

Standards on General Principles and Responsibilities (SA 200 to 299)

22 November 2014



Standards (SA 200 to 299) – General Principles and Responsibilities

The following auditing standards relating to General Principles and Responsibilities have been issued under the Clarity Project by the Auditing and Assurance Standard Board (AASB) of the ICAI:

SA 200 (Revised) “Overall Objectives of the Independent auditor and the conduct of an audit in accordance with standards on auditing”

SA 210 (Revised) “Agreeing the terms of an audit engagement”

SA 220 (Revised) “Quality control for an audit of financial statements”

SA 230 (Revised) “Audit Documentation”

SA 240 (Revised) “The auditor’s responsibilities relating to fraud in an audit of financial statements”

SA 250 (Revised) “Consideration of laws and regulations in an audit of financial statements”

SA 260 (Revised) “Communication with those charged with governance”

SA 265 (Revised) “Communicating deficiencies in internal control to those charged with governance and management”

SA 299 (Revised) “Responsibility of joint auditors”

SA 200 – Overall objectives of an independent auditor and the conduct of an audit in accordance with standards on auditing

What is the overall objective of an auditor?

- a) To obtain **reasonable assurance** about whether the financial statements as a whole are **free from material misstatement**, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are **prepared, in all material respects, in accordance with an applicable financial reporting framework**; and

- (b) To **report on the financial statements**, and communicate **as required by the SAs**, in accordance with the auditor's findings.

Applicable financial reporting framework – The financial reporting framework adopted by management and, where appropriate, those charged with governance in the preparation and presentation of the financial statements that is acceptable in view of the nature of the entity and the objective of the financial statements, or that is required by law or regulation.

SA 200 – Overall objectives of an independent auditor and the conduct of an audit in accordance with standards on auditing

(Continued)

Requirements

- **Ethical requirements relating to audit of financial statements:**
 - The auditor shall comply with relevant ethical requirements, including those pertaining to independence, relating to financial statement audit engagements
- **Professional skepticism:**
 - The auditor shall plan and perform an audit with professional skepticism recognising that circumstances may exist that cause the financial statements to be materially misstated
- **Professional Judgment:**
 - The auditor shall exercise professional judgment in planning and performing an audit of financial statements
- **Sufficient Appropriate Audit Evidence and Audit Risk:**
 - To obtain reasonable assurance, the auditor shall obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion
- **Conduct of an audit in accordance with SAs:**
 - The auditor shall comply with all SAs relevant to the audit. An SA is relevant to the audit when the SA is in effect and the circumstances addressed by the SA exist

SA 200 – Overall objectives of an independent auditor and the conduct of an audit in accordance with standards on auditing

Consideration specific to smaller entities

- **A smaller entity refers to an entity which typically possesses qualitative characteristics such as:**
 - Concentration of ownership and management in a small number of individuals (often a single individual); and
 - One or more of the following (not an exhaustive list and may not display all of these characteristics)
 - Straightforward or uncomplicated transactions
 - Simple record-keeping
 - Few lines of business and few products within business lines
 - Few internal controls
 - Few levels of management with responsibility for a broad range of controls
 - Few personnel, many having a wide range of duties
 - The considerations specific to smaller entities included in the SAs have been developed primarily with unlisted entities in mind. Some of the considerations, however, may be helpful in audits of smaller listed entities

- **The objective of the auditor is to accept or continue an audit engagement only when the basis upon which it is to be performed has been agreed, through:**
 - Establishing whether the preconditions for an audit are present; and
 - Confirming that there is a common understanding between the auditor and management, and where appropriate, those charged with governance of the terms of the audit engagement
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SA 210 – Agreeing the terms of audit engagements

Preconditions for an audit

- **In order to establish whether the preconditions for an audit are present, the auditor shall:**
 - Whether the financial reporting framework to be applied in the preparation of the financial statements is acceptable; and
 - Obtain the agreement of management that it acknowledges and understands its responsibility:
 - For the preparation of the financial statements in accordance with the applicable financial reporting framework, including where relevant their fair presentation
 - For such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and
 - To provide the auditor with :
 - ✓ Access to all information relevant to the audit of the financial statements
 - ✓ Additional information that the auditor may request from the management for purpose of the audit
 - ✓ Unrestricted access to persons within the entity from whom the auditors determines it necessary to obtain audit evidence.

• **Some practical challenges/ issues:**

- Limitation on scope prior to audit engagement acceptance
- Acceptance of a change in the terms of the audit engagement
- Financial reporting framework prescribed by law or regulation, which may not be acceptable
- Auditors report prescribed by law or regulation

SA 220 Quality Control for an audit of financial statements

What is the objective of this standard?

The objective of the auditor is to implement quality control procedures at the engagement level that provide the auditor with reasonable assurance that:

- (a) The audit complies with professional standards and regulatory and legal requirements; and
- (b) The auditor's report issued is appropriate in the circumstances.

Requirements of Quality Control

- (a) Engagement partner to take responsibility for the overall quality of each audit engagement
- (b) Evaluating compliance with relevant ethical requirements by members of the engagement team
- (c) Compliance with the independence requirements
- (d) Acceptance and continuance of client relationships and audit engagements
- (e) Engagement performance including Engagement Quality Control Review

Definitions

(a) Audit documentation – The record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached (terms such as “working papers” or “work-papers” are also sometimes used).

(b) Audit file – One or more folders or other storage media, in physical or electronic form, containing the records that comprise the audit documentation for a specific engagement.

- **The auditor shall prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand:**
 - The nature, timing, and extent of the audit procedures performed to comply with the SAs and applicable legal and regulatory requirements;
 - The results of the audit procedures performed, and the audit evidence obtained; and
 - Significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions
- **In documenting the nature, timing and extent of audit procedures performed, the auditor shall record:**
 - The identifying characteristics of the specific items or matters tested;
 - Who performed the audit work and the date such work was completed; and
 - Who reviewed the audit work performed and the date and extent of such review

- **Some practical challenges/ issues:**

- Are superseded drafts of work-papers/ financial statements required to be included
- Client does not share photo-copies of documents/ agreements due to confidentiality / bulkiness
- In case of smaller entities where the work is performed by the engagement partner, would audit documentation be different

- **Why is audit documentation so necessary?**

- Provides evidence of the auditor's basis for a conclusion about the achievement of the overall objectives of the auditor
- Provides evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements
- Assisting the engagement team to plan and perform the audit and be accountable for its work
- Assisting members of the engagement team responsible for supervision to direct and supervise the audit work, and to discharge their review responsibilities in accordance with SA 220
- Retaining a record of matters of continuing significance to future audits
- Enabling the conduct of quality control reviews and inspections in accordance with SQC 1
- Enabling the conduct of external inspections in accordance with applicable legal, regulatory or other requirements

SA 230 Audit Documentation

- **Matters arising after the date of the Auditor's Report:**

If, in exceptional circumstances, the auditor performs new or additional audit procedures or draws new conclusions after the date of the auditor's report, the auditor shall document

- The circumstances encountered
- The new or additional audit procedures performed, audit evidence obtained and conclusions reached, and their effect on the auditor's report
- When and by whom the resulting changes to audit documentation were made and reviewed

- **Assembly of the Final Audit File:**

SQC 1 requires firms to establish policies and procedures for the timely completion of the assembly of audit files. An appropriate time limit within which to complete the assembly of the final audit file is ordinarily not more than 60 days after the date of the auditor's report.

The completion of the assembly of the final audit file after the date of the auditor's report is an administrative process that does not involve the performance of new audit procedures or the drawing of new conclusions. Changes may, however, be made to the audit documentation during the final assembly process if they are administrative in nature. Examples of such changes include

- Deleting or discarding superseded documentation
- Sorting, collating and cross referencing working papers
- Signing off on completion checklists relating to the file assembly process

What is a Fraud and its characteristics:

Fraud is 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.

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

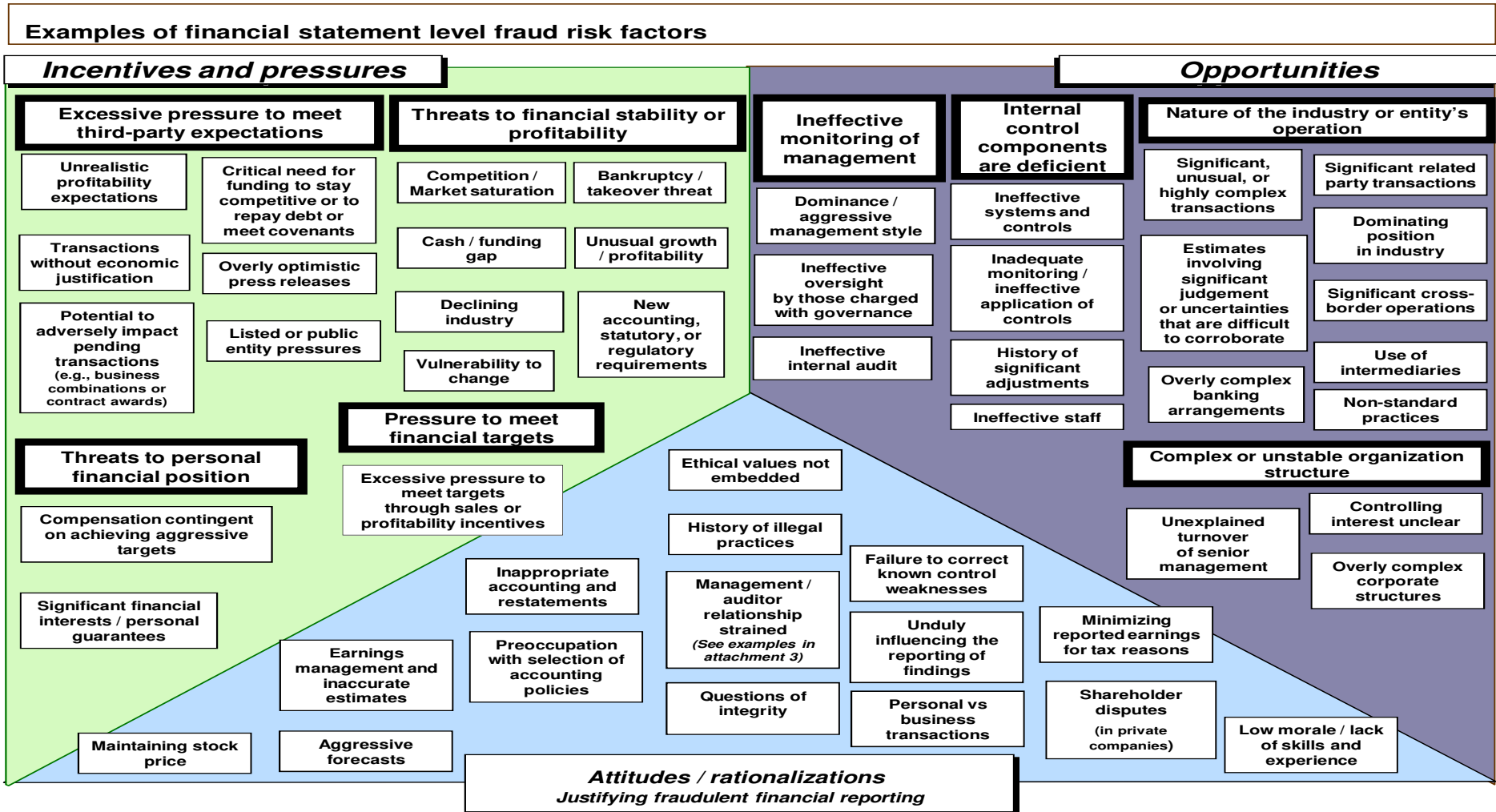
The distinguishing factor between fraud and error is whether the underlying action that results in the misstatement of the financial statements is intentional or unintentional.

The auditor is concerned with fraud that causes a material misstatement in the financial statements. Intentional misstatements that are relevant to the auditor are those resulting from fraudulent financial reporting and those resulting from misappropriation of assets.

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

SA 240 The Auditor's Responsibilities Relating to Fraud

(Continued)



Requirements:

The auditor shall:

- Maintain professional skepticism notwithstanding past positive experience
- Discussion amongst engagement team members
- Risk assessment procedures and related activities:
 - Inquiries of management and others within the entity
 - Understanding how those charged with governance exercise oversight
 - Whether unusual or unexpected relationships have been identified while performing analytical procedures
 - Consideration of other information obtained

Rebuttable Presumption

When the auditor has concluded that the presumption that there is a risk of material misstatement due to fraud related to revenue recognition is not applicable in the circumstances of the engagement, the auditor shall document the reasons for that conclusion.

Audit procedures responsive to risks related to management override of controls:

- Test the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements.
- Review accounting estimates for biases and evaluate whether the circumstances producing the bias, if any, represent a risk of material misstatement due to fraud
- For significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual given the auditor’s understanding of the entity and its environment and other information obtained during the audit, the auditor shall evaluate whether the business rationale (or the lack thereof) of the transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets
- Evaluate the need to perform other audit procedures in addition to those specifically referred to above.

SA 240 – The Auditor’s Responsibilities Relating to Fraud

Management Representations:

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

- (a) They acknowledge their responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud;
- (b) They have disclosed to the auditor the results of management’s assessment of the risk that the financial statements may be materially misstated as a result of fraud;
- (c) They have disclosed to the auditor their knowledge of fraud or suspected fraud affecting the entity involving:
 - Management;
 - Employees who have significant roles in internal control; or
 - Others where the fraud could have a material effect on the financial statements; and
- (d) They have disclosed to the auditor their knowledge of any allegations of fraud, or suspected fraud, affecting the entity’s financial statements communicated by employees, former employees, analysts, regulators or others.

Responsibilities of the auditor

Auditor is required to assess if there is a material misstatement of the financial statements due to non-compliance with laws and regulations.

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

The auditor's consideration of compliance with laws and regulations involve the following :

- (a) The auditor shall obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations generally recognised to have a direct effect on the determination of material amounts and disclosures in the financial statements; or
- (b) The auditor shall perform the audit procedures – inquiry of management and inspecting correspondence with licensing/ regulatory authorities - to help identify instances of non-compliance with other laws and regulations that may have a material effect on the financial statements.
- (c) Remain alert that other audit procedures may bring instances of non-compliance or suspected non-compliance to the auditor's attention
- (d) Obtain management representations.

SA 250 Consideration of laws and regulations in an audit of FS

- **Audit procedures when non-compliance is identified or suspected:**

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

- **Challenges/ Issues an auditor may face:**

- Management or those charged with governance are involved in non-compliance
- Non-compliance has material effect on the financial statements and has not been disclosed in the financial statements

This SA provides an overarching framework for the auditor's communication with those charged with governance, and identifies some specific matters to be communicated with them.

Those charged with governance are the person(s) or organisation(s) (e.g., a corporate trustee) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity.

In some cases, all of those charged with governance are involved in managing the entity, for example, a small business where a single owner manages the entity and no one else has a governance role. In these cases, if matters required by this SA are communicated with person(s) with management responsibilities, and those person(s) also have governance responsibilities, the matters need not be communicated again with those same person(s) in their governance role.

SA 260 – Communication with those charged with governance

Matters to be communicated

- The auditor's responsibilities in relation to the financial statement audit:
 - The auditor is responsible for forming and expressing an opinion on the financial statements that have been prepared by management with the oversight of those charged with governance
 - The audit of the financial statements does not relieve management or those charged with governance of their responsibilities. The transactions have been appropriately authorised and approved.
- An overview of the planned scope and timing of the audit
- Communicate significant findings from the audit
 - The auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures
 - Significant difficulties, if any, encountered during the audit
 - Significant matters, if any, arising from the audit, or subject to correspondence with the management
 - Written representations the auditor is requesting
- Other matters, if any, arising from the audit that, in the auditor's professional judgment are significant to the oversight of the financial reporting process.
- In case of listed entities, the auditor shall communicate that the engagement team and others in the firm , as appropriate, have complied with the relevant ethical requirements regarding independence.

Definitions:

(a) Deficiency in internal control – This exists when:

- (i) A control is designed, implemented or operated in such a way that it is unable to prevent, or detect and correct, misstatements in the financial statements on a timely basis; or
- (ii) A control necessary to prevent, or detect and correct, misstatements in the financial statements on a timely basis is missing.

(b) Significant deficiency in internal control – A deficiency or combination of deficiencies in internal control that, in the auditor’s professional judgment, is of sufficient importance to merit the attention of those charged with governance.

SA 265 – Communicating deficiencies in internal control to those charged with governance and management

Requirements:

If the auditor has identified one or more deficiencies in internal control, the auditor shall determine, on the basis of the audit work performed, whether, individually or in combination, they constitute significant deficiencies.

The auditor shall communicate in writing significant deficiencies in internal control identified during the audit to those charged with governance on a timely basis.

The auditor shall also communicate to management at an appropriate level of responsibility on a timely basis:

- In writing, significant deficiencies in internal control that the auditor has communicated or intends to communicate to those charged with governance, unless it would be inappropriate to communicate directly to management in the circumstances; and
- Other deficiencies in internal control identified during the audit that have not been communicated to management by other parties and that, in the auditor's professional judgment, are of sufficient importance to merit management's attention.

The auditor shall include in the written communication of significant deficiencies in internal control:

- (a) A description of the deficiencies and an explanation of their potential effects; and
- (b) Sufficient information to enable those charged with governance and management to understand the context of the communication

- **Joint auditors conduct the audit of large entities jointly and report on the financial statements of the entity.**
- **The auditing standard deals with the professional responsibilities which the auditors undertake when accepting appointment as joint auditors.**
- **Division of work:**
 - Where joint auditors are appointed, they should, by mutual discussion, divide the audit work amongst themselves; or
 - The division of work among joint auditors as well as the areas of work to be covered by all of them should be adequately documented and preferably communicated to the entity
- **Coordination**

Where, in the course of his work, a joint auditor comes across matters which are relevant to the areas of responsibility of other joint auditors and which deserve their attention, or which require disclosure or require discussion with, or application of judgment by, other joint auditors, he should communicate the same to all the other joint auditors in writing.

Relationship among joint auditors:

- In respect of audit work divided among the joint auditors, each joint auditor is responsible only for the work allocated to him, whether or not he has prepared a separate report on the work performed by him.
- All the joint auditors are jointly and severally responsible –
 - in respect of the audit work which is not divided among the joint auditors and is carried out by all of them in respect of decisions taken by all the joint auditors concerning the nature, timing or extent of the audit procedures to be performed by any of the joint auditors;
 - in respect of matters which are brought to the notice of the joint auditors by any one of them and on which there is an agreement among the joint auditors;
 - for examining that the financial statements of the entity comply with the disclosure requirements of the relevant statute; and
 - for ensuring that the audit report complies with the requirements of the relevant statute.

SA 299 Responsibility of joint auditors

Relationship among joint auditors:

- Each joint auditor is entitled to assume that the other joint auditors have carried out their part of the audit work in accordance with the generally accepted audit procedures.
- It is not necessary for a joint auditor to review the work performed by other joint auditors or perform any tests in order to ascertain whether the work has actually been performed in such a manner.
- Each joint auditor is entitled to rely upon the other joint auditors for bringing to his notice any departure from generally accepted accounting principles or any material error noticed in the course of the audit.

Reporting Responsibilities

Normally, the joint auditors are able to arrive at an agreed report. However, where the joint auditors are in disagreement with regard to any matters to be covered by the report, each one of them should express his own opinion through a separate report.

A joint auditor is not bound by the views of the majority of the joint auditors regarding matters to be covered in the report and should express his opinion in a separate report in case of a disagreement.

Thank you

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