CHAPTER 7

# COMPLETION AND REVIEW

## LEARNING OUTCOMES

**After studying this chapter, you would be able to understand-**

- Meaning of “Subsequent Events”
- SA 560- Subsequent Events
- Meaning of “Going Concern” and its significance
- SA 570- Going Concern
- SA 450- Evaluation of misstatements identified during the audit
- Meaning of Written representations
- SA 580-Written representations
- Significance of Communication with Those charged with governance
- Overview of SA 260 -concerning Communication with Those charged with governance
- Necessity of communication of significant deficiencies in internal control
- Overview of SA 265- Communicating Deficiencies in Internal Control to Those Charged with Governance and Management
- Practicality of above concepts using examples and case studies.

## CHAPTER OVERVIEW

- SA 260 — COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE
- SA 265 — COMMUNICATING DEFICIENCIES IN INTERNAL CONTROL TO THOSE CHARGED WITH GOVERNANCE AND MANAGEMENT
- SA 450 — EVALUATIONS OF MISSTATEMENTS IDENTIFIED DURING THE AUDIT

- SA 560 — SUBSEQUENT EVENTS
- SA 570 — GOING CONCERN
- SA 580 — WRITTEN REPRESENTATIONS

Excited as he was, to know outcome of audit his friend Shekhar was part of, Sameer called him up one day. He came to know that substantive procedures have already been performed and audit is in its last leg of completion. A question arose in his mind. Is something more to be done? Are there still some procedures left to be performed?

It is in this context, he came to know about "Subsequent events". He was under the impression that audit is concerned only with events occurring up to date of financial statements. However, he rued his elementary understanding. Not only auditor is concerned with events occurring up to date of financial statements, he has also to deal with effects of events occurring up to date of auditor's report. Even after signing audit report, if auditor becomes aware of certain facts, he has to take necessary steps in certain situations. What are those steps and situations?

Apart from this, auditor has to assess whether use of *going concern assumption* by management in preparation of financial statements is appropriate. Applying his accountancy knowledge of AS 1, he remembered that it is one of the three fundamental accounting assumptions. It means that an enterprise will continue to be in business in foreseeable future. It is the basic assumption which affects how financial statements of an enterprise are prepared. Wow! That is why it is so important for auditors.

He was also considering whether misstatements found during audit have to be informed to the management first. Why it is necessary to do so? The reason behind it must be to provide an opportunity to management to correct those misstatements. Another reason could be of judging response of management to such misstatements. Something new may come to knowledge of auditors before he forms opinion and signs on dotted lines.

Remembering that audit suffers from inherent limitations, he knew that audit procedures are not completely fool-proof. An auditor may falter due to limitations of procedures themselves or due to their faulty selection. In such a case, how can auditor be sure of everything, of completeness of information, of recording of all transactions? That is where written representations come in the picture.

He has understood now reason for lull period in the audit and why an auditor takes time to sign report.

There are still procedures to be performed by auditor after completion of substantive procedures involving detailed checking. An auditor has to deal with effect of subsequent events. He has to obtain sufficient appropriate evidence regarding appropriateness of use by management of going concern assumption in preparation of financial statements. Misstatements identified during audit have to be evaluated and communicated. Communication regarding significant audit findings and other matters is made to those charged with governance. Written representations are obtained. All such procedures are performed before signing of audit report.

## 1. SUBSEQUENT EVENTS

Events occurring between the date of the financial statements and the date of the auditor's report and facts that become known to the auditor after the date of the auditor's report are known as subsequent events.

Consider case of a company which may have planned an agreement to merge between the date of the financial statements and the date of the auditor's report. Or a fire claim amount of an entity receivable from insurance company as on date of financial statements may have been settled at a reduced amount before date of auditor's report. These are some of the examples of subsequent events.

Financial statements may be affected by certain events that occur after the date of the financial statements. Many financial reporting frameworks specifically refer to such events. Such financial reporting frameworks ordinarily identify two types of events: -

(a) Those that provide evidence of conditions that existed at the date of the financial statements and

(b) Those that provide evidence of conditions that arose after the date of the financial statements.

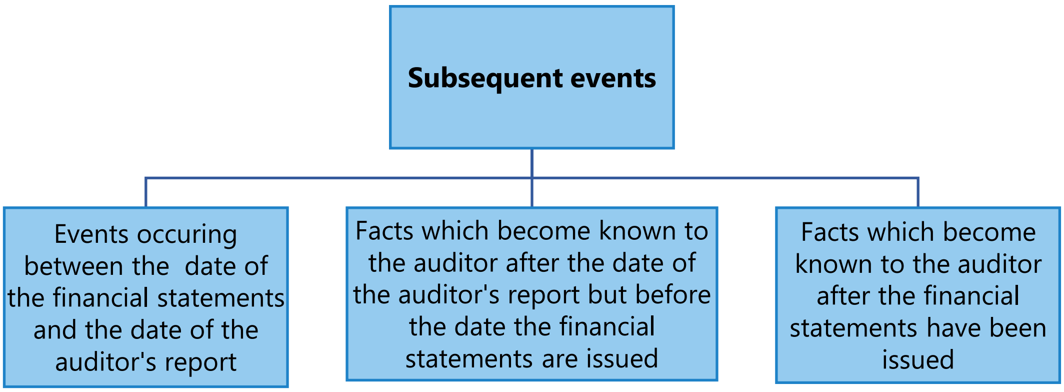
**Examples of events providing evidence of conditions that existed at the date of the financial statements**

- Declaration of insolvency of a major debtor of the entity between the date of financial statements and the date of auditor's report providing evidence on the recoverability of the money due from debtor as on date of the financial statements.
- Settling a legal claim outside the court at a reduced amount between the date of financial statements and the date of auditor's report for which provision

has already been made in financial statements. It provides evidence on adjustment in provision amount already made in financial statements, if any.

**Examples of events providing evidence of conditions that arose after the date of the financial statements**

- Issue of new share capital.
- Planned merger of the company.
- Destruction of substantial inventories due to fire between the date of the financial statements and the date of auditor's report.




## 1.1 SA 560 Subsequent Events

SA 560 deals with the auditor's responsibilities relating to subsequent events in an audit of financial statements.

## 1.2 Objectives of auditor in accordance with SA 560

The objectives of the auditor are to: -

(a) Obtain sufficient appropriate audit evidence about whether events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements are appropriately reflected in those financial statements and

(b) Respond appropriately to facts that become known to the auditor after the date of the auditor's report, that, had they been known to the auditor at that date, may have caused the auditor to amend the auditor's report.

## 1.3 Audit procedures relating to events occurring between the date of the financial statements and the date of the auditor's report

The auditor shall perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements have been identified. The auditor is not, however, expected to perform additional audit procedures on matters to which previously applied audit procedures have provided satisfactory conclusions.

The auditor shall perform the procedures required above so that they cover the period from the date of the financial statements to the date of the auditor's report, or as near as practicable thereto. The auditor shall take into account the auditor's risk assessment in determining the nature and extent of such audit procedures, which shall include the following: -

(a) Obtaining an understanding of any procedures management has established to ensure that subsequent events are identified.

(b) Inquiring of management and, where appropriate, those charged with governance as to whether any subsequent events have occurred which might affect the financial statements.

(c) Reading minutes, if any, of the meetings, of the entity's owners, management and those charged with governance, that have been held after the date of the financial statements and inquiring about matters discussed at any such meetings for which minutes are not yet available.

(d) Reading the entity's latest subsequent interim financial statements, if any.

Such information may also be obtained by auditor from accounting records pertaining to period after date of financial statements, reading entity's latest available budgets etc.

When, as a result of the procedures performed, the auditor identifies events that require adjustment of, or disclosure in, the financial statements, the auditor shall determine whether each such event is appropriately reflected in those financial statements.

The auditor shall request management and, where appropriate, those charged with governance, to provide a written representation in accordance with SA 580, "Written Representations" that all events occurring subsequent to the date of the financial statements and for which the applicable financial reporting framework requires adjustment or disclosure have been adjusted or disclosed.

**Meaning of "Date the financial statements are issued"**

It reflects the date that *the auditor's report and audited financial statements are made available to third parties.* The date the financial statements are issued generally depends on the regulatory environment of the entity. In some circumstances, the date the financial statements are issued may be the date that they are filed with a regulatory authority. Since audited financial statements cannot be issued without an auditor's report, the date that the audited financial statements are issued must not only be at or later than the date of the auditor's report, but must also be at or later than the date the auditor's report is provided to the entity.

## 1.4 Facts which become known to the auditor after the date of the auditor's report but before the date the financial statements are issued

The auditor has no obligation to perform any audit procedures regarding the financial statements after the date of the auditor's report. However, when, after the date of the auditor's report but before the date the financial statements are issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report, the auditor shall:

(a) Discuss the matter with management and, where appropriate, those charged with governance.

(b) Determine whether the financial statements need amendment and, if so,

(c) Inquire how management intends to address the matter in the financial statements.

**If management amends the financial statements, the auditor shall:**

(a) Carry out the audit procedures necessary in the circumstances on the amendment.

(b) Unless the circumstances in succeeding para apply: -

 (i) Extend the audit procedures, already referred, to the date of the new auditor's report and

 (ii) Provide a new auditor's report on the amended financial statements.

The new auditor's report shall not be dated earlier than the date of approval of the amended financial statements.

When law, regulation or the financial reporting framework does not prohibit management from restricting the amendment of the financial statements to the effects of the subsequent events or events causing that amendments and those responsible for approving the financial statements are not prohibited from restricting their approval to that amendment, the auditor is permitted to restrict the audit procedures on subsequent events to that amendment. In such cases, the auditor shall either: -

(a) Amend the auditor's report to include an additional date restricted to that amendment that thereby indicates that the auditor's procedures on subsequent events are restricted solely to the amendment of the financial statements described in the relevant note to the financial statements or

(b) Provide a new or amended auditor's report that includes a statement in an Emphasis of Matter paragraph or Other Matter(s) paragraph that conveys that auditor's procedures on subsequent events are restricted solely to the amendment of the financial statements as described in the relevant note to the financial statements.

In some entities, management may not be required by the applicable law, regulation or the financial reporting framework to issue amended financial statements and, accordingly, the auditor need not provide an amended or new auditor's report. However, when management does not amend the financial statements in circumstances where the auditor believes they need to be amended, then: -

(a) If the auditor's report has not yet been provided to the entity, the auditor shall modify the opinion as required by SA 705 and then provide the auditor's report or

(b) If the auditor's report has already been provided to the entity, the auditor shall notify management and, unless all of those charged with governance are involved in managing the entity, those charged with governance, not to issue the financial statements to third parties before the necessary amendments have been made. If the financial statements are nevertheless subsequently issued without the necessary amendments, the auditor shall take appropriate action, to seek to prevent reliance on the auditor's report.

## 1.5 Facts which become known to the auditor after the financial statements have been issued

After the financial statements have been issued, the auditor has no obligation to perform any audit procedures regarding such financial statements. However, when, after the financial statements have been issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report, the auditor shall: -

(a) Discuss the matter with management and, where appropriate, those charged with governance.

(b) Determine whether the financial statements need amendment and, if so,

(c) Inquire how management intends to address the matter in the financial statements.

**If the management amends the financial statements, the auditor shall: -**

(a) Carry out the audit procedures necessary in the circumstances on the amendment.

(b) Review the steps taken by management to ensure that anyone in receipt of the previously issued financial statements together with the auditor's report thereon is informed of the situation.

(c) Unless such circumstances when law, regulation or the financial reporting framework does not prohibit management from restricting the amendment of the financial statements to the effects of the subsequent events or events causing that amendments and those responsible for approving the financial statements are not prohibited from restricting their approval to that amendment apply: -

  (i) Extend the audit procedures, already referred, to the date of the new auditor's report, and the date the new auditor's report no earlier than the date of approval of the amended financial statements and

(ii) Provide a new auditor's report on the amended financial statements.

(d) When the circumstances are such that law, regulation or the financial reporting framework does not prohibit management from restricting the amendment of the financial statements to the effects of the subsequent events or events causing that amendments and those responsible for approving the financial statements are not prohibited from restricting their approval to that amendment, amend the auditor's report, or provide a new auditor's report as already discussed.

The auditor shall include in the new or amended auditor's report an Emphasis of Matter paragraph or Other Matter(s) paragraph referring to a note to the financial statements that more extensively discusses the reason for the amendment of the previously issued financial statements and to the earlier report provided by the auditor.

If management does not take the necessary steps to ensure that anyone in receipt of the previously issued financial statements is informed of the situation and does not amend the financial statements in circumstances where the auditor believes they need to be amended, the auditor shall notify management and, unless all of those charged with governance are involved in managing the entity, those charged with governance, that the auditor will seek to prevent future reliance on the auditor's report.

If, despite such notification, management or those charged with governance do not take these necessary steps, the auditor shall take appropriate action to seek to prevent reliance on the auditor's report.

**(A) Overview of auditor's responsibilities regarding subsequent events between the date of the financial statements and the date of the auditor's report**

| Checkbox | Auditor's responsibilities regarding subsequent events |
|---|---|
| ✓ | Perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements have been identified. |
| ✓ | If such subsequent events that require adjustment of, or disclosure in, the financial statements have been identified, it shall |

| | |
|---|---|
| | be determined whether each such event is appropriately reflected in those financial statements. |
| ✓ | Obtain a written representation from management or those charged with governance that all events occurring subsequent to the date of the financial statements and for which the applicable financial reporting framework requires adjustment or disclosure have been adjusted or disclosed. |

**(B) Overview of auditor's responsibilities after the date of the auditor's report but before the date the financial statements are issued**

| Checkbox | Auditor's responsibilities after the date of the auditor's report but before the date the financial statements are issued |
|---|---|
| ✓ | No obligation for auditor to perform any audit procedures regarding the financial statements after the date of the auditor's report. However, when, after the date of the auditor's report but before the date the financial statements are issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report, determine if financial statements need amendment. |
| ✓ | If management amends financial statements, carry out audit procedures on amendment and extend the procedures to date of new audit report and provide new auditor's report on amended financial statements. |
| ✓ | When management does not amend the financial statements in circumstances where the auditor believes they need to be amended and auditor's report has not been provided to the entity, the auditor shall modify the opinion as required by SA 705 and then provide the auditor's report. |
| ✓ | If the auditor's report has already been provided to the entity, the auditor shall notify management not to issue the financial statements to third parties before the necessary amendments have been made. If the financial statements are nevertheless subsequently issued without the necessary amendments, the auditor shall take appropriate action, to seek to prevent reliance on the auditor's report. |

**(C) Overview of auditor's responsibilities after the financial statements have been issued**

| Checkbox | Auditor's responsibilities after the financial statements have been issued |
|---|---|
| ✓ | No obligation to perform any audit procedures regarding financial statements after the financial statements have been issued. However, after financial statements have been issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report, determine if financial statements need amendment. |
| ✓ | If the management amends the financial statements, the auditor shall carry out the audit procedures necessary in the circumstances on the amendment. |
| ✓ | Review the steps taken by management to ensure that anyone in receipt of the previously issued financial statements together with the auditor's report thereon is informed of the situation. Extend the audit procedures, already referred, to the date of the new auditor's report and provide a new auditor's report on the amended financial statements. |
| ✓ | Include in the new auditor's report an Emphasis of Matter paragraph or Other Matter(s) paragraph referring to a note to the financial statements that more extensively discusses the reason for the amendment of the previously issued financial statements and to the earlier report provided by the auditor. |
| ✓ | If management does not take the necessary steps to ensure that anyone in receipt of the previously issued financial statements is informed of the situation and does not amend the financial statements in circumstances where the auditor believes they need to be amended, the auditor shall notify management that the auditor will seek to prevent future reliance on the auditor's report.<br>If, despite such notification, management or those charged with governance do not take these necessary steps, the auditor shall take appropriate action to seek to prevent reliance on the auditor's report. |

### Test Your Understanding 1

CA PK Jacob is conducting audit of a company for year 2021-22. The company is engaged in export of ethnic rugs to buyers in Europe. The audit is nearing completion in month of July 2022. However, it becomes known to the auditor that one of overseas buyers has made a legal claim against the company on 1st June 2022 for injury caused to a customer of one European buyer due to sub-standard dyes used in rugs of one lot of order shipped in August, 2021. The management of company has decided to agree to an out of court settlement of Rs.5 crore to protect its reputation. The financial statements of the company are silent on this issue.

Discuss, how, CA PK Jacob should proceed to deal with above issue.

### Test Your Understanding 2

CA Chandni Khanna is going to complete audit of a company within next few days. She has performed necessary audit procedures like inquiry of management personnel, reading minutes of meetings held after date of financial statements, going through books of accounts after date of financial statements to make sure that all subsequent events before signing audit report have been considered by her. Still, she wants to be certain that no such events have been left out. What she should do in such a situation? Also, discuss the rationale of doing so.

## 2. MEANING OF GOING CONCERN AND ITS SIGNIFICANCE

**Going concern** is one of the fundamental accounting assumptions. The enterprise is normally viewed as a going concern, that is, as continuing in operation for the foreseeable future. It is assumed that the enterprise has neither the intention nor the necessity of liquidation or of curtailing materially the scale of the operations.

Under the going concern basis of accounting, the financial statements are prepared on the assumption that the entity is a going concern and will continue its operations for the foreseeable future. General purpose financial statements are prepared using the going concern basis of accounting, unless management either intends to liquidate the entity or to cease operations, or has no realistic alternative but to do so.

The significance of ***Going Concern*** is due to its effect on preparation of financial statements. Ability or otherwise of an enterprise to be viewed as going concern affects its preparation of financial statements.

When the use of the going concern basis of accounting is appropriate, assets and liabilities are recorded on the basis that the entity will be able to realize its assets and discharge its liabilities in the normal course of business.

When an enterprise is not viewed as a going concern, the financial statements are prepared on liquidation basis. For example, inventories may need to be written down as these may be sold for a lower price. Assets may have to be recorded at the likely prices they will fetch.

## 2.1 SA 570 Going Concern

***SA 570 Going Concern*** deals with the auditor's responsibilities in the audit of financial statements relating to going concern and the implications for the auditor's report.

## 2.2 Responsibility for assessment of the entity's ability to continue as a going concern

The preparation of the financial statements requires management to assess the entity's ability to continue as a going concern even if the financial reporting framework does not include an explicit requirement to do so. Management's assessment of the entity's ability to continue as a going concern involves making a judgment, at a particular point in time, about inherently uncertain future outcomes of events or conditions. The following factors are relevant to that judgment: -

- The degree of uncertainty associated with the outcome of an event or condition increases significantly the further into the future an event or condition or the outcome occurs.
- The size and complexity of the entity, the nature and condition of its business and the degree to which it is affected by external factors affect the judgment regarding the outcome of events or conditions.
- Any judgment about the future is based on information available at the time at which the judgment is made. Subsequent events may result in outcomes

that are inconsistent with judgments that were reasonable at the time they were made.

## 2.3 Responsibilities of the auditor

The auditor's responsibilities are to obtain sufficient appropriate audit evidence regarding and conclude on the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements and to conclude, based on the audit evidence obtained, whether a material uncertainty exists about the entity's ability to continue as a going concern. These responsibilities exist even if the financial reporting framework used in the preparation of the financial statements does not include an explicit requirement for management to make a specific assessment of the entity's ability to continue as a going concern.

However, as described in SA 200, the potential effects of inherent limitations on the auditor's ability to detect material misstatements are greater for future events or conditions that may cause an entity to cease to continue as a going concern. The auditor cannot predict such future events or conditions. Accordingly, the absence of any reference to a material uncertainty about the entity's ability to continue as a going concern in an auditor's report cannot be viewed as a guarantee as to the entity's ability to continue as a going concern.

## 2.4 Objectives of auditor in accordance with SA 570

The objectives of the auditor are: -

(a) To obtain sufficient appropriate audit evidence regarding and conclude on the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements;

(b) To conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern; and

(c) To report in accordance with this SA.

## OBJECTIVES

- To obtain sufficient appropriate audit evidence regarding, and conclude on, the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements;
- To conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern; and
- To report in accordance with this SA.

## 2.5 Risk assessment procedures and related activities

When performing risk assessment procedures as required by SA 315, the auditor shall consider whether events or conditions exist that may cast significant doubt on the entity's ability to continue as a going concern. In so doing, the auditor shall determine whether management has already performed a preliminary assessment of the entity's ability to continue as a going concern and: -

(a) If such an assessment has been performed, the auditor shall discuss the assessment with management and determine whether management has identified events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern and, if so, management's plans to address them or

(b) If such an assessment has not yet been performed, the auditor shall discuss with management the basis for the intended use of the going concern basis of accounting, and inquire of management whether events or conditions exist that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern.

The auditor shall remain alert throughout the audit for audit evidence of events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.

***Examples of events or conditions that may cast significant doubt on the entity's ability to continue as a going concern***

The following are examples of events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern

***<u>Financial events or conditions</u>***

- Net liability or net current liability position
- Fixed-term borrowings approaching maturity without realistic prospects of renewal or repayment; or excessive reliance on short-term borrowings to finance long-term assets
- Indications of withdrawal of financial support by creditors
- Negative operating cash flows indicated by historical or prospective financial statements
- Adverse key financial ratios
- Substantial operating losses or significant deterioration in the value of assets used to generate cash flows
- Arrears or discontinuance of dividends
- Inability to pay creditors on due dates
- Inability to comply with the terms of loan agreements
- Change from credit to cash-on-delivery transactions with suppliers
- Inability to obtain financing for essential new product development or other essential investments

***<u>Operating events or conditions</u>***

- Management intentions to liquidate the entity or to cease operations
- Loss of key management without replacement
- Loss of a major market, key customer(s), franchise, license, or principal supplier(s)
- Labour difficulties
- Shortages of important supplies

- Emergence of a highly successful competitor

***Other events or conditions***

- Non-compliance with capital or other statutory or regulatory requirements, such as solvency or liquidity requirements for financial institutions
- Pending legal or regulatory proceedings against the entity that may, if successful, result in claims that the entity is unlikely to be able to satisfy
- Changes in law or regulation or government policy expected to adversely affect the entity
- Uninsured or underinsured catastrophes when they occur

## 2.6 Evaluating management's assessment

The auditor shall evaluate management's assessment of the entity's ability to continue as a going concern. Management's assessment of the entity's ability to continue as a going concern is a key part of the auditor's consideration of management's use of the going concern basis of accounting.

It is not the auditor's responsibility to rectify the lack of analysis by management. In some circumstances, however, the lack of detailed analysis by management to support its assessment may not prevent the auditor from concluding whether management's use of the going concern basis of accounting is appropriate in the circumstances.

For example, when there is a history of profitable operations and a ready access to financial resources, management may make its assessment without detailed analysis. In this case, the auditor's evaluation of the appropriateness of management's assessment may be made without performing detailed evaluation procedures if the auditor's other audit procedures are sufficient to enable the auditor to conclude whether management's use of the going concern basis of accounting in the preparation of the financial statements is appropriate in the circumstances.

In other circumstances, evaluating management's assessment of the entity's ability to continue as a going concern, may include an evaluation of the process management followed to make its assessment, the assumptions on which the assessment is based and management's plans for future action and whether management's plans are feasible in the circumstances.

In evaluating management's assessment of the entity's ability to continue as a going concern, the auditor shall cover the same period as that used by management to make its assessment as required by the applicable financial reporting framework, or by law or regulation if it specifies a longer period. If management's assessment of the entity's ability to continue as a going concern covers less than twelve months from the date of the financial statements, the auditor shall request management to extend its assessment period to at least twelve months from that date.

## 2.7 Additional audit procedures when events or conditions are identified

If events or conditions have been identified that may cast **significant** doubt on the entity's ability to continue as a going concern, the auditor shall obtain sufficient appropriate audit evidence to determine whether or not a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern through performing additional audit procedures, including consideration of mitigating factors. These procedures shall include: -

(a) Where management has not yet performed an assessment of the entity's ability to continue as a going concern, requesting management to make its assessment.

(b) Evaluating management's plans for future actions in relation to its going concern assessment, whether the outcome of these plans is likely to improve the situation and whether management's plans are feasible in the circumstances.

(c) Where the entity has prepared a cash flow forecast, and analysis of the forecast is a significant factor in considering the future outcome of events or conditions in the evaluation of management's plans for future actions:

   (i) Evaluating the reliability of the underlying data generated to prepare the forecast; and

   (ii) Determining whether there is adequate support for the assumptions underlying the forecast.

(d) Considering whether any additional facts or information have become available since the date on which management made its assessment.

(e) Requesting written representations from management and, where appropriate, those charged with governance, regarding their plans for future actions and the feasibility of these plans.

***Examples of audit procedures when events or conditions have been identified that may cast significant doubt on the entity's ability to continue as going concern***

- Analysing and discussing cash flow, profit and other relevant forecasts with management
- Analysing and discussing the entity's latest available interim financial statements
- Reading the terms of debentures and loan agreements and determining whether any have been breached
- Reading minutes of the meetings of shareholders, those charged with governance and relevant committees for reference to financing difficulties
- Inquiring of the entity's legal counsel regarding the existence of litigation and claims and the reasonableness of management's assessments of their outcome and the estimate of their financial implications
- Confirming the existence, legality and enforceability of arrangements to provide or maintain financial support with related and third parties and assessing the financial ability of such parties to provide additional funds
- Evaluating the entity's plans to deal with unfilled customer orders
- Performing audit procedures regarding subsequent events to identify those that either mitigate or otherwise affect the entity's ability to continue as a going concern
- Confirming the existence, terms and adequacy of borrowing facilities
- Obtaining and reviewing reports of regulatory actions
- Determining the adequacy of support for any planned disposals of assets

## 2.8 Auditor's conclusions

The auditor shall evaluate whether sufficient appropriate audit evidence has been obtained regarding, and shall conclude on, the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements. Based on the audit evidence obtained, the auditor shall conclude whether, in the auditor's judgment, a material uncertainty exists related to events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern. A material uncertainty exists when the magnitude of its potential impact and likelihood of occurrence is such that, in the auditor's judgment, appropriate disclosure of the nature and implications of the uncertainty is necessary.

## 2.9 Adequacy of disclosures when events or conditions have been identified and a material uncertainty exists

If the auditor concludes that management's use of the going concern basis of accounting is appropriate in the circumstances but a material uncertainty exists, the auditor shall determine whether the financial statements: -

(a) Adequately disclose the principal events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and management's plans to deal with these events or conditions and

(b) Disclose clearly that there is a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and, therefore, that it may be unable to realize its assets and discharge its liabilities in the normal course of business.

## 2.10 Adequacy of disclosures when events or conditions have been identified but no material uncertainty exists

If events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern but, based on the audit evidence obtained the auditor concludes that no material uncertainty exists, the auditor shall evaluate whether, in view of the requirements of the applicable financial reporting framework, the financial statements provide adequate disclosures about these events or conditions.

## 2.11 Implications for the auditor's report

**(I) If use of Going concern basis of accounting is inappropriate**

If the financial statements have been prepared using the going concern basis of accounting but, in the auditor's judgment, management's use of the going concern basis of accounting in the preparation of the financial statements is inappropriate, the ***auditor shall express an adverse opinion.***

**(II) If use of going concern basis of accounting is appropriate but a material uncertainty exists**

**(A) Adequate Disclosure of a Material Uncertainty is made in the Financial Statements**

If adequate disclosure about the material uncertainty is made in the financial statements, the auditor shall express ***an unmodified opinion*** and the auditor's report shall include a separate section under the heading *"Material Uncertainty Related to Going Concern"* to: -

(a) Draw attention to the note in the financial statements that discloses such matters.

(b) State that these events or conditions indicate that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the auditor's opinion is not modified in respect of the matter.

**(B) Adequate Disclosure of a Material Uncertainty is Not Made in the Financial Statements**

If adequate disclosure about the material uncertainty is not made in the financial statements, the auditor shall:

(a) Express a ***qualified opinion or adverse opinion***, as appropriate, in accordance with SA 705.

(b) In the Basis for Qualified (Adverse) Opinion section of the auditor's report, state that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the financial statements do not adequately disclose this matter.

**(III) Management unwilling to make or extend its assessment**

If management is unwilling to make or extend its assessment when requested to do so by the auditor, the auditor shall consider the implications for the auditor's report. In such a situation, ***a qualified opinion or a disclaimer of opinion*** in the auditor's report may be appropriate, because it may not be possible for the auditor to obtain sufficient appropriate audit evidence regarding management's use of the going concern basis of accounting in the preparation of the financial statements.

**Overview of auditor's responsibilities regarding Going Concern**

| Checkbox | Auditor's responsibilities regarding going concern |
|---|---|
| ✓ | Obtain sufficient appropriate audit evidence regarding the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements. |
| ✓ | Conclude, based on the audit evidence obtained, whether a material uncertainty exists about the entity's ability to continue as a going concern. |
| ✓ | Report in accordance with SA 570. |

## Test Your Understanding 3

During course of audit of a company, CA. Varun Aggarwal notices that company is facing significant skilled labour shortages resulting in hampering of operations of company. The company's manufacturing is dependent upon skilled labour coming from villages in certain districts of Eastern UP. However, due to job opportunities available near villages now, many are not interested in going out from their native villages.

Such a situation has led to company not being able to keep its commitments, losing out on orders and fall in its revenues. Fixed costs of the company remain at a high level. As a result, company is facing a liquidity crunch and is not able to pay its creditors on time. The bankers of company are also not willing to help the company to tide over liquidity crisis. The auditor is having doubts over going concern status of the company.

How should management of the company try to address auditor's concerns? What audit procedures may be performed by auditor in such a situation?

## 3. EVALUATION OF MISSTATEMENTS IDENTIFIED DURING THE AUDIT

Before forming an opinion on the financial statements, the auditor evaluates effects of identified misstatements on the audit and of uncorrected misstatements on financial statements after consideration of materiality. Uncorrected misstatements refer to those misstatements that the auditor has accumulated during the audit and that have not been corrected.

## 3.1 SA 450 Evaluation of Misstatements Identified during the Audit

SA 450 deals with the auditor's responsibility to evaluate the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial statements.

## 3.2 Objectives of auditor in accordance with SA 450

**The objective of the auditor is to evaluate: -**

(a) The effect of identified misstatements on the audit and

(b) The effect of uncorrected misstatements, if any, on the financial statements.

## 3.3 Accumulation of misstatements identified during the audit

The auditor shall accumulate misstatements identified during the audit, other than those that are clearly trivial. A misstatement may arise from a variety of factors**. For example,** an inaccuracy in gathering or processing data from which financial statements are prepared or an omission of an amount or disclosure can result into a misstatement.

An entity has wrongly capitalized machinery repair expenses amounting to Rs.5 lacs resulting in overstatement of profits. It is an example of misstatement.

## 3.4 Consideration of identified misstatements as the audit progresses

**The auditor shall determine whether the overall audit strategy and audit plan need to be revised if: -**

(a) The nature of identified misstatements and the circumstances of their occurrence indicate that other misstatements may exist that, when aggregated with misstatements accumulated during the audit, could be material or

(b) The aggregate of misstatements accumulated during the audit approaches materiality determined in accordance with SA 320.

The auditor may request management to examine a class of transactions, account balance or disclosure in order for management to understand the cause of a misstatement identified by the auditor, perform procedures to determine the amount of the actual misstatement in the class of transactions, account balance or disclosure, and to make appropriate adjustments to the financial statements. Such a request may be made, for example, based on the auditor's projection of misstatements.

If, at the auditor's request, management has examined a class of transactions, account balance or disclosure and corrected misstatements that were detected, the auditor shall perform additional audit procedures to determine whether misstatements remain.

## 3.5 Communication and correction of misstatements

The auditor shall communicate on a timely basis all misstatements accumulated during the audit with the appropriate level of management, unless prohibited by law or regulation. The auditor shall request management to correct those misstatements. Timely communication of misstatements to the appropriate level of management is important as it enables management to evaluate whether the items are misstatements, inform the auditor if it disagrees and take action as necessary.

The correction by management of all misstatements, including those communicated by the auditor, enables management to maintain accurate accounting books and records and reduces the risks of material misstatement of future financial statements because of the cumulative effect of immaterial uncorrected misstatements related to prior periods.

If management refuses to correct some or all of the misstatements communicated by the auditor, the auditor shall obtain an understanding of management's reasons for not making the corrections and shall take that understanding into account when evaluating whether the financial statements as a whole are free from material misstatement.

## 3.6 Evaluating the effect of uncorrected misstatements

Prior to evaluating the effect of uncorrected misstatements, the auditor shall reassess materiality determined in accordance with SA 320 to confirm whether it remains appropriate in the context of the entity's actual financial results.

**The auditor shall determine whether uncorrected misstatements are material, individually or in aggregate. In making this determination, the auditor shall consider: -**

(a) 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 and

(b) 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.

## 3.7 Communication with those charged with governance

The auditor shall communicate with those charged with governance regarding uncorrected misstatements and the effect that they, individually or in aggregate, may have on the opinion in the auditor's report, unless prohibited by law or regulation. The auditor's communication shall identify material uncorrected misstatements individually. The auditor shall request that uncorrected misstatements be corrected.

The auditor shall also communicate with those charged with governance 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.

## 3.8 Written Representation from management regarding effects of uncorrected statements

The auditor shall request a written representation from management and, where appropriate, those charged with governance whether they believe the effects of uncorrected misstatements are immaterial, individually and in aggregate, to the financial statements as a whole. A summary of such items shall be included in or attached to the written representation.

## 3.9 Documentation regarding misstatements identified during audit

**The audit documentation shall include: -**

(a) The amount below which misstatements would be regarded as clearly trivial;

(b) All misstatements accumulated during the audit and whether they have been corrected; and

(c) The auditor's conclusion as to whether uncorrected misstatements are material, individually or in aggregate, and the basis for that conclusion.

**Overview of auditor's responsibilities regarding evaluation of misstatements identified during the audit**

| Checkbox | Auditor's responsibilities regarding evaluation of misstatements identified during the audit |
|---|---|
| ✓ | Accumulate misstatements identified during the audit other than those that are clearly trivial. |
| ✓ | Consider if the above process indicates that other misstatements may exist that, when aggregated with misstatements accumulated during the audit, could be material or the aggregate of misstatements accumulated during the audit approaches materiality determined in accordance with SA 320. |
| ✓ | If so, consider if revision is necessary in audit strategy and plan. |
| ✓ | Communicate on a timely basis all misstatements accumulated during the audit with the appropriate level of management and request for correction of all misstatements. |
| ✓ | Upon management refusal to correct some or all of the misstatements communicated, obtain an understanding of management's reasons for not making the corrections and consider the same at time of evaluating whether the financial statements as a whole are free from material misstatement. |
| ✓ | In case of failure of management to correct all of the misstatements, reassess materiality 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. |
| ✓ | Communicate with those charged with governance regarding uncorrected misstatements and the effect that they, individually or in aggregate, may have on the opinion in the auditor's report. |
| ✓ | Request written representation from management that they believe that effects of uncorrected statements are immaterial. |
| ✓ | Maintain documentation. |

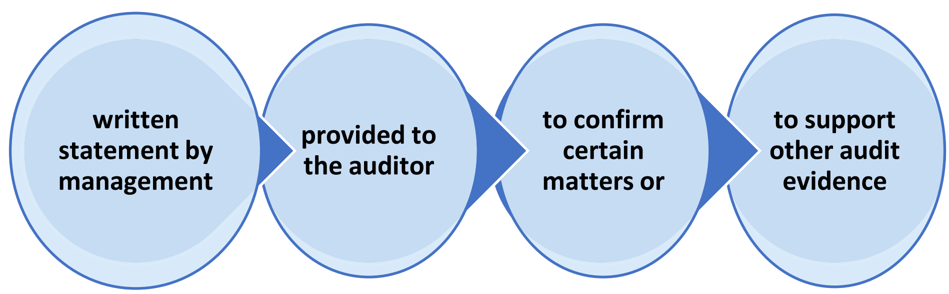
### Test Your Understanding 4

You are nearing completion of audit of a company. On going through your working papers, it is noticed that finished goods inventory was overvalued by Rs. 2 crore. It has also been noticed that freight of Rs.10 lacs paid on import of machinery was charged to statement of profit and loss.

Discuss, how you should, proceed and communicate in above situation before signing audit report.

## 4. WRITTEN REPRESENTATIONS

A written representation is a written statement by management provided to the auditor to confirm certain matters or to support other audit evidence. Written representations in this context do not include financial statements, the assertions therein, or supporting books and records.



## 4.1 Written representations as audit evidence

Audit evidence is all the information used by the auditor in arriving at the conclusions on which the audit opinion is based. Written representations are necessary information that the auditor requires in connection with the audit of the entity's financial statements. Accordingly, similar to responses to inquiries, written representations are audit evidence.

Written representations are an important source of audit evidence. If management modifies or does not provide the requested written representations, it may alert the auditor to the possibility that one or more significant issues may exist. Further, a request for written, rather than oral, representations in many cases may prompt management to consider such matters more rigorously, thereby enhancing the quality of the representations.

Although written representations provide ***necessary audit evidence***, they ***do not*** provide ***sufficient appropriate audit evidence*** on their own about any of the matters with which they deal**.** Furthermore, the fact that management has provided reliable written representations does not affect the nature or extent of other audit evidence that the auditor obtains about the fulfilment of management's responsibilities, or about specific assertions.

## 4.2 SA 580- Written Representations

SA 580- Written representations deals with the auditor's responsibility to obtain written representations from management and, where appropriate, those charged with governance.

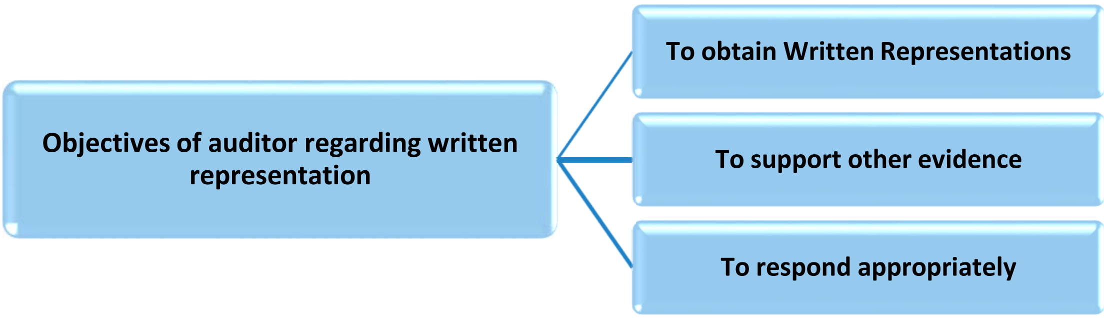
## 4.3 Objectives of auditor in accordance with SA 580

**The objectives of the auditor are: -**

(a) To obtain written representations from management and, where appropriate, those charged with governance that they believe that they have fulfilled their responsibility for the preparation of the financial statements and for the completeness of the information provided to the auditor;

(b) To support other audit evidence relevant to the financial statements or specific assertions in the financial statements by means of written representations, if determined necessary by the auditor or required by other SAs; and

(c) To respond appropriately to written representations provided by management and, where appropriate, those charged with governance, or if management or, where appropriate, those charged with governance do not provide the written representations requested by the auditor.




## 4.4 From whom Written representations are requested by auditor?

The auditor shall request written representations from management with appropriate responsibilities for the financial statements and knowledge of the matters concerned. Written representations relate to fulfilment of management's responsibilities or to support other audit evidence relevant to the financial statements or one or more specific assertions in the financial statements.

## 4.5 Written representations about management's responsibilities

Written representation about management's responsibilities involves confirmation of fulfilment of management's responsibilities in following areas: -

**(I) Preparation of the financial statements**

The auditor shall request management to provide a written representation that it has fulfilled its responsibility for the preparation of the financial statements in accordance with the applicable financial reporting framework, including, where relevant, their fair presentation, as set out in the terms of the audit engagement.

Due to its responsibility for the preparation and presentation of the financial statements and its responsibilities for the conduct of the entity's business, management would be expected to have sufficient knowledge of the process followed by the entity in preparing and presenting the financial statements and the assertions therein on which to base the written representations.

In some cases, however, management may decide to make inquiries of others who participate in preparing and presenting the financial statements and assertions therein, including individuals who have specialized knowledge relating to the matters about which written representations are requested. Such individuals may include:

- An actuary responsible for actuarially determined accounting measurements.
- Staff engineers who may have responsibility for and specialized knowledge about environmental liability measurements.
- Internal counsel who may provide information essential to provisions for legal claims.

In some cases, management may include in the written representations qualifying language to the effect that representations are made to the best of its knowledge and belief. It is reasonable for the auditor to accept such wording if the auditor is satisfied that the representations are being made by those with appropriate responsibilities and knowledge of the matters included in the representations. To reinforce the need for management to make informed representations, the auditor may request that management include in the written representations, confirmation that it has made such inquiries as it considered appropriate to place it in the position to be able to make the requested written representations.

**(II) Information provided and completeness of transactions**

**The auditor shall request management to provide a written representation that: -**

(a) It has provided the auditor with all relevant information and access as agreed in the terms of the audit engagement and

(b) All transactions have been recorded and are reflected in the financial statements.

## 4.6 Why Written representations about management responsibilities are necessary?

Audit evidence obtained during the audit that management has fulfilled its responsibilities regarding preparation of financial statements and about information provided and completeness of transactions is not sufficient without obtaining confirmation from management that it believes that it has fulfilled those responsibilities. This is because the auditor is not able to judge solely on other audit evidence whether management has prepared and presented the financial statements and provided information to the auditor on the basis of the agreed acknowledgement and understanding of its responsibilities.

For example, the auditor could not conclude that management has provided the auditor with all relevant information agreed in the terms of the audit engagement without asking it whether, and receiving confirmation that, such information has been provided.

The written representations requiring fulfilment of management responsibilities in relation to above draw on the agreed acknowledgement and understanding of management of its responsibilities in the terms of the audit engagement by requesting confirmation that it has fulfilled them. The auditor may also ask management to reconfirm its acknowledgement and understanding of those responsibilities in written representations.

**This is particularly appropriate when: -**

- Those who signed the terms of the audit engagement on behalf of the entity no longer have the relevant responsibilities;
- The terms of the audit engagement were prepared in a previous year;
- There is any indication that management misunderstands those responsibilities; or
- Changes in circumstances make it appropriate to do so.

## 4.7 Description of management's responsibilities in the Written representations

Management's responsibilities shall be described in the "Written representations required about management responsibilities" in the manner in which these responsibilities are described in the terms of the audit engagement.

## 4.8 Other Written representations

Other SAs require the auditor to request written representations. If, in addition to such required representations, the auditor determines that it is necessary to obtain one or more written representations to support other audit evidence relevant to the financial statements or one or more specific assertions in the financial statements, the auditor shall request such other written representations.

In addition to the written representation about management's responsibilities regarding preparation of financial statements, the auditor may consider it necessary to request other written representations about the financial statements. Such written representations may supplement, but do not form part of, the written representation relating to management's responsibilities regarding preparation of financial statements. They may include representations about the following: -

- Whether the selection and application of accounting policies are appropriate; and
- Whether matters such as the following, where relevant under the applicable financial reporting framework, have been recognized, measured, presented or disclosed in accordance with that framework: -
    - Plans or intentions that may affect the carrying value or classification of assets and liabilities;
    - Liabilities, both actual and contingent;
    - Title to, or control over, assets, the liens or encumbrances on assets, and assets pledged as collateral; and
    - Aspects of laws, regulations and contractual agreements that may affect the financial statements, including non-compliance.

## 4.9 Additional Written representations about information provided to the auditor

In addition to the written representation required by auditor regarding management responsibility about information provided to auditor, the auditor may consider it necessary to request management to provide a written representation that it has communicated to the auditor all deficiencies in internal control of which management is aware.

## 4.10 Written representations about specific assertions

**When obtaining evidence about, or evaluating, judgments and intentions, the auditor may consider one or more of the following:**

- The entity's past history in carrying out its stated intentions.
- The entity's reasons for choosing a particular course of action.
- The entity's ability to pursue a specific course of action.
- The existence or lack of any other information that might have been obtained during the course of the audit that may be inconsistent with management's judgment or intent.

In addition, the auditor may consider it necessary to request management to provide written representations about specific assertions in the financial statements, in particular, to support an understanding that the auditor has obtained from other audit evidence of management's judgment or intent in relation to, or the completeness of, a specific assertion.

For example, if the intent of management is important to the valuation basis for investments, it may not be possible to obtain sufficient appropriate audit evidence without a written representation from management about its intentions. Although such written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own for that assertion.

## 4.11 Date of and Period(s) covered by Written Representations

The date of the written representations shall be as near as practicable to, ***but not after,*** the date of the auditor's report on the financial statements. The written representations shall be for all financial statements and period(s) referred to in the auditor's report.

Because written representations are necessary audit evidence, the auditor's opinion cannot be expressed, and the auditor's report cannot be dated, before the date of the written representations. Furthermore, because the auditor is concerned with events occurring up to the date of the auditor's report that may require adjustment to or disclosure in the financial statements, the written representations are dated as near as practicable to, but not after, the date of the auditor's report on the financial statements.

The written representations are for all periods referred to in the auditor's report because management needs to reaffirm that the written representations it previously made with respect to the prior periods remain appropriate.

Situations may arise where current management were not present during all periods referred to in the auditor's report. Such persons may assert that they are not in a position to provide some or all of the written representations because they were not in place during the period. This fact, however, does not diminish such persons' responsibilities for the financial statements as a whole. Accordingly, the requirement for the auditor to request from them written representations that cover the whole of the relevant period(s) still applies.

## 4.12 Form of Written representations

The written representations shall be in the form of a representation letter addressed to the auditor. If law or regulation requires management to make written public statements about its responsibilities, and the auditor determines that such statements provide some or all of the representations required regarding management responsibilities, the relevant matters covered by such statements need not be included in the representation letter.

**Illustrative Written representation letter**

**On the letterhead of the entity**

To

PJ Shrimali & Co. 15th July, 2022

Chartered Accountants

Dear Sir,

This representation letter is provided in connection with your audit of the financial statements of XXXX Limited for the year ended March 31, 2022 for the purpose of expressing an opinion as to whether the financial statements give a true and fair view in accordance with the applicable accounting standards in India.

We confirm that (to the best of our knowledge and belief, having made such inquiries as we considered necessary for the purpose of appropriately informing ourselves):

***Financial Statements***

- We have fulfilled our responsibilities, as set out in the terms of the audit engagement dated 17th August 2021, for the preparation of the financial statements in accordance with financial reporting Standards, in particular, the financial statements give a true and fair view in accordance with the applicable accounting standards in India.
- Significant assumptions used by us in making accounting estimates, including those measured at fair value, are reasonable.
- Related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the requirements of applicable accounting standards in India. (SA 550)
- All events subsequent to the date of the financial statements and for which applicable accounting standards in India require adjustment or disclosure have been adjusted or disclosed. (SA 560)
- The effects of uncorrected misstatements are immaterial, both individually and in the aggregate, to the financial statements as a whole. A list of the uncorrected misstatements is attached to the representation letter. (SA 450)

***Information provided***

- We have provided you with: -

  Access to all information of which we are aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;

  Additional information that you have requested from us for the purpose of the audit; and

  Unrestricted access to persons within the entity from whom you determined it necessary to obtain audit evidence.
- All transactions have been recorded in the accounting records and are reflected in the financial statements.
- We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.

- We have disclosed to you all information in relation to fraud or suspected fraud that we are aware of and that affects the entity and involves: -

  - Management;

  - Employees who have significant roles in internal control; or

  - Others where the fraud could have a material effect on the financial statements.

- We have disclosed to you all information in relation to allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators or others.
- We have disclosed to you all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing financial statements.
- We have disclosed to you the identity of the entity's related parties and all the related party relationships and transactions of which we are aware. (SA 550)

Chief Financial Officer

## 4.13 Doubt as to the reliability of Written representations

If the auditor has concerns about the competence, integrity, ethical values or diligence of management, or about its commitment to or enforcement of these, the auditor shall determine the effect that such concerns may have on the reliability of representations and audit evidence in general.

In particular, if written representations are inconsistent with other audit evidence, the auditor shall perform audit procedures to attempt to resolve the matter. If the matter remains unresolved, the auditor shall reconsider the assessment of the competence, integrity, ethical values or diligence of management, or of its commitment to or enforcement of these, and shall determine the effect that this may have on the reliability of representations and audit evidence in general.

If the auditor concludes that the written representations are not reliable, the auditor shall take appropriate actions, including determining the possible effect on the opinion in the auditor's report in accordance with SA 705, having regard to the requirement of disclaimer of opinion.

## 4.14 Requested Written representations not provided

**If management does not provide one or more of the requested written representations, the auditor shall: -**

(a) Discuss the matter with management;

(b) Re-evaluate the integrity of management and evaluate the effect that this may have on the reliability of representations and audit evidence in general; and

(c) Take appropriate actions, including determining the possible effect on the opinion in the auditor's report in accordance with SA 705 having regard to the requirement of disclaimer of opinion.

## 4.15 Disclaimer of opinion in case of non-reliability of Written Representations about management's responsibilities or failure to provide such Written Representations

**The auditor shall disclaim an opinion on the financial statements in accordance with SA 705 if:**

(a) The auditor concludes that there is sufficient doubt about the integrity of management such that the written representations about management fulfilling its responsibilities regarding preparation of financial statements and about information provided and completeness of transactions are not reliable; or

(b) Management does not provide the written representations relating to fulfilling its responsibilities regarding preparation of financial statements and about information provided and completeness of transactions.

**Overview of auditor's responsibilities regarding Written representations**

| Checkbox | Auditor's responsibilities regarding Written representations |
|---|---|
| ✓ | Obtain Written representations from management and, where appropriate, those charged with governance that they believe that they have fulfilled their responsibility for the preparation of the |

| | |
|---|---|
| | financial statements and for the completeness of the information provided to the auditor. |
| ✓ | Obtain Written representations to support other audit evidence relevant to the financial statements or specific assertions in the financial statements, if determined necessary by the auditor or required by other SAs. |
| ✓ | Respond appropriately to written representations provided by management and, where appropriate, those charged with governance, or if the written representations requested by the auditor are not provided, then discuss the matter with management, re-evaluate the integrity of the management and evaluate effect on auditor's opinion. |
| ✓ | Disclaim opinion on financial statements in accordance with SA 705 in case of non-reliability of Written representations about management responsibilities or non-providing of Written representations about management responsibilities. |

## Test Your Understanding 5

CA R Gurumurthy is about to complete audit of a company. Before completion, he asks management to provide him a written representation confirming that management has fulfilled its responsibilities regarding preparation of financial statements. He also wants management to confirm in writing about providing of all the necessary information and completeness of transactions to him. The management feels that auditor is seeking irrelevant documents near the completion of audit. Why view of management is not proper? What possible implications it may lead to?

## 5. SIGNIFICANCE OF COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE

**Communication from auditor is important with those charged with governance. An effective two-way communication is important in assisting: -**

(a) The auditor and those charged with governance in understanding matters related to the audit in context, and in developing a constructive working relationship. This relationship is developed while maintaining the auditor's independence and objectivity.

(b) The auditor in obtaining from those charged with governance information relevant to the audit. For example, those charged with governance may assist the auditor in understanding the entity and its environment, in identifying appropriate sources of audit evidence, and in providing information about specific transactions or events; and

(c) Those charged with governance in fulfilling their responsibility to oversee the financial reporting process, thereby reducing the risks of material misstatement of the financial statements.

## 5.1 Who are "Those charged with governance"?

The person(s) or organization(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. This includes overseeing the financial reporting process. For some entities, those charged with governance may include management personnel, for example, executive members of a governance board of a private or public sector entity, or an owner-manager.

Governance structures vary by entities, reflecting influences such as different cultural and legal backgrounds, and size and ownership characteristics. For example, in some entities, a supervisory board exists that is separate from executive board. In other entities, both supervisory and executive functions are performed by a single board. In some entities, those charged with governance hold positions that are an integral part of the entity's legal structure. For example, company directors. In some cases, some or all of those charged with governance are involved in managing the entity. In others, those charged with governance and management comprise different persons.

In most entities, governance is the collective responsibility of a governing body, such as a board of directors, a supervisory board, partners, proprietors, a committee of management, trustees, or equivalent persons. In some smaller entities, however, one person may be charged with governance, for example, the owner-manager where there are no other owners, or a sole trustee.

Such diversity means that it is not possible to specify for all audits the persons with whom the auditor is to communicate particular matters. Also, in some cases, the appropriate persons with whom to communicate may not be clearly identifiable from the applicable legal framework or other engagement circumstances, for example, entities where the governance structure is not formally defined, such as some family-owned entities and some not-for-profit organizations.

In such cases, the auditor may need to discuss and agree with the engaging party the relevant persons with whom to communicate. In deciding with whom to communicate, the auditor's understanding of an entity's governance structure and processes obtained in accordance with SA 315 is relevant. The appropriate persons with whom to communicate may vary depending on the matter to be communicated.

## 5.2 Scope of SA 260- Communication with Those Charged with Governance

SA 260 deals with the auditor's responsibility to communicate with those charged with governance in an audit of financial statements.

## 5.3 Objectives of auditor in accordance with SA 260

**The objectives of the auditor are: -**

(a) To communicate clearly with those charged with governance the responsibilities of the auditor in relation to the financial statement audit, and an overview of the planned scope and timing of the audit;

(b) To obtain from those charged with governance information relevant to the audit;

(c) To provide those charged with governance with timely observations arising from the audit that are significant and relevant to their responsibility to oversee the financial reporting process and

(d) To promote effective two-way communication between the auditor and those charged with governance.

Objectives of auditor as per SA 260

- To communicate clearly with those charged with governance the responsibilities of the auditor in relation to the financial statement audit, and an overview of the planned scope and timing of the audit;
- To obtain from those charged with governance information relevant to the audit;
- To provide those charged with governance with timely observations arising from the audit that are significant and relevant to their responsibility to oversee the financial reporting process and
- To promote effective two-way communication between the auditor and those charged with governance.

## 5.4 Determining appropriate persons with whom to communicate

The auditor shall determine the appropriate person(s) within the entity's governance structure with whom to communicate.

## 5.5 Matters to be communicated by auditor

**Following matters are required to be communicated by auditor with those charged with governance: -**

**(a) The auditor's responsibilities in relation to the financial statement audit**

The auditor shall communicate with those charged with governance the responsibilities of the auditor in relation to the financial statement audit, including that:

(a) 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 and

(b) The audit of the financial statements does not relieve management or those charged with governance of their responsibilities.

**(b) Planned scope and timing of the audit**

The auditor shall communicate with those charged with governance an overview of the planned scope and timing of the audit, which includes communicating about the significant risks identified by the auditor.

**(c) Significant findings from the audit**

The auditor shall communicate with those charged with governance: -

(a) The auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures. When applicable, the auditor shall explain to those charged with governance why the auditor considers a significant accounting practice, that is acceptable under the applicable financial reporting framework, not to be most appropriate to the particular circumstances of the entity

(b) Significant difficulties, if any, encountered during the audit;

(c) Unless all of those charged with governance are involved in managing the entity: -

   (i) Significant matters arising during the audit that were discussed, or subject to correspondence, with management;

   (ii) Written representations the auditor is requesting

(d) Circumstances that affect the form and content of the auditor's report, if any and

(e) Any other significant matters arising during the audit that, in the auditor's professional judgment, are relevant to the oversight of the financial reporting process.

## 5.6 Communication of auditor's independence in case of listed entities

**In the case of listed entities, the auditor shall communicate with those charged with governance: -**

(a) A statement that the engagement team and others in the firm as appropriate, the firm and, when applicable, network firms have complied with relevant ethical requirements regarding independence and

(b) (i) All relationships and other matters between the firm, network firms, and the entity that, in the auditor's professional judgment, may reasonably be thought to bear on independence. This shall include total fees charged during the period covered by the financial statements for audit and non-audit services provided by the firm and network firms to the entity and components controlled by the entity. These fees shall be allocated to categories that are appropriate to assist those charged with governance in assessing the effect of services on the independence of the auditor and

(ii) The related safeguards that have been applied to eliminate identified threats to independence or reduce them to an acceptable level.

## 5.7 The Communication process

The auditor shall communicate with those charged with governance the form, timing and expected general content of communications.

The auditor shall communicate in writing with those charged with governance regarding significant findings from the audit if, in the auditor's professional judgment, oral communication would not be adequate. Written communications need not include all matters that arose during the course of the audit. The auditor shall communicate in writing with those charged with governance regarding auditor independence when required in case of listed entities.

The auditor shall communicate with those charged with governance on a timely basis.

## 5.8 Adequacy of the communication process

The auditor shall evaluate whether the two-way communication between the auditor and those charged with governance has been adequate for the purpose of the audit. If it has not, the auditor shall evaluate the effect, if any, on the auditor's assessment of the risks of material misstatement and ability to obtain sufficient appropriate audit evidence, and shall take appropriate action.

## 5.9 Documentation

Where matters required by SA 260 to be communicated are communicated orally, the auditor shall include them in the audit documentation, and when and to whom they were communicated. Where matters have been communicated in writing, the auditor shall retain a copy of the communication as part of the audit documentation.

**Overview of auditor's responsibilities regarding communicating with those charged with governance**

| Checkbox | Auditor's responsibilities regarding communicating with those charged with governance |
|---|---|
| ✓ | Determine the appropriate person(s) within the entity's governance structure with whom to communicate. |
| ✓ | Communicate matters relating to auditor's responsibilities in relation to the financial statement audit, planned scope and timing of audit and significant findings from the audit. |
| ✓ | In case of listed entities, communicate about auditor's independence. |
| ✓ | Retain copy of communication of matters communicated in writing as part of audit documentation. In case of matters communicated orally, include them in the audit documentation stating when and to whom they were communicated. |

# 6. WHY COMMUNICATION OF SIGNIFICANT DEFICIENCIES IN INTERNAL CONTROL IS NECESSARY?

Communicating significant deficiencies in internal control in writing to those charged with governance reflects the importance of these matters and assists those charged with governance in fulfilling their oversight responsibilities.

## 6.1 Scope of SA 265- Communicating Deficiencies in Internal Control to Those Charged with Governance and Management

SA 265 deals with the auditor's responsibility to communicate appropriately to those charged with governance and management deficiencies in internal control that the auditor has identified in an audit of financial statements.

The auditor is required to obtain an understanding of internal control relevant to the audit when identifying and assessing the risks of material misstatement. In making those risk assessments, the auditor considers internal control in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control. The auditor may identify deficiencies in internal control not only during this risk assessment process but also at any other stage of the audit. SA 265 specifies which identified deficiencies the auditor is required to communicate to those charged with governance and management.

## 6.2 Objective of auditor in accordance with SA 265

The objective of the auditor is to communicate appropriately to those charged with governance and management deficiencies in internal control that the auditor has identified during the audit and that, in the auditor's professional judgment, are of sufficient importance to merit their respective attentions.

## 6.3 Meaning of "Deficiency in internal control" and "significant deficiency in internal control"

**(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.

The significance of a deficiency or a combination of deficiencies in internal control depends not only on whether a misstatement has actually occurred, but also on the likelihood that a misstatement could occur and the potential magnitude of the misstatement. Significant deficiencies may, therefore, exist even though the auditor has not identified misstatements during the audit.

**Examples of matters that the auditor may consider in determining whether a deficiency or combination of deficiencies in internal control constitutes a significant deficiency**

- The likelihood of the deficiencies leading to material misstatements in the financial statements in the future.
- The susceptibility to loss or fraud of the related asset or liability.
- The subjectivity and complexity of determining estimated amounts, such as fair value accounting estimates.
- The financial statement amounts exposed to the deficiencies.
- The volume of activity that has occurred or could occur in the account balance or class of transactions exposed to the deficiency or deficiencies.
- The importance of the controls to the financial reporting process, for example:
  - General monitoring controls (such as oversight of management).
  - Controls over the prevention and detection of fraud.
  - Controls over the selection and application of significant accounting policies.
  - Controls over significant transactions with related parties.
  - Controls over significant transactions outside the entity's normal course of business.
  - Controls over the period-end financial reporting process (such as controls over non-recurring journal entries).
- The cause and frequency of the exceptions detected as a result of the deficiencies in the controls.

- The interaction of the deficiency with other deficiencies in internal control.

**Examples of indicators of significant deficiencies in internal control**

- Evidence of ineffective aspects of the control environment, such as: -
    - Indications that significant transactions in which management is financially interested are not being appropriately scrutinised by those charged with governance.
    - Identification of management fraud, whether or not material, that was not prevented by the entity's internal control.
    - Management's failure to implement appropriate remedial action on significant deficiencies previously communicated.
- Absence of a risk assessment process within the entity where such a process would ordinarily be expected to have been established.
- Evidence of an ineffective entity risk assessment process, such as management's failure to identify a risk of material misstatement that the auditor would expect the entity's risk assessment process to have identified.
- Evidence of an ineffective response to identified significant risks (e.g., absence of controls over such a risk).
- Misstatements detected by the auditor's procedures that were not prevented, or detected and corrected, by the entity's internal control.
- Disclosure of a material misstatement due to error or fraud as prior period items in the current year's Statement of Profit and Loss.
- Evidence of management's inability to oversee the preparation of the financial statements.

## 6.4 Determination of significant deficiencies in internal control

The auditor shall determine whether, on the basis of the audit work performed, the auditor has identified one or more deficiencies in internal control.

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.

## 6.5 Communication of significant deficiencies in internal control to those charged with governance

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: -

(a) 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

(b) 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.

**In particular, the auditor shall explain that: -**

(i) The purpose of the audit was for the auditor to express an opinion on the financial statements;

(ii) The audit included consideration of internal control relevant to the preparation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control; and

(iii) The matters being reported are limited to those deficiencies that the auditor has identified during the audit and that the auditor has concluded are of sufficient importance to merit being reported to those charged with governance.

**Overview of auditor's responsibilities regarding communicating deficiencies in internal control to those charged with governance and management**

| Checkbox | Auditor's responsibilities regarding communicating deficiencies in internal control to those charged with governance and management |
|---|---|
| ✓ | Determine whether, on the basis of the audit work performed, one or more deficiencies in internal control have been identified. |
| ✓ | If one or more deficiencies in internal control have been identified, determine, on the basis of the audit work performed, whether, individually or in combination, they constitute significant deficiencies. |
| ✓ | Communication in writing significant deficiencies in internal control identified during the audit to those charged with governance on a timely basis giving their description, explanation of potential effects and sufficient information to those charged with governance and management to understand context of communication. |

## Test Your Understanding 6

On reviewing internal control over inventories as part of statutory audit of a company, auditor finds that physical verification is not being conducted at regular intervals as stipulated by the management. The auditor finds it to be significant deficiency in internal control over inventories.

He points it out to the management in a one-liner as under: -

"Physical verification of inventories is not being conducted at regular intervals as stipulated by management."

Is above communication by auditor proper? Ignore statutory reporting requirements, if any in this regard.

# CASE STUDY

CA. Gaurav Gogoi is about to conclude audit of a company. It has been noticed during the course of audit that there is shortage of important raw material supplies being imported from China due to prevailing geo-political situation. The company has shared with him its plan to deal with the situation. He is satisfied with assessment of the company for dealing with the matter. The issue is disclosed in financial statements and considering management's assessment, it is felt that use of going concern assumption by company in preparation of financial statements is appropriate.

Besides, he also wants to be sure that all subsequent events till now have been considered and accounted for, where ever necessary, in financial statements.

Before concluding audit, he requests written representations from management regarding its responsibilities. However, it is noticed that such written representations provided by management use qualifying language.

He has also communicated significant findings from audit in writing with those charged with governance in the company and has retained copy of relevant mails. Besides, there are certain matters which were communicated by him orally from time to time during the course of audit to those charged with governance.

## Based on above, answer the following questions: -

*(1) As regards description of matter above concerning issue of going concern, which of the following statements is most appropriate for auditor's report?*

*(a) The auditor should express an unmodified opinion.*

*(b) The auditor should express a qualified opinion as material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.*

*(c) Besides expressing an unmodified opinion, the auditor's report shall include a separate section under the heading "Material Uncertainty Related to Going Concern" drawing attention to the note in which such disclosure is made in financial statements along with related matters.*

*(d) Such an issue does not affect auditor's opinion.*

*(2) As regards going concern basis of accounting is concerned, which of the following statements is true?*

*(a) A company showing net loss in its financial statements is essentially not a going concern.*

*(b) Following going concern assumption of accounting is primary duty of auditor.*

(c) *In case, a company is not a going concern, its financial statements must be prepared on liquidation basis.*

(d) *Audit procedure seeking confirmation from banker regarding outstanding balance relates to verification of going concern assumption.*

(3) *Which of the following statements is true in respect of auditor's responsibilities in respect of subsequent events?*

(a) *There is no obligation for an auditor to perform audit procedures for events occurring between date of financial statements and date of auditor's report.*

(b) *There is no obligation for an auditor to perform audit procedures after signing of auditor's report, even if he comes to know of an event, which if known to him earlier would have caused him to amend the audit report.*

(c) *The auditor has only to rely upon written representation of management regarding subsequent events. He has no other means to know about such events.*

(d) *The auditor should perform necessary audit procedures to know about events occurring between the date of financial statements and date of auditor's report.*

(4) *As regards use of qualifying language in written representations, which of the following statement is most appropriate?*

(a) *It is reasonable for the auditor to accept such wording if the auditor is satisfied that the representations are being made by those with appropriate responsibilities and knowledge of the matters included in the representations.*

(b) *Written representations should be unconditional. Such a wording is not acceptable.*

(c) *Such a wording dilutes intent of written representations. However, it can be accepted by auditor only in exceptional circumstances.*

(d) *Qualifying language in written representations is compulsory.*

(5) *As regards auditor's responsibility regarding matters communicated orally with those charged with governance, which of following is most appropriate?*

(a) *Matters communicated orally have to be documented by the auditor stating when and to whom these were communicated.*

(b) *Matters communicated orally need not be put into writing. It is sufficient for auditor to have communicated orally.*

(c) *Matters communicated orally need not be put into writing. It is not practically feasible.*

(d) *Matters communicated orally have to be documented by the auditor stating to whom these were communicated.*

## Answers to MCQs involving case study

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| **1.** | **c** | **2.** | **c** | **3.** | **d** | **4.** | **a** | **5.** | **a** |

# SUMMARY

- Events occurring between the date of the financial statements and the date of the auditor's report and facts that become known to the auditor after the date of the auditor's report are known as subsequent events.
- Such events may be those that provide evidence of conditions that existed at the date of the financial statements and those that provide evidence of conditions that arose after the date of the financial statements.
- SA 560 deals with the auditor's responsibilities relating to subsequent events in an audit of financial statements.
- Going concern is one of the fundamental accounting assumptions. The enterprise is normally viewed as a going concern, that is, as continuing in operation for the foreseeable future. It is assumed that the enterprise has neither the intention nor the necessity of liquidation or of curtailing materially the scale of the operations.
- SA 570 Going Concern deals with the auditor's responsibilities in the audit of financial statements relating to going concern and the implications for the auditor's report.

- Before forming an opinion on the financial statements, the auditor evaluates effects of identified misstatements on the audit and of uncorrected misstatements on financial statements after consideration of materiality.
- Uncorrected misstatements refer to those misstatements that the auditor has accumulated during the audit and that have not been corrected.
- SA 450- Evaluation of misstatements identified during the audit deals with the auditor's responsibility to evaluate the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial statements.
- A written representation is a written statement by management provided to the auditor to confirm certain matters or to support other audit evidence. Written representations in this context do not include financial statements, the assertions therein, or supporting books and records.
- Although written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal.
- SA 580 Written representations deals with the auditor's responsibility to obtain written representations from management and, where appropriate, those charged with governance.
- Communication from auditor is important with those charged with governance.
- "Those Charged with Governance" refer to the person(s) or organization(s) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process.
- SA 260- Communication with Those Charged with Governance deals with the auditor's responsibility to communicate with those charged with governance in an audit of financial statements.
- Communicating significant deficiencies in internal control in writing to those charged with governance reflects the importance of these matters and assists those charged with governance in fulfilling their oversight responsibilities.

- SA 265 Communicating Deficiencies in Internal Control to Those Charged with Governance and Management deals with the auditor's responsibility to communicate appropriately to those charged with governance and management, deficiencies in internal control that the auditor has identified in an audit of financial statements.

# TEST YOUR KNOWLEDGE

## MCQs based Questions

(1) *An auditor of a company communicates significant findings from audit with those charged with governance in the company. Which of the statements is false in regard to communication made?*

(a) *Evaluation of adequacy of communication process is required on part of the auditor.*

(b) *Planned scope and timing of audit has also to be communicated.*

(c) *Communication of rationale behind audit procedures is necessary.*

(d) *Significant difficulties encountered during audit, if any, have to be communicated.*

(2) *Written representations are: -*

(a) *Necessary audit evidence*

(b) *Sufficient appropriate audit evidence*

(c) *Not audit evidence*

(d) *Audit evidence depending upon auditor's professional judgment*

(3) *Which of the following is false regarding communication of misstatements identified during course of an audit?*

(a) *The auditor should request those charged with governance for correction of identified misstatements.*

(b) *The auditor should obtain written representation acknowledging management belief that effect of uncorrected misstatements is material.*

*(c) The auditor should obtain written representation acknowledging management belief that effect of uncorrected misstatements is immaterial.*

*(d) The auditor should communicate 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.*

*(4) Which of the following is not an example of subsequent event?*

*(a) Event occurring between date of financial statements and date of auditor's report.*

*(b) Event occurring on date of financial statements.*

*(c) Event occurring after filing audit report with tax authorities. Had such an event been known earlier, auditor would have amended report.*

*(d) Event occurring during course of performing audit procedures after date of financial statements.*

*(5) Which of the following is not an example of events or conditions that may cast significant doubt on the entity's ability to continue as a going concern?*

*(a) Adverse key financial ratios*

*(b) Inability to invest in modernisation of plant*

*(c) Inability to pay creditors on time*

*(d) Inability to pay salary of staff*

## Descriptive Questions

1. *List out some matters that the auditor may consider in determining whether a deficiency or combination of deficiencies in internal control constitutes a "significant deficiency".*

2. *In what ways an effective two-way communication between auditor and those charged with governance is important?*

3. *The auditor of a company is having concerns about following of going concern basis of accounting followed by management for preparation of financial statements. It asks the management to justify preparation of financial statements. However, management is not willing to make its assessment and*

*share with auditor. What are implications for auditor's report in such a scenario?*

4. *Discuss documentation requirements for an auditor regarding misstatements identified during audit under SA 450.*

5. *Discuss meaning of "Date the financial statements are issued" under SA 560.*

# ANSWERS/SOLUTIONS

## Answers to the MCQs based Questions

1. **(c)** 2. **(a)** 3. **(b)** 4. **(b)** 5. **(b)**

## Answers to Questions involving Descriptive Questions

1. Refer to topic on "Examples of some matters that the auditor may consider in determining whether a deficiency or combination of deficiencies in internal control constitutes a significant deficiency".

2. Refer to topic on "Significance of Communication with Those charged with governance."

3. Refer to topic on "Implication for auditor's report" under heading SA 570 Going Concern

4. Refer to topic on "Documentation regarding misstatements identified during audit"

5. Refer to topic on "Meaning of "Date the financial statements are issued" under SA 560.

## Answers to Questions involving Test Your Understanding

1. In the given case, the auditor has come to know of legal claim against the company before issue of audit report. It has also come to his knowledge that management of company has agreed to an out of court settlement of Rs.5 crore. It is an example of subsequent event between the date of the financial statements and the date of the auditor's report. It provides evidence of conditions that existed at the date of the financial statements and requires adjustment in financial statements.

He should ask company management to make necessary adjustment to the financial statements. If adjustment is not made by management, he should consider impact on auditor’s report.

2. She has already performed necessary audit procedures like inquiry of management personnel, reading minutes of meetings after date of financial statements and going through books after date of financial statements.

   Now, she should request management and, where appropriate, those charged with governance, to provide a written representation in accordance with SA 580, “Written Representations” that all events occurring subsequent to the date of the financial statements and for which the applicable financial reporting framework requires adjustment or disclosure have been adjusted or disclosed.

   The rationale of obtaining written representations is that even after performing abovesaid procedures, she may not come to know all subsequent events. Therefore, it is necessary from an auditor’s point of view to obtain acknowledgment from management in the form of Written representations that all such events for which the applicable financial reporting framework requires adjustment or disclosure have been adjusted or disclosed.

3 Significant shortage of skilled labour, inability to pay creditors on time and overall liquidity crisis faced by the company are examples of events or conditions that, individually or collectively, may cast significant doubt on the entity’s ability to continue as a going concern.

   In such a situation, management should try to address auditor’s concerns by preparing its future plan of action including preparation of cash flow forecast showing inflow and outflow of cash. Such a cash flow forecast should address auditor’s concerns regarding liquidity crisis being faced by the company.

   The auditor should perform audit procedures to evaluate the reliability of the underlying data to prepare the forecast and determining whether there is adequate support for the assumptions underlying the forecast. The auditor should also consider whether any additional facts or information have become available since the date on which management made its assessment.

4. The instances highlighted in above situation are examples of misstatements identified during the audit. Over valuation of inventory of finished goods by

Rs. 2 crore and wrongly charging freight of Rs. 10 lacs paid on machinery to statement of profit and loss instead of capitalizing are examples of misstatements.

The auditor should communicate above identified misstatements to those charged with governance and request for correction of these misstatements. In case, these are not corrected, understand the reasons for not making the corrections and reassess materiality. It should also be considered whether uncorrected statements are material individually or in aggregate. Effect of uncorrected misstatements on the opinion in auditor's report should be communicated to those charged with governance.

5. The view of management is not proper. Audit evidence obtained during the audit that management has fulfilled its responsibilities regarding preparation of financial statements and about information provided and completeness of transactions is not sufficient without obtaining confirmation from management that it believes that it has fulfilled those responsibilities. This is because the auditor is not able to judge solely on other audit evidence whether management has prepared and presented the financial statements and provided information to the auditor on the basis of the agreed acknowledgement and understanding of its responsibilities.

   In case of refusal of management to provide such a confirmation, it may lead to disclaimer of opinion by the auditor.

6. While pointing out significant deficiencies in internal control, auditor has not only to communicate significant deficiencies giving their description but also explain the potential effects and sufficient information to those charged with governance and management to understand context of communication.

   Therefore, the above communication is not proper. Not only significant deficiency has to be communicated, it should also be explained to management the potential effects of not carrying out physical verification of inventories at regular intervals as stipulated by management. It should explain that such a significant deficiency can lead to misstatement of inventories impacting profits of the company. Highlighting importance of such a control, it should be stated that responsibility be fixed for concerned persons for adhering to such an important control.

# NOTES