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A Conceptual Review on Select Standards on Auditing (SAs) in the Backdrop of Audit Activities in India

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Abstract
The study identifies a few audit activities which may have significant influence on overall audit quality. They are, 'accepting the terms of engagement', 'formulating an audit plan', 'collecting audit evidences', 'adopting audit samples', 'documenting audit working papers' and 'preparing auditors' report'. Statutory auditors' responsibilities with regard to each of these issues are prescribed in separate Standards on Auditing (SAs) issued by the Institute of Chartered Accountants of India (ICAI). They are SA-210, SA-300, SA-500, SA-530, SA-230, and SA-700 respectively. Important requirements of these SAs keeping in view overall audit quality are discussed in this paper.
Keywords: Audit Engagement, Audit Planning, Audit Evidences, Audit Sampling, Audit Documentation, Auditors' Report, ICAI, SAs**.**

1. Introduction

Quality audit is an integral component of well-functioning capital market and overall corporate performance. Literature shows that statutory auditors have to deliver quality audit to avoid cost of litigation as they are legally liable for audit failures. Moreover, statutory auditors also have a reputation to uphold which received huge blow at the advent of recent corporate demises. In this circumstance, most of the clients prefer big accounting firms making the market for accounting profession a less competitive one. However, due to internal deficiencies in audit procedures, even big accounting firms sometimes face severe failure (Skinner & Srinivasan, 2012). Back in 2009, financial reporting of Satyam Computer Services Ltd, and their unholy nexus with statutory auditor, PricewaterhouseCoopers (PwC) ultimately brought into formal investigation in order to detect financial fraud. Truly speaking, quality of audit also depends upon quality of financial reporting of the client organisation (Hennes, et. al., 2011). Hence, while accepting an audit engagement, statutory auditors should look into the fulfilment of precondition of audit (Kanodia & Mukherji, 1994). Firms often fail to deliver quality audit on a persistent basis due to absence of a pervasive plan. Soon after the audit plan, the auditor starts collecting sufficient and appropriate audit evidences in order to explore as to whether there are possibilities of material misstatements in financial books. These evidences are the foundation of quality of audit. Consistent with the findings of prior research, it can be said that adequacy and reliability of audit evidences form the basis of auditors' report. Most of the case of client defections happens in case of statutory auditors' failure in collecting necessary evidences (Lennox, 1999). While collecting audit evidences, it is also imperative to describe the audit sample, as it becomes difficult for the engagement team to audit each unit of financial statements. The last part of audit process is auditors' report, which is the reflection of their professional skepticism and professional judgement throughout an engagement. In several corporate failures, involvement of statutory auditors was diagnosed from the discrepancy in auditors' report. The entire process of audit needs to be documented for further review.

In India, the Institute of Chartered Accountants of India (ICAI) monitors statutory audit of financial statements which is performed by Chartered Accountants (CAs) with the help of 37 Standards on Auditing (SAs) issued so far. Diverse areas of statutory financial audit are covered under these SAs. However, there are a few audit activities, such as ~~involve~~ 'accepting the terms of engagement', 'formulating audit plan', 'collecting audit evidences', 'adopting audit samples', 'documenting audit working papers' and 'preparing auditors' report' which are instrumental in maintaining quality of audit (Gupta, 2005). Hence, with the passage of time compliance with the provisions of the SAs governing these issues have become all ~~the~~ more imperative. The study here makes a conceptual review of select SAs governing mentioned issues and justifies their effectiveness in Indian scenario.

2. Key Audit Activities of a Statutory Financial Auditor

Statutory audit process starts with accepting the terms of audit engagement. After accepting the engagement, the statutory auditor formulates overall audit strategy and specific audit plans to conduct different audit procedures. Audit procedures are conducted to collect sufficient and appropriate evidences to assist an auditor to form their conclusions on financial statements on which their reports are made. While deciding the nature, timing and scope of audit procedures based on evaluation of the client organisation's internal control system, and other matters, the auditor takes decision about audit sampling that is the portion of auditable units to be sampled for detailed verification.

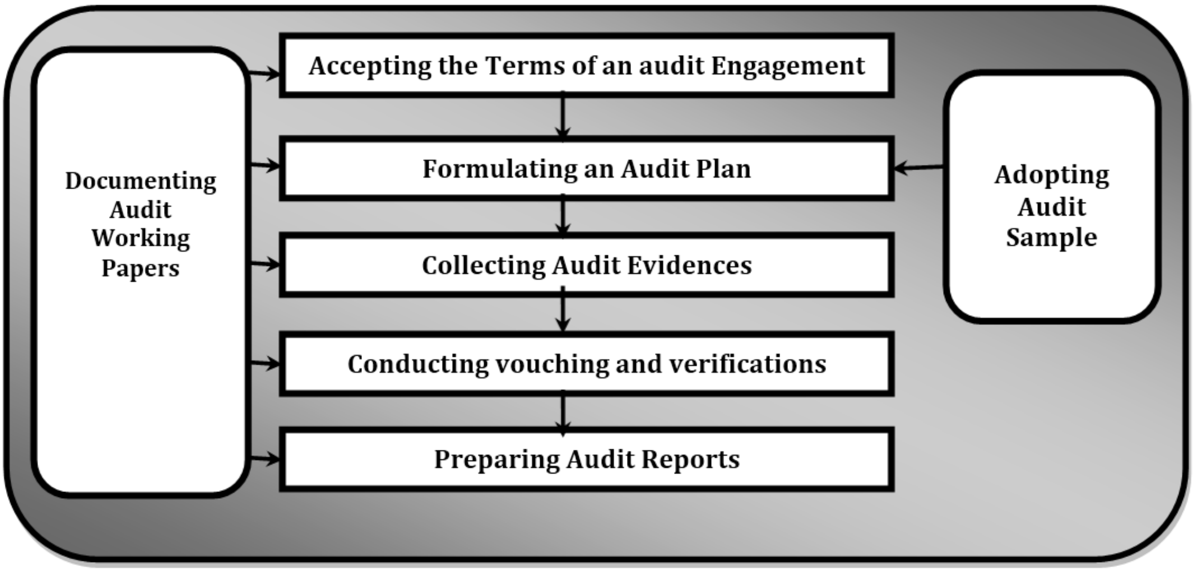

Exhibit-1: Structure of a General Statutory Audit Process

Sufficient and appropriate audit evidences are collected mainly for the sampled out units. The entire process of auditing as described above is documented from time to time. These documents are known as 'audit working papers'. They make a link between client's financial statements and the auditors' report and They are used for further review of audit procedures. In the following segments, a few significant audit activities, such as 'accepting the terms of an engagement', 'formulating audit plan', 'collecting audit evidences', 'adopting audit samples', 'documenting audit working papers' and 'preparing audit report' are identified. Responsibilities of statutory auditors with respect to these issues based on their governing standards are enumerated as well.

3. Accepting the Terms of an Engagement [Based on SA-210]

Responsibilities of the auditor with respect to agreeing the terms of audit engagement are guided by SA–210 (Revised) titled *'Agreeing the Terms of Audit Engagement'*. In the light of the standard, prerequisite of an audit should be fulfilled. If auditor has partial access to information, they should not accept the engagement. If preconditions are not there, the auditor should discuss the matter with management. The auditor should accept the engagement on the basis of their agreement on (a) objective and scope of auditor; (b) responsibilities of the auditor; (c) responsibilities of the management; (d) applicable financial reporting framework; (e) form and content of audit report. In case of recurring audits, the auditor should make a decision whether the audit agreement needs to be revised.

Once an agreement is accepted, the auditor should not recognise any change in such agreement at the management discretion. If any change is necessary, both auditor and management should have the same opinion to the revised agreement. If management changes the agreement without auditors' consent, the auditor should pull out from engagement or inform the matter to those charged with governance. If apart from financial reporting standards, financial statements have to comply with some additional obligation, the auditor should determine whether any conflicts arise between these two sets of standards before accepting an engagement. If auditor determines that the appropriate financial reporting framework would make the financial statements misleading, they should accept the engagement, only when the management agrees to make additional disclosure about the financial statements. If the form and content of audit report as per applicable regulation is diverse from that of SAs, the auditor should not accept the engagement.

Accepting an audit engagement is the first step of an audit engagement. It involves continuous interaction between management, auditors and those charged with governance. Integrity of information communicated during these interactions determines future quality of audit. If auditors accepts an engagement without giving due consideration to the stated requirements, he would not be able to formulate a good audit procedures and the whole purpose of auditing will go into fuss.

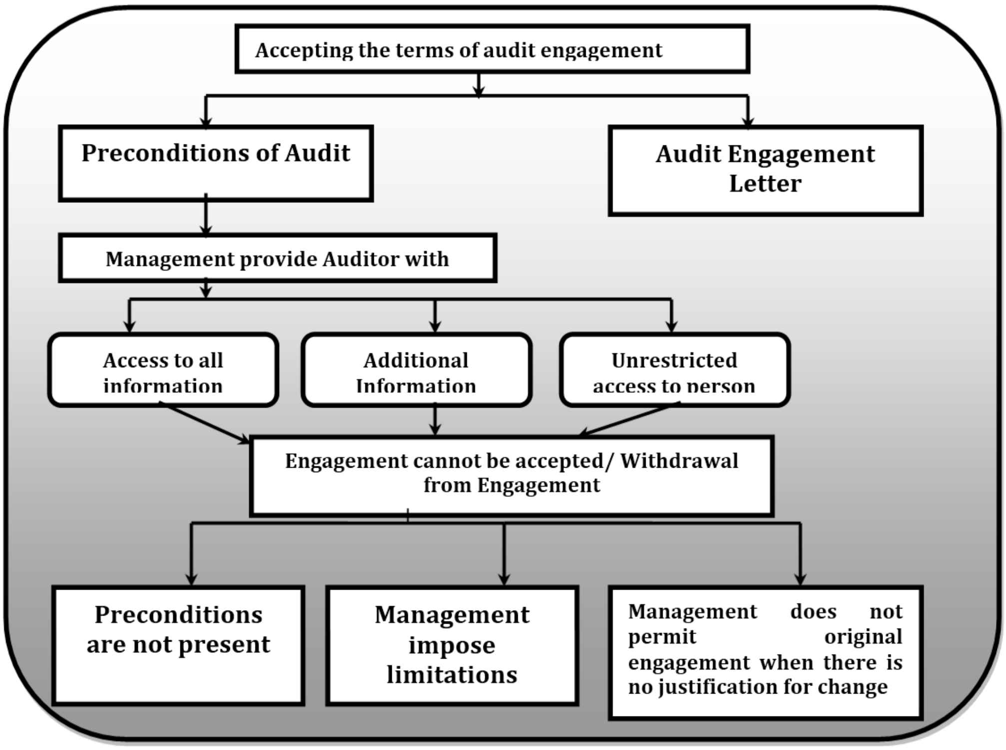

Exhibit-2: Accepting the terms of Engagement
(Source: Adapted from Bansal, 2015)

4. Formulating an Audit Plan [Based on SA–300]

Statutory auditor plans audit of a financial statements based on provisions of SA–300 (Revised) titled *'Planning an Audit of Financial Statements'*. The engagement partner and other key members of the engagement team should contribute in the planning process. The auditor should assume preliminary engagement activities with respect to (a) understanding terms of engagement; (b) continuance of client relationships; (c) relevant ethical requirements.

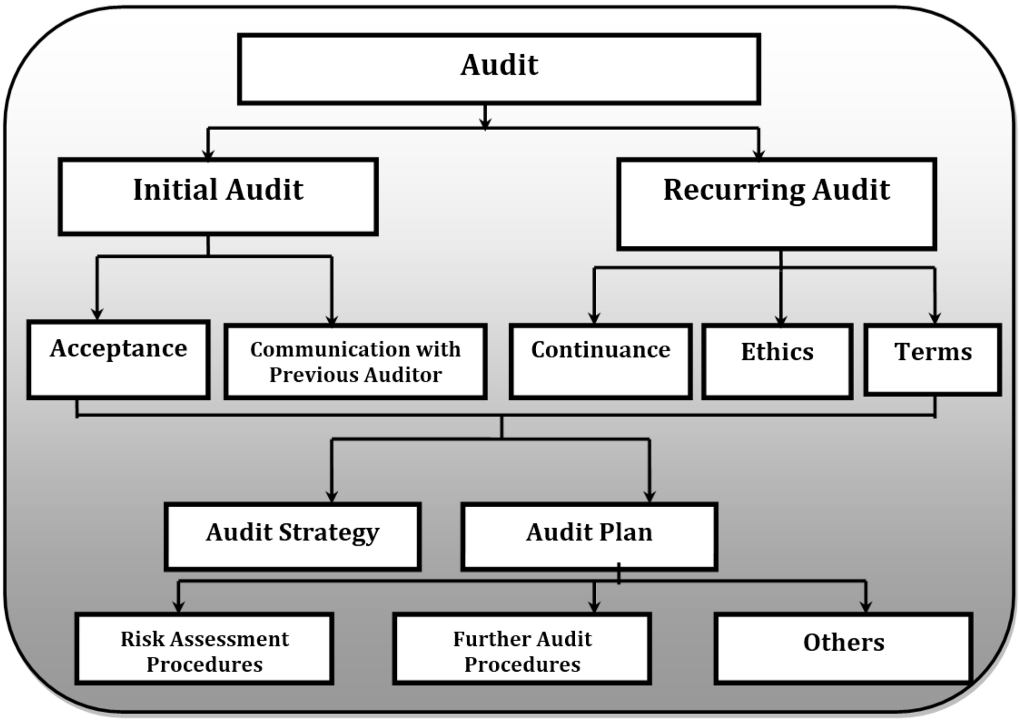

Exhibit-3: Formulating an Audit Plan
(Source: Adapted from Bansal, 2015)

The auditor should devise an overall audit strategy based on (a) nature, timing and scope of audit; (b) characteristics of engagement; (c) professional judgement of auditors; (d) nature of resources required. The audit plan is based on audit strategywhich may be changed during the course of an audit. Audit strategy, audit plan and any noteworthy changes made in these two documents should be properly documented. In case of first audit engagement, the auditor should plan their procedures for accepting a client relationship and communicating with predecessor auditor. A preliminary planning on audit of financial statements would help an auditor to complete the audit procedures in a methodical manner within limited time and scope. It is necessary to achieve a quality audit.

5. Collecting Audit Evidences [Based on SA–500]

Statutory auditors' responsibilities with respect to collection of sufficient and appropriate audit evidences are discussed under SA–500 (Revised) titled *'Audit Evidence'*. The auditor should plan their audit procedures in a way to collect sufficient and appropriate evidences. While designing audit procedures the auditor should consider reliability and relevance of audit evidence. If the information to be used as audit evidence is prepared by a management's expert, the auditor should evaluate the proficiency and independence of that expert and nature and extent of his operation. Audit procedures designed for collecting audit evidences can be broadly classified under two heads, (a) Test of Control; (b) Substantive Procedure.

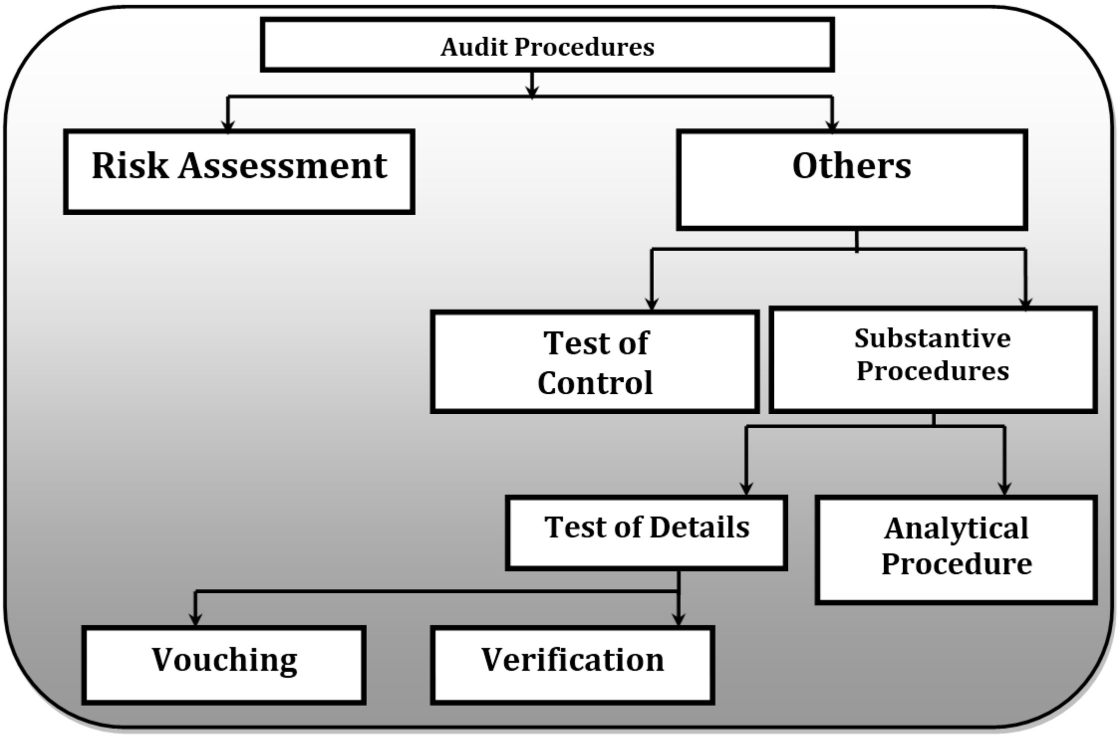

Exhibit-4: Collecting Audit Evidences
(Source: Adapted from Bansal, 2015)

Test of control involves collecting evidence on effectiveness of internal control mechanism of the company. Whereas substantive procedures involves collection of evidences from internal and external sources to validate every transactions and balances in the accounting records. Inspection, Observation, External Confirmations, Recalculations, Analytical Procedures and Re–performance are some of the audit procedures designed to collect sufficient and appropriate audit evidences. In case of test of control and substantive procedure, the auditor should select an item wisely. If the audit evidence obtained from two different sources is defective or inconsistent, the auditor should determine the appropriate actions. Auditors form their conclusion on financial statements based on audit evidence. Therefore, evidences are collected subject to the provision of this act, they become quality evidence and report drawn on the basis of such evidences would be quality report.

6. Adopting Audit Sample [Based on SA–530]

Limitations on time available for audit lead to a statutory auditor to go for audit sampling, where auditors sample out few units of accounts and perform their procedures on those units to draw their conclusion on the entire financial statements. SA–530 (Revised) titled, *'Audit Sampling'* guides an auditor in this respect. The auditor is required to determine the nature of audit and character of population before drawing a sample. The auditor should explain the sample in such way so that sampling risk is minimised and the sample is well representative of the population.

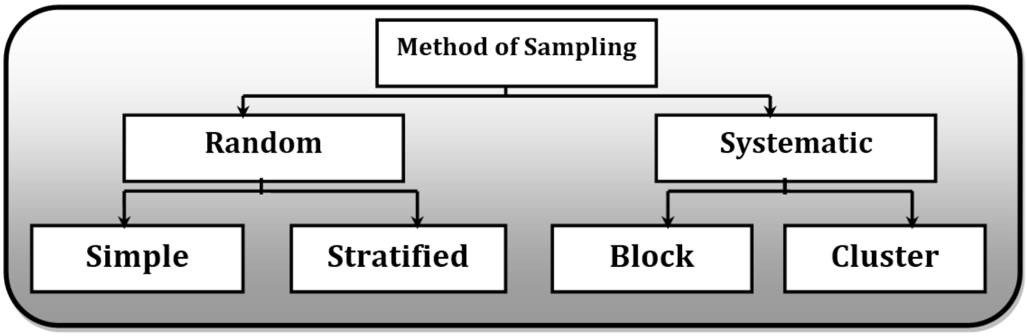

Exhibit-5: Method of Collecting Audit Samples
(Source: Bansal, 2015)

The auditor should perform audit procedures on each item of the sample. If the item is not appropriate for the audit procedure, it should be considered as a deviation from the population and it should be replaced by another item from the population. The auditor should try to find out the nature and cause of deviations in a selected item. If the sample is not representative of the entire population, the auditor should take substitute means. The result based on sampling is to be projected for the whole population. The auditor should assess the conclusion reached based on audit sampling and sampling risk involved.

Given the limited time and scope of an auditor, it is not possible for an auditor to execute a detailed examination of all the aspects in financial statements. Therefore, the auditor needs to select few representative units from all accounts balance and classes of transaction. The auditor conducts their detailed audit procedures on these samples and forms the basis of their conclusion. Therefore, selection and proper evaluation of samples as per the provision of this standard determines quality of overall audit work.

7. Documenting Audit Working Papers [Based on SA–230]

One of the important responsibilities of the statutory auditor is to document their findings on the financial statements. An appropriate documentation is maintained as per the provisions of SA–230 (Revised) titled '*Audit Documentation*'. The auditor should organize audit documents on a timely basis. The auditor should document (a) nature, timing and extent of audit; (b) result of audit procedures and audit evidence collected; (c) major findings of audit and conclusion reached; (d) features of specific items or matters tested; (e) name of the auditor and nature of audit; (f) name of the reviewer and level of review; (g) noteworthy discussion with management, those charged with governance and others; (h) the course of dealing with inconsistencies in information obtained and final conclusion of the auditors.

If the auditor departs from any mandatory requirement, nature of such departure along with reasons thereof and substitute audit procedures performed should be documented. If after publication of the audit report, some new events are encountered which may change the auditors' conclusion, the auditor should document nature of such event, audit procedures undertaken to deal with that event, audit evidences collected, and new conclusions drawn. The auditor should collect all the documentation in an audit file before the release date and retain the documents. However, the time within which the documentation should be filed or the period for which it is required to be retained are not specified in the standard. If the auditor finds an audit document after document completion date, it should make necessary changes in the audit documentation. Reasons for such change should be documented.

After a particular audit engagement is complete, its quality is judged by peer review of audit work. Peer reviewer basically consults these documents to identify compliance with applicable regulation and significant judgements made by the auditors in forming their opinion on financial statements. If these issues conform to the actual requirement, it can be said that quality in audit procedures has been maintained. Therefore, audit documentation has a great impact on overall audit quality.

8. Preparing Audit Report [Based on SA–700]

The final step of audit procedures is to report the findings on financial statements and disclose whether financial statements represent 'true and fair' view of the financial affair of the business. An auditor draws up a report based on the requirements of SA–700 (Revised) titled '*Forming an Opinion and Reporting on Financial Statements*'. The auditor should evaluate (a) whether financial statements is prepared based on accounting policies on a consistent basis; (b) accounting policies are in conformity with applicable accounting framework; (c) information conveyed through the financial statements is relevant, reliable, comparable and understandable; (d) reasonableness of accounting estimates; (e) effect of material transactions on the disclosure made in financial statements; (f) terminology used in the financial statement; (g) overall fair representation of the financial statements. Statutory auditor on the basis of their careful evaluation should determine presence of management's bias in selection of accounting policies or development of accounting estimates. The auditors obtain reasonable assurance that financial statements are free from material misstatement due to fraud and error and form their opinion and material accuracy and fairness of financial statements. If financial statements are free from material misstatement, the auditor should issue an unmodified report. If financial statements are misstated or if auditors are unable to gather sufficient and appropriate evidence to form their opinion on the financial statements, they should modify their opinion. The auditor should also discuss the matter with management of the audit client. The auditor's report should be in writing. Title of the audit report should clearly specify that the audit has been conducted by an independent auditor. The report should be addressed as required by the engagement.

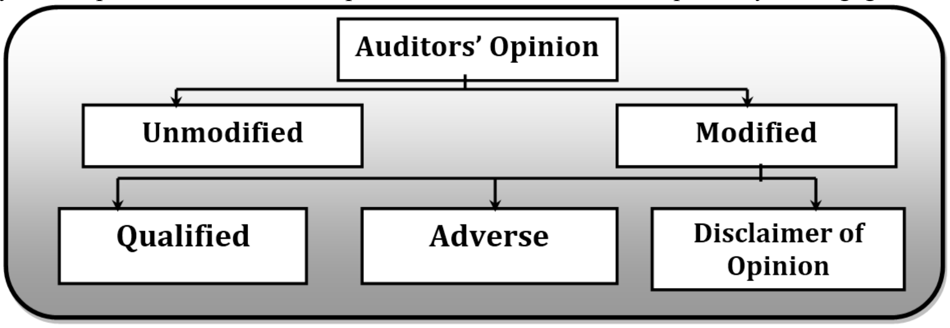

Exhibit-6: Auditors' Opinion on Financial Statements
(Source: Adapted from Bansal, 2015)

The introductory paragraph of the report should contain (a) name of the audit client; (b) name of the financial statements audited; (c) period of financial statements, (d) summary of accounting policies, etc. The section on management responsibility incorporates responsibility of the management with regard to preparation and fair representation of financial statements in accordance with applicable financial reporting framework. The auditor's responsibilities in audit report deals with (a) performance of audit complying with Indian GAAP; (b) certification that financial statements is free from material misstatement due to error and fraud; (c) collecting sufficient and appropriate evidences; (d) application of suitable audit procedures based on audit judgement; (e) evaluating reasonableness of internal control system; (f) determining relevance and reasonableness of accounting estimates. Where financial statements are prepared on a fair presentation framework, the auditor should refer the matter in their report. The report also incorporates unmodified or modified opinion of auditor on financial statements. If financial statements are prepared fairly in all material respect in accordance with applicable financial reporting framework, the auditor issues an unmodified opinion. Hence, the auditor should try to find out the origin of the applicable financial reporting framework. The auditor may also fulfil other reporting responsibilities over and above requirements of SAs. These reporting responsibilities should be incorporated in the audit report under a separate head. The audit report should include signature of the auditor. Name and location of the audit firm should also be mentioned. The audit report should be dated on that day when auditors have reasonable assurance that (a) all the financial statements have been prepared; (b) those responsible for preparation of financial statements have taken responsibility for all financial statements. The report should contain the location where the audit report is being signed. If the auditor is required to provide report in accordance with any other standards apart from SAs, they need to ensure that aforesaid requirements of an audit report have been complied with. In some cases, an auditor may have to perform an audit in accordance with national standards as well as International Standards on Auditing (ISAs). In the report, the auditor should ensure that any conflicts of interests have not arisen on these two sets of standards. If supplementary information is presented with financial statements which are not required as per applicable financial reporting framework, statutory auditor has to issue their opinion on such information.

Reporting is the last part of auditing process. Issuance of appropriate report is an important criterion of audit quality. Therefore, the auditor should form their opinion on financial statements as per the provision of this standard and issue an unqualified, qualified or adverse report which is appropriate in particular circumstances.

9. Conclusions

In India, the SAs issued by the ICAI are designed and implemented keeping in view the quality criteria for statutory financial audit. The current paper basically reviews the important provisions of select SAs that govern a few significant audit activities which involve 'accepting the terms of engagement', 'formulating audit plan', 'collecting audit evidences', 'adopting audit samples', 'documenting audit working papers' and 'preparing auditors' report'. The study reveals that each of these standards is well structured and statutory auditors' role with respect to the aforesaid issues is clearly documented there. Sometimes, the provisions are also supported by applications and other explanatory materials. It is deduced that the quality of audit depends upon auditors' observance on the audit engagement. Fulfilment of preconditions and terms of engagement basically determines whether statutory auditors would be able to take up the engagement with adequate competence and independence. It follows an audit plan which sets the basic framework of audit activities. Statutory auditors' approach towards client organisation's internal control system and other issues determines the adequacy of audit samples. After the samples are decided, the auditor then applies substantive audit procedures on them to obtain sufficient and appropriate evidences. It forms the basis of auditors' conclusion on the financial statements. Such conclusion is finally reflected in the auditors' report. The entire audit procedure, from engagement to reporting is documented to facilitate future audits and audit inspections. It is evident that such structure provides an auditor little scope to deviate from their actual duties. However, proper enforcement of these standards is necessary. Peer Review Board of the Council of Chartered Accountants of India and Quality Review Board under the Central Government of India are performing their role. However, more improvements in this segment may be possible when National Financial Reporting Authority as per the provision of Indian Companies Act, 2013 come into place.

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