

Hyderabad Branch of SIRC of ICAI

21st WORLD CONGRESS OF ACCOUNTANTS 2022

Virtual CPE Meeting
Saturday 18th June, 2022
Timings : 6.00 pm to 8.00 pm

Structured CPE 2Hrs
Fees Rs 194/-
Incl GST

Topic	Resource Person
"Standards on Auditing: Relating To Finalizing Audit SA 500, SA 501, SA 505"	 CA. R. S. Balaji Chennai

CPE credit on attending full programme only

Team Hyderabad Branch of SIRC of ICAI

CA. Deepak Ladda Chairman	CA. Satish Kumar Mylevarapu Vice Chairman	CA. Anil Sankara Reddy P Secretary
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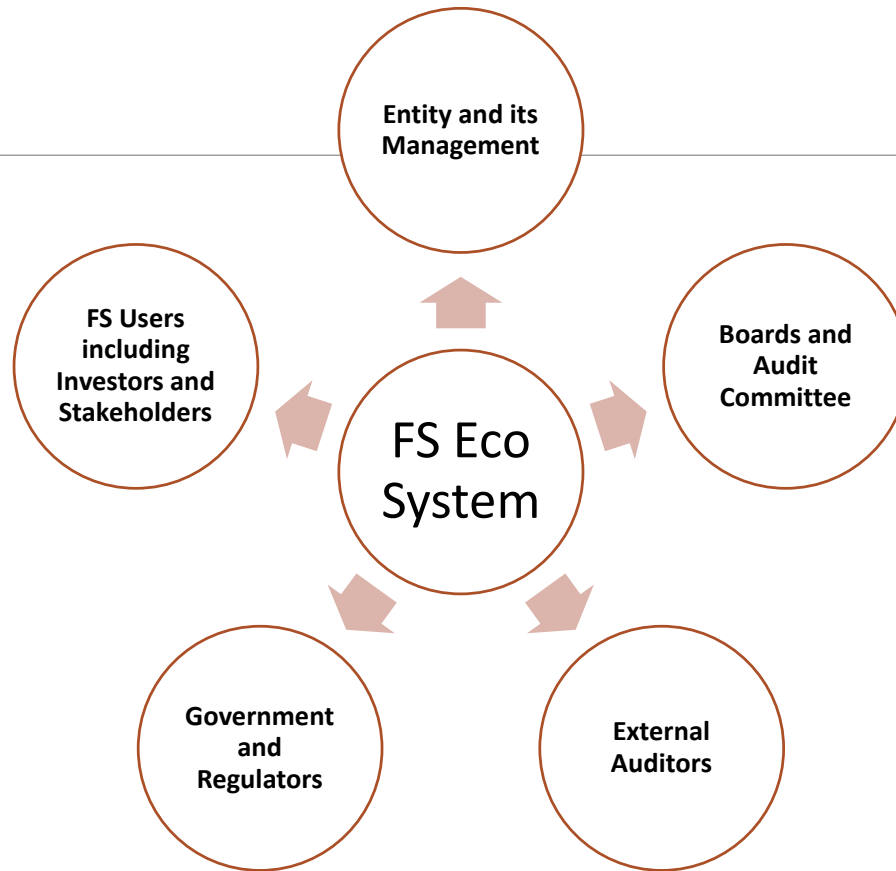
For Registration link: <https://hydical.org/event/details/1212>

Virtual CPE Meeting Standards on Auditing Relating to Finalizing Audit (SA 500, SA 501, SA 505)

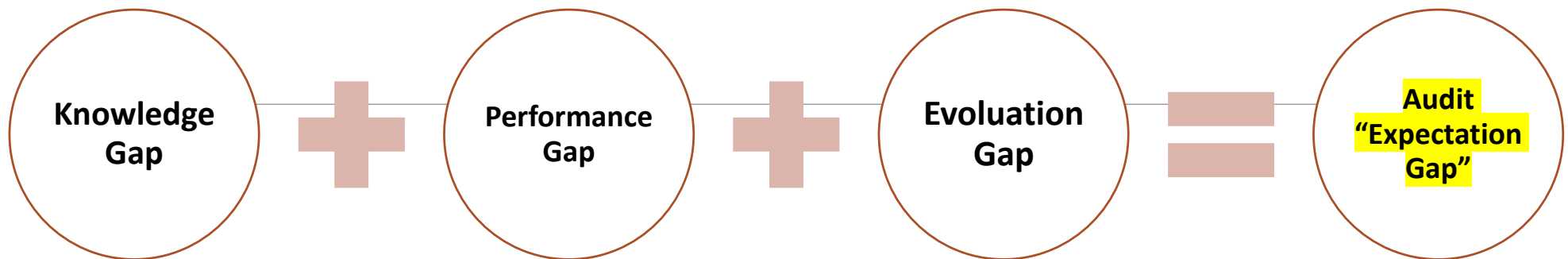
Virtual CPE Meeting - Standards on Auditing Relating to Finalizing Audit (SA 500, SA 501, SA 505) Hosted by Hyderabad Branch of SIRC

CA R S BALAJI, B.COM., FCA
CO-OPTED MEMBER – AASB, ICAI (2019-22)

Financial Reporting Eco System



Audit Expectation Gap



"Knowledge Gap"

The difference between what the public thinks auditors do and what auditors actually do.

This recognizes that the **public may misunderstand the role of auditors**

"Performance Gap"

Auditors

do not do

what auditing or standards or regulations require

"EVOLUTION GAP"

Areas of the audit where there is a **need for evolution**, taking into consideration the general public's demand, **technological advances**, and how the overall audit process could be enhanced

- Sec. 143(9) - Every Auditor shall **comply** with the Auditing Standards.

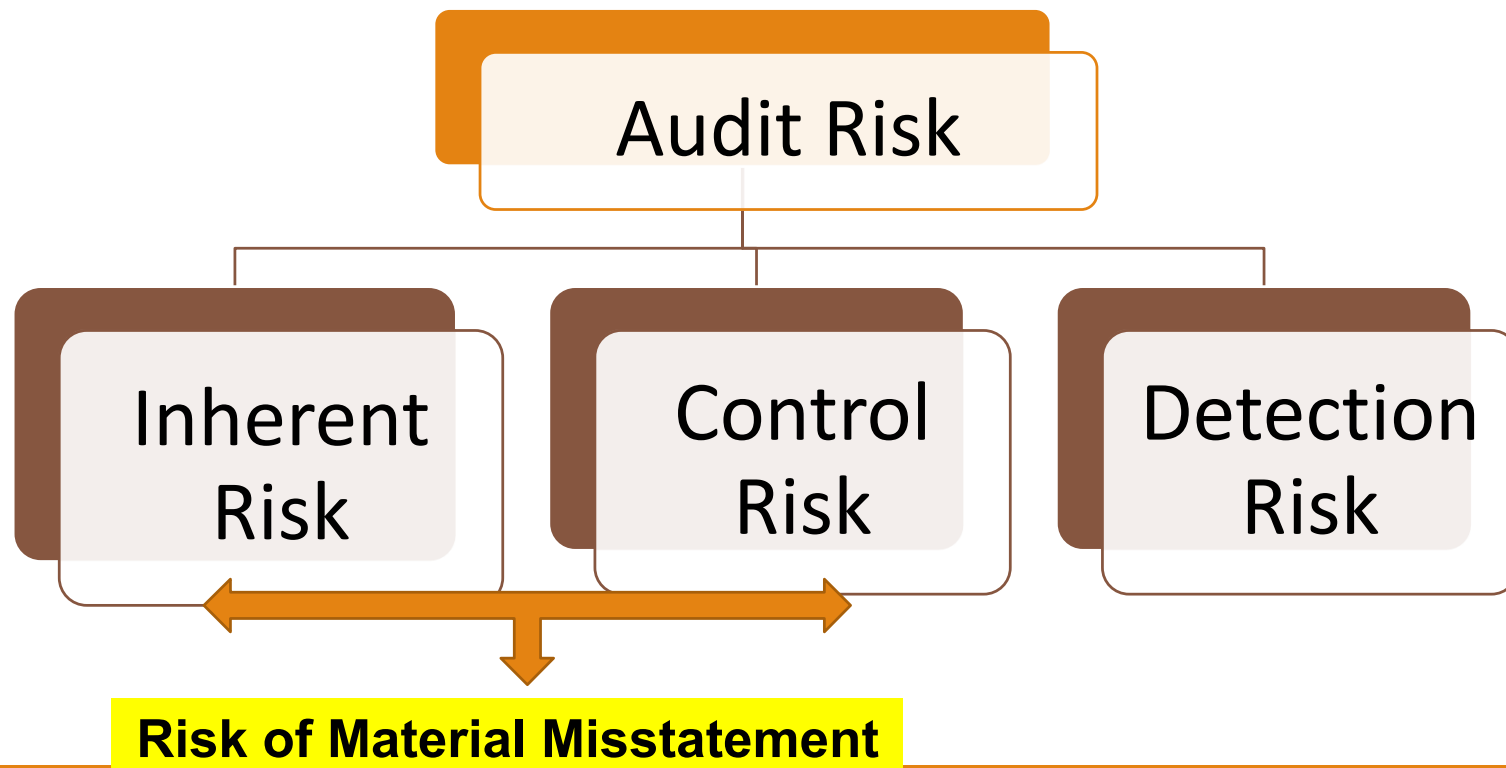
- Sec.143(10) - The Central Government may prescribe the **Standards of Auditing**, as recommended by the ICAI, in consultation with and after examination of the recommendations made by the National Financial Reporting Authority.

An Audit of Financial Statements

The SAs contain items designed to **support the auditor** in obtaining reasonable assurance.

The SAs **require**, that the auditor exercise professional **judgment and maintain professional skepticism** and **shall**:

1. Identify and assess **risks of material misstatement**, whether due to fraud or error, based on an understanding of the entity and its environment, including the entity's internal control.
2. Obtain sufficient appropriate audit evidence about whether material misstatements exist, through designing and implementing appropriate responses to **assessed risks**
3. Form an opinion on the financial statements based on conclusions drawn from the audit evidence obtained.



Standards on Auditing

500-Audit Evidence

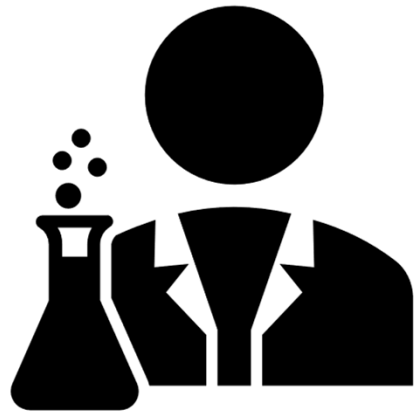
Audit Evidence



Audit evidence – Information used by the auditor in arriving at the conclusions on which the auditor's opinion is based.

Audit evidence includes both information contained in the accounting records underlying the financial statements and other information.

Management's Expert



An individual or organisation possessing expertise in a field other than accounting or auditing, whose work in that field is used by the entity to assist the entity in preparing the financial statements.

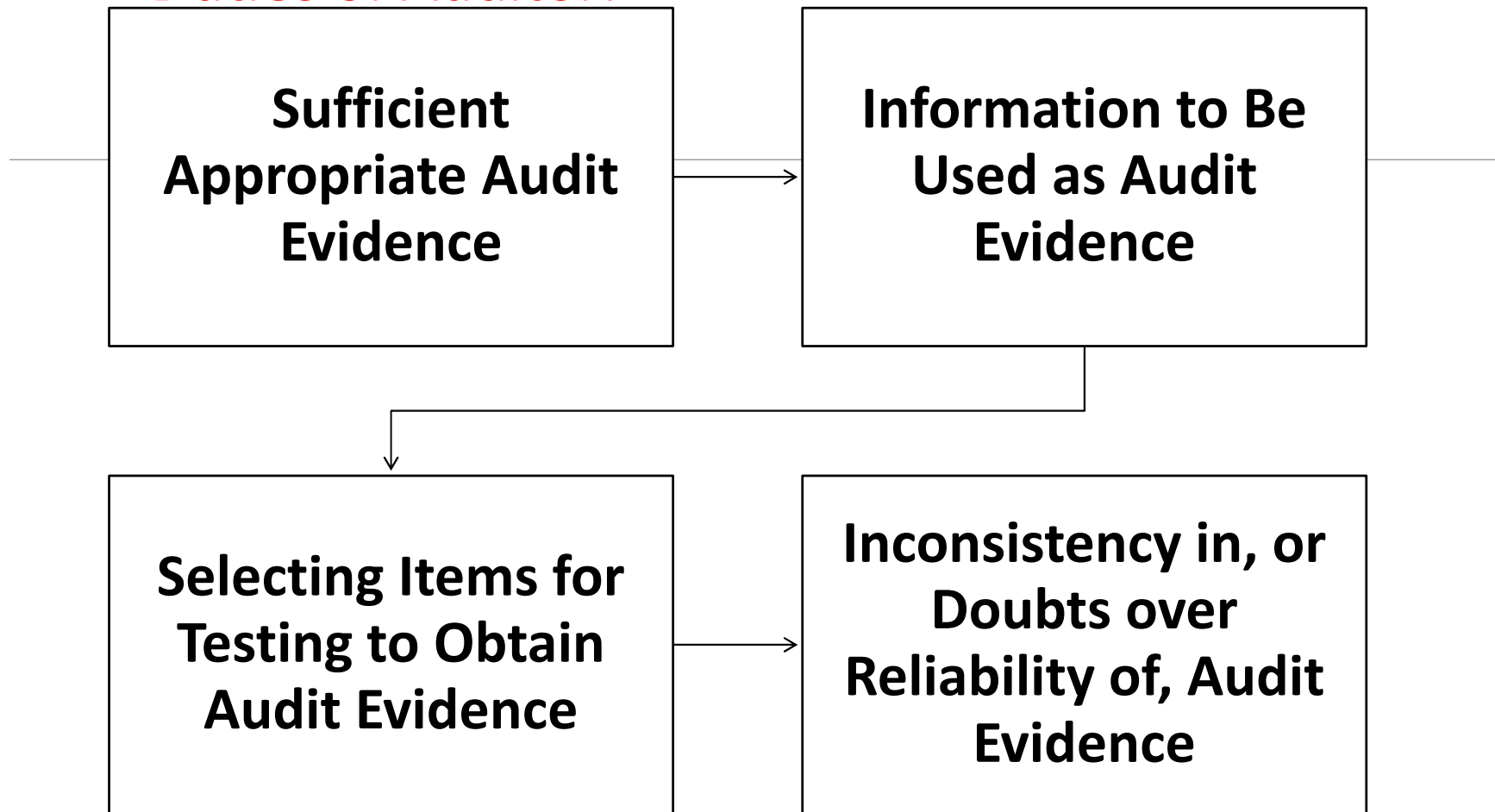
Example – Use of Management's Expert

Clause 3(i) on Property Plant Equipment:

(d) Whether the Company has revalued its Property, Plant and Equipment (including Right of Use assets) or intangible assets or both during the year and, if so, whether the revaluation is based on the valuation by a Registered Valuer. Specify the amount of change, if change is 10% or more in the aggregate of the net carrying value of each class of Property, Plant and Equipment or intangible assets;

Principles stated in SA 500 regarding **use of Managements Expert** shall be applied by the auditor while considering the word done by the registered Valuer.

Duties of Auditor:





Rules for Reliability of Audit Evidence



1. External evidences are more reliable than Internal Evidences.
2. Internal evidences are reliable, if internal controls are effective.
3. Audit Evidence is more reliable when it exists in documentary form, whether paper, electronic or other medium
4. Original documents are more reliable than photocopies
5. Evidences obtained directly by the auditor is more reliable

While Performing Audit Procedures the auditor shall consider the relevance and reliability

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graph TD; A[While Performing Audit Procedures the auditor shall consider the relevance and reliability] --> B[Information produced using Work by Management's Expert]; A --> C[Information Produced by Entity]; B --> D["1. Evaluate the competence & Objectivity<br/>2. Obtain an understanding<br/>3. Evaluate the appropriateness"]; C --> E["1. Verify for Accuracy and Completeness<br/>2. Evaluate for Sufficiency in details"]
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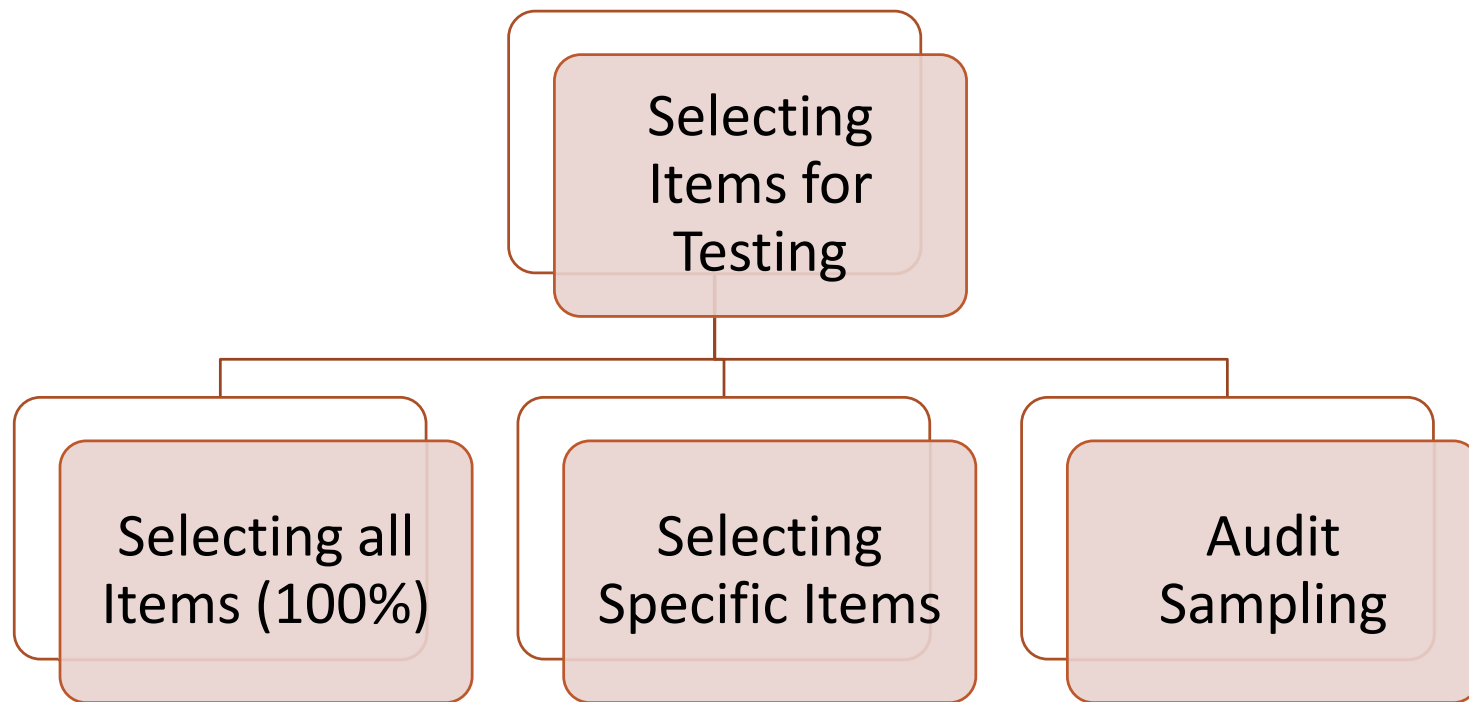
Information produced using
Work by Management's
Expert

1. Evaluate the competence & Objectivity
2. Obtain an understanding
3. Evaluate the appropriateness

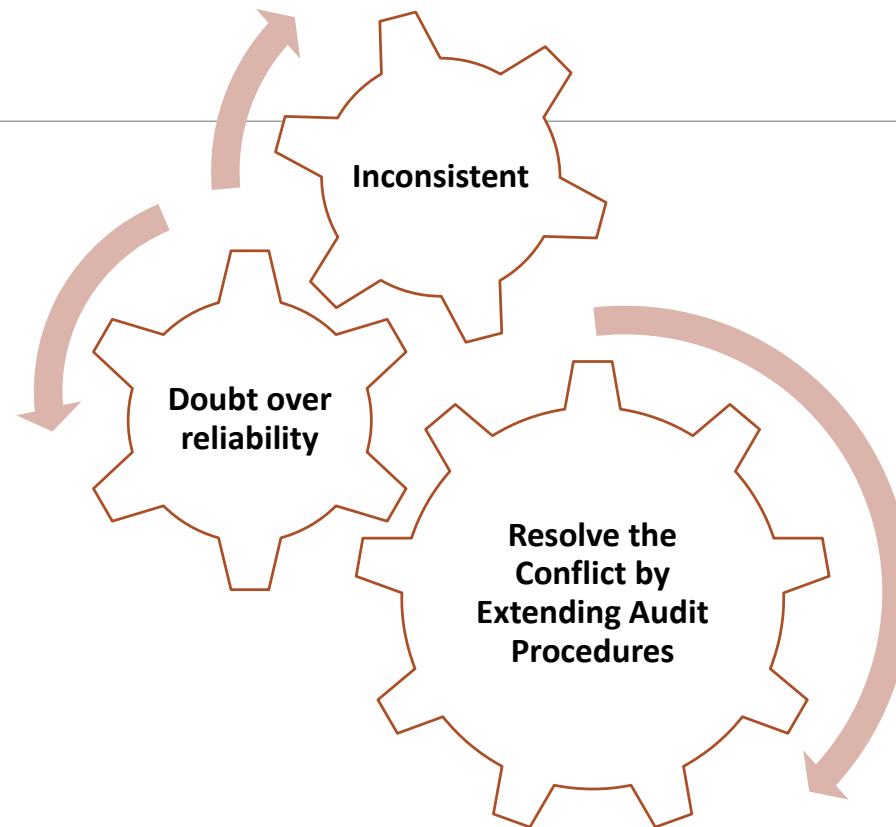
Information
Produced by
Entity

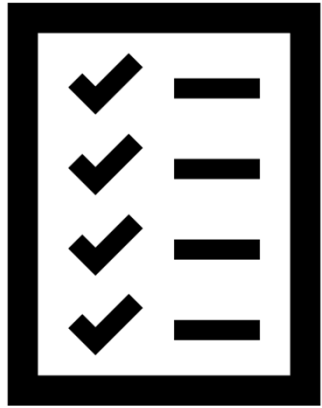
1. Verify for Accuracy and Completeness
2. Evaluate for Sufficiency in details

Selecting Items for Testing



Audit Evidence





Documentation

1. Compliance of SA 500
2. Audit Procedures Performed
3. Evaluation of SAAE
4. Conclusions reached

Duties of Auditor – Sec.143(1):

- (a) Whether **Loans and Advances** made by the Company on the basis of security have been properly secured and whether the terms on which they have been made are prejudicial to the interests of the Company or its Members,
- (b) Whether transactions of the Company, which are represented merely by **Book Entries**, are prejudicial to the interests of the Company,
- (c) Where the Company is not an Investment Company or Banking Company, whether Assets of the Company consisting of Shares, Debentures, and other Securities have been **sold at a price less** than that at which they were purchased by the Company.
- (d) Whether Loans and Advances made by the Company have been shown as **Deposits**,
- (e) Whether **Personal Expenses** have been charged to Revenue Account,
- (f) Where any **Shares have been allotted for cash**, whether cash has actually been received, and if no cash has been received, whether the position as stated in the account books and the Balance Sheet is correct, regular and not misleading.

Sec.143(3)



Whether he has sought and obtained all **information and explanations** to the best of his knowledge and belief that are necessary for the purpose of his audit. If the required information is not obtained, details and effect in Financial Statements should be mentioned.



Whether, in his opinion, **proper books of account** as required by law have been kept by the Company so far as appears from his examination of those books and proper returns adequate for the purposes of his audit have been received from Branches not visited by him,



Whether the report on the **accounts of any Branch Office** audited by a person other than the Company Auditor has been forwarded to him and how he has dealt with the same in preparing the Auditor's Report,



Whether the Company's Balance Sheet and Profit and Loss account dealt with in the report are in **agreement with the books** of account and returns,

Sec.143(3)



Whether, in his opinion, the Financial Statements **comply with the Accounting Standards**,



the observations or comments of the Auditors on financial transactions or matters which have any **adverse effect** on the **functioning** of the Company,



Whether any Director is disqualified from being appointed as a Director u/s 164(2),



any **Qualification, Reservation or Adverse Remark** relating to the maintenance of accounts and other matters connected therewith,



Whether the Company has adequate **Internal Financial Controls** with reference to Financial Statements in place and the operating effectiveness of such controls,

Sec.143(3)

Other matters as may be prescribed –

- (a) whether the Company has disclosed the impact, if any, of **pending litigations** on its financial position in its Financial Statement,
- (b) whether the Company has made provision, as required under any law or Accounting Standards, for **material foreseeable losses**, if any, on long-term contracts including Derivative Contracts,
- (c) whether there has been any **delay** in transferring amounts, required to be transferred, to the **Investor Education and Protection Fund** by the Company.

Investments through Intermediary

- (i) Whether the management has represented that, to the best of its knowledge and belief, other than as disclosed in the notes to the accounts, **no funds have been advanced or loaned or invested** (either from borrowed funds or share premium or any other sources or kind of funds) by the company to or in any other persons or entities, including foreign entities ("Intermediaries"), with the understanding, whether recorded in writing or otherwise, that the Intermediary shall, whether, directly or indirectly lend or invest in other persons or entities identified in any manner whatsoever **by or on behalf of the company** ("Ultimate Beneficiaries") or provide any guarantee, security or the like on behalf of the Ultimate Beneficiaries,

Loans / Funds Obtained:

- (ii) Whether the management has represented, that, to the best of its knowledge and belief, other than as disclosed in the notes to the accounts, **no funds have been received by the company** from any persons or entities, including foreign entities ("Funding Parties"), with the understanding, whether recorded in writing or otherwise, that the company shall, whether, directly or indirectly, lend or invest in other persons or entities identified in any manner whatsoever **by or on behalf of the Funding Party** ("Ultimate Beneficiaries") or provide any guarantee, security or the like on behalf of the Ultimate Beneficiaries, and

Audit Procedures for the above:

- (iii) Based on such audit procedures that the auditor has considered reasonable and appropriate in the circumstances, **nothing has come to their notice** that has caused them to believe that the representations under above sub-clause (i) and (ii) **contain any material mis-statement.**

e) **Payment of Dividend:** Whether the **dividend declared or paid during the year** by the company **is in compliance with Sec. 123** of the Companies Act, 2013.

- **Statement on Managerial Remuneration**
[Sec.197]: In his report u/s 143, the Auditor of the Company shall make a statement as to whether the Remuneration paid by the Company to its Directors is in accordance with Sec.197, whether Remuneration paid to any Director is in excess of the limit laid down u/s 197 and shall give other prescribed details.

Report on CARO u/s 143(11)

Report on Fraud u/s 143(12)

SA 501 – Audit Evidence Specific Considerations

SA 501 - Specific Considerations for:



1. Existence and condition of Inventory
2. Completeness of Litigation and claims
3. Presentation and disclosure of Segment Information – (Compliance FRF)

Verification of Inventory

1. Basic Responsibility with the Management
2. Auditor to apply principles enunciated in SA 500 & 501

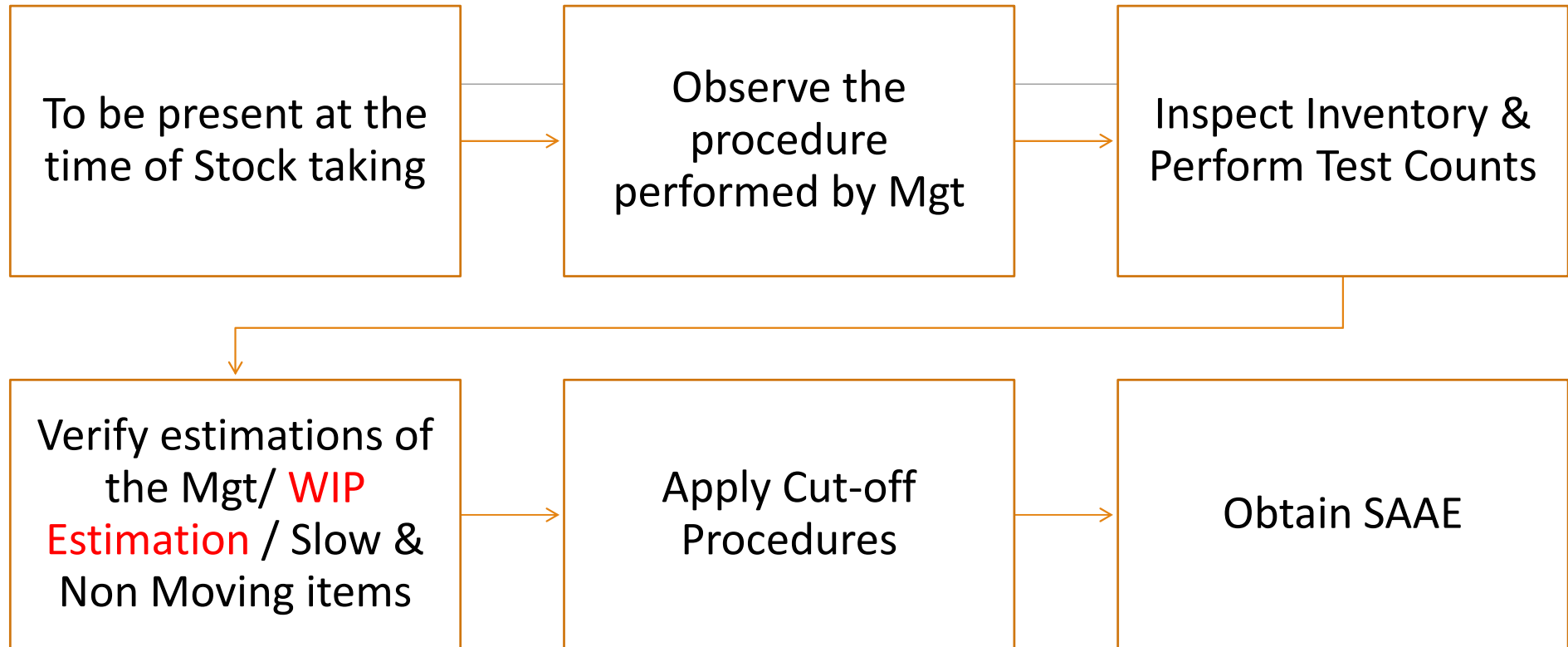
Physical Verification of Inventory

CARO 2020 - 3(ii) – Inventories

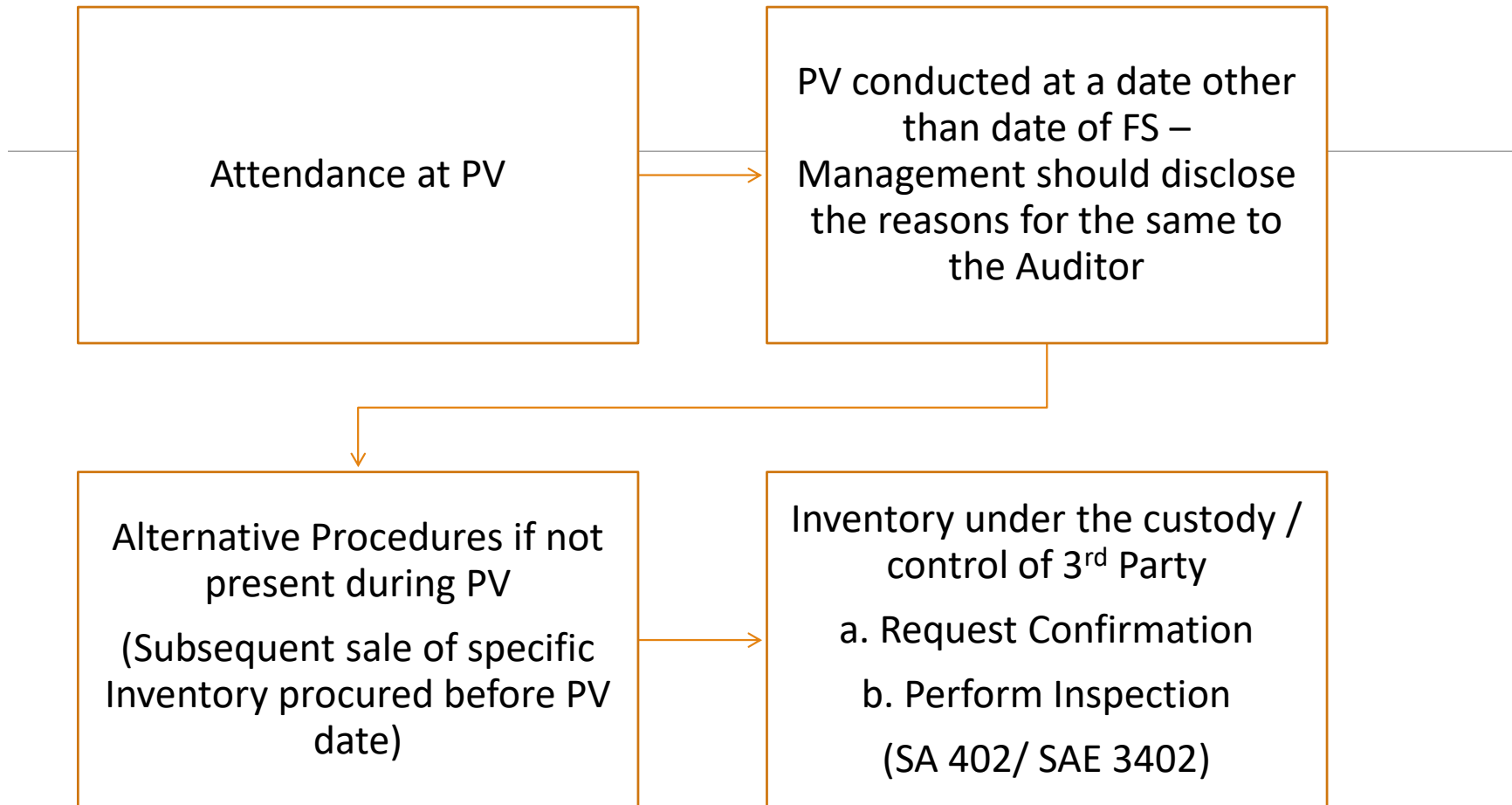
(a) whether physical verification of inventory has been conducted at reasonable intervals by the management and whether, in the opinion of the auditor, the coverage and procedure of such verification by the management is appropriate; whether any discrepancies of 10% or more in the aggregate for each class of inventory were noticed and if so, whether they have been properly dealt with in the books of account;

(b) whether during any point of time of the year, the Company has been sanctioned working capital limits in excess of Rs. 5 crores, in aggregate, from banks or financial institutions on the basis of security of current assets; whether the quarterly returns/statements filed by the Company with such banks or financial institutions are in agreement with the books of account of the Company. If not, give details.

Procedures to be followed by Auditor



Specific Requirement of SA 501



Attendance at Physical Inventory is impracticable [Para A.12 of SA 501]

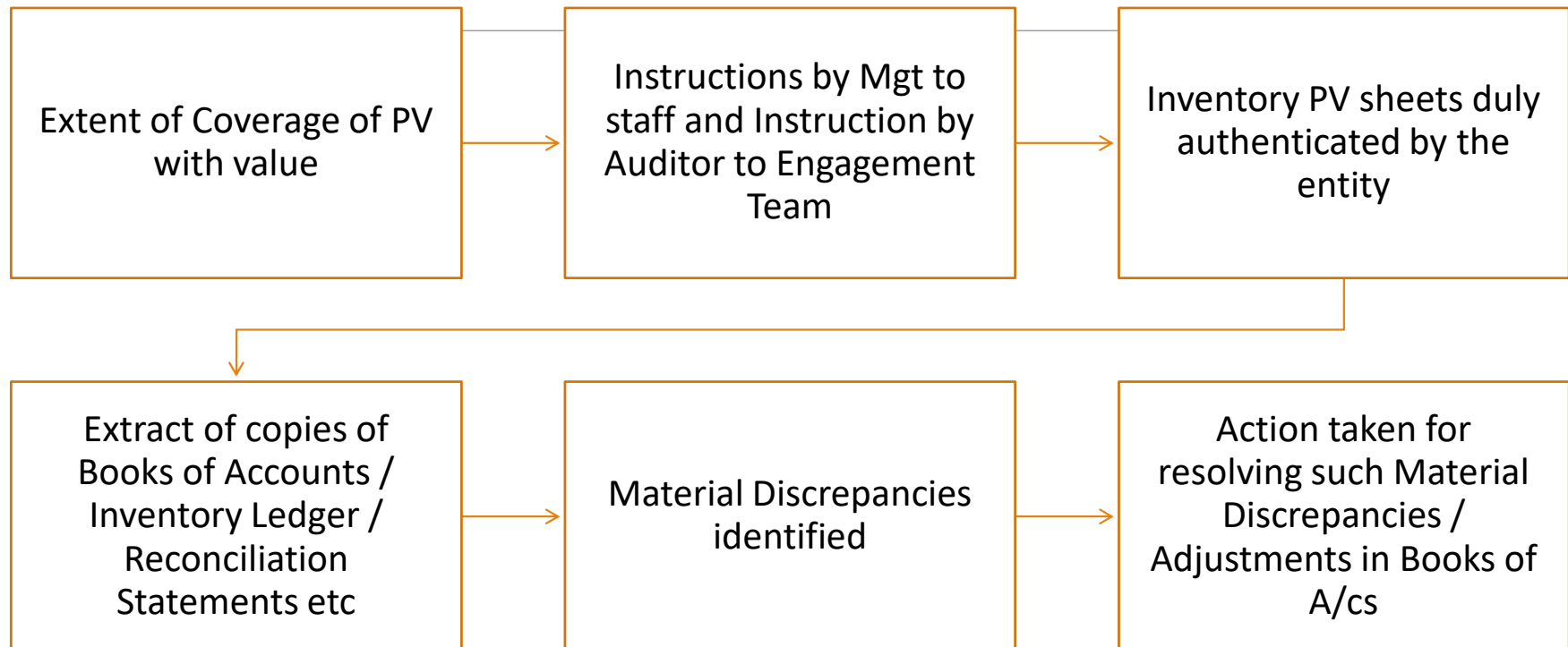
Auditors Attendance at physical inventory counting may be impracticable.

1. Factors such as nature and location of the inventory, [Example, where inventory is held in a location that may pose threats to the safety of the auditor.]
2. The matter of general inconvenience to the auditor

These are not sufficient to support a decision by the auditor that attendance is impracticable.

the matter of difficulty, time, or cost involved **is not in itself a valid basis for the auditor to omit an audit procedure.**

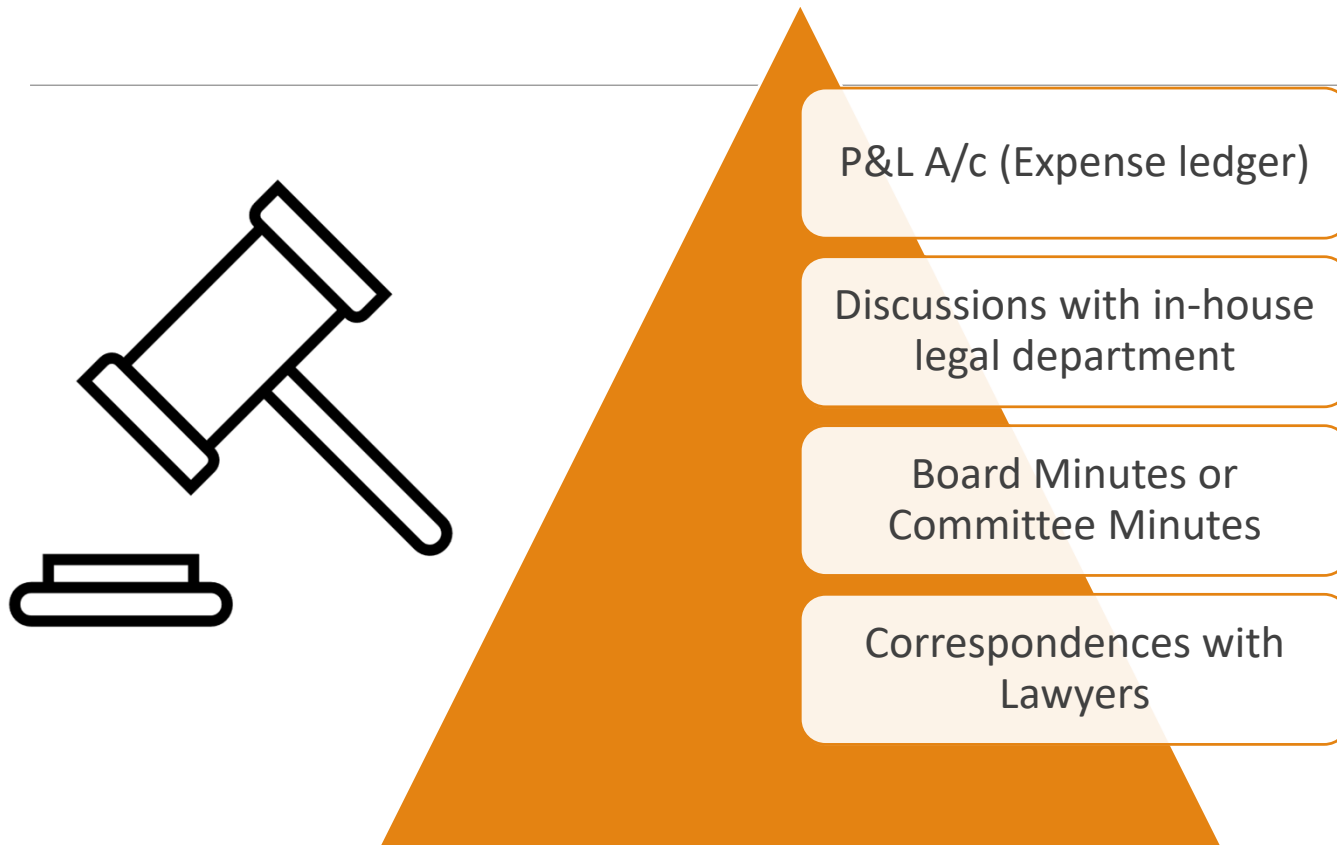
Document the Following:



Other Prescribed matters (under Rule 11) to be reported u/s 143(3):

1. Disclosure of impact of **pending litigations** on its financial position,
2. Provision as required under any law or Accounting Standards, for **material foreseeable losses** on long-term contracts including Derivative Contracts,
3. **Delay** in transferring amounts to **Investor Education and Protection Fund**.

Source of Information





Obtain direct confirmation from the lawyer

- List of litigations and its outcome

Meet the lawyer (in case of significant risk or when there is a **dis-agreement between** the management & lawyer)

Obtain a Management Representation
(on identification, accounting & disclosure)

In case of incomplete information – issue a modified opinion..

Example CARO 2020 Impact:

Dispute in Title Deeds of Immovable Property:

The management is responsible for legal determination of the validity of title deeds. In case of any discrepancy, including any pending/disputed court cases relating to ownership, which needs detailed discussion with the management and should be properly documented.

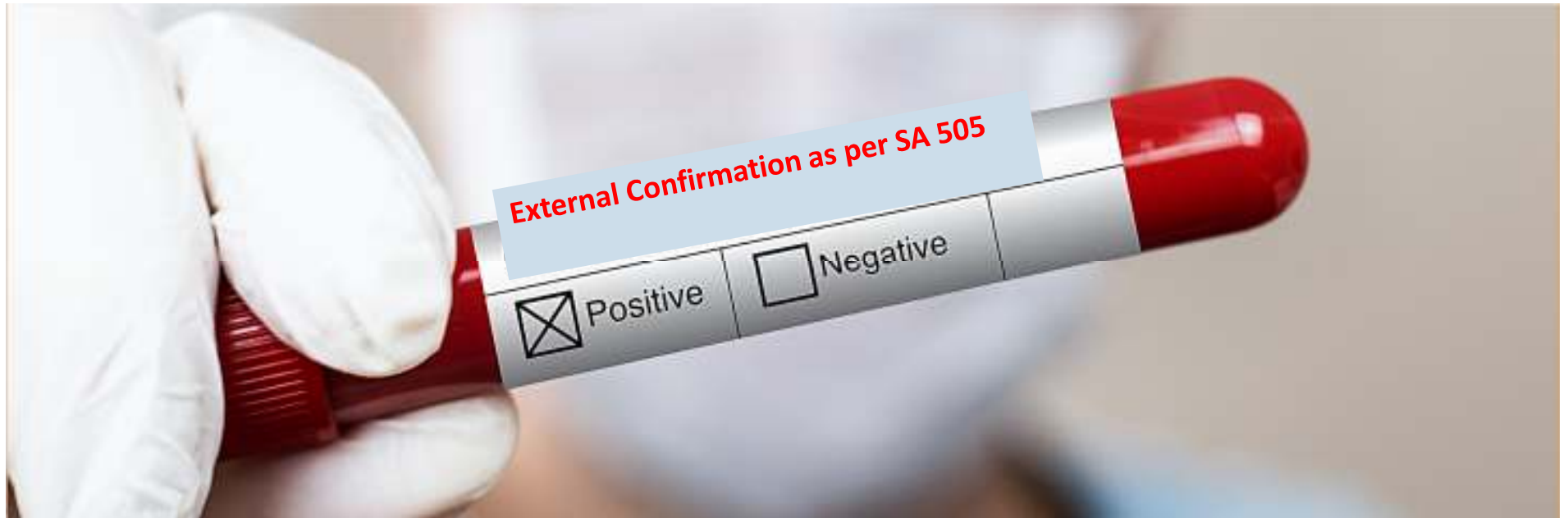
In this context, the auditor may also consider communicating with the legal counsel, whether in-house or external, in accordance with the principles enunciated in SA 501, “Audit Evidence – Specific Considerations for Selected Items”.

The auditor may also consider disclosing the dispute while reporting under this clause

Example CARO
2020 Impact:

Prohibition of Benami Property Transactions Act, 1988 – Clause 3(i)(e)

Consideration of Disputed Statutory Dues - Clause 3(vii)



SA 505 - External Confirmation

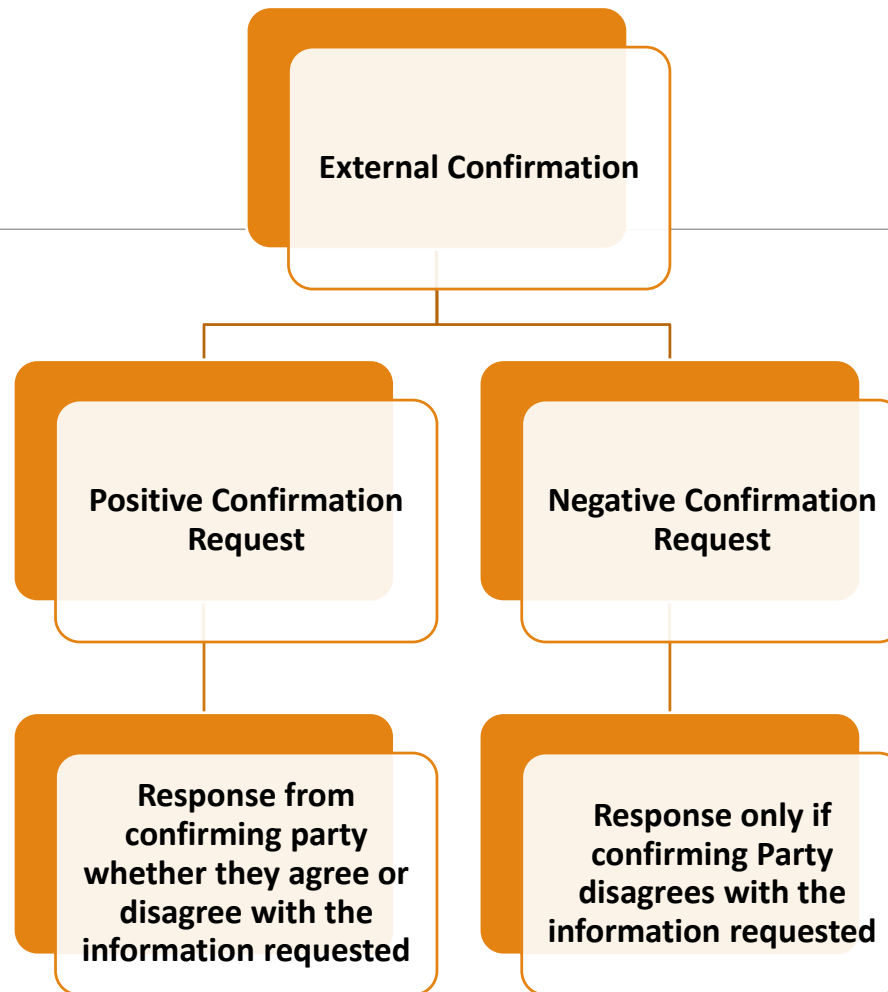


External Confirmation:

Audit Evidence obtained as a Direct Written Response to the Auditor from a third party (the confirming party), in paper form, or by Electronic or other medium.

Examples:

- Bank balances,
- Debtors,
- Creditors,
- Stocks / other assets held by third parties, etc



Example CARO 2020 Impact:

Some Instances for Mandatory Confirmations as per SA :

Mortgage of Title Deeds of Immovable Property: Where the title deeds of the immovable property have been mortgaged with the banks/financial institutions, etc., for securing the borrowings and loan raised by the company, **a confirmation about the same should be sought from the respective institution to this effect.** The auditor may also consider verifying this information from the online records, if available, of the relevant State.

Wilful defaulter: The auditor when obtaining confirmations of outstanding loans and interest from banks/ financial institutions may include a question whether the company has been declared a wilful defaulter

Stocks lying with Third Parties: For items of stock which are held by third parties, the auditor should obtain confirmations for stock held by them. In case, in the opinion of the auditor, the procedures and coverage of physical verification of inventories is not appropriate, the auditor has to report the same.

Default in Payment of loans / Borrowings: The auditor should obtain the confirmation of the concerned lender as to the status of the loan account including the overdue position as at the balance sheet date.

Use of third Party to Co-ordinate and Provide Responses:

If a confirming party uses a third party to coordinate and provide responses to confirmation requests, the auditor **may perform procedures to address the risks** that:

- (a) The response may not be from the proper source;
- (b) A respondent may not be authorised to respond; and
- (c) The integrity of the transmission may have been compromised.

Management Request to skip confirmation

Consider whether is it reasonable

If not reasonable – Consider the effect of SA 260 & 705

SA 570 - Going Concern (Revised)

Material uncertainty

“Material Uncertainty” means the **uncertainties related to events or conditions** which may cast **significant doubt on the entity’s ability to continue as a going concern that should be disclosed** in the financial statements.

It is also termed as “**significant uncertainty**” is used in similar circumstances.

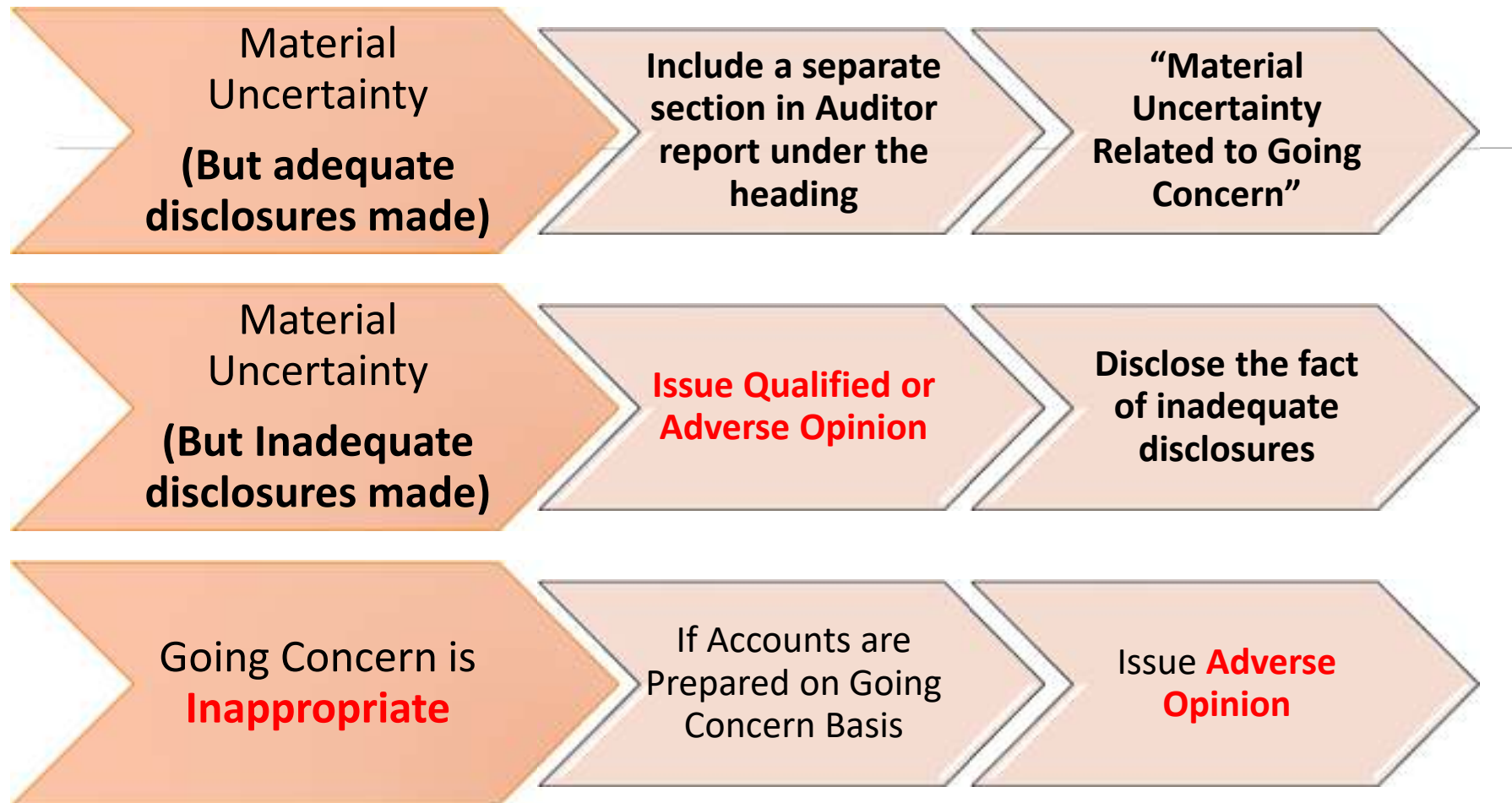
Reporting Change

Instead of the earlier requirement to report material uncertainties within an **Emphasis of Matter paragraph**, reporting of a material uncertainty is now required to be made within a separate section of auditor's report titled as **“Material Uncertainty related to Going Concern”**.

CARO 2020- Clause (xix) – Material Uncertainty

On the basis of the financial ratios, ageing and expected dates of realisation of financial assets and payment of financial liabilities, other information accompanying the financial statements, the auditor's knowledge of the Board of Directors and management plans, whether the auditor is of the opinion that no material uncertainty exists as on the date of the audit that company is capable of meeting its liabilities as and when they fall due within a period of one year from the balance sheet date.

Auditors Duty: Reporting on Going Concern



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