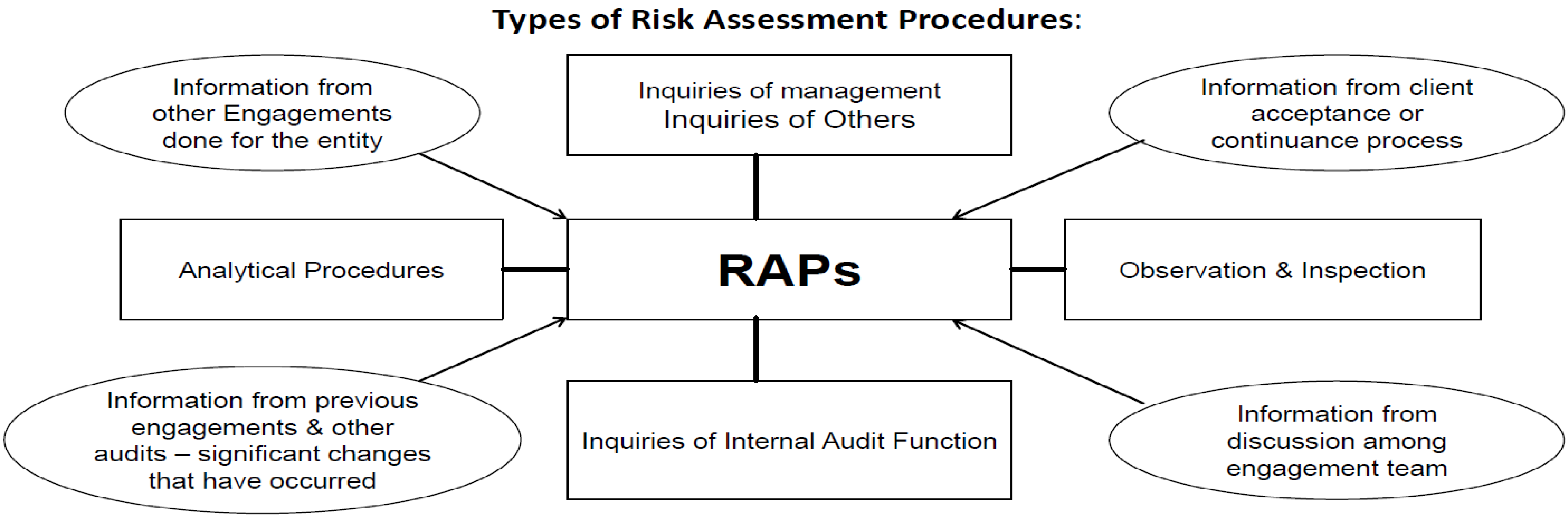
External Factors	• Nature of Industry • Regulatory environment • Financial reporting framework
Nature of Entity	• Operations, ownership & governance • People, investments & structure • Application of accounting policies
Entity Objectives & Strategies	• Related business risks • Financial consequences
Measurement/ Review of Financial Performance	• What key measures are used • What pressures are on management to improve business performance

Auditor need to obtain understanding of **internal control *relevant to* the audit.**
When obtaining an understanding of controls that are relevant to the audit, the auditor shall evaluate the '**design of those controls (Design Effectiveness) and determine whether they have been implemented (Operating Effectiveness)**, by performing procedures in addition to inquiry of the entity's personnel.

Understanding entity’s Internal Control

- Control Environment
- The entity’s risk assessment process
- Information System and Communication
- Control activities relevant to the audit
- Monitoring of controls

Risk Assessment Procedures



Significant Risks

Definition: 'An identified and assessed risk of material misstatement that, in the auditor's judgment, **requires special audit consideration.**' Auditor **need to exercise professional judgement** to identify risks that require special audit consideration.
The auditor shall **exclude the effects of identified controls** related to the risk.

Let's look at the **factors** to be considered for identifying Significant Risks!

- Whether the risk is a **risk of fraud (including presumed risks of fraud)**;
- Whether the risk is related to recent **significant economic, accounting, or other developments** like changes in regulatory environment, etc., and, therefore, requires specific attention;
- The **complexity** of transactions;
- Whether the risk involves **significant transactions with related parties**;
- The **degree of subjectivity** in the measurement of financial information related to the risk, especially those measurements **involving a wide range of measurement uncertainty**; and
- Whether the risk involves **significant transactions** that are outside the **normal course of business for the entity**, or that otherwise appear to be **unusual**

Significant Risks

Significant risks often relate to –

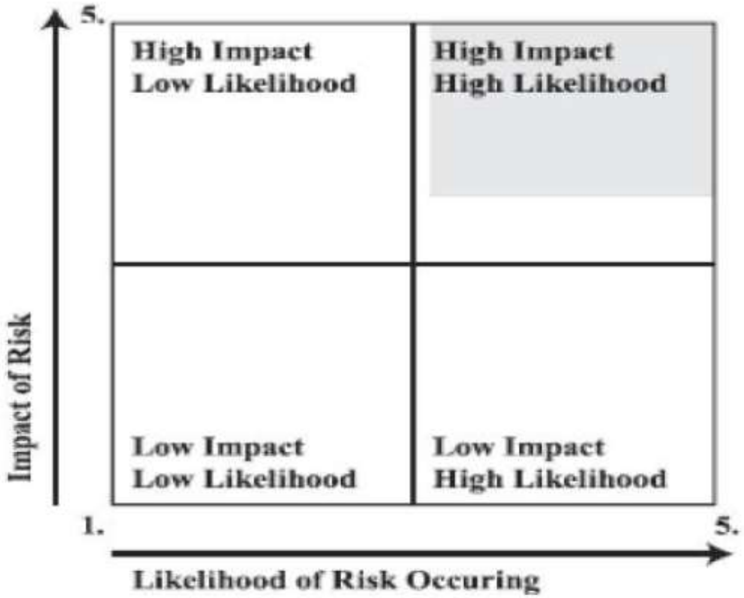
- **significant non-routine transactions**

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

- **judgmental matters**

✓ Accounting principles for accounting estimates or revenue recognition may be subject to differing interpretation.
✓ Required judgment may be subjective or complex, or require assumptions about the effects of future events, for example, judgment about fair value.

Significant Risks



Risks falling in the **“high impact, high likelihood”** area of the chart clearly require management controls to mitigate. In addition, these will likely be determined as being **significant risks, which require special audit consideration.**

Risks for Which Substantive Procedures Alone Do Not Provide Sufficient Appropriate Audit Evidence

These risks are –

- related **routine and significant** classes of transactions or account balances such as an entity's revenue, purchases, and cash receipts or cash payments.
- subject to **highly automated processing** with little or no manual intervention
- Audit evidence may be available only in electronic form and its sufficiency and appropriateness of usually **depend on the effectiveness of IT controls** over its accuracy and completeness.
- **The potential** for improper initiation or alteration of information may be **greater if such controls are not operating effectively.**

SA 330 further describes the consequences for further audit procedures of identifying such risks.

Revision for risk assessment

Sometimes, information obtained during the course of audit **significantly varies** from the information on which risk assessment was based.

For Examples,
• Certain control on which reliance was placed were not operating effectively, or
• Misstatements detected are greater in frequency or amounts than originally assessed level.

In such circumstances, auditor need to **revise original risk assessment** and **plan further audit procedures** to address the revised assessment.

SA 330 provides further guidance on the same.

Documentation

Documentation of Risk Assessment should cover following

- The discussion among the team and significant decision reached
- Key Elements of understanding obtained regarding each aspects of entity and its environment, including internal controls.
- Sources from which information was obtained and risk assessment procedures performed thereon.
- Identified and assessed risk of material misstatements
- Significant Risks (which require special audit considerations) and related controls
- Risks for which substantive procedures alone do not suffice and related controls.

Form and extent of documentation depends on

- nature, size and complexity of the entity and its internal control,
- availability of information from the entity and
- the audit methodology and technology used in the course of the audit.

SA320 : Materiality in planning and performing an audit

Scope:

SA 320 deals with the auditor's responsibility to apply the concept of materiality in planning and performing an audit of financial statements

Objective:
Auditor to apply the concept of materiality appropriately in planning and performing the audit.

Materiality in the Context of an Audit:
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.
Auditor uses materiality when planning and performing an audit to reduce audit risk to an acceptably low level that is consistent with the objective of an audit. It is one of the key judgments on the audit, This judgment provide a basis for:

- Determining the nature, timing and extent of risk assessment procedures;
- Identifying and assessing the risks of material misstatement; and
- Determining the nature, timing and extent of further audit procedures

SA320 : Materiality in planning and performing an audit

Materiality, from an **entity's point of view**:

- is the threshold at which the subject matter information becomes important enough to be reported.
- includes consideration of whether the reported subject matter information is free from misstatements that would affect the decisions of users taken on the basis of that information.

Materiality, from **auditors' perspective**, helps us to:

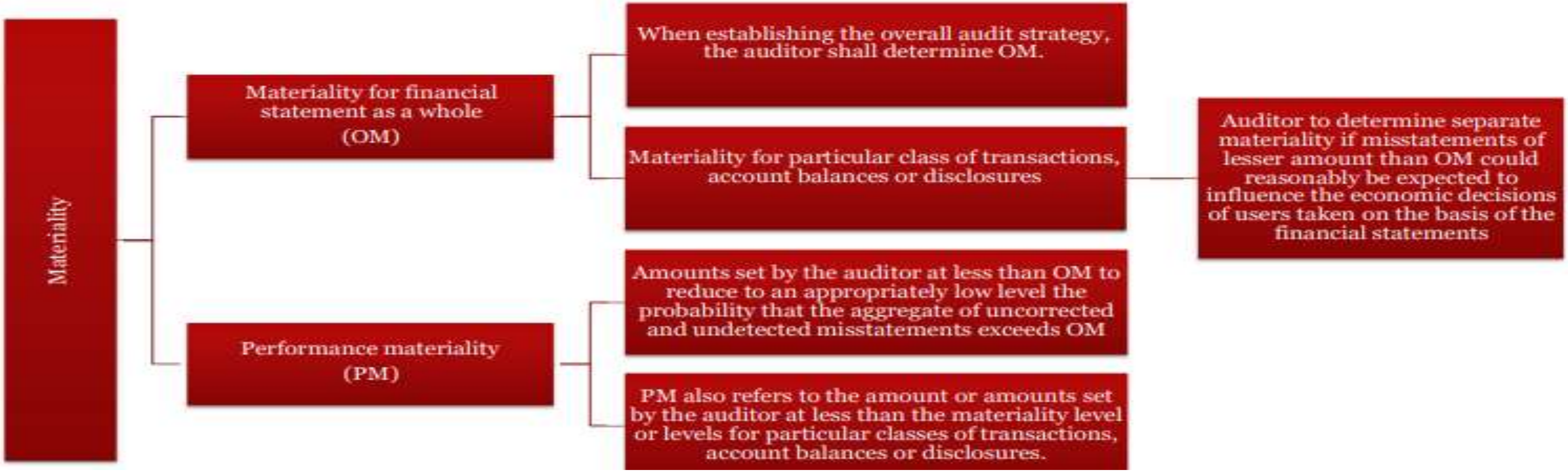
- determine the nature, timing and extent of our evidence gathering procedures.
- evaluate whether the subject matter information is free from misstatement.

Materiality from the **user's perspective**:

A misstatement or the aggregate effect of misstatements is material when, in the context of the surrounding circumstances, it is probable that the decision of a user who is relying on the reported subject matter information and who has a reasonable knowledge of entity and its activities, would be changed or influenced by such misstatement or the aggregate effect.

Materiality Determination

Materiality for the financial statements as a whole (OM) and performance materiality (PM)



Determining materiality for the financial statements as a whole and performance materiality

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.

- Examples of benchmarks that may be appropriate, depending on the circumstances of the entity, include:

✓ Profit before tax
✓ total revenue
✓ gross profit
✓ total expenses
✓ total equity or net asset value etc

Factors affecting the identification of an appropriate benchmark :

- The elements of the financial statements ;
- Whether there are items on which the attention of the users of the particular entity’s financial statements tends to be focused;
- 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;
- The entity’s ownership structure and the way it is financed;
- The relative volatility of the benchmark

Scenario

- 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.

Factors affecting the t the percentage to be applied to a chosen benchmark

- Determining a percentage to be applied 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. 5% of PBT vis-à-vis 1% of total revenue or expenses.

Considerations when selecting appropriate benchmark

Scenario	Benchmark
Profit before tax is nominal	Profit before tax and remuneration
Entities doing public utility programs/projects	Total Cost or Expenses Less Revenues
Current Year Profits are Low	Average of the Past three years
Profit oriented entity with break-even results	Revenue
Private Equity Firm primary focus on EBITDA	EBIDTA
Production Costs recharged to Group	Production Costs
Mutual Funds	Net Assets

Materiality Level or Levels for Particular Classes of Transactions, Account Balances or Disclosures

Revision as the Audit Progresses:
The auditor shall revisit and if needed revise materiality in the event of becoming aware of new information or a change in the auditor's understanding of the entity andits operations as a result of performing further audit procedures.

Documentation: The audit documentation shall include the following amounts and the factors considered in their determination :

- Materiality for the financial statements as a whole
- If applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures
- Performance materiality and
- Any revision of above as the audit progressed

SA 330 : Auditor’s Response to Assessed Risks

Scope:

Auditor’s responsibility to:

–Design & implement responses to risk of material misstatements identified & assessed in accordance with SA 315.

Objective:

Obtain sufficient appropriate audit evidence about the assessed risk of material misstatement,through designing & implementing appropriate responses to those risks

- Overall responses (Audit Procedures Responsive to the Assessed Risks of Material Misstatement at the financial statement level)
- Audit Procedures Responsive to the Assessed Risks of Material Misstatement at the Assertion Level
- Evaluating the Sufficiency and Appropriateness of Audit Evidence
- Audit Documentation

SA 330 : Auditor's Response to Assessed Risks

Substantive Procedures:
Audit Procedures designed to detect material misstatements at assertion level:
- Tests of details –classes of transactions/ account balances/ disclosures.
- Substantive analytical procedures.

Tests of Controls:
Audit Procedure for evaluating operating effectiveness of controls in preventing/ detecting & correcting material misstatement at assertion level

SA 330 : Auditor's Response to Assessed Risks

Overall Responses :
The auditor shall design and implement overall responses to address the assessed risks of material misstatement at the financial statement level.

May include :

- Emphasizing to the audit team the need to maintain professional skepticism.
- Assigning more experienced staff or those with special skills or using experts.
- Providing more supervision.
- Incorporating additional elements of unpredictability in the selection of further audit procedures to be performed.
- Making general changes to the nature, timing or extent of audit procedures, for example: performing substantive procedures at the period end instead of at an interim date; or modifying the nature of audit procedures to obtain more persuasive audit evidence.

SA 330 : Auditor’s Response to Assessed Risks

- The auditor shall design and perform further audit procedures whose nature, timing and extent are based on and are responsive to the assessed risks of material misstatement at the assertion level.

- In designing the further audit procedures to be performed, the auditor shall:

✓ Consider the reasons for the assessment given to the risk of material misstatement at the assertion level for each class of transactions, account balance, and disclosure, including:

(i) The likelihood of material misstatement due to the particular characteristics of the relevant class of transactions, account balance, or disclosure (i.e., the inherent risk); and

(ii) Whether the risk assessment takes into account the relevant controls (i.e., the control risk), thereby requiring the auditor to obtain audit evidence and consequently the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures;

✓ Obtain more persuasive audit evidence the higher the auditor’s assessment of risk.

SA 330 : Auditor’s Response to Assessed Risks

Test of Controls

- Design and perform tests of controls at assertion level when:

(a) Auditor’s expects controls are operating effectively.
(b) Auditor intends to rely on the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures.
(c) Substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level.

- In designing and performing tests of controls, the auditor shall obtain more persuasive audit evidence the greater the reliance the auditor places on the effectiveness of a control.

SA 330 : Auditor's Response to Assessed Risks

- Extent of ToC – factors to consider:
  - Frequency of performance of control by entity during the period.
  - Length of time during the audit period of reliance on control effectiveness.
  - Expected rate of deviation from control.
  - Relevance & reliability of audit evidence at assertion level.
  - Extent to which audit evidence is obtained from tests of other controls related to the assertion

- Timing of TOC:
  - Reliance at a point of time – test controls at point of time. Eg. Controls over physical inventory counting.
  - Reliance over a period of time – test should be able to provide evidence that controls were effective over the period of time.

SA 330 : Auditor's Response to Assessed Risks

Using Audit Evidence Obtained in Previous Audits:

- Before using evidence from previous audit:
  - Establish continuous relevance of that evidence.
  - Understand whether there is any change in relevant controls affecting the relevance of audit evidence by performing: Inquiry + Observation + Inspection.
  - If change in control – test controls in current audit.
  - If no change:
    - Test controls atleast once in every third audit.
    - Test some controls each audit – provides corroborating evidence about continuing effectiveness.
  - Use professional judgment

- Greater reliance on controls/ higher ROMM → shorter time span between re-testing:

Designing and Implementing appropriate responses to those risks

At Financial statement level

- To maintain professional skepticism.
- More experienced staff with special skills or experts
- Elements of unpredictability
- Providing more supervision
- General changes to the nature, timing and extent of audit procedures. (e.g. performing substantive procedures at period end)

At Assertion Level, auditor shall design and perform further audit procedures

- Performing tests of controls
- Performing substantive procedures only
- A combined approach using both tests of controls and substantive procedures

Evaluating the Sufficiency and Appropriateness of Audit Evidence

- Evaluate whether the assessments of the risks of material misstatement at the assertion level remain appropriate
- Conclude whether sufficient appropriate audit evidence has been obtained.
- Express a qualified opinion or a disclaimer of opinion, if not able to obtain sufficient appropriate evidence

Auditor’s Response to Assessed Risks

Auditor shall document:

- The overall responses to address the assessed risks of material misstatement at the financial statement level, and the nature, timing and extent of the further audit procedures performed;
- The linkage of those procedures with the assessed risks at the assertion level; and
- The results of the audit procedures, including the conclusions where these are not otherwise clear.

Auditor plans to use audit evidences about the operating effectiveness of controls obtained in previous audits, the auditor shall document the conclusions reached about relying on such controls that were tested in a previous audit.

SA 402 – Audit Considerations relating to an Entity using a Service Organisation

Scope

- deals with the user auditor's responsibility to obtain sufficient appropriate audit evidence when a user entity uses the services of one or more service organisations.
- 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,.

Objective

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

SA 402 – Audit Considerations relating to an Entity using a Service Organisation

Obtaining an Understanding of the Services Provided by a Service Organisation, Including Internal Control

- 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:

(a) 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;

(b) The nature and materiality of the transactions processed or accounts or financial reporting processes affected by the service organisation;

(c) The degree of interaction between the activities of the service organisation and those of the user entity; and

(d) 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.

SA 402 – Audit Considerations relating to an Entity using a Service Organisation

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.

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;

(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 organisation

SA 402 – Audit Considerations relating to an Entity using a Service Organisation

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:

- The service auditor's professional competence and independence from the service organisation; and
- The adequacy of the standards under which the Type 1 or Type 2 report was issued.

If the user auditor plans to use a Type 1 or Type 2 report as audit evidence he shall :

- 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;
- 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
- Determine whether complementary user entity controls identified by the 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.

Reporting by user auditor

The user auditor **shall modify the opinion** in the user auditor's report if the user auditor is **unable to obtain sufficient appropriate audit evidence** regarding the services provided by the service organization.

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.

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.

SA 450 : Evaluation of Misstatements Identified during the audit

<u>Scope :</u>

Deals with the auditor's responsibility to evaluate the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial statements.

<u>Objective :</u>

The objective of the auditor is to evaluate:

- The effect of identified misstatements on the audit; and
- The effect of uncorrected misstatements, if any, on the financial statements

SA 450 : Evaluation of Misstatements Identified during the audit

Misstatement :

A difference between the amounts, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework.

- ✓ Misstatements can arise from error or fraud.
- ✓ Inaccuracy in gathering or processing data.
- ✓ Omission of an amount or disclosure.
- ✓ Incorrect accounting estimate arising from overlooking or clear misinterpretation of facts.
- ✓ Judgements of management concerning accounting estimates that the auditor considers unreasonable or inappropriate.

When the auditor expresses an opinion on whether the financial statements give a true and fair view or are presented fairly, in all material respects, misstatements also include those adjustments of amounts, classifications, presentation, or disclosures that, in the auditor's judgment, are necessary for the financial statements to give a true and fair view or present fairly, in all material respects.

SA 450 : Evaluation of Misstatements Identified during the audit

<u>Uncorrected misstatements :</u>

Misstatements that the auditor has accumulated during the audit and that have not been corrected.

<u>Accumulation of Identified Misstatements :</u>

The auditor shall accumulate misstatements identified during the audit, other than those that are clearly trivial.

<u>Consideration of Identified Misstatements as the Audit Progresses :</u>

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

(a) The nature of identified misstatements and the circumstances of their occurrence indicate that other misstatements may exist that could be material; or

(b) The aggregate of misstatements accumulated during the audit approaches materiality determined in accordance with SA 320.

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

SA 450 : Communication and Correction of Misstatements

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

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

SA 450 : Evaluation of Uncorrected Misstatements

- Prior to evaluating the effect of uncorrected misstatements, the auditor shall reassess materiality determined in accordance with SA 320 to confirm whether it remains appropriate in the context of the entity's actual financial results.
- The auditor shall determine whether uncorrected misstatements are material, individually or in aggregate.
- In making this determination, the auditor shall consider:

(a) The size and nature of the misstatements, both in relation to particular classes of transactions, account balances or disclosures and the financial statements as a whole, and the particular circumstances of their occurrence; and

(b) The effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole.

SA 450 : Communication with TCWG

The auditor shall communicate TCWG uncorrected misstatements and the effect that they, individually or in aggregate, may have on the opinion in the auditor's report, unless prohibited by law or regulation.

The auditor's communication shall identify material uncorrected misstatements individually. The auditor shall request that uncorrected misstatements be corrected.

The auditor shall also communicate with those charged with governance the effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole.

SA 450 : Written representation

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

SA 450 : Documentation

The audit documentation shall include:

(a) The amount below which misstatements would be regarded as clearly trivial (paragraph 5);

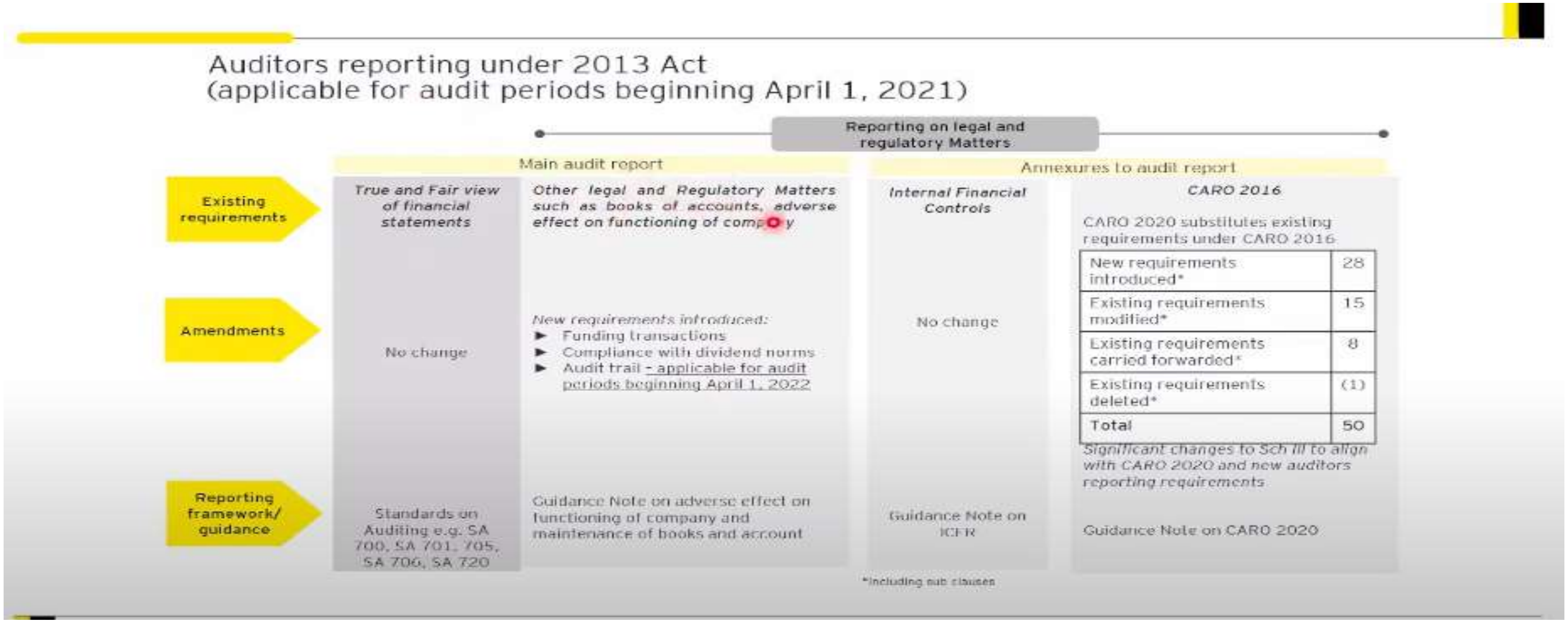
(b) All misstatements accumulated during the audit and whether they have been corrected (paragraphs 5,8 and 12); and

(c) The auditor's conclusion as to whether uncorrected misstatements are material, individually or in aggregate, and the basis for that conclusion. (paragraph 11)

Standards on Audit Opinion

Particulars
<u>**Reporting and Conclusion**</u>
SA 700 Forming an Opinion and Reporting on the Financial Statements.300 Planning
SA 701 Communicating Key Audit Matters in the Independent Auditor’s Report
SA 705 Modifications to the Opinion in the Independent Auditor’s Report
SA 706 Emphasis of Matter Paragraphs and Other Matter paragraphs in the Independent Auditor’s Report
SA 720 The Auditor’s Responsibilities Relating to Other Information

Audit Report



Enhancement to Auditors Report

All entities	Listed entities

► Opinion first, followed by Basis for Opinion
► Affirmative statement of independence and fulfilment of relevant ethical responsibilities
  ► Going concern
  ► Description of management and auditor responsibilities
► Separate dedicated section to material uncertainty, when exists
► Identification of those charged with governance within management responsibilities section
► Expanded description of auditor responsibilities, including key features of an audit
	► New section addressing Key Audit Matters
	  ► Those matters, in the auditor's judgment, were of most significance in the audit of the current period

Changes in SA 700 (Revised)

- The flow of the reporting has been changed substantially from the earlier SA-700.

- The new Standard is applicable for audits of all the financial statement for accounting periods beginning **<u>on and after April 1, 2018.</u>**

- This applies only to a complete set of General Purpose Financial Statement.

Flow of the Report

- Title
- Addressee
- Auditors' Opinion
- Basis for Opinion (to be given even for unmodified opinion)
- Going Concern (SA-570 - Revised)
- Key Audit Matter (SA-701 Revised)
- Emphasis of Matter (SA-706 Revised)
- Management Responsibility for Financial Statements
- Auditors' Responsibilities for the audit of financial statements
- Other Information (SA720 Revised)
- Reporting on other legal and regulatory matters (SA-706 Revised)
- Signature block
- Place and Date of Signing

Auditor's Opinion

- The auditor shall form an opinion on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

- In order to form that opinion, the auditor shall conclude as to whether the auditor has obtained reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error.

- Auditor shall express unmodified/modified opinion based on appropriate conclusions resulted from evaluation of the audit evidence obtained.

SA 701 Key Audit Matter

What is Key Audit Matter ?
Are those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period.

Key audit matters are selected from matters communicated with those charged with governance

KAM is required to be Disclosed by All Listed Entities and those entities that are components to a Listed Entities Consolidated Financial Statements as the Holding Company Auditor may request for mention of KAM in his Component Auditor letter.

There is however no bar on including KAM in an unlisted entity not covered by above situation also as it is the Auditors Prerogative to mention and report matters that he considers significant to the reader of the Audit Report.

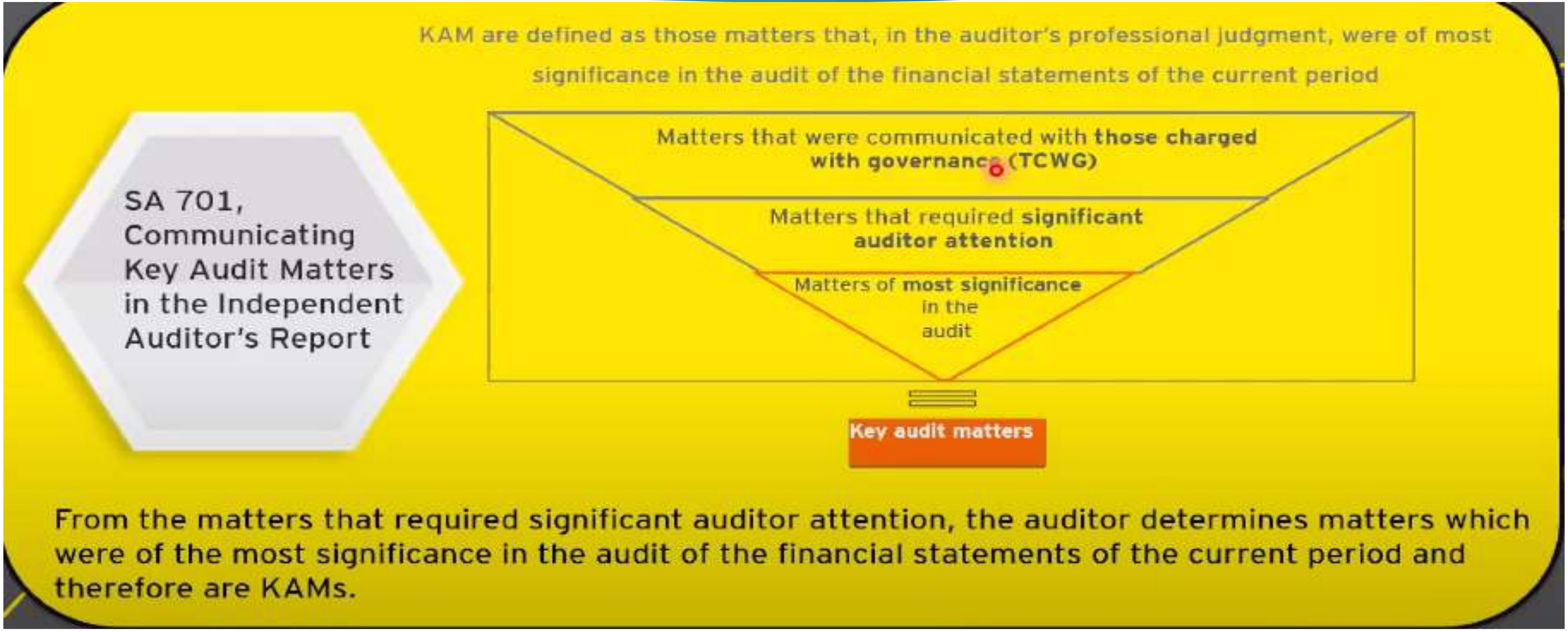
SA 701 Key Audit Matter – Why it should be reported ?

- The objective of reporting is to determine key audit matters and having formed an opinion on the financial statements , communicate those matters by describing them in the auditors' report.

- The purpose of communicating key audit matters is to enhance the communicative value of the auditor's report by providing greater transparency about the audit that was performed.

- Communicating key audit matters may also assist intended users in understanding the entity and areas of significant management judgment in the audited financial statements

SA 701 Key Audit Matter – What needs to be covered



SA 701 Key Audit Matter – Disclosure and Modification of Opinion paragraphs

- Matters that are part of Audit opinion modification either as qualification or adverse opinion or a disclaimer of opinion do not need mention once again as a KAM although these by their nature are Key Audit matters.
- They need to be disclosed as per the Applicable SA namely SA 705.
- Similarly a Material uncertainty relating to Going Concern being disclosed in accordance with SA-570 revised does not need a separate mention once again as KAM.
- If there is no KAM to communicate, KAM section is still required where the auditor should mention that no KAM to be reported.
- Do not include KAM references to disclosures or other information outside financial statements . You can give reference to note to financial statements.

SA 705 Modification to the Opinion

- Deals with circumstances when the auditor concludes modification to the report is necessary.

- Types of modified opinions
  - Qualified Opinion
  - Adverse Opinion
  - Disclaimer of Opinion

- The decision on the type of opinion depends upon:
  - ✓ The nature of the matter giving rise to the modification i.e. whether the financial statements are materially misstated.
  - ✓ Inability to obtain sufficient and appropriate audit evidence.
  - ✓ Auditor's judgment about the pervasiveness of the effects or possible effects of the matter.

- The auditor shall modify the opinion when:
  - ✓ He concludes that, based on audit evidence, the financial statements as a whole are NOT free of material misstatements; or
  - ✓ The auditor is UNABLE to obtain sufficient appropriate audit evidence to conclude that the financial statements are free of material misstatements.

SA 705 Modification to the Opinion

Auditor's Modification Matrix :

Nature of matter giving rise to the modification	Auditor's Judgment about the Pervasiveness of the Effects or Possible Effects on the Financial Statements	
	Material but not pervasive	**Material and Pervasive**
Financial statements are materially misstated	Qualified opinion	Adverse opinion
Inability to obtain sufficient appropriate audit evidence	Qualified opinion	Disclaimer of opinion

SA 705 Modification to the Opinion

- If, after accepting the engagement, the auditor becomes aware that management has imposed a limitation on the scope of the audit that the auditor considers likely to result in the need to express a qualified opinion or to disclaim an opinion on the financial statements, the auditor shall request that management remove the limitation.

- If management refuses to remove the limitation , the auditor shall communicate the matter to those charged with governance and determine whether it is possible to perform alternative procedures to obtain sufficient appropriate audit evidence, in absence of which auditor should consider to withdraw from audit.

SA 706 Emphasis of Other Matter Paragraph and Other Matter Paragraph

- An emphasis of matter paragraph is useful when the auditor, having formed an opinion, intends to draw the attention of the users to :
- ✓ A matter, though appropriately presented and disclosed, is of fundamental importance to the users to understand the financial statements;
- ✓ Any other matter relevant to the users' understanding of the audit, auditor's responsibility or Auditor's Report.
- ✓ Where an emphasis of matter paragraph is required by any other auditing standard, the disclosure shall be as per this SA.

- Such a paragraph shall refer to information presented and disclosed in financial statements.

- The auditor should have obtained sufficient appropriate audit evidence that the matter is not materially misstated.

SA 706 Emphasis of Other Matter Paragraph and Other Matter Paragraph

- The emphasis of matter paragraph shall be placed immediately after the Opinion paragraph in the Auditor's Report under the heading "Emphasis of Matter Paragraph"
- Include a clear reference to the matter being emphasized and to the relevant disclosures.
- Indicate that the Auditor's opinion is NOT modified by using words like " Without qualifying our opinion" or "Our report is not qualified on this account"

SA 720 Other Information

- This standard deals with the Auditors' responsibility with respect to other information included in the entity's annual report.

- Every Auditor is required to read all the contents in the Annual report which includes the financial statement.

- The auditor is also required to mention in his audit report that he has read and has not noticed any material inconsistency between the audit evidence and his understanding on the basis of which he formed his opinion nor is there any material misstatement.

SA 720 What if there is a material inconsistency or material misstatement

- The auditor is required to inform of such material inconsistency or material misstatement to the people charged with governance to make suitable correction before the same is circulated.

- If the said corrections are not carried out then the Auditor is required to take such steps as may be necessary as per the Standards on Auditing if the opinion of the Auditor will undergo a change pursuant to such matter.

- If the opinion does not change, then the auditor is required to report the errors noticed by him which are material in nature.

SA 720 What if the other information is not made available when the audit report is issued

- If the other information to be included in the annual report is not made available he has to make a specific mention of that fact in the audit report.
- Even if part of the information is not available the mention of sections or portions not read are to be mentioned.
- This does not absolve the auditor from reading in case of a listed Company.
- The auditor is still required to read such matter, when they are ready, to check if there are any material inconsistency or material misstatement in such other information.

Questions?

Thank You