DEVELOPMENTS IN AUDIT REPORTING REQUIREMENTS

- Auditor’s reporting responsibility:-
- Overview of Reporting Standards - SA 240, 700, 705, 706

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Given below is the summary of the revised/new reporting standards:

SA 700 (Revised), Forming an Opinion and Reporting on Financial Statements	**Represents the central standard for auditor reporting in accordance with the SAs; includes elements of the auditor's report, and specifies the contents of the sections for the opinion, basis for opinion, management responsibilities and auditor responsibilities.**
SA 701, Communicating Key Audit Matters in the Independent Auditor's Report	Includes the requirements and guidance for communicating Key Audit Matters (KAMs) – the centerpiece of the new auditor's report and the most significant change to auditor reporting.
SA 705 (Revised), Modifications to the Opinion in the Independent Auditor's Report	Addresses how the elements of the auditor's report are affected when a qualified, adverse or disclaimer of opinion is expressed.
SA 706 (Revised), Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report	Addresses the requirements for inclusion of Emphasis of Matter (EOM) and Other Matter (OM) paragraphs in the auditor's report. Updated to: • Explain the relationship of EOM and KAMs. • Remove reporting of material uncertainties related to going concern as a form of EOM reporting.

SA 700(R)

FORMING AN OPINION AND REPORTING ON FINANCIAL STATEMENTS

SA 700 (R) - Forming an opinion and Reporting on financial statements

Effective Date

This SA is effective for audits of financial statements for periods beginning from 01st April, 2018.

Objectives of SA 700

- To form an opinion on the financial statements based on an evaluation of the conclusions drawn from the audit evidence obtained; and
- To express clearly that opinion through a written report

Prescribed contents of an Auditor’s Report

- Title
- An addressee
- ***Opinion***
- ***Basis of Opinion***
- *Material Uncertainty Related to Going Concern – in case report is not modified.*
- *Key audit Matters.*
- *Management responsibility of preparation of financial statements*
- Auditors responsibilities for the audit of the financial statements.
- Other matter
- Report on other legal and regulatory requirements
- *Where applicable, a section that addresses, and is not inconsistent with the reporting of SA 570 (R).*
- Auditor Signature
- Place of signature
- Date of audit report

Form of Opinion

- Unmodified opinion :

when auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

- Modified Opinion :
  - In case fair presentation is not achieved
  - If the auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement;

Modify the opinion in the auditor’s report in accordance with SA 705 (Revised).

Auditors report as per SA 700 in consonance with SA 600- Using the Work of Another Auditor

- Auditor’s responsibilities in a consolidated audit :

  The division of responsibility for the financial information of the entity by indicating the extent to which the financial information of components is audited by the other auditors have been included in the financial information of the entity,

  Example : number of divisions/branches/subsidiaries or other components audited by other auditors.

Concept of Key Audit Matters (SA 701)

- Key audit matters are :
- In auditors judgement are most significant matters observed in the audit
- The matters need to be part of communication with those charged with governance
- the auditor describes these matters in the auditor's report unless law or regulation precludes public disclosure about the matter or
- when, in extremely rare circumstances, the auditor determines that a matter should not be communicated in the auditor's report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Peculiar Reporting Situations

Situation :
How does auditor issues Auditors Report in a situation where Audit is conducted in accordance with both Standards on Auditing Issued by ICAI and International Standards on Auditing

- The auditor's report may refer to Standards on Auditing in addition to the International Standards on Auditing but the auditor shall do so only if:

  - There is no conflict between the requirements in the ISAs and those in SAs that would lead the auditor
    (i) to form a different opinion, or
    (ii) not to include an Emphasis of Matter paragraph or Other Matter paragraph that, in the particular circumstances, is required by SAs;

Reference to More than One Financial Reporting Framework

- When financial statements are prepared in accordance with two financial reporting frameworks (e.g., Accounting Standards referred to in section 133 of the Companies Act, 2013 and the IFRSs).

- Appropriate only if the financial statements comply with each of the frameworks individually.
- Financial statements need to comply with both frameworks simultaneously and without any need for reconciling statements.

- In practice, simultaneous compliance is unlikely unless the other framework (e.g., IFRSs) has been adopted as the framework applicable to that entity.

SA 701

COMMUNICATING KEY AUDIT MATTERS
IN
THE INDEPENDENT AUDITOR'S REPORT

SA 701 - Communicating Key Audit Matters in the Independent Auditor's Report

Effective Date

- This SA is effective for audits of financial statements for periods beginning from 01st April, 2018.

Applicability of this SA

Listed entities;
circumstances when the auditor otherwise decides to communicate key audit matters in the auditor's report.

Prohibition : when the auditor disclaims an opinion, unless such reporting is required by law or regulation.

SA 701- Key Audit Matters

- Communicating key audit matters in the auditor's report is not a substitute :
  - for disclosures in the financial statements that are necessary to achieve fair presentation
  - for the auditor expressing a modified opinion when required
  - for reporting in accordance with SA 570 (Revised) - going concern, or
  - A separate opinion on individual matters

Interaction between Descriptions of Key Audit Matters and Other Elements Required to Be Included in the Auditor's Report

- Going concern issue : A material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with SA 570 (Revised), Giving rise to a modified opinion are by their nature key audit matters.

- However, in such circumstances, these matters shall not be described in the Key Audit Matters section of the auditor's report

- Report on these matter(s) in accordance with the applicable SA(s).

Question : How does an auditor decide whether he should give a 'clean' or 'unmodified' opinion?

Response: the auditor needs to reach a conclusion that those financial statements, taken as a whole, are free from material misstatement, whether due to fraud or error.

To reach this conclusion, the auditor has to determine whether:

(a) Sufficient appropriate audit evidence has been obtained in accordance with SA 330. *(auditors response to audit risk)*

(b) Uncorrected misstatements are, individually or in the aggregate, not material in accordance with SA 450*(evaluation of misstatement)*;

(c) Requirements of the financial reporting framework (e.g., the Accounting Standards) have been materially complied with;

(d) Management's judgments in preparing the financial statements are free from 'bias' (refer SA 260 *(communication with those charged with governance)* and SA 540 *(estimates)*;

(e) The financial statements adequately disclose the accounting policies selected and applied;

(f) Those accounting policies are appropriate and consistent with the financial reporting framework;

Continued..

(g) The accounting estimates made by management are reasonable;
(h) The information presented in the financial statements is relevant, reliable, comparable and understandable;
(i) There are adequate disclosures in financial statements for the users to understand the effect of material transactions and events on the information conveyed in the financial statements;
(k) In reporting under a fair presentation framework, the financial statements indeed achieve a true and fair presentation.

- The overall presentation, structure and content of the financial statements, and that The financial statements, including the related notes, represent the underlying transactions in a manner that is true and fair.

Continued..

- Reaching an audit opinion on a set of financial statements AND *To be able to “Prove”* that the auditor reached an informed opinion before signing
  - Requires considerable amount of diligent work, and
  - Documenting the work done.

- Issuing an opinion is therefore
  - *An outcome based on meticulous collection of evidence,*
  - *Detailed documentation of work performed, and*
  - *Analyzing it with professional skill, competence and judgments.*

Question : When should an auditor refuse to give a clean (unmodified) opinion?

Response :

1. when the auditor is unable to obtain sufficient appropriate audit evidence. Or

2. due to non-availability of sufficient appropriate audit evidence, he does not have the ability to reach a definite conclusion that the financial statements, taken as a whole, are free from material misstatement(s).

3. When reporting under a fair presentation framework, if the auditor concludes that the fair presentation is not achieved, he should discuss the matter with management to resolve the issue and based on the outcome, decide whether he should give a modified opinion.

Question : Is it necessary that an auditor's report should follow a particular form and style?

Response: Yes.

- Consistency in auditor's reports promotes credibility in the global marketplace.
- It helps to promote the users' understanding,
- Helps to identify unusual circumstances when they occur.

Question : What has changed in the structure of the Independent auditor’s report?

Response :
The opinion section is now required to be presented first, instead of placing after the responsibility paragraphs, which was the erstwhile requirement,

followed by the basis for opinion paragraph. There is no separate introductory paragraph as the same has now become part of opinion paragraph.

There are two new sections, namely, going concern (where applicable) and key audit matters (as applicable).

The key audit matters paragraph needs to be mandatorily provided only in the case of listed entities or in case of unlisted entities where the auditor believes that such matters are required to be reported.

AN OVERVIEW OF THE KEY CHANGES IN THE STRUCTURE OF THE INDEPENDENT AUDITOR'S REPORT IS GIVEN BELOW:

Pre-revised SA 700	Revised SA 700
Report on the Financial Statements	**Report on the Audit of the Financial Statements**
• Title: Independent Auditor's Report • Addressee: As per Engagement terms • **Subtitle: Report on the Financial Statements** • Introductory Paragraph: To mention - Whose Financial Statements are audited and period covered - Title of each statement in Financial Statements - Refer summary of significant accounting policies and explanatory information	• Title: Independent Auditor's Report • Addressee: As per Engagement terms • **Subtitle: Report on the Audit of the Financial Statements** • Opinion: Including information to be mentioned in introductory paragraph before • Basis for Opinion • Emphasis of Matter • Key Audit Matters
• Management's Responsibility for the financial statement	• Responsibilities of Management and Those Charged with Governance for the Financial Statements
Auditor's Responsibility • Basis for modified opinion, if any • Auditor's Opinion • Emphasis of Matter • Other Matter • **Subtitle: Report on Other Legal and Regulatory Requirements** • Signature • Date • Place	Auditor's Responsibilities for the Audit of the Financial Statement • Other Matter • **Subtitle: Report on Other Legal and Regulatory Requirements** • Signature • Date • Place

Question : Where an entity does not have any material uncertainty regarding the entity's ability to continue as a going concern, should the Management's Responsibility paragraph continue to include the disclosure as required SA 700 (Revised)?

Response : Yes, even if there is no material uncertainty regarding an entity's ability to continue as a going concern, the management's responsibility paragraph regarding going concern would need to be included. This is because the management's responsibility paragraph provides a summary of responsibility, including going concern assessment.

Question : Consequent to the enhancement in the auditor's responsibility paragraph, is there a real increase in the auditor's responsibility insofar as the audit is concerned?

Response: No, the auditor's responsibility remains the same. SA 700(revised) requires the auditor to put out to the readers of the auditor's report, such responsibility in a more enhanced manner.

For example:

- Evaluating the appropriateness of accounting policies used and reasonableness of accounting estimates.

  As part of audit procedures, auditor already evaluates all.

It is now specifically included in the auditors responsibility statement.

Question: Is it possible for the financial statements to be prepared in accordance with two financial reporting frameworks and if so, how is auditor's opinion expressed?

Response:

- In some cases, the financial statements may represent that they are prepared in accordance with two financial reporting frameworks (e.g., Accounting Standards referred to in section 133 of the Companies Act, 2013 and the IFRSs).

- in which case both are applicable financial reporting frameworks. Such description is appropriate only if the financial statements comply with each of the frameworks individually.

- To be regarded as being prepared in accordance with both frameworks, the financial statements need to comply with both frameworks simultaneously and without any need for reconciling statements.

Question : How does the auditor comply with this SA if the law or regulation prescribes a format of auditor's report that is different from the format required under this SA?

Response:

- This situation frequently confronts an auditor in India. Various laws and regulatory agencies prescribe the form in which they expect the auditor's report to be given.

- wherever they have the liberty to modify the prescribed format to broadly bring it in line with the requirements of this SA, they should do so to the extent possible.

This SA requires that if the difference between the prescribed format and this SA are only in layout and some wording, the auditor needs to assess. If they are all there but in a different layout, he may give his report in the prescribed format, so long as the basic principles of this SA are met.

Continued..

Paragraph 48 of this SA requires an auditor's report to contain, at a minimum, the following elements:

(a) title,
(b) addressee,
(c) opinion section with reference to the applicable financial reporting framework,
(d) identification of the financial statements audited,
(e) Auditor's independence,
(f) management's responsibility,
(g) auditor's responsibility for the audit with reference to SAs/ laws/ regulations,
(h) signature,
(i) place of signature and
(j) date.

Continued..

However, if the prescribed format of the audit report does not include the minimum elements required under paragraph 48 of this SA and if the auditor does not have the liberty to change the format to include the missing elements, then he cannot include a statement in the auditor's responsibility paragraph of the report that

"We conducted the audit in accordance with the Standards on Auditing specified under Section 143(10) of the Act" or

"We conducted the audit in accordance with the Standards on Auditing issued by the Institute of Chartered Accountants of India."

Question: Can an audit be done under two different sets of auditing standards: such as the SAs and International Standards on Auditing (ISAs)? How will reporting be done in such a situation?

Response:

- SA for Indian GAAP financial statements of a foreign subsidiary; and
- ISA for parent reporting.

- Same audit report for the two sets of Standards is possible - Provided do not have any conflict that would require the auditor to form a different opinion
- audit report may refer to compliance with both the Standards by specifically naming them in his report. e.g. "We conducted the audit in accordance with the Standards on Auditing issued by the Institute of Chartered Accountants of India and the International Standards on Auditing".

- If a conflict exists, the auditor needs to give two separate auditor's reports,

Question : How does an auditor deal with a situation where the audited entity voluntarily provides supplementary information or where a law or regulation requires additional information that is outside the scope of the applicable financial reporting framework?

Response:

consider discussing with the client if such information could be displayed separately outside the financial statements. If that is possible, there is no further issue.

Where such supplementary information cannot be clearly differentiated from the rest of the financial statements, the auditor's opinion shall have to cover that too. This means that the auditor would need to audit this information and report on it, in the ordinary course.

If the management (or law/ regulation) requires such information not to be subjected to audit, the auditor must ensure that such information is presented in a way that clearly shows that it is "unaudited".

the auditor still has the responsibility to read such information to identify if it contains any material inconsistency with the audited financial statements.

SA 705(R)

MODIFICATION TO THE OPINION

IN
THE INDEPENDENT AUDITOR’S REPORT

Introduction to the Standard

- Three types of modified opinions,
  - a qualified opinion,
  - an adverse opinion, and
  - a disclaimer of opinion.

- The decision regarding which type of modified opinion is appropriate depends upon:

The nature of the matter giving rise to the modification, that is,

- whether the financial statements are materially misstated or,
- In the case of an inability to obtain sufficient appropriate audit evidence

pervasiveness of the effects or possible effects of the matter on the financial statements.

Determining the Type of Modification to the Auditor’s Opinion

Qualified Opinion

The auditor shall express a qualified opinion when:

- The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or
- The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.

Continued..

Adverse Opinion

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

Disclaimer of Opinion - *Issue is both* *material and pervasive*

- The auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive.

- The auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive.

Consequence of an Inability to Obtain Sufficient Appropriate Audit Evidence - Scope Limitation

- the auditor shall request that management remove the limitation.

- the auditor shall determine the implications as follows:

1. could be material but not pervasive, the auditor shall qualify the opinion; or
2. could be both material and pervasive -
   - ✓ communicate the gravity of the situation
   - ✓ Withdraw from the audit, where practicable and possible under applicable law or regulation;…… *Contemporary example*
   - ✓ If withdrawal from the audit before issuing the auditor’s report is not practicable or possible, disclaim an opinion on the financial statements.

- Before withdrawing, the auditor shall communicate to those charged with governance any matters regarding misstatements identified during the audit that would have given rise to a modification of the opinion.

- **If there is a material misstatement of the financial statements that relates to the nondisclosure of information required to be disclosed, what shall auditor do :**

  (a) Discuss the non-disclosure with those charged with governance;

  (b) Describe in the Basis for Opinion section the nature of the omitted information; and

  (c) Unless prohibited by law or regulation, include the omitted disclosures, provided it is practicable to do so and the auditor has obtained sufficient appropriate audit evidence about the omitted information.

- If the modification results from an inability to obtain sufficient appropriate audit evidence, the auditor shall include in the Basis for Opinion section the reasons for that inability.

Disclaimer of opinion and key audit matters

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

Keep the Communication channel open - Bad news should be known to the whole universe

- When the auditor expects to modify the opinion in the auditor's report, the auditor shall communicate with those charged with governance the circumstances that led to the expected modification and the wording of the modification.

Table summarizes the criteria and the nature of modification in different situations:

Nature of matter giving rise to modification	*Auditor's judgment about the Materiality and Pervasiveness 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

Question: For which audits does the auditor need to follow this revised reporting standard i.e. SA 705 (Revised)?

Response: Applicable for audits of financial statements for periods beginning on or after April 1, 2018.

Question: What are the circumstances requiring issue of modified opinions?

Response: There are two circumstances as given below:

1. The auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement.

2. The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.

Question: If the management imposes a scope limitation after the auditor has accepted the engagement, what should he do?

Response:

STEP 1: Auditor should request the management to remove the scope restriction. If the management refuses, he should communicate with those charged with governance and simultaneously explore ways to perform alternative procedures to obtain sufficient appropriate audit evidence.

STEP 2 Determine if the possible effect of undetected misstatements is likely to be material but not pervasive. --------Qualify

STEP 3 If possible effect of undetected misstatements is likely to be both material and pervasive ------- consider withdrawing from the audit, if permitted to do so, by the applicable law or regulation.

STEP 4 : Give a disclaimer of opinion.

Question: When the auditor's report carries a modification from earlier years, does this impact the auditor's opinion on internal financial controls over financial reporting?

Response: Yes. Even when the auditor's report carries a modification from earlier years, it may have a direct impact on accounting records and reliable financial information. Hence the auditor needs to exercise professional judgement to determine whether a modification in the auditor's reporting on internal financial controls over financial reporting should be made.

Question: While considering the observations (for instance modification and /or emphasis of matter/other matter in accordance with SA 705/706) of the component auditor in his report on the standalone financial statements, the parent auditor should comply with the requirements of SA 600, "Using the Work of Another Auditor"." Whether principal auditor has to mandatorily reproduce all the observations of component auditors and ensure same is in compliance with the requirements of SA 705 (Revised)?

Response:

- If the principal auditor, decides to use the work of another auditor in relation to the audit of consolidated financial statements, he should comply with the requirements of SA 600.

- While reporting on the Consolidated Financial Statements, Auditors have to give due consideration to the nature and significance of the findings of component auditors with reference to the Consolidated Financial Statements as a whole before concluding whether to reproduce the comments of component auditor in his report on the Consolidated Financial Statements.

- Once the auditor concludes to include qualification reported by the component auditor in the report on consolidated financial statements also, then the same needs to be reproduced.

SA 706(R)

EMPHASIS OF MATTER PARAGRAPHS
&
OTHER MATTER PARAGRAPHS

IN THE INDEPENDENT AUDITOR'S REPORT

Introduction to the Standard

- SA 706 deals with additional communication in the auditor's report when the auditor considers it necessary to:

  (a) Draw attention to a matter presented or disclosed in the financial statements that are of such importance that they are fundamental to users' understanding of the financial statements; or

  (b) Draw attention to any matter other than those presented or disclosed in the financial statements that are relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.

Including an Emphasis of Matter Paragraph in the Auditor's Report

- The inclusion of an Emphasis of Matter paragraph in the auditor's report does not affect the auditor's opinion. An Emphasis of Matter paragraph is not a substitute for:

  (a) A modified opinion;

  (b) Disclosures in the financial statements that the applicable financial reporting framework requires management to make, or that are otherwise necessary to achieve fair presentation; or

  (c) Reporting in accordance with SA 570 (Revised) when a material uncertainty exists relating to events or conditions that may cast significant doubt on an entity's ability to continue as a going concern.

Question: If the matter is already appropriately presented or disclosed in the financial statements, why is it necessary for an auditor to emphasize it in his report?

Response:

An emphasis of matter paragraph is defined as “A paragraph included in the auditor’s report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor’s judgment, ***is of such importance that it is fundamental to users’ understanding of the financial statements.”***

Question: What kind of circumstances may require issuing an emphasis of matter paragraph?

Response:

- An uncertainty relating to the future outcome of an exceptional litigation or regulatory action.

- A significant subsequent event that occurs between the date of the financial statements and the date of the auditor's report.

- Early application (where permitted) of a new Accounting Standard that has a material effect on the financial statements.

- A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position.

- An unconventional interpretation of an Accounting Standard that an entity may have taken, even though the auditor is fully in agreement with it – SIGNIFICANT .

Question: Is it advisable for an auditor to give emphasis of matter paragraphs to highlight all significant matters and transactions that affect the financial statements?

Response : No. The SA 706 (Revised) clearly states that “widespread use of emphasis of matter paragraphs may diminish the effectiveness of the auditor’s communication about such matters”. An auditor’s report is a carefully worded document that should contain such information as is required.

Care taken while issuing EOM :

- Cannot introduce new fact or information that is not already presented or disclosed in FS.
- EOM is not a substitute for disclosures in the financial statements

Question : Will key audit matters be emphasis of matter paragraphs?

Response: No, key audit matters are not emphasis of matter paragraphs.
By definition, an EOM can be included, where SA 701 applies, only when the matter has not been determined to be a key audit matter to be communicated in the auditor’s report.

Question: If an auditor disagrees with or is uncomfortable about the recognition, measurement, disclosure or presentation of a transaction in the financial statements, can he highlight it in an emphasis of matter paragraph?

Response: No. It is important to note that Emphasis of Matter is given only in respect of matters that are "appropriately presented or disclosed" in the financial statements. This means that the auditor should and is deemed to agree entirely with the treatment of that matter in the financial statements.

In case the auditor has a reservation about a matter – He needs to qualify.

Question : What are the requirements for including an Emphasis of Matter paragraph in the auditor's report?

Response:

(a) Include the paragraph within a separate section of the auditor's report with an appropriate heading that includes the term "Emphasis of Matter".

(b) Clear reference to the matter being emphasized and to where relevant disclosures that fully describe the matter can be found in the financial statements. The paragraph shall refer only to information presented or disclosed in the financial statements.

(c) Indicate that the auditor's opinion is not modified in respect of the matter emphasized.

SA 240

THE AUDITOR’S RESPONSIBILITIES RELATING TO FRAUD IN AN AUDIT OF FINANCIAL STATEMENTS

Scope of this SA

- Deals with the auditor's responsibilities relating to fraud in an audit of financial statements.

- It expands on how SA 315, "Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment," and

- SA 330, "The Auditor's Responses to Assessed Risks," are to be applied in relation to risks of material misstatement due to fraud.

Characteristics of Fraud

- Although fraud is a broad legal concept, for the purposes of this SA, the auditor is concerned with fraud that causes a material misstatement in the financial statements.

- Two types of intentional misstatements are relevant to the auditor–
- `` misstatements resulting from fraudulent financial reporting; and
  - misstatements resulting from misappropriation of assets.

Responsibility for the Prevention and Detection of Fraud

- Primary responsibility a) those charged with governance of the entity b) management.

- Management to place 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.

- Management should create a culture of honesty and ethical behavior which can be reinforced by an active oversight by those charged with governance.

Responsibilities of the Auditor

- An auditor is responsible for obtaining reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error.

- Owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with the SAs.

- 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 deliberate failure to record transactions or intentional misrepresentations, collusion

- 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.

Need to be Professionally Skeptical

- The auditor shall maintain professional skepticism throughout the audit:
  - Possibility that fraud exist, notwithstanding the auditor's past experience of the honesty and integrity of the entity's management and those charged with governance.
  - Where responses to inquiries of management or those charged with governance are inconsistent, the auditor shall investigate the inconsistencies
- **Questions : Does that mean should auditor assume that books are cooked in all cases?**

  Answer : Unless the auditor has reason to believe the contrary, the auditor may accept records and documents as genuine.
- <u>*A QUESTIONING MIND IS THE NEED OF THE HOUR*</u>
- If the auditor believes that a document may not be authentic or document have been modified, the auditor shall investigate further.

How should audit team prepare themselves to be skeptical

- **Fraud Discussion Among the Engagement Team :**
- Discussion among the engagement team members including the engagement partner.
- Discussion around where the entity’s financial statements may be susceptible to fraud, including how fraud might occur.
- The discussion shall occur notwithstanding the engagement team members’ beliefs that management and those charged with governance are honest and have integrity.
- Encourage team members to be of questioning mind

Oversight exercised by Those Charged with Governance on Fraud Prevention

- The auditor shall obtain an understanding of how those charged with governance exercise oversight of management's processes for identifying and responding to the risks of fraud

- The internal control that management has established to mitigate these risks.

- Auditor to make inquiries of those charged with governance to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity.

- These inquiries are made in part to corroborate the responses to the inquiries of management.

Evaluation of Fraud Risk Factors - *The Famous Three elements*

- Identify events or conditions that indicate
  - Incentive
  - Pressure
  - Opportunity

- Example:
  - Need to meet expectations of third parties to obtain financing may create pressure to commit fraud.
  - Granting of significant bonus on high profit targets
  - Weak control environment

Presumed Risk of fraud on components of FS

- Risk of fraud in Revenue Recognition
  - ➢ Premature revenue recognition
  - ➢ Recording fictious revenue

- The auditor shall treat those assessed risks of material misstatement due to fraud as significant risks and accordingly, to the extent not already done so, the auditor shall obtain an understanding of the entity's related controls, including control activities, relevant to such risks.

- Management override of control
  - ➢ Journal entries and other adjustment
  - ➢ Business rationale for significant transactions
  - ➢ Accounting estimates
  - ➢ Judgmental areas

Some suggestive Audit Procedures to address Risk of material misstatement due to Fraud

(a) Incorporate an element of unpredictability in nature, timing and extent of audit procedures.
(b) Review significant unusual transactions
(c) Detailed review of year end and quarter end adjusting entries
(d) Involving auditors experts may be required
(e) Use Computer assisted techniques to test anomalies in population
(f) Observing inventory counts at certain locations on an unannounced basis
(g) Management estimates
(h) Comparing key ratios with industry norms
(i) Employee identification by reviewing PAN, investment proofs etc
(j) Independent confirmations

Communications to Regulatory and Enforcement Authorities

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. 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.

REPORTING ON FRAUD AGAINST THE COMPANY

- Section 143(12) - Where auditor, *in the course of the performance of his duties, has reason to believe (sufficient - rules)* that an *offence involving fraud* is being or has been committed *against the Company* by officers or employees of the Company, auditor to immediately report the matter to the CG but not later than *60 days of his knowledge* and after following the specified procedure.
- *No duty* to which an auditor of a company may be subject to *shall be regarded as having been contravened* by reason of his reporting the matter as above *if it is done in good faith*.

QUESTIONS ?