

# Compliance with Technical and Professional Standards

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*Organised by Peer Review Board of ICAI and hosted  
by Pune Branch of ICAI.*

Presented by  
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# Agenda

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- Meaning of Technical and Professional Standards
  
- Frameworks :
  - Compliance
  - Fair Presentation
  
- Auditing Standards – brief overview

# Technical and Professional Standards

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Accounting Standards

Auditing Standards

Guidance Notes

Schedule III

Applicable laws – Company Law etc

Statements issued by ICAI

Code of Ethics

Any other publications of ICAI for members

# Frame work

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## **An Accounting framework means:**

Published set of criteria that is used to measure, recognise, present and disclose the information appearing in an entity's financial statements.

## **Common Frameworks :**

- USGAAP
- IFRS
- India – Indian GAAP
- IndAS

# Compliance Framework

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Set of systems, processes, documentation that outlines an organisation commitment to compliance.

Legislative Requirements

Regulatory Compliance

Standards of Good Governance

Ethics and Community

# Fair Presentation Framework

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Financial Reporting Framework

True and Fair

Faithful vs Fair Presentation

The Accounting Standards are part of Fair Presentation Framework

# Essentials on Conducting an Audit

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- Responsibility of Financial Statements
- Auditors Responsibility
- Independence
- Ethics
- Professional Skepticism
- Analytical Ability
- E-Auditing : Auditing techniques under Computer Environment

## Background on Standards on Auditing

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- Standards prescribed by ICAI
- It will provide quality assurance
- Cover all aspects required to make an assertion
- Takes care of WHAT CAN GO WRONG
- Support in terms of any subsequent claims
- Professional Diligence is established
- Certain Standards are modified in line with International Standards



# Standards on Auditing

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- Assessing Risk
- Planning an audit
- Documentation
- Audit Evidence
- Sampling
- External Confirmation
- Analytical Review
- Estimate Uncertainties
- Fraud
- Going Concern
- Relying on work of an expert
- Reporting and Conclusion

# Identifying and Assessing the Risks of Material Misstatement

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SA315

# Risk

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- Identify and assess the risks of material misstatement
  
- Understanding the entity and its environment,
  - including internal control
  
- Types of Risks
  - Inherent Risk
  - Control Risk
  - Detection Risk

## Objective

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- Providing a basis for designing and implementing responses to the assessed risks of material misstatement – Audit Planning
- To reduce the risk of material misstatement to an acceptably low level

## How to Achieve the Objective?

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- Apply Risk Assessment Procedures
- Understand
  - The Entity and Its Environment
  - The Entity's Internal Control
- Risks that require Special Audit Consideration
- Risks for which Substantive Procedures alone do not provide sufficient appropriate Audit Evidence
- Revision of Risk Assessment
- Documentation
- Complex Structures and beneficial ownerships

## **How to Achieve the Objective**

**Contd...**

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- Inquiries - Management and Others within the Entity
- Analytical Procedures
- Observation and Inspection
- Information Obtained in Prior Periods
- Discussion Among the Engagement Team
- Considerations Specific to Smaller Entities
- Risks arising from IT
- Internal Audit Functions
- Related party transactions

# Internal Control

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## Control environment

- integrity and ethical values
- Commitment to competence
- Participation by those charged with governance
- Management's philosophy and operating style
- Organizational structure
- Assignment of authority and responsibility
- Human resource policies and practices

# Internal Control

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## Control Activities

- Performance reviews
- Information processing
- Physical controls
- Segregation of duties



# Planning an Audit - The Auditor's Responses to Assessed Risk

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SA300 to 330

## Scope

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- Design and implement responses to the risks of material misstatement identified and assessed in accordance with SA 315
- Obtain sufficient appropriate audit evidence about the assessed risks of material misstatement

## How to achieve the above ?

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### Tests of Controls

- Nature and Extent of Tests of Controls
- Timing of Tests of Controls
- audit evidence - interim period
- audit evidence - in previous audits
- Evaluating the Operating Effectiveness of Controls

## How to achieve the above ?

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### Substantive Procedures

- Substantive Procedures Related to the Financial Statement Closing Process
- Substantive Procedures Responsive to Significant Risks
- Timing of Substantive Procedures

## Assertions about :

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### Transactions

- Occurrence
- Completeness
- Accuracy
- Cut off
- Classification

### Account balances at period end

- Existence
- Rights and Obligations
- Completeness
- Valuation

# Auditors Response

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To plan audit accordingly

- More persuasive substantive audit
- Experienced Staff
- Unpredictable audit  
*Verifications/confirmations/testing/procedure*
- Audit Evidence evaluation
- Test of Detail vs Test of Control – both can be performed simultaneously
- Control processes to be checked once in three years
- Changes in IT authorisations – Unauthorised access

# Audit Evidence

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SA500

## Meaning and Scope

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- What constitutes audit evidence
- Design and perform audit procedures to enable the auditor to obtain sufficient appropriate audit evidence
- Selecting Items for Testing to Obtain Audit Evidence
- Inconsistency, Doubts over Reliability



# Audit Sampling

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SA 530

## Scope & Objectives

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- Auditor decided to use audit sampling in performing audit procedures
- Statistical and non-statistical sampling
- Reasonable basis to draw conclusions about the population
- Ensure that all transactions should have a chance of getting into the sample without any bias – scientific methodology.

## How to use Sampling Technique?

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- Sample Design, Size and Selection of Items for Testing
- Non-Sampling Risk
- Sampling Unit
- Tolerable Misstatement
- Selection of Items for Testing
- Performing Audit Procedures
- Nature and Cause of Deviations and Misstatements
- Projecting Misstatements
- Evaluating Results of Audit Sampling

# External Confirmation

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SA505

## Scope and Objective

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- External confirmation procedures to obtain audit evidence
- Reliability of Responses to Confirmation Requests
- Non-Responses
- When a Response to a Positive Confirmation Request is Necessary to obtain Sufficient Appropriate Audit Evidence

# External Confirmation Procedures to Obtain Audit Evidence

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Determining the Information to be Confirmed or Requested

- Selecting the Appropriate Confirming Party

- Follow-Up on Confirmation Requests

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

- Reasonableness of Management's Refusal

- Implications for the Assessment of Risks of Material Misstatement

- Alternative Audit Procedures

# Results of the External Confirmation Procedures

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-Exceptions

-Negative Confirmations

Evaluating the Evidence Obtained

What can go wrong?

# Analytical Procedures

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SA 520



## How to Apply

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- Nature of Analytical Procedures *like pathological tests in medical terms*
- Substantive Analytical Procedures
- Suitability of Particular Analytical Procedures for given assertions
- The Reliability of the Data
- Evaluation of Whether the Expectation Is Sufficiently Precise
- Amount of Difference of Recorded Amounts from Expected Values that Is Acceptable
- Analytical Procedures that Assist When Forming an Overall Conclusion
- Investigating Results of Analytical Procedures

## **Analytical Procedures to be performed**

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- Trends
- Reasonableness
- Ratios

Sources of information - reliability

# Auditing Estimate Uncertainties

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SA540

## Process of Verification

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- How Management Identifies the Need for Accounting Estimates
- How Management Makes the Accounting Estimates
- Reviewing Prior Period Accounting Estimates
- Past history of the estimates made vs actuals
- Considering need for specialized skills or knowledge
- Eliminating management bias

## Related Parties

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SA550

## **Scope & Objectives**

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- Related Party Transactions and associated risk of misstatement – High risk
- Identification of Related Parties
- Identification of Arms Length Prices
- Transactions with Related Parties to be examined

# Auditors responsibilities relating to Fraud in Financial Statements

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SA240

# Meaning and characteristics of Fraud

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Misstatement in Financial Statement

- Unintentional – Error
- Intentional – Fraud



# Detection of Fraud

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**Responsibility of the Management – Primary**

**Responsibility of Auditor – Secondary**

Inherent risk – misstatement due to fraud may not be detected even though compliance with SA

Why because :

- Sophisticated and carefully organised method to conceal facts
- Forgery
- Deliberate failure to record transaction
- Intentional misrepresentation to auditors

## **Types of Fraud**

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### **Two types of fraud:**

- Management fraud
- Employee related

### **Management fraud difficult to detect due to :**

- Ability of management to manipulate records
- Present fraudulent information
- Override of controls

## Professional skepticism

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- Not to get carried away by past honesty of the management
- Generally documents given by the management are considered as genuine. If conditions are otherwise, then go into further details.
- Inconsistency in the response by the management
- Discussion amongst the assignment team

## **Audit process as response to assessed risks**

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- Test the appropriateness of Journal Entries – particularly those passed at the end of accounting period
- Review Accounting Estimates – subsequent events and past results of estimate
- Retrospective review of past estimates and judgements
- Check for bias in judgements
- Significant unusual transactions given the understanding of business environment
- Audit Evidence – Analytical Review

## Possible fall out

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- Withdrawal out of Audit Engagement
- Management Representation
- Communicating with those Charged with Governance
- Communicating with Regulatory authorities – duty vs confidentiality
- Documentation
- Significant decisions regarding susceptibility

## The incentives for fraud

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- Incentive or pressure to report fraudulent financial statements – pressure on profits
- Incentive to misappropriate assets as living beyond means
- Possibility of internal controls may be overridden
- Can rationalise fraudulent activities
- Tax savings
- Inflate earnings to secure bank borrowings

## How fraud is perpetrated :

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- Recording fictitious journal entries
- Inappropriately adjusting assumptions and changing judgments.
- Omitting, advancing or delaying recognition transactions that have occurred during the reporting period.
- Concealing, or not disclosing, facts
- Engaging in complex transactions that are structured
- Altering records and terms related to significant and unusual transactions.

## **In case of fraud by employees**

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- Embezzling receipts
- Stealing physical assets or intellectual property.
- Causing an entity to pay for goods and services not received
- Using an entity's assets for personal use.



## Talk to / Make inquiries

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- Employees with different levels of authority.
- Employees involved in initiating, processing or recording complex or unusual transactions and those who supervise or monitor such employees.
- In-house legal counsel.
- Chief ethics officer or equivalent person.
- The person or persons charged with dealing with allegations of fraud.
- Internal Auditor
- Operating personnel not directly involved in the financial reporting process.

## Pressure from third parties

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- Profitability or trend level expectations of investment analysts, institutional investors, significant creditors, or other external parties
- Need to obtain additional debt or equity financing
- Marginal ability to meet exchange listing requirements or debt repayment or other debt covenant requirements.
- Perceived or real adverse effects of reporting poor financial results on significant pending transactions, such as business combinations or contract awards.

## Financial position of management threatened due to

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- Significant financial interests in the entity.
- Significant portions of their compensation (for example, bonuses, stock options, and earn-out arrangements) being contingent upon achieving aggressive targets for stock price, operating results, financial position, or cash flow.
- Personal guarantees of debts of the entity.
- There is excessive pressure on management or operating personnel to meet financial targets established by those charged with governance, including sales or profitability incentive goals.

## Red flags

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- Significant related-party transactions not in the ordinary course of business or with related entities not audited or audited by another firm.
- Significant, unusual, or highly complex transactions, especially those close to period end that pose difficult “substance over form” questions.
- Use of business intermediaries for which there appears to be no clear business justification.
- Significant bank accounts or subsidiary or branch operations in tax-haven jurisdictions for which there appears to be no clear business justification.

## Attitudes/Rationalizations

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- Non ethical values
- Non-financial management's excessive participation in or preoccupation with the selection of accounting policies or the determination of significant estimates.
- Known history of violations of securities laws or other laws and regulations, or claims against the entity, its senior management, alleging fraud or violations of laws and regulations.
- Excessive interest by management in maintaining or increasing the entity's stock price or earnings trend.
- The practice by management of committing to analysts, creditors, and other third parties to achieve aggressive or unrealistic forecasts.
- Management failing to remedy known significant deficiencies in internal control on a timely basis.

## Attitudes/Rationalizations

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- Low morale among senior management.
- The owner-manager makes no distinction between personal and business transactions.
- Dispute between shareholders in a closely held entity.
- Recurring attempts by management to justify marginal or inappropriate accounting on the basis of materiality.

## Auditors response to the perceived fraud situation

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- Assigning personnel with specialised skills like Forensic Audit and IT enabled reviews
- Assigning more experienced staff
- Performing substantive procedures on selected account balances and assertions not otherwise tested due to their materiality or risk.
- Adjusting the timing of audit procedures from that otherwise expected.
- Using different sampling methods.
- Performing audit procedures at different locations or at locations on an unannounced basis.
- Analyse Cash flow statements
- Judgements relating to estimates

# Going Concern

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SA570 -



# Going Concern

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**Reporting required only if the standard requires disclosure.**

Fundamental principle for preparation of Financial Statement.

Some of the examples of situations impacting Going Concern

- Negative Current Ratio
- Fixed term borrowing maturing without prospect of renewal
- Short Term borrowing for long term usage
- Withdrawal of financial support by creditors
- Negative Operating Cash flows

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- Adverse Key financial ratios
  - Substantial Operating losses

Managements has perform assessment:

- To discuss the assessment
- If significant doubt created – how addressed

Management has not assessed:

- To discuss with management
- Evaluate whether the basis for going concern valid

Evaluating the underlying data for basis of conclusion

Third party confirmations for commitments

MRL - Obtaining written management representation

Three scenarios:

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Use of Going concern not appropriate – Adverse Opinion

Use of Going Concern appropriate:

Events or conditions identified and material uncertainty exists

Unmodified Opinion – separate section :

**Material Uncertainty related to Going Concern.**

FS prepared on liquidation basis – Unmodified Report

- With proper disclosures in Basis of Opinion
- With adequate disclosures in Emphasis of Matter.

## Three scenarios:

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### Adequate disclosures :

- When events or conditions exists
- Material uncertainty exists

### Adequate disclosures not made:

- Qualified opinion – if material but not pervasive
- Adverse Opinion – if pervasive
- Significant delay in approving FS due to deliberation on Going Concern – report

## Case Study 1– Going Concern

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A Company operating Hotel with negative net worth of (-) Rs.50 crores

Hotel Building:

- Book Value – Rs.100 crores
- Market Value – Rs.200 crores

Net Current Assets – Negative = Rs.50 crores

Bank Term Loan – NPA and loans recalled.

Whether Going Concern ?

## Case Study 2 : Going Concern

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A Company operating Hotel with negative net worth of (-) Rs.50 crores

Hotel Building:

- Book Value – Rs.100 crores
- Market Value – Rs.200 crores

Net Current Assets – Negative = Rs.50 crores

Bank Term Loan – NPA and loans recalled.

Shareholders have ability and capacity to fund Rs.100 crores in the Company.

Whether Going Concern ?

## Case Study 3 : Going Concern

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A Company operating Hotel with negative net worth of (-) Rs.50 crores

Hotel Building:

- Book Value – Rs.100 crores
- Market Value – Rs.200 crores

Net Current Assets – Negative = Rs.50 crores

Bank Term Loan – NPA and loans recalled.

Company has additional vacant surplus land area which is proposed to be sold and realise Rs.100 crore

Whether Going Concern ?

## Case Study 4 : Going Concern

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A Company operating a Real Estate Project with net worth of Rs.50 crores

Company has received a legal claim of Rs.300 crore

Company has obtained a written opinion from an eminent law firm of big standing that the claim is frivolous not tenable.

Whether Going Concern ?



# Using the Work of Internal Auditors

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SA610 -

## Relying on work of Internal Auditor

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Relationship between the Internal Audit Function and the External Auditor – Scope definition

Determining whether and to what extent to use the Work of the Internal Auditors - Capabilities

## Work of Internal Auditor

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- Whether the work of the Internal Auditors is likely to be adequate for Purposes of the Audit
- Planned Effect of the Work of the Internal Auditors on the Nature, Timing or Extent of the External Auditor's Procedures  
Using Specific Work of Internal Auditors  
Documentation

# Using the Work of Auditor's Expert

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SA620 -

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- The Auditor's Responsibility for the Audit Opinion
  - Determining the Need for an Auditor's Expert
  - Nature, Timing and Extent of Audit Procedures
  - The Competence, Capabilities and Objectivity of the Auditor's Expert
  - Obtaining an Understanding of the Field of Expertise of the Auditor's Expert
  - Agreement with the Auditor's Expert
  - Evaluating the Adequacy of the Auditor's Expert's Work
  - Reference to the Auditor's Expert in the Auditor's Report

# Standards on Auditing

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SA700 -

Forming an Opinion and Reporting on Financial Statements

## Standards on Audit – Conclusions and Reporting

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SA 700 – Forming an Opinion and Reporting on Financial Statements

SA705 – Modification to the Opinion

SA 701 – Key Audit Matters

SA706 – Emphasis of Matter

SA710 – Comparative Information

SA720 – Other Information

## Standards on Audit - Revised

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International Accounting and Auditing Standards Board modified Audit Report – 2017.

Changes in Audit Report Format in India –

Effective date : All financial statements commencing on or after 1.4.2018.

Pursuant to changes by IAASB

Response to various scams

Substantial Disclosures in Audit Report



## How an auditor forms an Opinion

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SA330 Sufficient Audit evidence is obtained

SA450 Uncorrected misstatements whether material

Evaluations of Management Judgements

Applicable Financial Framework

Estimates are reasonable

Information is relevant, comparable and reliable

Adequate Disclosures

Terminology is appropriate

Overall presentations

FS represents underlying transactions and events – fair presentation

## Audit Report – Revised Format

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- Title
- Addressee
- Auditors Opinion
- Basis for Opinion
- Going Concern – (SA 570)
- Key Audit Matters – (SA 701)
- Emphasis of Matter – (SA 706)
- Other Information – (SA 720)

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## 2. Audit Report – Revised Format

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### Responsibilities for the Financial Statements

- Management
- Auditor

### Other Reporting Responsibilities

Signature of Auditor

Place of Signature

Date of Signature

## Title - INDEPENDENT AUDITORS REPORT

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What is Independence?

Independence in State of Mind

Opinion without influence

Independence in appearance

Avoidance of certain facts and circumstances

# INDEPENDENT AUDITORS REPORT

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## **Expected :**

Integrity

Objectivity

Professional Skeptism

No Conflict of Interest

Faith reposed by the Society

## Threats to Independence

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### **Self Interest**

- Financial Interest
- Loans or Guarantees
- Professional Fees – leverage – in excess of 40% - group fees
- Business Relationship
- Potential of Employment
- Contingent Fees – Success Fee
- Other assignments – non assurance

## Threats to Independence

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### **Self Review**

Performed services which is subject to his review

Having previous relationships

### **Advocacy Threats**

Dealing in shares

Assignment for advocate in litigation matters

# Threats to Independence

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## **Familiarity Threats**

Close relationship with client

Long association

Acceptance of gifts and hospitality

Rotation of Auditors – external and internal

## **Intimidation Threats**

Threat of replacement

Statutory Auditor cannot be Internal Auditor

Cannot be financial advisor

Independence applies to each partner of the firm.



## CODE OF ETHICS - AMENDED

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Independence – Code of Ethics modified w.e.f. 1.4.2020. The same was deferred till 30<sup>th</sup> September 22 and introduced wef 1.10.22 as under:

The threshold limit for fees for two consecutive years from a group as compared to total :

For Public Interest Entities – 20% of the gross annual fees

For other entities – 40% of the gross annual fees

Report to ICAI

Not applicable if total fees Rs. 20 lacs or less

Not applicable to Government Companies or Banks etc where appointment is made by Government

# Types of Opinion

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## Unmodified

- FS are prepared in compliance with applicable Financial framework, free from material misstatement.
- Modified Opinion

Qualified

Adverse

Disclaimer

When : If FS not free from material misstatement

Unable to obtain sufficient audit evidence

If Modified Opinion – discuss with Those Charged With Governance

# Auditors Modified Opinion

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<b>Name of Matter giving Rise to Modification</b>	<b>Material but NOT Pervasive</b>	<b>Material AND Pervasive</b>
Financial Statements are materially misstated	Qualified Opinion	Adverse Opinion
Inability to obtain sufficient appropriate audit evidence	Qualified Opinion	Disclaimer of Opinion

## Last but not least :

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### Follow Standards on Audit

- Documentation – What is not documented is not done
- Be alert – check and read any material on which reliance is placed
- Document – Memorandum of Dispute Resolution (MDR)
- Maintain Independence
- Compliance with Accounting Standards

### Else

- Face : ICAI/NFRA disciplinary action
- Class Action Suits
- Serious Fraud Investigation Office

Any Questions ?

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# Thank You

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