

Standards on Auditing

4 May 2024



Agenda

- 01** SA 300 Planning an Audit of Financial Statements
- 02** SA 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment
- 03** SA 320 Materiality in Planning and Performing an Audit
- 04** SA 450 Evaluation of Misstatements Identified During the Audit
- 05** SA 505 External Confirmations
- 06** SA 580 Written Representations

How do you feel?



Worried



Excited



Anxious



Uncertain



Other

Meet Pavan and Carrie



Hi! I'm Pavan. I'm excited and a little nervous about not being able to grasp all the concepts. I'll ask questions if I don't understand *why* we are doing something.



Hi! I'm Carrie. I can't wait to learn everything I need to know! Along the way I'll ask questions as to *why* something is important if I am unsure.

Purpose of an audit

Question 1

What is an audit?

A

Performing bookkeeping and tax returns for an entity.

B

An independent examination of financial information of a profit-oriented entity only.

C

Applying analytical procedures and making inquiries of persons responsible for financial and accounting matters.

D

An independent examination of financial information of any entity, whether profit oriented or not, irrespective of its size or legal form.



Question 1: Debrief

What is an audit?

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An independent examination of financial information of any entity, whether profit oriented or not, irrespective of its size or legal form.



Question 2

What does an auditor do to perform the audit? (Select all that apply.)

A

Remain ethical and independent during the audit engagement, in addition to demonstrating competence and capabilities to perform the engagement.

B

Form a close personal relationship with entity management and perform management functions of the entity when necessary.

C

Exercise professional judgment, apply professional skepticism, and conduct the audit in accordance with standards.

D

Plan and perform audit procedures to obtain reasonable assurance whether financial statements are free of material misstatements.



Question 2: Debrief

What does an auditor do to perform the audit? (Select all that apply.)

A

Remain ethical and independent during the audit engagement, in addition to demonstrating competence and capabilities to perform the engagement.

B

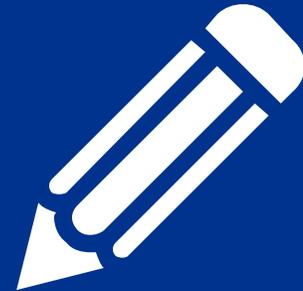
Form a close personal relationship with entity management and perform management functions of the entity when necessary.

C

Exercise professional judgment, apply professional skepticism, and conduct the audit in accordance with standards on auditing.

D

Plan and perform audit procedures to obtain reasonable assurance whether financial statements are free of material misstatements.



What is a financial statement audit (FSA) ?



Examine

Amounts and disclosures in the financial statements to determine whether they are presented fairly in accordance with the applicable accounting standards.



Report

Opinion on the financial statements.

Standards relevant to Auditor and management

SA 200



Accounting and reporting standards



Management



Auditor



Auditing standards



Auditor

What are the auditor's responsibilities in performing an audit?



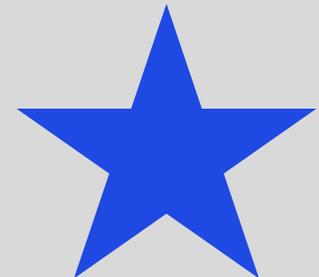
- Plan and perform audit procedures to obtain reasonable assurance whether financial statements are free of material misstatements.



- Demonstrate competence and capabilities to perform engagement.
- Exercise professional judgment and apply professional skepticism.
- Conduct audit in accordance with standards on auditing issued by the ICAI.



- Remain ethical and independent during the audit period and the professional engagement period.



Materiality basics

Do you audit every transaction?

Indicate your response:

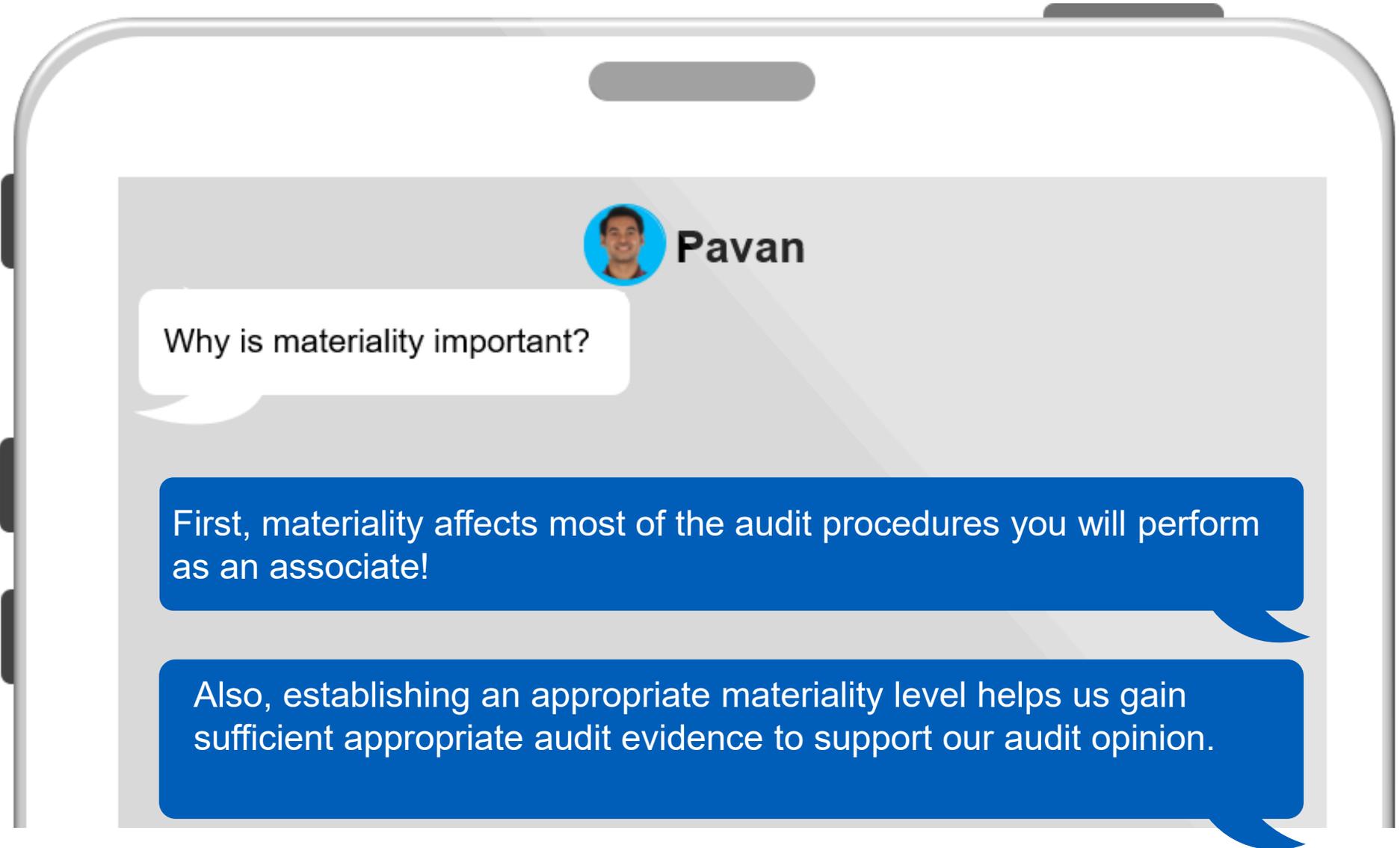
- As auditors, the engagement team does not guarantee absolute assurance.
- You use the concept of materiality to:
 - Plan and perform the audit,
 - Evaluate the results of the audit, and
 - Ultimately, form an opinion on the financial statements.

No

Materiality is the amount you believe will be **material** to the users of the financial statements.



Pavan is wondering ...



What is *material*?



Information that could reasonably be expected to lead users to make a different judgment about doing business with or investing in the entity.

Two different audit engagements...

Engagement 1: Global retailer

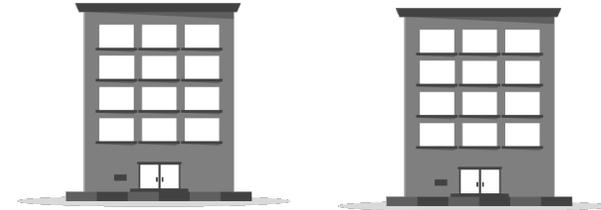


Not material



100,000

Engagement 2: Small boutique

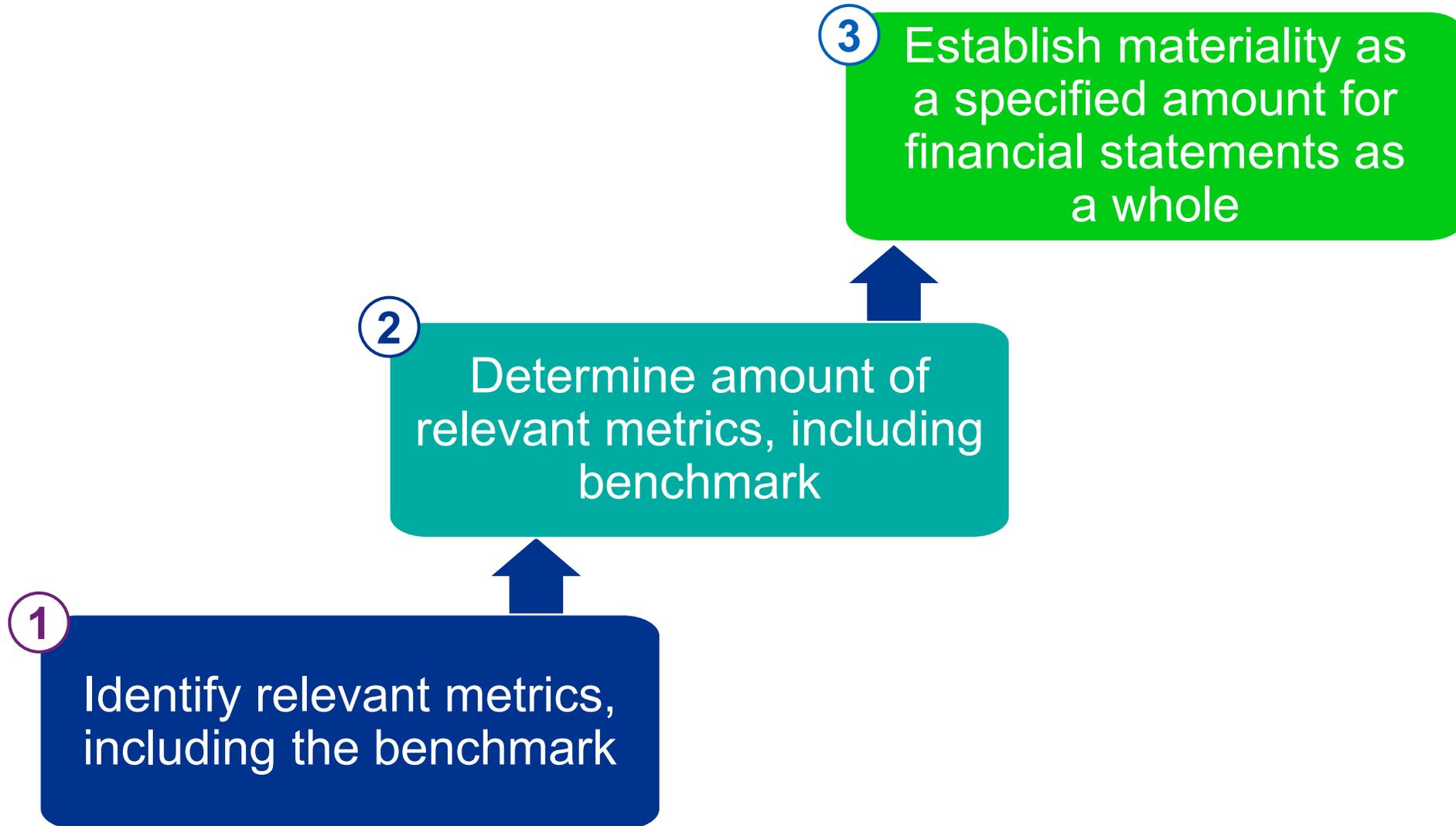


Material



100,000

Steps in establishing materiality



- Use professional judgment.
- Team documents materiality in the Workflow as a specified amount.



PM and AMPT

Question 3

What is the definition of performance materiality?

A

A quantitative threshold for determining whether a misstatement is clearly trivial

B

A measure the engagement team uses to assess and respond to risk at the assertion level

C

The amount the engagement team believes will be material to the users of the financial statements

D

A quantitative threshold for determining whether to report the misstatement to those charged with governance



Question 3: Debrief

What is the definition of performance materiality?

A

A quantitative threshold for determining whether a misstatement is clearly trivial

B

A measure the engagement team uses to assess and respond to risk at the assertion level

C

The amount the engagement team believes will be material to the users of the financial statements

D

A quantitative threshold for determining whether to report the misstatement to those charged with governance



Performance materiality

What is the definition of performance materiality?

A measure the engagement team uses to assess and respond to risk at the assertion level.

- This is established at an amount less than materiality to:
 - Reduce aggregation risk.
 - Reduce audit risk to an appropriate level.
- Key input in determining sample sizes for substantive testwork.

Debrief: Aggregation risk

What is the definition of aggregation risk?

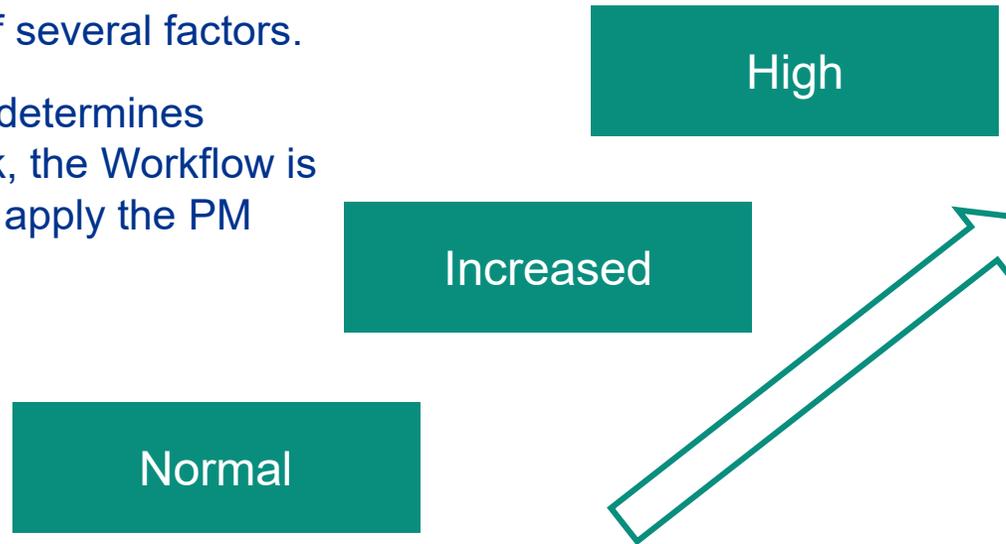
The risk that uncorrected and undetected misstatements exist and exceed materiality for the financial statements as a whole.

- The team's assessment of aggregation risk includes both:
 - Historical knowledge of the entity.
 - Information from the current period audit.

Aggregation risk levels

What are the three levels of aggregation risk?

- Engagement team determines aggregation risk based on consideration of several factors.
- Once the team determines aggregation risk, the Workflow is programmed to apply the PM percentage.



Examples of aggregation risk factors

Level of turnover of senior management or key financial reporting personnel.

Management's willingness to correct misstatements.



Debrief: AMPT

What is the definition of audit misstatement posting threshold?

A quantitative threshold for determining whether a misstatement is clearly trivial.

- 'Clearly trivial' misstatements would not have a material effect on the financial statements, individually, in combination with other misstatements and when considering possible undetected misstatements.
- If you find a misstatement, check if it's over AMPT.

Risks

What is audit risk?



SA 200

Audit risk is the risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated.



Audit opinion

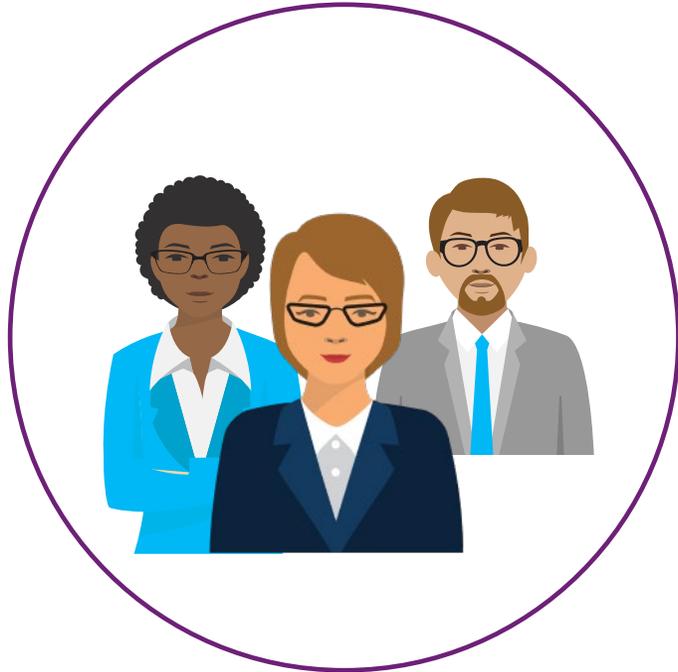


SA 200



The audit opinion provides ***reasonable assurance***, not absolute assurance, that the financial statements are free from material misstatement due to error or fraud.

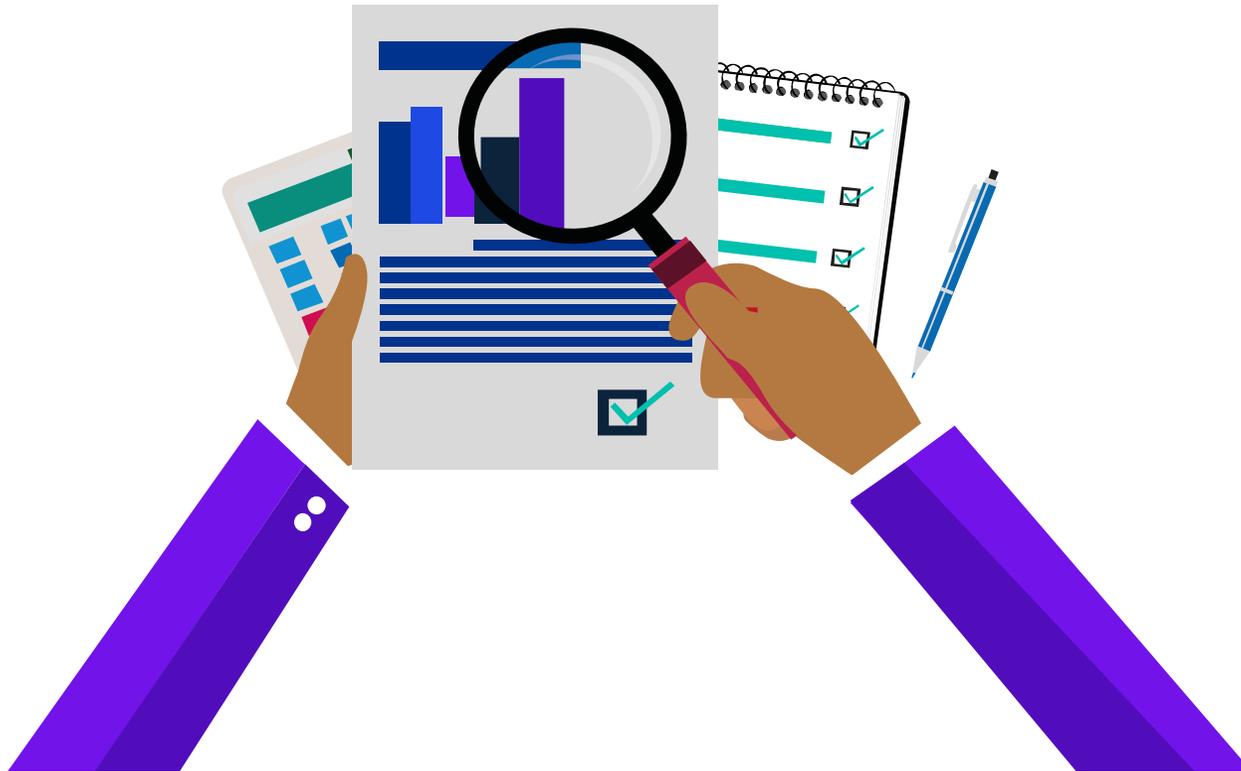
What is a material misstatement?



A misstatement is a difference between the reported amount, classification, presentation, or disclosure of a financial statement item and that required for the item to be in compliance with GAAP.

A material misstatement is one that the engagement team could reasonably expect to influence the economic decisions of the users of the financial statements.

Reduce audit risk



Obtain audit evidence to reduce audit risk to an acceptably low level.

Question from Pavan



Why is understanding audit risk important to me?

The audit procedures you perform reduce audit risk.

Risks of misstatement (RMs)

Description of a situation that could result in a misstatement to the financial statements.

When the risk of misstatement applies to the financial statements we are auditing, the risk is identified as an RM.



Types of RMs

Assertion-level RMs

Specific financial statement accounts, disclosures, and assertions.

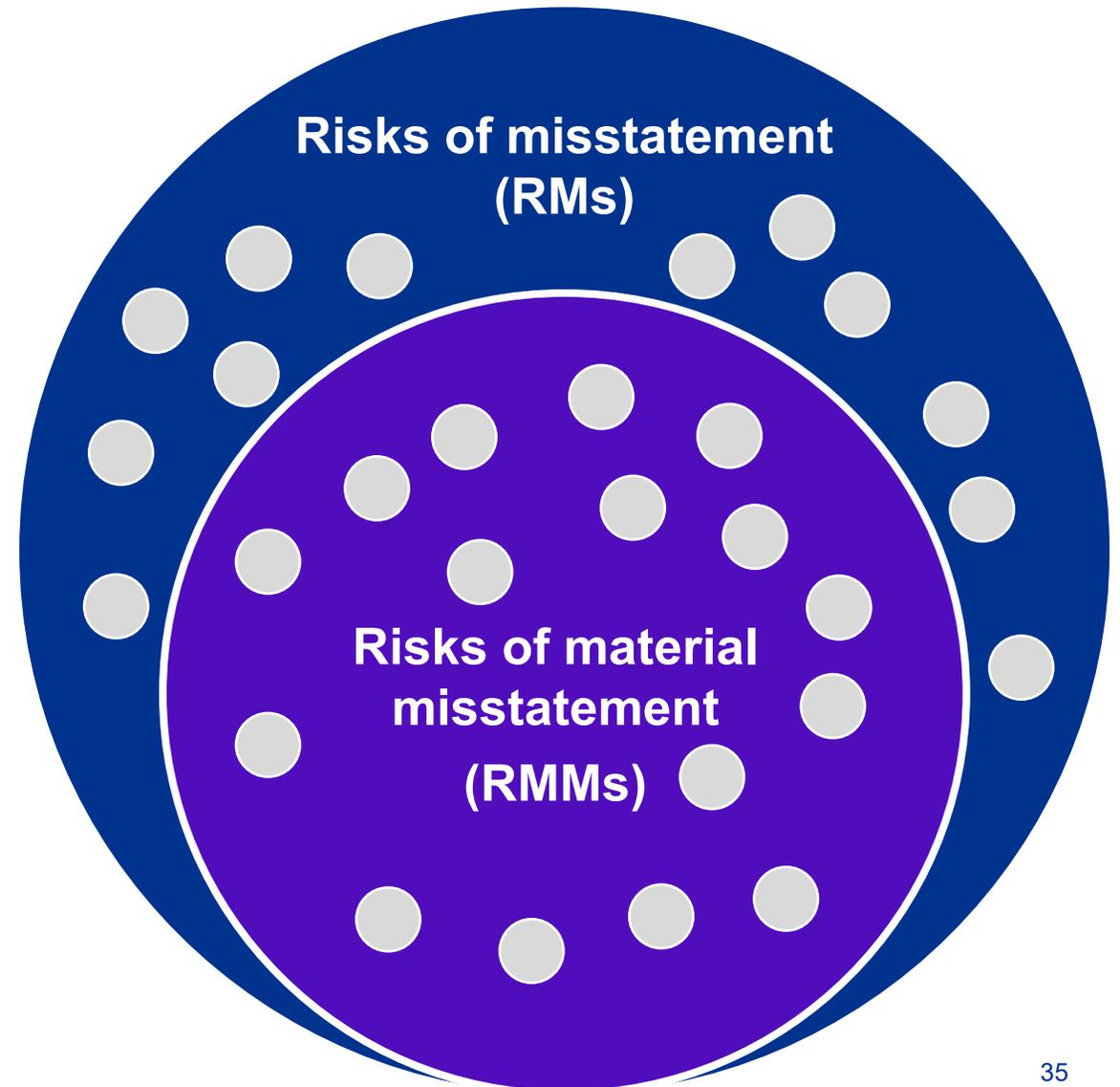
Financial statement level RMs (FSL RMs)

Risks that have **pervasive effect** on the financial statements as a whole and/or relate to many assertions.

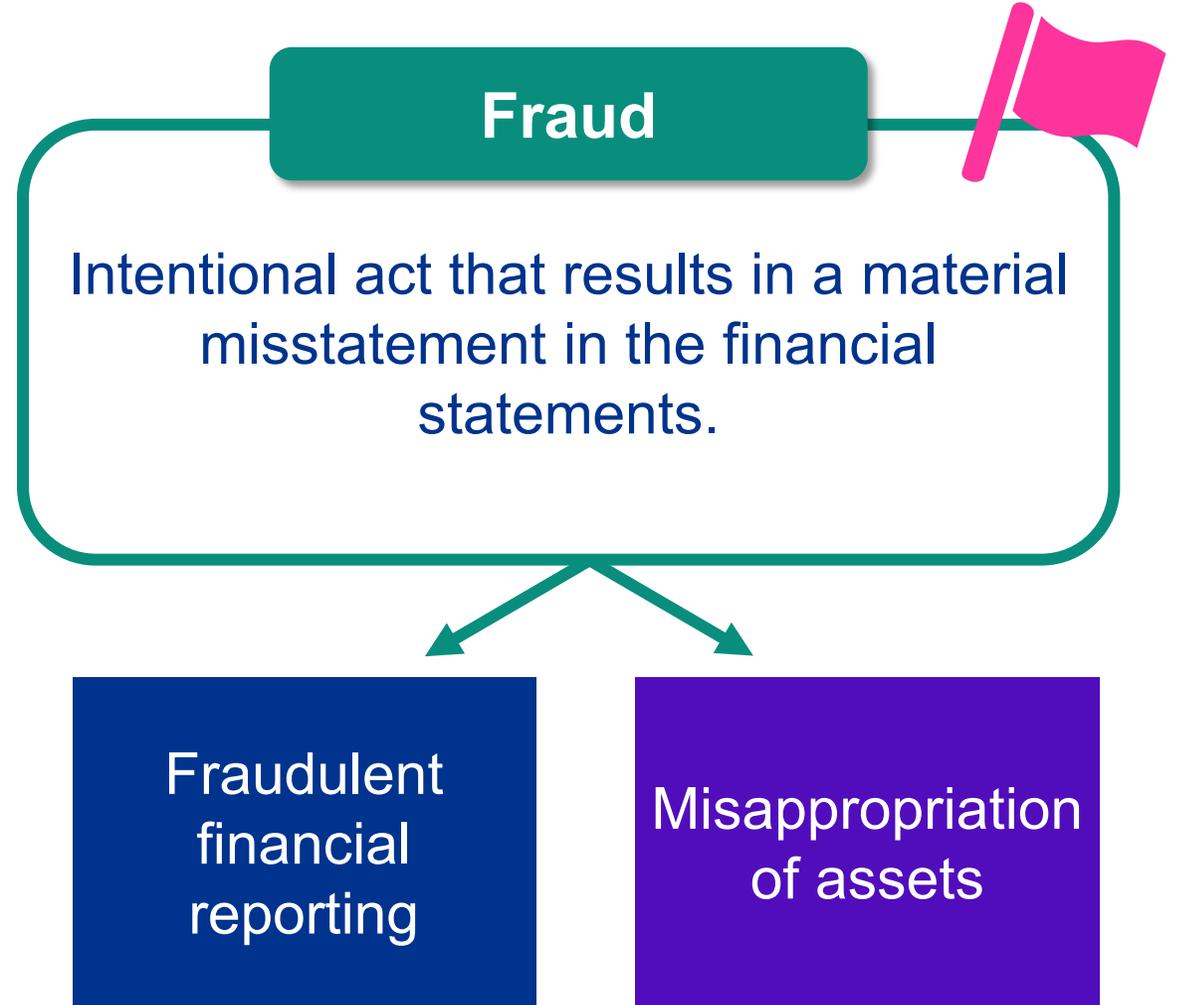
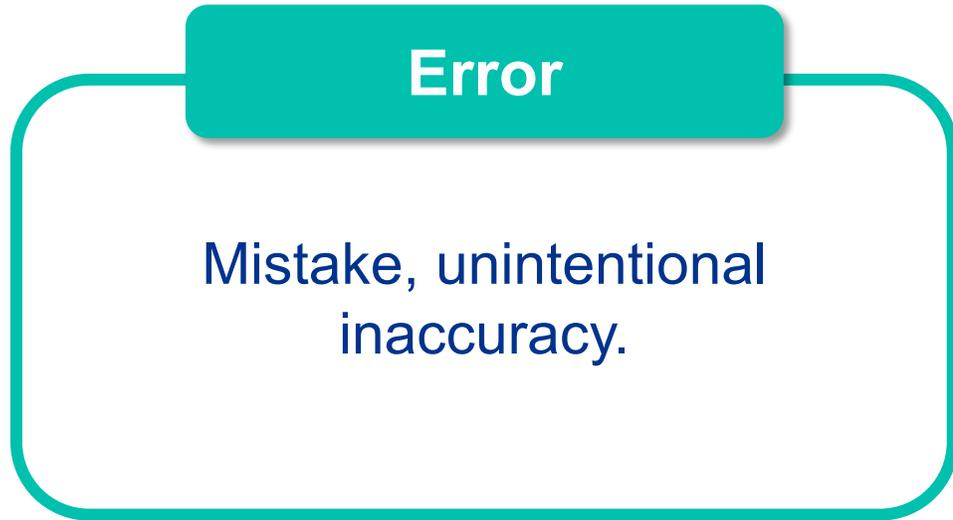
Risks of material misstatement (RMMs)

RMM is a description of a situation that could result in a material misstatement, either individually or in combination with others, to the financial statements.

Once the population of RMs is identified, determine if each RM rises to the level of an RMM.



Risk of error and risk of fraud



Question 5

Scenario: You keep cash under your bed and count it regularly. You count the money late at night when you are tired.

What type of risk does this represent?

A

Error

B

Fraud

C

Reputational



Question 5: Debrief

Scenario: You keep cash under your bed and count it regularly. You count the money late at night when you are tired.

What type of risk does this represent?

A

Error

B

Fraud

C

Reputational



Another scenario

Your roommate, who is looking to pay off their credit card debt, came into your room without knocking and saw you counting your cash.

Your roommate doesn't know exactly where you keep your cash but knows when you are in your room and when you are not in your room, so there are opportunities to look in your room for your cash when you are not there.

Is this a risk of error or risk of fraud?

Risk of
error



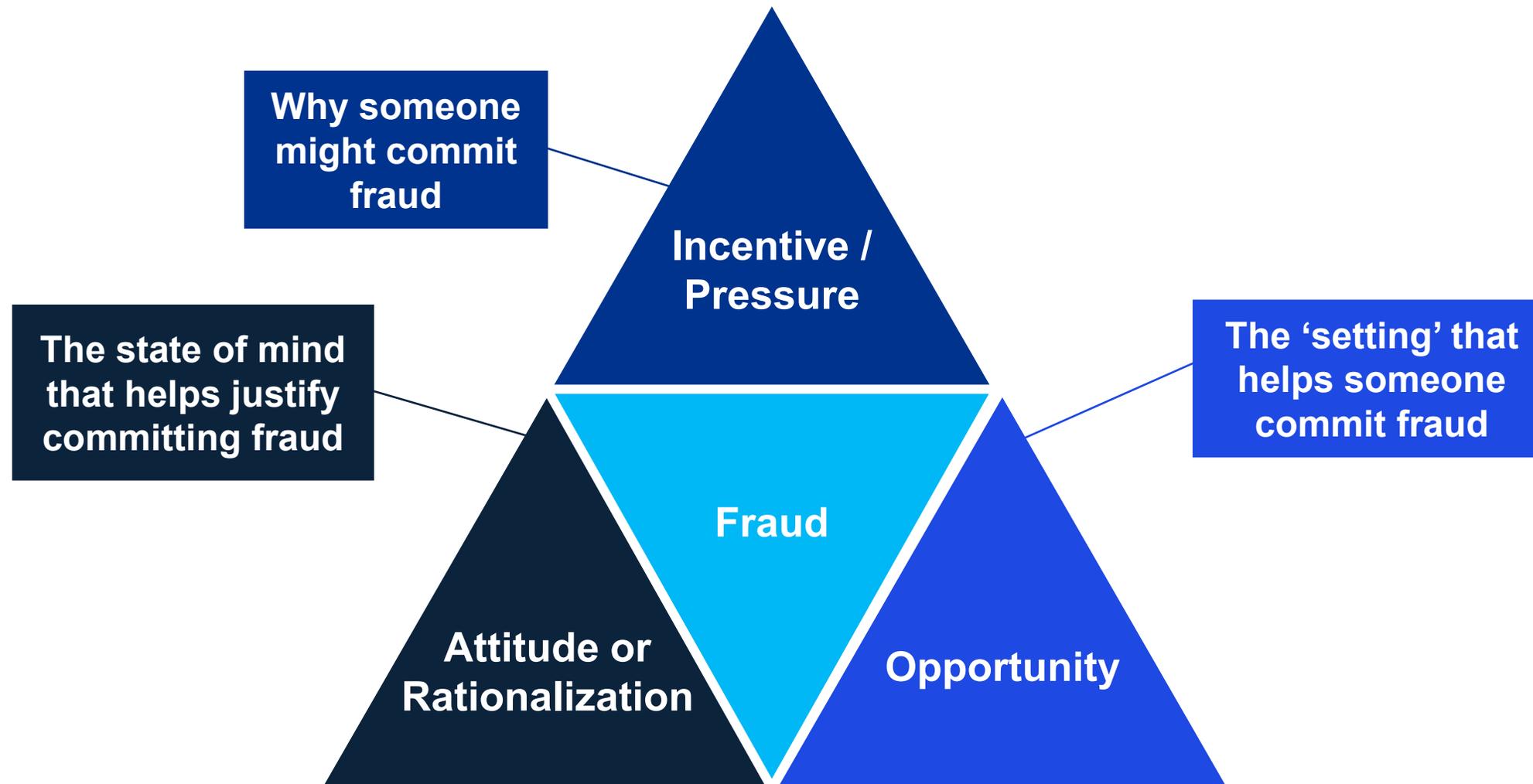
OR



Risk of
fraud



Understanding of fraud risk factors



Presumed risk of fraud related to revenue

- Rebuttable presumption that there is a fraud risk involving improper revenue recognition.
- During risk assessment, evaluate which specific revenue transactions may give rise to a fraud risk.



Question 1

In many industries, revenue is a key metric and an area of focus for investors and financial statement users, as it directly affects earnings and other key metrics. Therefore, an entity often has a greater _____ or _____ to manipulate revenue.

A

Attitude or rationalization

B

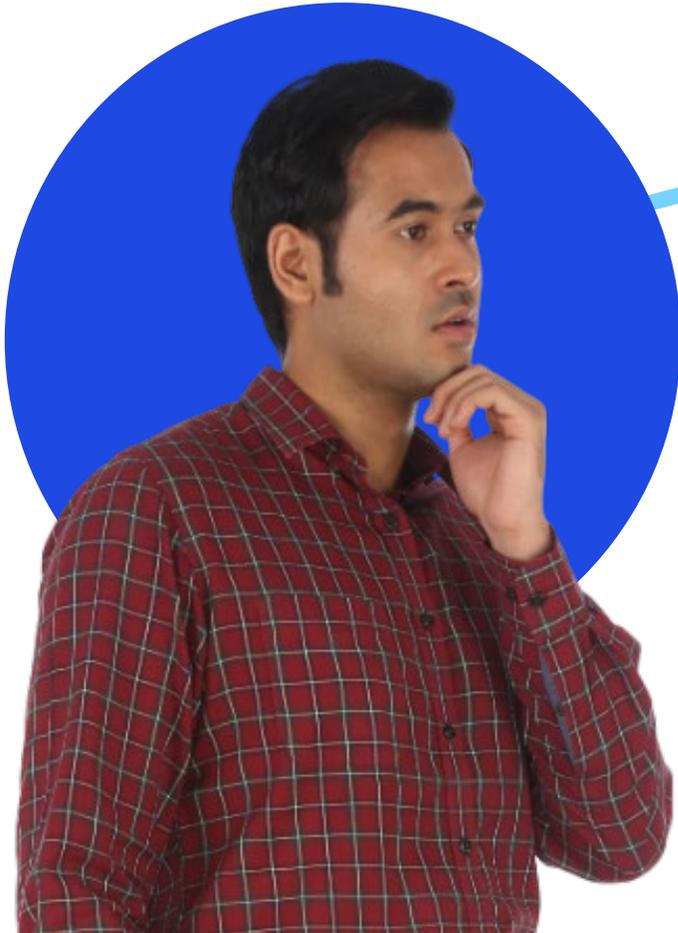
Opportunity or incentive

C

Incentive or pressure



Question from Pavan



Why is it important for me to understand the RMMs due to fraud or error the engagement team identified?

It's important to understand how the risks relate to the audit procedures you perform so you know **why** you are performing those procedures.

Audit evidence

What is audit evidence?



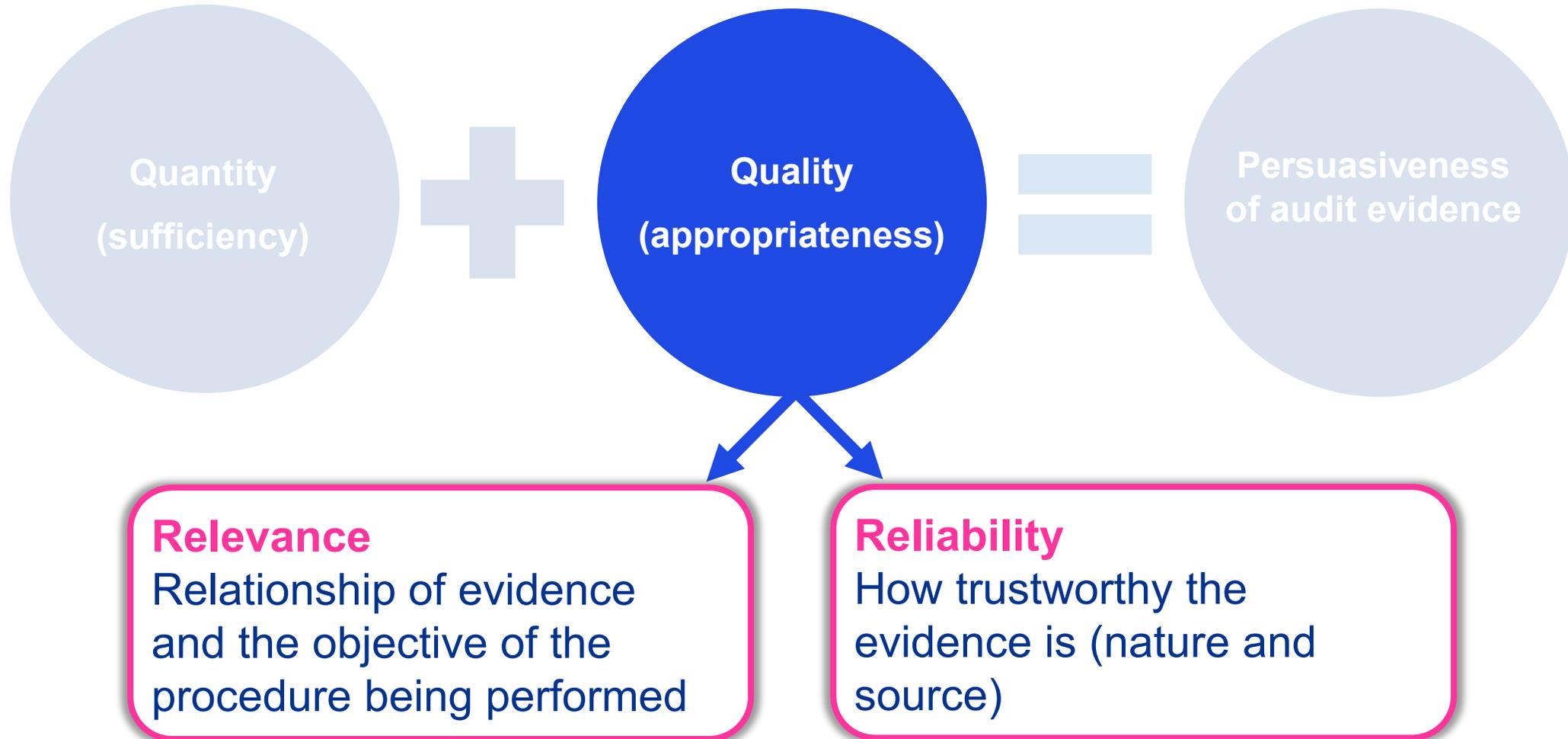
Information obtained by performing audit procedures

Supporting documentation



Documents the entity has to support their financial records

Sufficiency and appropriateness



Debrief: Which audit evidence is more reliable?

Evidence obtained from a knowledgeable source that is independent of the entity is generally more reliable than evidence obtained from internal sources.

Evidence obtained directly is generally more reliable than evidence obtained indirectly.

Reliability is influenced by the source and nature of the information and the circumstances under which it was obtained.

Remember...



As audit risk increases, the engagement team seeks more *persuasive* audit evidence.

Sufficient, appropriate audit evidence supports the conclusion reached. The conclusion reached is what forms the audit opinion.

Question from Carrie

Why is understanding the sufficiency and appropriateness of audit evidence important to me?

Audit quality is the outcome when audits are executed consistently, in line with the requirements and intent of applicable professional standards.

Every member of the engagement team is responsible for audit quality. For you, that includes obtaining sufficient and appropriate audit evidence when performing audit procedures.



Question 6

What type of assurance does the audit opinion on the financial statements provide?

A

Positive assurance

B

Absolute assurance

C

Reasonable assurance

D

Negative assurance



Question 6: Debrief

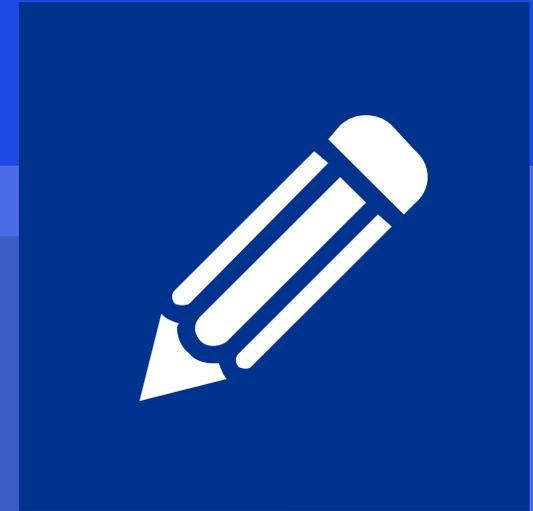
What type of assurance does the audit opinion on the financial statements provide?

A Positive assurance

B Absolute assurance

C Reasonable assurance

D Negative assurance



Question 7

In a financial statement audit, the engagement team obtains evidence in order to determine whether the amounts and disclosures in the financial statements are presented in accordance with the accounting standards.

True or false?

A

True

B

False



Question 7: Debrief

In a financial statement audit, the engagement team obtains evidence in order to determine whether the amounts and disclosures in the financial statements are presented in accordance with the accounting standards.

True or false?

A

True

B

False



Name that risk! #1

A risk that there is an intentional act that results in a material misstatement in the financial statements that are the subject of an audit is a:

fraud
risk



Name that risk! #2

The risk that there could be a mistake or an unintentional inaccuracy is a:

risk of
error



Key points to remember

01

An auditor's role is to plan and perform audit procedures to obtain reasonable assurance whether the financial statements are free of material misstatements.

02

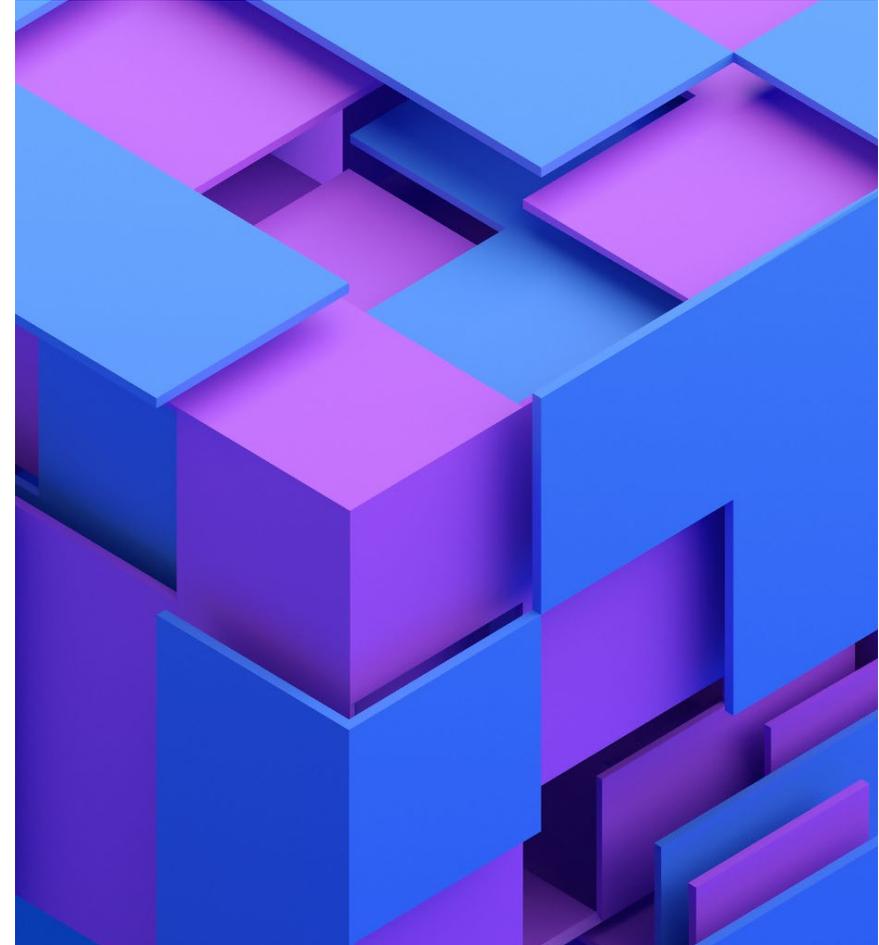
The accounting, reporting and auditing standards vary depending on the type of entity being audited.

03

Risk of misstatement is a description of a situation that could result in a misstatement to the financial statements.

04

Generally, written evidence obtained directly, such as external confirmations, is more reliable than verbal evidence obtained only from internal entity sources, such as inquiry.



External confirmations

External Confirmation Procedures to Obtain Audit Evidence



SA 500: Reliability of audit evidence influenced by source and nature

More reliable when obtained from independent sources outside entity

More reliable when obtained directly by auditor

More reliable when in documentary form

External confirmations may be more reliable than internal evidence

This SA assists in designing and performing external confirmation procedures

Requirements: External Confirmation Procedures



Information to be confirmed or requested

Determined by the auditor

Appropriate confirming party

Selected by the auditor

Design of confirmation requests

Determined by the auditor

Properly addressed with return information

Sending of requests

Performed by the auditor

Includes follow-up requests when applicable

Management's Refusal to Allow the Auditor to Send a Confirmation Request



- Inquire as to management's reasons for refusal and seek audit evidence of their validity and reasonableness
- Evaluate implications of refusal on assessment of risks of material misstatement and on nature, timing, and extent of other audit procedures
- Perform alternative audit procedures to obtain relevant and reliable audit evidence
- If refusal is unreasonable or alternative audit procedures are insufficient, communicate with those charged with governance and determine implications for audit and auditor's opinion

Results of the External Confirmation Procedures: Reliability of Responses to Confirmation Requests



Factors that give rise to doubts about the reliability of the response to a confirmation request

Auditor shall obtain further audit evidence to resolve those doubts

Implications on the assessment of the relevant risks of material misstatement

Includes the risk of fraud

Related nature, timing and extent of other audit procedures

Alternative audit procedures must be performed in case of non-responses

Relevant and reliable audit evidence must be obtained

Types of Confirmations



POSITIVE CONFIRMATIONS

Response to positive confirmation request necessary for sufficient appropriate audit evidence

Alternative audit procedures will not provide required audit evidence

If confirmation not obtained, implications for audit and auditor's opinion determined in accordance with SA 705

NEGATIVE CONFIRMATIONS

Less persuasive evidence than positive confirmations

Not to be used as sole substantive audit procedure

Unless risk of material misstatement is low

And sufficient audit evidence is obtained

Applicable to large number of small, homogeneous items

Very low exception rate expected

No known circumstances causing recipients to disregard requests

Confirmation responses



Request responses to be sent **directly** to the auditor to maintain control.



Verify the **source** and **contents** of any responses received via fax or email in a telephone call to the purported sender so they can be treated as valid audit evidence.



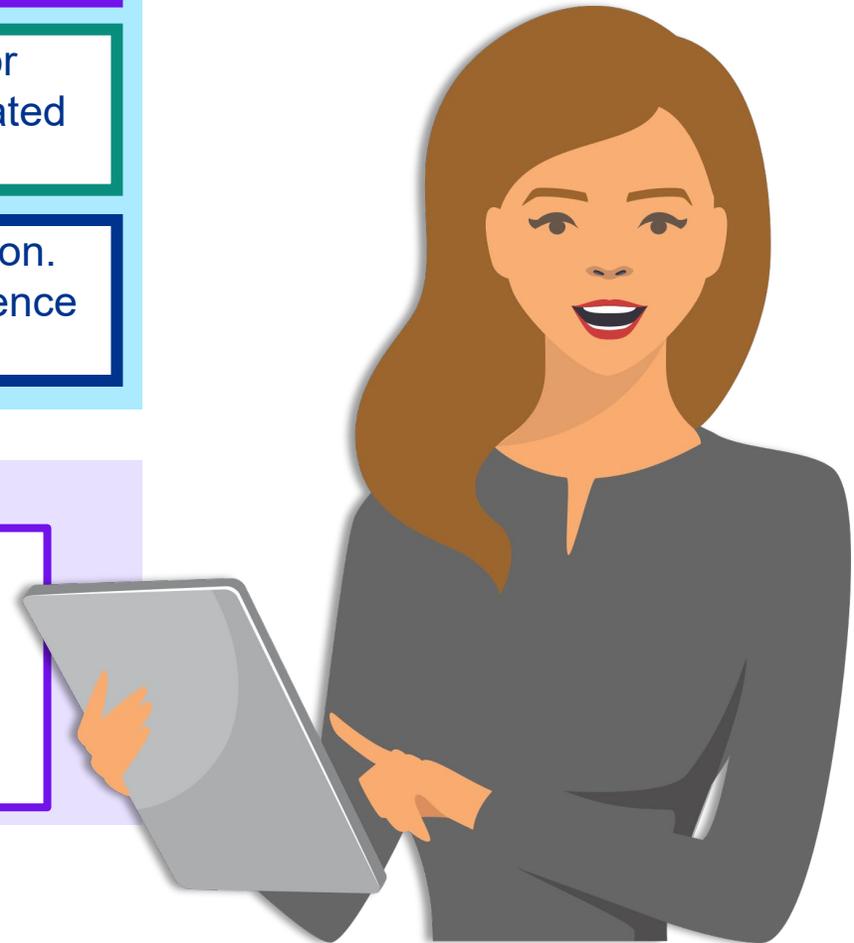
An **oral response** alone does not meet the definition of a confirmation. Consider applying alternative procedures that complement the evidence obtained from the oral responses.

When using negative confirmation responses:

← Not used for UC

Investigate exceptions to determine whether they are indicative of misstatements.

If the investigation indicates a pattern of misstatements, reconsider the combined assessed level of inherent and control risk (CAR), and consider the effect on planned audit procedures.



Question 1

What do you do if you do not receive all confirmation responses?

A Discuss with management that there is an error in the account.

B Document that there is an error in the account.

C Document that you did not receive a response and do nothing else.

D Send a follow-up request.



Question 1: Debrief

What do you do if you do not receive all confirmation responses?

A

Discuss with management that there is an error in the account.

B

Document that there is an error in the account.

C

Document that you did not receive a response and do nothing else.

D

Send a follow-up request.



What if you do not receive a response?



Send follow-up requests if necessary.

Evaluate the implications of responses that are not received or not reliable.

This includes when a response to a positive confirmation request is necessary to obtain sufficient appropriate audit evidence.



Evaluate the implications on the assessment of the RMMs, including RMMs due to fraud.



Re-assess the nature, timing and extent of other audit procedures.



Do not send follow-up requests:

- For negative confirmations, or
- For positive confirmations if you determine it is unlikely the respondent will respond.

Question 2

Which of the following is true regarding confirmation responses?

A

Negative confirmation responses with exceptions require investigation to determine whether they are indicative of misstatements.

B

Emailed responses require no additional consideration to restrict risks and treat the confirmations as valid audit evidence.

C

Oral confirmations meet the definition of a confirmation.

D

Confirmation responses are sent directly to entity management.



Question 2: Debrief

Which of the following is true regarding confirmation responses?

A

Negative confirmation responses with exceptions require investigation to determine whether they are indicative of misstatements.

B

Emailed responses require no additional consideration to restrict risks and treat the confirmations as valid audit evidence.

C

Oral confirmations meet the definition of a confirmation.

D

Confirmation responses are sent directly to entity management.



**Perform alternative
procedures**

Question 3

Select the response that completes this sentence:

The engagement team performs alternative procedures when

_____.

A responses are received directly by the audit team

B responses are received one day after the requested due date

C responses are not received or are not reliable

D responses are received via mail or fax



Question 3: Debrief

Select the response that completes this sentence:

The engagement team performs alternative procedures when _____.

A responses are received directly by the audit team

B responses are received one day after the requested due date

C responses are not received or are not reliable

D responses are received via mail or fax



When do you perform alternative procedures?

When responses are not received or are not reliable.



If you identify factors that give rise to doubts about the **reliability** of the response to a confirmation request, you should obtain further audit evidence to resolve those doubts.

In the case of each **non-response**, you should perform alternative audit procedures to obtain relevant and reliable audit evidence.

What are alternative procedures?

Alternative procedures **achieve the same objective as the original procedure.**

The nature and extent of alternative procedures **will vary according to the RMMs** the confirmation procedure addresses. You might perform testwork over a **combination** of these documents.



Invoices

SA 505

SA 330

Proof of shipment

- bill of lading (BOL)
- 3rd party shipping document

Subsequent cash receipts

- Check received
- Bank statement

Alternative procedures - What if no payment was received?

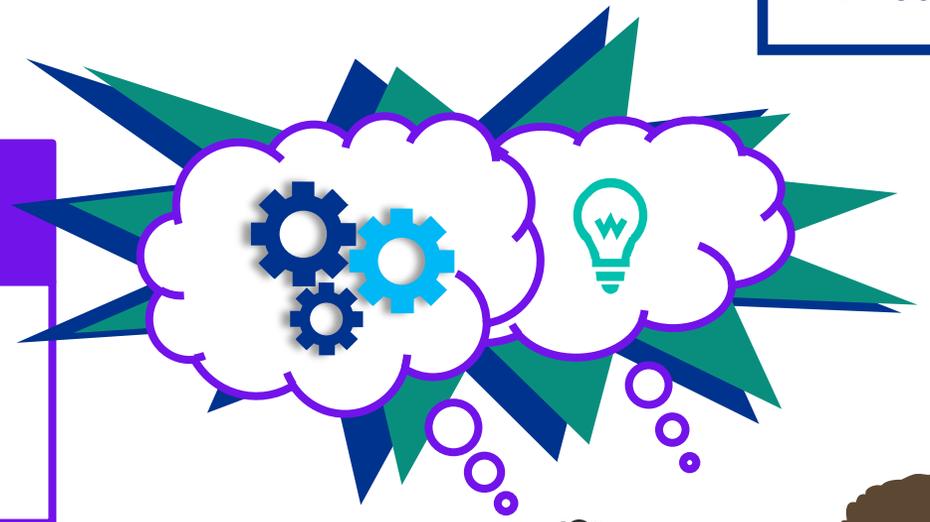
Obtain invoice from management *and* additional support to evidence that the receivable *exists* and is *accurate* as of period end, for example:

- Copy of purchase order.
- Shipping documents.
- Subsequent communications between management and the customer regarding when payment is expected.
- Historical payment trends of the customer such as an aging history.
- Inquire with management about a history of payment issues with the customer.

Professional skepticism

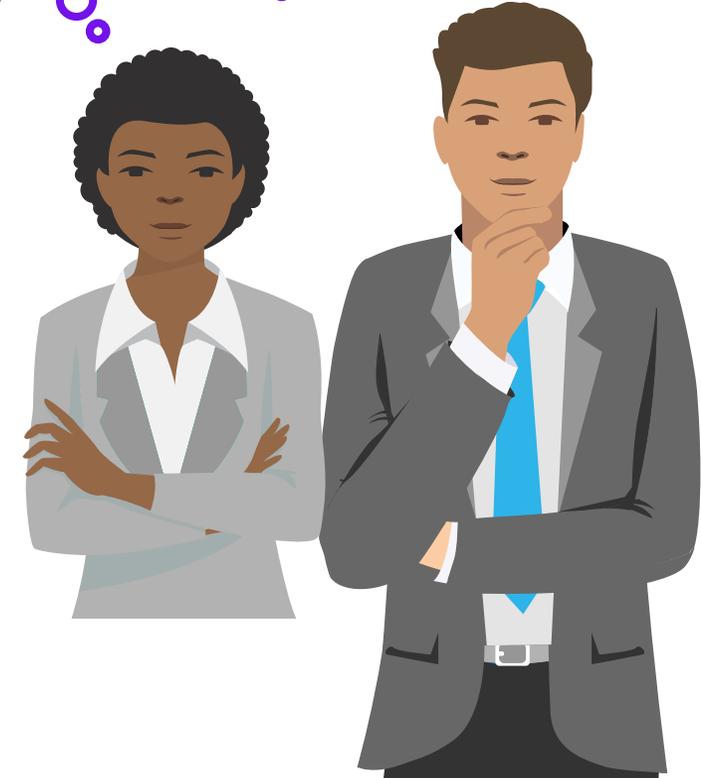
Exercise professional skepticism throughout the confirmation process:

- Design the confirmation request,
- Perform the confirmation procedures, and
- Evaluate results of the confirmation procedures.



Exercise professional skepticism through maintaining a **questioning mind** and **critically assessing** the audit evidence you obtain.

Validate the authenticity of the response.	Evaluate responses for possible disconfirming evidence.	Obtain sufficient evidence when exceptions are noted.
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How did you remain skeptical?

What did you notice about the Selco Importing & Distributing confirmation response that didn't seem right?

What about the Minor Distributors confirmation? Was there anything in the response that would raise concern?

Did anything else stick out while reviewing the confirmation responses?



Evaluation of misstatements identified during the Audit

Definitions



Misstatement

A difference between reported and required financial statement items

Can arise from error or fraud

Adjustments may be necessary for true and fair view

Uncorrected Misstatements

Misstatements accumulated during audit

Have not been corrected

Consideration of Identified Misstatements as the Audit Progresses



Revision of overall audit strategy and plan

When nature of misstatements indicate other misstatements may exist

When aggregate of misstatements approaches materiality

Additional audit procedures

When management has corrected detected misstatements

To determine if misstatements remain

Communication and Correction of Misstatements



Timely communication of misstatements to management

Auditor requests management to correct misstatements

Management refusal to correct misstatements

Auditor evaluates reasons for refusal

Taken into account when evaluating financial statements

Evaluating the Effect of Uncorrected Misstatements

- Reassess materiality determined in accordance with SA 320 to confirm whether it remains appropriate in the context of the entity's actual financial results.
- Determine whether uncorrected misstatements are material, individually or in aggregate.
 - Consider 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.
 - Consider 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.

Communication with Those Charged with Governance

- Uncorrected Misstatements
 - Effect on auditor's report opinion
 - Identification of material uncorrected misstatements
 - Request for correction
- Effect of Prior Period Uncorrected Misstatements
 - Impact on transactions, account balances, disclosures, and financial statements

Written Representation



Request for written representation from management and those charged with governance

Regarding the effects of uncorrected misstatements

Whether they are immaterial, individually and in aggregate, to the financial statements

Summary of such items included in or attached to the written representation

Written Representations

Written Representations about Management's Responsibilities: Preparation of the Financial Statements

Management provides written representation of responsibility for financial statements

Preparation in accordance with applicable financial reporting framework

Includes fair presentation as set out in audit engagement terms



Written Representations about Management's Responsibilities: Information Provided and Completeness of Transactions



Management is requested to provide a written representation that:

All relevant information and access has been provided to the auditor as agreed in the terms of the audit engagement

All transactions have been recorded and are reflected in the financial statements

Other Written Representations

- Other SAs require the auditor to request written representations
 - Required representations support other audit evidence relevant to the financial statements
 - One or more specific assertions in the financial statements may require additional written representations

Date of and Period(s) Covered by Written Representations

- Date of Written Representations
 - Should be as close as possible to the date of the auditor's report
 - But not after the date of the auditor's report
- Coverage of Written Representations
 - For all financial statements referred to in the auditor's report
 - For all period(s) referred to in the auditor's report

Doubt as to the Reliability of Written Representations

- Doubt as to the Reliability of Written Representations
 - Concerns about management's competence, integrity, ethical values or diligence
 - Effect on the reliability of representations and audit evidence
- Requested Written Representations Not Provided
 - Inconsistency with other audit evidence
 - Reconsideration of management's assessment
 - Possible effect on the opinion in the auditor's report

Actions for Unprovided Written Representations

- Discuss the matter with management
- Re-evaluate the integrity of management and evaluate the effect on the reliability of representations and audit evidence
- Take appropriate actions, including determining the possible effect on the opinion in the auditor's report

Actions for Unprovided Written Representations – Contd.

- The auditor shall disclaim an opinion on the financial statements in accordance with SA 705 if:
 - There is sufficient doubt about the integrity of management such that the written representations required by paragraphs 9 and 10 are not reliable
 - Management does not provide the written representations required by paragraphs 9 and 10

**What
questions
do you
have?**



Thank you!

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