

# **PART-I**



# PART – I : STANDARDS

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## Preface to Standards on Quality Control, Auditing, Review, Other Assurance and Related Services<sup>1</sup>

*(Effective from April 1, 2008)*

### Introduction

1. This Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services has been issued to facilitate understanding of the scope and authority of the pronouncements of the AASB issued under the authority of the Council of the Institute of Chartered Accountants of India (the ICAI).
2. The ICAI is committed to the goal of enabling the accountancy profession in India to provide services of high quality in the public interest and which are accepted worldwide. To further this goal, the ICAI develops and promulgates technical Standards and other professional literature. The ICAI being one of the founder members of the International Federation of Accountants (IFAC), the Standards developed and promulgated by the AASB under the authority of the Council of the ICAI are in conformity with the corresponding International Standards issued by the International Auditing and Assurance Standards Board (IAASB), established by the IFAC. The "Due Process" of the AASB for formulation of Standards, Statements, Guidance Notes and its other pronouncements is given in the **Appendix** to this Preface.

### Standards Issued by AASB under the Authority of the Council of ICAI

3. The following Standards issued by the Auditing and Assurance Standards Board under the authority of the Council are collectively known as the Engagement Standards:
  - (a) Standards on Auditing (SAs), to be applied in the audit of historical financial information.
  - (b) Standards on Review Engagements (SREs), to be applied in the review of historical financial information.
  - (c) Standards on Assurance Engagements (SAEs), to be applied in assurance engagements, other than audits and reviews of historical financial information.
  - (d) Standards on Related Services (SRSs), to be applied to engagements involving application of agreed-upon procedures to information, compilation engagements, and other related services engagements, as may be specified by the ICAI.
4. Standards on Quality Control (SQC), issued by the AASB under the authority of the Council, are to be applied for all services covered by the Engagement Standards as described in paragraph 3 above.

A diagram containing the structure of the Standards issued by the Auditing and Assurance Standards Board under the authority of the Council is given as **Annexure** to this Preface.

### Standards on Auditing

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<sup>1</sup> Issued in July, 2007.

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5. The Standards on Auditing (SAs) referred to in Paragraph 3(a) above are formulated in the context of an audit of financial statements by an independent auditor. They are to be adapted as necessary in the circumstances when applied to audits of other historical financial information. The authority of SAs is set out in SA 200<sup>2</sup>.

### **Standards on Quality Control**

6. SQCs are written to apply to firms<sup>3</sup> in respect of all their services falling under the Engagement Standards issued by the AASB of ICAI. The authority of SQCs is set out in the introduction to the SQCs.

### **Other Standards**

7. The other Engagement Standards identified in paragraph 3 (b) to (d) as well as Standards on Quality Control referred to in paragraph 4 contain basic principles and essential procedures (identified in **bold type** lettering and by the word "should") together with related guidance in the form of explanatory and other material, including appendices. The basic principles and essential procedures are to be understood and applied in the context of the explanatory and other material that provides guidance for their application. It is therefore necessary to consider the entire text of a Standard to understand and apply the basic principles and essential procedures. Appendices, which form part of the application material, are an integral part of a Standard. The purpose and intended use of an appendix are explained in the body of the related Standard or within the title and introduction of the appendix itself. An individual Standard should be read in the context of the objective stated in the Standard as well as this Preface. Any limitation of the applicability of a specific Standard is made clear in the Standard itself.

### **Statements on Auditing**

8. Statements on Auditing are issued with a view to securing compliance by professional accountants on matters which, in the opinion of the Council, are critical for the proper discharge of their functions. Statements are, therefore, mandatory.

### **General Clarifications**

9. General Clarifications are issued by the Board under the authority of the Council of the Institute with a view to clarify any issues arising from the Standards. General Clarifications are mandatory in nature.

### **Professional Judgment**

10. The nature of the Standards/Statements/General Clarifications requires the professional accountant<sup>4</sup> to exercise professional judgment in applying them.

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<sup>2</sup> SA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing".

<sup>3</sup> The term "firm" refers to a sole practitioner/proprietor, partnership, or any such entity of professional accountants, as may be permitted by law.

<sup>4</sup> The term "professional accountant" refers to a member of the Institute of Chartered Accountants of India.

**Authority Attached to Other Standards, Statements on Auditing and General Clarifications**

11. It is the duty of the professional accountants to ensure that the Standards/Statements/General Clarifications are followed in the engagements undertaken by them<sup>5</sup>. The need for the professional accountants to depart from a relevant requirement is expected to arise only where the requirement is for a specific procedure to be performed and, in the specific circumstances of the engagement, that procedure would be ineffective. If because of that reason, a professional accountant has not been able to perform an engagement procedure in accordance with any Standard/Statement/General Clarification, he is required to document how alternative procedures performed achieve the purpose of the procedure, and, unless otherwise clear, the reasons for the departure. Further, his report should draw attention to such departures. However, a mere disclosure in his report does not absolve a professional accountant from complying with the applicable Standards/Statements/General Clarifications<sup>6</sup>.

12. There may be a situation where a matter is covered both by a Standard as also by a Statement on Auditing. In such a situation, the Statement shall prevail till the time the Standard becomes mandatory. Once a Standard becomes mandatory, the concerned Statement or the relevant portion(s) thereof will automatically be withdrawn.

**Guidance Notes**

13. Guidance Notes are issued to assist professional accountants in implementing the Engagement Standards and the Standards on Quality Control issued by the AASB under the authority of the Council. Guidance Notes are also issued to provide guidance on other generic or industry specific audit issues, not necessarily arising out of a Standard. Professional accountants should be aware of and consider Guidance Notes applicable to the engagement. A professional accountant who does not consider and apply the guidance included in a relevant Guidance Note should be prepared to justify the appropriateness and completeness of the alternate procedures adopted by him to deal with the objectives and basic principles set out in the Guidance Note.

**Technical Guides, Practice Manuals, Studies and Other Papers Published by the Auditing and Assurance Standards Board**

14. The Board may also publish Technical Guides, Practice Manuals, Studies and other papers. Technical Guides are ordinarily aimed at imparting broad knowledge about a particular aspect

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<sup>5</sup> Members' attention is invited to Clause 5 of Part I of the Second Schedule to the Chartered Accountants Act, 1949, according to which a chartered accountant in practice shall be deemed to be guilty of professional misconduct, if he fails to disclose a material fact known to him which is not disclosed in a financial statement, but disclosure of which is necessary in making such financial statement where he is concerned with that financial statement in a professional capacity. Further Clause 7 of Part I of the Second Schedule to the Chartered Accountants Act, 1949 states that a chartered accountant in practice shall be deemed to be guilty of professional misconduct, if he does not exercise due diligence, or is grossly negligent in the conduct of his professional duties.

<sup>6</sup> Attention of the members is also drawn to Clause 9 of Part I of the Second Schedule to the Chartered Accountants Act, 1949, whereby, a member is deemed to be guilty of professional misconduct if he fails to invite attention to any material departure from the generally accepted procedures of audit applicable to the circumstances.

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or of an industry to the professional accountants. Practice Manuals are aimed at providing additional guidance to professional accountants in performing audit and other related assignments. Studies and other papers are aimed at promoting discussion or debate or creating awareness on issues relating to quality control, auditing, assurance and related service, affecting the profession. Such publications of the Board do not establish any basic principles or essential procedures to be followed in audit, review, other assurance or related services engagements, and accordingly, have no authority of the Council attached to them.

### **Material Modifications to the Preface to International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services**

#### **Addition**

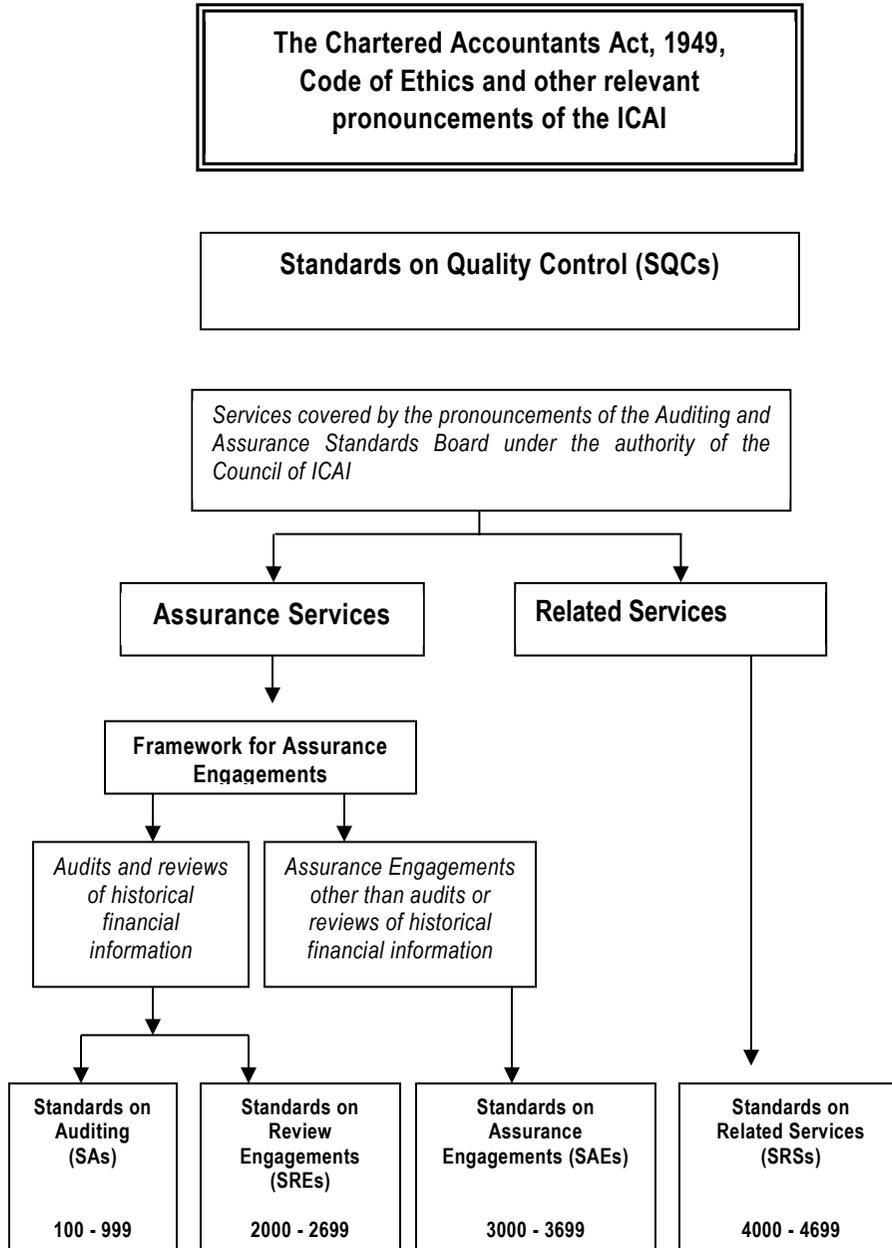
This Preface deals, apart from the Standards, with the Statements on Auditing and the General Clarifications as the mandatory documents for use by the professional accountants in performing engagements by them, whereas, the Preface issued by the IAASB does not deal with such aspects. Further, the nomenclature of International Auditing Practice Statements (IAPSs) referred in the Preface issued by the IAASB has been changed to Guidance Notes in this Preface.

#### **Deletion**

The Preface issued by the IAASB provides to include, in appropriate cases, additional considerations specific to public sector entities within the body of the Standard. However, since the Standards, Statements, General Clarifications and Guidance Notes issued by the ICAI are equally applicable in case of all engagements, irrespective of the form, nature and size of the entity, this Preface does not deal separately with the public sector perspective.

**Annexure**

**Structure of Standards issued by the Auditing and Assurance Standards Board under the Authority of the Council of ICAI**



#### **Auditing and Assurance Standards Board and its Due Process**

##### **Brief History**

1. The Institute of Chartered Accountants of India (ICAI) constituted the Auditing Practices Committee (APC) on 17<sup>th</sup> September 1982, to review the existing auditing practices in India and to develop Statements on Standard Auditing Practices so that these may be issued under the authority of the Council of the Institute. Subsequently, at its 226<sup>th</sup> meeting held in July 2002, the Council of the Institute approved certain recommendations of the APC to strengthen its role in the growth and development of the accountancy profession in India. The Council, at the said meeting, also approved the renaming of the Auditing Practices Committee as the Auditing and Assurance Standards Board (AASB) as well as renaming of the Statements on Standard Auditing Practices as Auditing and Assurance Standards (AASs).

2. The ICAI is one of the founder members of the International Federation of Accountants (IFAC). It is one of the membership obligations of the Institute to actively propagate the pronouncements of the International Auditing and Assurance Standards Board (IAASB) of the IFAC to contribute towards global harmonisation and acceptance of the Standards issued by the IAASB. Accordingly, while formulating Engagement and Quality Control Standards, the AASB takes into consideration the corresponding Standards, if any, issued by the IAASB. In addition, the AASB also takes into consideration the applicable laws, customs, usages and business environment prevailing in India within the parameters of the July 2006 Policy Paper, A Guide for National Standard Setters that Adopt IAASB's International Standards but Find it Necessary to Make Limited Modifications, issued by the IAASB.

##### **Objectives and Functions of the Auditing and Assurance Standards Board**

3. The following are the objectives and functions of the Auditing and Assurance Standards Board:
- (i) To review the existing and emerging auditing practices worldwide and identify areas in which Standards on Quality Control, Engagement Standards and Statements on Auditing need to be developed.
  - (ii) To formulate Engagement Standards, Standards on Quality Control and Statements on Auditing so that these may be issued under the authority of the Council of the Institute.
  - (iii) To review the existing Standards and Statements on Auditing to assess their relevance in the changed conditions and to undertake their revision, if necessary.
  - (iv) To develop Guidance Notes on issues arising out of any Standard, auditing issues pertaining to any specific industry or on generic issues, so that those may be issued under the authority of the Council of the Institute.
  - (v) To review the existing Guidance Notes to assess their relevance in the changed circumstances and to undertake their revision, if necessary.
  - (vi) To formulate General Clarifications, where necessary, on issues arising from Standards.
  - (vii) To formulate and issue Technical Guides, Practice Manuals, Studies and other papers under

its own authority for guidance of professional accountants in the cases felt appropriate by the Board.

### **Composition**

4. The composition of the AASB is fairly broad-based and attempts to ensure participation of all interest groups in the standard-setting process. Apart from amongst the elected members of the Council of the ICAI the following are also represented on AASB:

- (i) Eminent members of the profession, whether in industry or in practice, as co-opted members on the Board.
- (ii) One special invitee from each three regulatory bodies, viz., the Securities and Exchange Board of India, the Reserve Bank of India and the Insurance Regulatory and Development Authority.
- (iii) One special invitee from the Indian Institute(s) of Management, or from any other prominent academic and/or research organisation, as considered appropriate.
- (iv) One special invitee from a prominent Industry association.
- (v) One special invitee representing public interest, e.g., not for profit organization, etc.

The special invitees mentioned at (ii) through (v) above are decided in consultation with the President of the Institute. Further, special invitees do not constitute the members of the Board, as referred to in this document.

### **Term of the Members**

5. The term of the Chairman of the Board is three years. Where such period of three years exceeds the term of the Council of ICAI during which the Chairman has been appointed, the term of the Chairman is restricted to the abovementioned term of the Council. The Council of the ICAI may fill any vacancy in the Office of the Chairman and the Chairman so appointed holds office for the unexpired term of the Council. The term of other members of the Board and the special invitees is one year. However, in case the period of one year exceeds the term of the Council during which the members have been appointed, the term of the members is restricted to the abovementioned term of the Council.

### **Attendance at the Meetings**

6. Each AASB meeting requires the presence, in person, of at least one third of the members of the Board. However, the AASB meetings whereat a Standard or Statement, at whatever stage (as envisaged in the following paragraphs), is proposed to be considered, requires attendance of at least two thirds of the AASB members, in person or by simultaneous telecommunication link (such as teleconferencing, videoconferencing, etc.).

7. In case any member of the AASB absents himself from three consecutive meetings of the Board, without seeking leave of absence the AASB would bring such fact to the attention of the Council.

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### **AASB Working Procedure**

#### **Standards, Statements on Auditing and General Clarifications**

##### ***Project Identification, Prioritization and Approval***

8. Project proposals to develop new, or revise existing Standards, Statements or General Clarifications are identified based on international and national developments, input from members of the Council of the ICAI, AASB members, members of other committees of the ICAI and/or recommendations received from other interested parties, such as regulators or professional accountants.

9. The AASB determines the priorities of various projects on hand for commencement.

10. In the preparation of Standards, Statements and General Clarifications, AASB is assisted by Study Groups/Task Forces constituted to consider specific projects. The AASB appoints one of the professional accountants as a convener of the Study Group/Task Force. The convener, in consultation with the Chairman, AASB, nominates other members of the Study Group/Task Force, ordinarily five to seven in number. For operating convenience and economy, a study group is usually based in the area where the convener is located. In situations considered necessary, the Board may also consider having an outside expert on such Study Groups/Task Forces and such an expert need not necessarily be a professional accountant. The Study Group/Task Force is responsible for preparing the basic draft of the Standard/ Statement/ General Clarification. In addition, a separate group of experts may be formed to advise the Study Group /Task Force.

11. The AASB may also conduct projects jointly with regulators and/or others. In such cases, the joint Study Group/Task Force is ordinarily chaired by the convener appointed with mutual consent.

##### ***Consultation and Debate***

12. The Study Group/Task Force develops the preliminary draft of the Standard/ Statement/ General Clarification based on appropriate research and consultation, which may include, depending on the circumstances, consultation with the other professionals, regulators and other interested parties, as well as reviewing professional pronouncements issued by IFAC member bodies and other professional bodies. The draft submitted by the study group, along with issue papers/background papers, is sent to the Chairman, AASB for approval.

13. The draft Standard/Statement/General clarification, along with other agenda papers, as approved by the Chairman, is hosted on the website of the AASB, ordinarily, at least twenty one days in advance of the AASB meeting at which such draft Standard/ Statement is planned to be considered. A notification to that effect is also sent to the AASB members. The printed version of the agenda papers, including background papers and draft Standard/ Statement/General Clarification prepared by the Study Group/Task Force for review and debate are made available to the members of and special invitees to the AASB at the concerned meeting.

14. The AASB considers the preliminary draft of the Standard/ Statement/General Clarification prepared by the Study Group/Task Force. The AASB may refer the draft to the Study

Group/Task Force to examine the issues arising out of the deliberations of the AASB and accordingly modify the draft Standard/ Statement/General Clarification.

15. In case the revision to the Standard/ Statement/General Clarification is made by the Study Group/ Task Force in terms of the requirements of paragraph 14 above, the procedure laid down in paragraphs 12 to 14 above is followed for the revised draft of the Standard/ Statement/General Clarification.

16. The draft of the proposed Standard/ Statement/General Clarification, as modified in the light of the deliberations of the Board and approved by the Chairman, AASB, is circulated to the Council members of the ICAI for their comments before being issued as an Exposure Draft. Normally, a period of ten days is given for receiving comments on the Draft Exposure Draft. AASB finalises the Exposure Draft of the proposed Standard/ Statement on the basis of the comments so received, if any. Ordinarily, an Exposure Draft of a General Clarification is not issued.

### ***Public Exposure***

17. The Exposure Draft of the proposed Standard / Statement is issued, by way of publication in the monthly Journal of the Institute and/or hosted on the website of the ICAI wherefrom it is downloadable free of charge, for comments by the professional accountants and the public. The Board, however, may decide not to issue an Exposure Draft of a Statement, in which case, the reasons for such a decision is recorded in the minutes of the relevant AASB meeting. Each Exposure Draft is, ordinarily, accompanied by an explanatory memorandum that highlights the objectives and significant proposals contained in the draft. The explanatory memorandum may also direct the respondents to those aspects of the Exposure Draft on which specific feedback is sought.

18. The Exposure Draft is sent to the members of the Council of the ICAI, the Institute's past Presidents, Regional Councils and their branches. Copies of the Exposure Draft are also sent to the following bodies:

- i. The Ministry of Company Affairs, Government of India
- ii. The Comptroller and Auditor General of India
- iii. The Reserve Bank of India
- iv. The Insurance Regulatory and Development Authority
- v. The Central Board of Direct Taxes
- vi. The Central Board of Excise and Customs
- vii. The Securities and Exchange Board of India
- viii. The Central Registrar of Co-operative Societies
- ix. The Institute of Cost and Works Accountants of India
- x. The Institute of Company Secretaries of India
- xi. The Indian Banks Association
- xii. Industry organizations such as Federation of Indian Chambers of Commerce and Industry,

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Associated Chambers of Commerce, Confederation of Indian Industry

- xiii. Indian Institute(s) of Management
- xiv. The Telecom Regulatory Authority of India
- xv. The Standing Conference on Public Enterprises
- xvi. Recognised stock exchanges in India
- xvii. Any other body considered relevant by the AASB keeping in view the nature and requirement of AAS/Statement.

19. To allow adequate time for due consideration and comment from all interested parties, exposure period is ordinarily 45 (forty five) days or such other period, but not less than 45 days in any case, as may be decided by the AASB. Further, the exposure period would be reckoned from the date of hosting of the Exposure Draft on the website of the Institute.

### ***Responses to Exposure Drafts and Consideration of Respondents' Comments***

20. An acknowledgement is sent to every respondent to an Exposure Draft. Except where the respondent has specifically indicated otherwise, the respondents' comments are considered a matter of public records. Comments which are received upto ten days prior to the date of the AASB meeting at which such comments are proposed to be considered, are hosted on the website of the AASB and kept there till the date of the AASB meeting at which the Exposure Draft and comments thereon are considered. The members of the AASB as well as the Council of the Institute are notified when the comments are hosted on the website of the AASB. Copies of the Exposure Draft and comment letters are also made available to the AASB members at the AASB meeting at which the Exposure Draft is scheduled for discussion.

21. The comments and suggestions received within the exposure period are read and considered by the AASB. The AASB's deliberations on the significant issues raised in the comments letters received together with the AASB's decision thereon are recorded in the minutes of the relevant AASB meeting and also hosted on the website of the AASB. The AASB may decide to discuss with the respondents their comment letters or explain to them the reasons for not having accepted their proposals. The nature and outcome of such discussions are reported and recorded in the minutes of the relevant AASB meeting.

22. Such part of the AASB meetings whereat the Exposure Draft of proposed Standard/ Statement and the comments thereon are to be discussed is open for public. The members of the public, at their own expenditure, can attend the said part of the meeting(s) as observers. Such observers, however, do not have the right to participate in the discussions at the meeting. The notification as to the date of the said AASB meeting is hosted on the website of the Institute at least 30 days in advance and the members of the public desirous of attending the said meeting(s) are required to send their request for the same to the Board at least 15 days prior to the date of the concerned AASB meeting. The seats for the members of the public at such meetings are limited to such numbers as may be decided by the AASB and allotted on a first come first serve basis. The AASB may also hold a meeting with the representatives of the specified bodies, as may be identified by the Board on a case to case basis, to ascertain their views on the draft of the proposed Standard/ Statement.

23. After taking into consideration the comments received, the draft of the proposed Standard/ Statement is finalized by the AASB and submitted to the Council of the ICAI for its consideration and approval. The draft of the General Clarification, as finalised by the AASB, is submitted to the Council of ICAI for its consideration and approval.

24. The Council of the ICAI considers the final draft of the proposed Standard/ Statement/General Clarification, and if found necessary, modifies the same in consultation with AASB. The concerned Standard/ Statement/ General Clarification is then issued under the authority of the Council of the ICAI.

***Re-exposure***

25. The AASB on a direction from the Council of the ICAI or on its own, in cases considered appropriate, may re-expose a proposed Standard/ Statement. The need for re-exposure may arise on account of factors such as significant issues coming to the notice of the Board subsequently, including, significant changes in the laws or regulations having an impact on the requirements of the Standard/ Statement or revision of the corresponding International Standard by IAASB. In cases where a re-exposure of a Standard or a Statement is required, the procedures as listed in paragraphs 12 to 24 are followed.

**Procedure for Issuing the Guidance Notes**

26. The AASB identifies the issues on which Guidance Notes need to be formulated and the priority in regard to selection thereof.

27. In the preparation of the Guidance Note, the AASB is assisted by Study Groups/Task Forces constituted to consider specific projects. The AASB appoints one of the professional accountants as a convener of the Study Group / Task Force. The Convenor nominates other members of the Study Group/Task Force and in the formation of Study Groups / Task Forces, provision is made for participation of a cross-section of members of the ICAI. In situations considered necessary, the Board may also consider having an outside expert on such Study Groups/Task Forces and such "expert" need not necessarily be a professional accountant. The Study Group/Task Force will be responsible for preparing the basic draft of the Guidance Note.

28. The Study Group/Task Force develops the preliminary draft of the Guidance Note based on appropriate research and consultation, which may include, depending on the circumstances, consulting with the other professionals, regulators and other interested parties, as well as reviewing professional pronouncements issued by IFAC member bodies and other parties and submits the preliminary draft Guidance Note to the AASB. The draft Guidance Note, along with the background papers, if any, is sent to the Chairman, AASB for approval.

29. The AASB considers the preliminary draft prepared by the Study Group/Task Force and may refer the same to the Study Group/Task Force to examine the issues arising out of the deliberations of the AASB and accordingly modify the draft Guidance Note. The modified Draft Guidance Note is once again considered by the Board. The draft Guidance Note as finalised by the Board is submitted for the consideration of the Council of the ICAI.

30. Unlike Standards/Statements, ordinarily, no proposed Guidance Note is exposed for comments of the professional accountants and others. However, in situations considered necessary by the Board, an Exposure Draft of a Guidance Note may well be issued for public

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comments. In case an Exposure Draft of a Guidance Note is to be issued, the same procedures as required for an Exposure Draft of the Standard/ Statement (as mentioned in paragraphs 17 to 22 above) is required to be followed. The reasons for issuing an Exposure Draft of the Guidance Note are recorded in the minutes of the relevant AASB meeting. However, the part of the AASB meeting at such Exposure Draft is considered is not open for public.

31. The Council of the Institute considers the final draft of the proposed Guidance Note and, if necessary, suggests modifications thereto in consultation with the AASB. The Guidance Note is then issued under the authority of the Council of the ICAI.

### **Limited or Substantive Revision to the Standard, Statement or Guidance Note**

32. Subsequent to issuance of a Standard, Statement or Guidance Note, the introduction of any new legal or professional requirement or any other national or international development in the field of auditing, may require a substantive revision to that Standard, Statement or Guidance Note. In that case, the Council of the ICAI makes substantive revision to such Standard/ Statement /Guidance Note. The procedure followed for substantive revision is the same as that followed for formulation of a new Standard, Statement or the Guidance Note, as the case may be, as detailed above.

33. Similarly, subsequent to issuance of a Standard, Statement or Guidance Note, some aspect(s) may require revision which are not substantive in nature. For this purpose, the Council of the ICAI may make limited revision to a Standard/ Statement /Guidance Note. In case of the Standards on Auditing (SAs), any revision to a Standard is treated as limited only if that revision is restricted to the application guidance of that Standard. The procedure followed for the limited revision is, in principle, the same as that followed for formulation of a Standard, Statement or Guidance Note, as the case may be. However, the AASB may decide to cut short some time limits, e.g. period of public exposure in case of a limited revision to a Standard/Statement, as detailed above, for the process.

### **Technical Guides, Practice Manuals, Studies and Other Papers Published by the Auditing and Assurance Standards Board**

34. For issuance of a Technical Guides/Studies, etc., the procedure adopted by the AASB is ordinarily the same as in case of a Guidance Note except that the draft Technical Guide/ Practice Manual/ Study is not exposed for public comments nor such part of the AASB meeting at which the proposed Technical Guide, Practice Manual, etc., is considered, open for public. Also, since the Technical Guides, Practice Manuals, Studies, etc., are not issued under the authority of the Council, these are not required to be placed for consideration and final approval of the Council, and are issued by the AASB under its own authority.

### **Voting**

35. The affirmative votes of a majority of the members of the Board, in person or by simultaneous telecommunication link, are required to approve the final draft of a Standard or Statement for submission to the Council.

36. Each member of the AASB has the right to one vote.

### Glossary of Terms\*

**Access controls** - Procedures designed to restrict access to on-line terminal devices, programs and data. Access controls consist of "user authentication" and "user authorization." "User authentication" typically attempts to identify a user through unique logon identifications, passwords, access cards or biometric data. "User authorization" consists of access rules to determine the computer resources each user may access. Specifically, such procedures are designed to prevent or detect:

- (a) Unauthorized access to on-line terminal devices, programs and data;
- (b) Entry of unauthorized transactions;
- (c) Unauthorized changes to data files;
- (d) The use of computer programs by unauthorized personnel; and
- (e) The use of computer programs that have not been authorized.

**Accounting estimate** - An approximation of a monetary amount in the absence of a precise means of measurement. This term is used for an amount measured at fair value where there is estimation uncertainty, as well as for other amounts that require estimation. Where SA 540<sup>1</sup> addresses only accounting estimates involving measurement at fair value, the term "fair value accounting estimates" is used.

**Accounting records** - The records of initial accounting entries and supporting records, such as checks and records of electronic fund transfers; invoices; contracts; the general and subsidiary ledgers, journal entries and other adjustments to the financial statements that are not reflected in journal entries; and records such as work sheets and spreadsheets supporting cost allocations, computations, reconciliations and disclosures.

**Accuracy Assertion** - Amounts and other data relating to recorded transactions and events have been recorded appropriately.

**Agreed-upon procedures engagement** - An engagement in which an auditor is engaged to carry out those procedures of an audit nature to which the auditor and the entity and any appropriate third parties have agreed and to report on factual findings. The recipients of the report form their own conclusions from the report by the auditor. The report is restricted to those parties that have agreed to the procedures to be performed since others, unaware of the reasons for the procedures may misinterpret the results.

**Analytical procedures** - Evaluations of financial information through analysis of plausible relationships among both financial and non-financial data. Analytical procedures also encompass such investigation as is necessary of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount.

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\*Definitions given in this Glossary should be read in the context of the respective Standards where they are appearing.

<sup>1</sup> SA 540, "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures".

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**Annual report** - A document issued by an entity, ordinarily on an annual basis, which includes its financial statements together with the auditor's report thereon.

**Anomaly** - A misstatement or deviation that is demonstrably not representative of misstatements or deviations in a population.

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

The term "fair presentation framework" is used to refer to a financial reporting framework that requires compliance with the requirements of the framework and:

- (a) Acknowledges explicitly or implicitly that, to achieve fair presentation of the financial statements, it may be necessary for management to provide disclosures beyond those specifically required by the framework; or
- (b) Acknowledges explicitly that it may be necessary for management to depart from a requirement of the framework to achieve fair presentation of the financial statements. Such departures are expected to be necessary only in extremely rare circumstances.

The term "compliance framework" is used to refer to a financial reporting framework that requires compliance with the requirements of the framework, but does not contain the acknowledgements in (a) or (b) above.

**Application controls in information technology** - Manual or automated procedures that typically operate at a business process level. Application controls can be preventative or detective in nature and are designed to ensure the integrity of the accounting records. Accordingly, application controls relate to procedures used to initiate, record, process and report transactions or other financial data.

**Applied criteria (in the context of SA 810<sup>2</sup>)** - The criteria applied by management in the preparation of the summary financial statements.

**Appropriateness (of audit evidence)** - The measure of the quality of audit evidence; that is, its relevance and its reliability in providing support for the conclusions on which the auditor's opinion is based.

**Arm's length transaction** - A transaction conducted on such terms and conditions as between a willing buyer and a willing seller who are unrelated and are acting independently of each other and pursuing their own best interests.

**Assertion-based Engagements** - In some assurance engagements, the evaluation or measurement of the subject matter is performed by the responsible party, and the subject matter information is in the form of an assertion by the responsible party that is made available to the intended users. These engagements are called "assertion-based engagements".

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<sup>2</sup> SA 810, "Engagements to Report on Summary Financial Statements."

**Assertions** - Representations by management, explicit or otherwise, that are embodied in the financial statements, as used by the auditor to consider the different types of potential misstatements that may occur.

**Assess** - Analyze identified risks of to conclude on their significance. "Assess," by convention, is used only in relation to risk. (also see *Evaluate*) Association - (see *Auditor association with financial information*)

**Assurance** - (see *Reasonable assurance*)

**Assurance engagement** - An engagement in which a practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria. The outcome of the evaluation or measurement of a subject matter is the information that results from applying the criteria (also see *Subject matter information*). Under the "Framework for Assurance Engagements" issued by the Institute of Chartered Accountants of India there are two types of assurance engagement a practitioner is permitted to perform: a reasonable assurance engagement and a limited assurance engagement.

*Reasonable assurance engagement*—The objective of a reasonable assurance engagement is a reduction in assurance engagement risk to an acceptably low level in the circumstances of the engagement<sup>3</sup> as the basis for a positive form of expression of the practitioner's conclusion.

*Limited assurance engagement*—The objective of a limited assurance engagement is a reduction in assurance engagement risk to a level that is acceptable in the circumstances of the engagement, but where that risk is greater than for a reasonable assurance engagement, as the basis for a negative form of expression of the practitioner's conclusion.

**Assurance engagement risk** - The risk that the practitioner expresses an inappropriate conclusion when the subject matter information is materially misstated.

**Audit documentation** - The record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached (terms such as "working papers" or "workpapers" are also sometimes used).

**Audit evidence** - Information used by the auditor in arriving at the conclusions on which the auditor's opinion is based. Audit evidence includes both information contained in the accounting records underlying the financial statements and other information. (See *Sufficiency of audit evidence* and *Appropriateness of audit evidence*.)

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<sup>3</sup> Engagement circumstances include the terms of the engagement, including whether it is a reasonable assurance engagement or a limited assurance engagement, the characteristics of the subject matter, the criteria to be used, the needs of the intended users, relevant characteristics of the responsible party and its environment, and other matters, for example events, transactions, conditions and practices, that may have a significant effect on the engagement.

## I.16 Auditing Pronouncements

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

**Audit firm** - (see *Firm*)

**Audit opinion** - (see *Modified opinion and Unmodified opinion*)

**Audit risk** - The risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated. Audit risk is a function of the risks of material misstatement and detection risk.

**Audit sampling (sampling)** - The application of audit procedures to less than 100% of items within a population of audit relevance such that all sampling units have a chance of selection in order to provide the auditor with a reasonable basis on which to draw conclusions about the entire population.

**Audited financial statements (in the context of SA 810)** - Financial statements<sup>4</sup> audited by the auditor in accordance with SAs, and from which the summary financial statements are derived.

**Auditor** - "Auditor" is used to refer to the person or persons conducting the audit, usually the engagement partner or other members of the engagement team, or, as applicable, the firm. Where an SA expressly intends that a requirement or responsibility be fulfilled by the engagement partner, the term "engagement partner" rather than "auditor" is used.

**Auditor association with financial information** - An auditor is associated with financial information when the auditor attaches a report to that information or consents to the use of the auditor's name in a professional connection.

**Auditor's expert** - An individual or organization possessing expertise in a field other than accounting or auditing, whose work in that field is used by the auditor to assist the auditor in obtaining sufficient appropriate audit evidence. An auditor's expert may be either an auditor's internal expert (who is a partner or staff, including temporary staff, of the auditor's firm or a network firm), or an auditor's external expert.

**Auditor's point estimate or auditor's range** - The amount, or range of amounts, respectively, derived from audit evidence for use in evaluating management's point estimate.

**Auditor's range** - (see *Auditor's point estimate*)

**Block Selection** - Block selection involves selection of a block(s) of contiguous items from within the population.

**Business risk** - A risk resulting from significant conditions, events, circumstances, actions or inactions that could adversely affect an entity's ability to achieve its objectives and execute its strategies, or from the setting of inappropriate objectives and strategies.

**Capabilities (of management's expert)** - Capability relates the ability of the management's expert to exercise that competence in the circumstances.

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<sup>4</sup> SA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing," paragraph 13(f), defines the term "financial statements."

**Classification assertion** - Transactions and events have been recorded in the proper accounts.

**Comparative financial statements** - Comparative information where amounts and other disclosures for the prior period are included for comparison with the financial statements of the current period but, if audited, are referred to in the auditor's opinion. The level of information included in those comparative financial statements is comparable with that of the financial statements of the current period.

**Comparative information** - The amounts and disclosures included in the financial statements in respect of one or more prior periods in accordance with the applicable financial reporting framework.

**Competence (of management's expert)** - Competence relates to the nature and level of expertise of the management's expert.

**Compilation engagement** -An engagement in which accounting expertise, as opposed to auditing expertise, is used to collect, classify and summarize financial information.

**Complementary user entity controls** - Controls that the service organization assumes, in the design of its service, will be implemented by user entities, and which, if necessary to achieve control objectives, are identified in the description of its system.

**Completeness Assertion** - All transactions and events that should have been recorded have been recorded.

**Completion memorandum** - A summary that describes the significant matters identified during the audit and how they were, or that includes cross reference to other relevant supporting audit documentation that provides such information.

**Compliance framework** - (see *Applicable financial reporting framework* and *General purpose framework*)

**Component** - An entity or business activity for which group or component management prepares financial information that should be included in the group financial statements.

**Component auditor** - An auditor who, at the request of the group engagement team, performs work on financial information related to a component for the group audit.

**Component management** - Management responsible for the preparation of the financial information of a component.

**Component materiality** - The materiality for a component determined by the group engagement team.

**Computer-assisted audit techniques** - Applications of auditing procedures using the computer as an audit tool (also known as CAATs).

**Control activities** - Those policies and procedures that help ensure that management directives are carried out. Control activities are a component of internal control.

**Control environment** - Includes the governance and management functions and the attitudes, awareness and actions of those charged with governance and management concerning the entity's internal control and its importance in the entity. The control environment is a component of internal control.

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**Control risk** - The risk that a material misstatement that could occur will not be prevented, or detected or corrected, on a timely basis by related internal controls (see *Risk of material misstatement*)

**Corresponding figures**—Comparative information where amounts and other disclosures for the prior period are included as an integral part of the current period financial statements, and are intended to be read only in relation to the amounts and other disclosures relating to the current period (referred to as “current period figures”). The level of detail presented in the corresponding amounts and disclosures is dictated primarily by its relevance to the current period figures.

**Corporate governance** - (see *Governance*)

**Capabilities (of management’s expert)** - Capability relates the ability of the management’s expert to exercise that competence in the circumstances.

**Criteria** - The benchmarks used to evaluate or measure the subject matter including, where relevant, benchmarks for presentation and disclosure. Criteria can be formal or less formal. There can be different criteria for the same subject matter. Suitable criteria are required for reasonably consistent evaluation or measurement of a subject matter within the context of professional judgment.

*Suitable criteria*—Exhibit the following characteristics:

- (a) *Relevance*: relevant criteria contribute to conclusions that assist decision-making by the intended users.
- (b) *Completeness*: criteria are sufficiently complete when relevant factors that could affect the conclusions in the context of the engagement circumstances are not omitted. Complete criteria include, where relevant, benchmarks for presentation and disclosure.
- (c) *Reliability*: reliable criteria allow reasonably consistent evaluation or measurement of the subject matter including, where relevant, presentation and disclosure, when used in similar circumstances by similarly qualified practitioners.
- (d) *Neutrality*: neutral criteria contribute to conclusions that are free from bias.
- (e) *Understandability*: understandable criteria contribute to conclusions that are clear, comprehensive, and not subject to significantly different interpretations.

**Cut-off Assertion** - Transactions and events have been recorded in the correct accounting period.

**Date of approval of the financial statements** - The date on which all the statements that comprise the financial statements, have been prepared and those with the recognized authority have asserted that they have taken responsibility for those financial statements.

**Date of report (in relation to quality control)** - The date selected by the practitioner to date the report.

**Date of the auditor's report** - The date the auditor dates the report on the financial statements in accordance with Revised SA 700.<sup>5</sup>

**Date of the financial statements**—The date of the end of the latest period covered by the financial statements.

**Date the financial statements are issued** - The date that the auditor's report and audited financial statements are made available to third parties.

**Deficiency in internal control** - This exists when:

- (a) 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
- (b) A control necessary to prevent, or detect and correct, misstatements in the financial statements on a timely basis is missing.

**Detection risk** - The risk that the procedures performed by the auditor to reduce audit risk to an acceptably low level will not detect a misstatement that exists and that could be material, either individually or when aggregated with other misstatements.

**Direct Reporting Engagements** - In other assurance engagements, the practitioner either directly performs the evaluation or measurement of the subject matter, or obtains a representation from the responsible party that has performed the evaluation or measurement that is not available to the intended users. The subject matter information is provided to the intended users in the assurance report. These engagements are called "direct reporting engagements".

**Documentation of the audit plan** - A record of the planned nature, timing and extent of risk assessment procedures and further audit procedures at the assertion level in response to the assessed risks.

**Documentation of the overall audit strategy** - A record of the key decisions considered necessary to properly plan the audit and to communicate significant matters to the engagement team.

**Element** - (see *Element of a financial statement*)

**Element of a financial statement (in the context of SA 805<sup>6</sup>)**— An element, account or item of a financial statement.

**Emphasis of Matter paragraph** - A paragraph included in the auditor's report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements.

**Engagement documentation**— The record of work performed, results obtained, and conclusions the practitioner reached (terms such as "working papers" or "workpapers" are

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<sup>5</sup> SA 700 (Revised), "Forming an Opinion and Reporting on Financial Statements."

<sup>6</sup> SA 805, "Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement."

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sometimes used). The documentation for a specific engagement is assembled in an engagement file.

**Engagement letter** - Written terms of an engagement in the form of a letter.

**Engagement partner** - The partner or other person in the firm who is a member of the Institute of Chartered Accountants of India and is in full time practice and is responsible for the engagement and its performance, and for the report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body.

**Engagement quality control review** - A process designed to provide an objective evaluation, before the date of the report, of the significant judgments the engagement team made and the conclusions it reached in formulating the report.

**Engagement quality control reviewer**- A partner, other person<sup>7</sup> in the firm, suitably qualified external person, or a team made up of such individuals, with sufficient and appropriate experience and authority to objectively evaluate the significant judgments the engagement team made and the conclusions it reached in formulating the report. However, in case the review is done by a team of individuals, such team should be headed by a member of the Institute.

**Engagement team** - All personnel performing the engagement, including any experts contracted by the firm in connection with that engagement.<sup>8</sup>

**Entity's risk assessment process** - A component of internal control that is the entity's process for identifying business risks relevant to financial reporting objectives and deciding about actions to address those risks, and the results thereof.

**Environmental matters** - (a) Initiatives to prevent, abate, or remedy damage to the environment, or to deal with conservation of renewable and non-renewable resources (such initiatives may be required by environmental laws and regulations or by contract, or they may be undertaken voluntarily);

(b) Consequences of violating environmental laws and regulations;

(c) Consequences of environmental damage done to others or to natural resources; and

(d) Consequences of vicarious liability imposed by law (for example, liability for damages caused by previous owners).

**Environmental performance report** - A report, separate from the financial statements, in which an entity provides third parties with qualitative information on the entity's commitments towards the environmental aspects of the business, its policies and targets in that field, its achievement in managing the relationship between its business processes and environmental risk, and quantitative information on its environmental performance.

**Environmental risk** - In certain circumstances, factors relevant to the assessment of inherent risk for the development of the overall audit plan may include the risk of material misstatement of the financial statements due to environmental matters.

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<sup>7</sup> Such other person should be a member of the Institute of Chartered Accountants of India.

<sup>8</sup> SA 620, "Using the Work of an Auditor's Expert," paragraph 6(a), defines the term "auditor's expert".

**Error** - An unintentional misstatement in financial statements, including the omission of an amount or a disclosure.

**Estimation uncertainty** - The susceptibility of an accounting estimate and related disclosures to an inherent lack of precision in its measurement.

**Evaluate** - Identify and analyze the relevant issues, including performing further procedures as necessary, to come to a specific conclusion on a matter. "Evaluation," by convention, is used only in relation to a range of matters, including evidence, the results of procedures and the effectiveness of management's response to a risk. (also see *Assess*)

**Exception** - A response that indicates a difference between information requested to be confirmed, or contained in the entity's records, and information provided by the confirming party.

**Existence Assertion** - Assets, liabilities, and equity interests exist.

**Experienced auditor** - An individual (whether internal or external to the firm) who has practical audit experience, and a reasonable understanding of:

- (a) Audit processes;
- (b) SAs and applicable legal and regulatory requirements;
- (c) The business environment in which the entity operates; and
- (d) Auditing and financial reporting issues relevant to the entity's industry.

**Expert** - (see *Auditor's expert* and *Management's expert*)

**Expertise** - Skills, knowledge and experience in a particular field.

**Extent of Audit Procedure** - Extent of an audit procedure refers to the quantity to be performed, for example, a sample size or the number of observations of a control activity.

**External confirmation** - Audit evidence obtained as a direct written response to the auditor from a third party (the confirming party), in paper form, or by electronic or other medium.

**Fair presentation framework** - (see *Applicable financial reporting framework* and *General purpose framework*)

**Financial Reporting Standards** - Means the Accounting Standards issued by the Institute of Chartered Accountants of India (ICAI) or Accounting Standards, notified by the Central Government by publishing the same as the Companies (Accounting Standards) Rules, 2006, or the Accounting Standards for Local Bodies issued by the ICAI, as may be applicable.

**Financial statements** - A structured representation of historical financial information, including related notes, intended to communicate an entity's economic resources or obligations at a point in time or the changes therein for a period of time in accordance with a financial reporting framework. The related notes ordinarily comprise a summary of significant accounting policies and other explanatory information. The term "financial statements" ordinarily refers to a complete set of financial statements as determined by the requirements of the applicable financial reporting framework, but it can also refer to a single financial statement.

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**Firm** - A sole practitioner/proprietor, partnership or any such entity of professional accountants, as may be permitted by law.

**Forecast** - Prospective financial information prepared on the basis of assumptions as to future events which management expects to take place and the actions management expects to take as of the date the information is prepared (best-estimate assumptions).

**Fraud** - An intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage.

**Fraud risk factors** - Events or conditions that indicate an incentive or pressure to commit fraud or provide an opportunity to commit fraud.

**Fraudulent financial reporting** - Involves intentional misstatements, including omissions of amounts or disclosures in financial statements, to deceive financial statement users.

**General IT-controls** - Policies and procedures that relate to many applications and support the effective functioning of application controls by helping to ensure the continued proper operation of information systems. General IT-controls commonly include controls over data center and network operations; system software acquisition, change and maintenance; access security; and application system acquisition, development, and maintenance.

**General purpose financial statements** - Financial statements prepared in accordance with a general purpose framework.

**General purpose framework** - A financial reporting framework designed to meet the common financial information needs of a wide range of users. The financial reporting framework may be a fair presentation framework or a compliance framework.

The term "fair presentation framework" is used to refer to a financial reporting framework that requires compliance with the requirements of the framework and:

(a) Acknowledges explicitly or implicitly that, to achieve fair presentation of the financial statements, it may be necessary for management to provide disclosures beyond those specifically required by the framework; or

(b) Acknowledges explicitly that it may be necessary for management to depart from a requirement of the framework to achieve fair presentation of the financial statements. Such departures are expected to be necessary only in extremely rare circumstances.

The term "compliance framework" is used to refer to a financial reporting framework that requires compliance with the requirements of the framework, but does not contain the acknowledgements in (a) or (b) above.<sup>9</sup>

**Governance** - Describes the role of person(s) or organization(s) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity.

**Group** - All the components whose financial information is included in the group financial statements. A group always has more than one component.

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<sup>9</sup> SA 200, paragraph 13(a).

**Group audit** - The audit of group financial statements.

**Group audit opinion** - The audit opinion on the group financial statements.

**Group engagement partner** - The partner or other person in the firm who is responsible for the group audit engagement and its performance, and for the auditor's report on the group financial statements that is issued on behalf of the firm. Where joint auditors conduct the group audit, the joint engagement partners and their engagement teams collectively constitute the group engagement partner and the group engagement team.

**Group engagement team** - Partners, including the group engagement partner, and staff who establish the overall group audit strategy, communicate with component auditors, perform work on the consolidation process, and evaluate the conclusions drawn from the audit evidence as the basis for forming an opinion on the group financial statements.

**Group financial statements** - Financial statements that include the financial information of more than one component. The term "group financial statements" also refers to combined financial statements aggregating the financial information prepared by components that have no parent but are under common control.

**Group management** - Management responsible for the preparation of the group financial statements.

**Group-wide controls** - Controls designed, implemented and maintained by group management over group financial reporting.

**Haphazard Selection** - Haphazard selection is a sample selection method in which the auditor selects the sample without following a structured technique.

**Historical financial information** - Information expressed in financial terms in relation to a particular entity, derived primarily from that entity's accounting system, about economic events occurring in past time periods or about economic conditions or circumstances at points in time in the past.

**Inconsistency** - Other information that contradicts information contained in the audited financial statements. A material inconsistency may raise doubt about the audit conclusions drawn from audit evidence previously obtained and, possibly, about the basis for the auditor's opinion on the financial statements.

**Independence** - Comprises:

(a) Independence of mind—the state of mind that permits the provision of an opinion without being affected by influences that compromise professional judgment, allowing an individual to act with integrity, and exercise objectivity and professional skepticism.

(b) Independence in appearance—the avoidance of facts and circumstances that are so significant a reasonable and informed third party, having knowledge of all relevant information, including any safeguards applied, would reasonably conclude a firm's, or a member of the assurance team's, integrity, objectivity or professional skepticism had been compromised.

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**Information system relevant to financial reporting** - A component of internal control that includes the financial reporting system, and consists of the procedures and records designed and established to

- Initiate, record, process and report entity transactions (as well as events and conditions) and to maintain accountability for the related assets, liabilities and equity.
- Resolve incorrect processing of transactions, for example, automated suspense files and procedures followed to clear suspense items out on a timely basis;
- Process and account for system overrides or bypasses to controls;
- Transfer information from transaction processing systems to the general ledger;
- Capture information relevant to financial reporting for events and conditions other than transactions, such as the depreciation and amortization of assets and changes in the recoverability of accounts receivables; and
- Ensure information required to be disclosed by the applicable financial reporting framework is accumulated, recorded, processed, summarized and appropriately reported in the financial statements.

**Inherent risk** - (see *Risk of material misstatement*)

**Initial audit engagement** - An engagement in which either:

- (a) The financial statements for the prior period were not audited; or
- (b) The financial statements for the prior period were audited by a predecessor auditor.

**Inquiry** - Inquiry consists of seeking information of knowledgeable persons, both financial and non-financial, within the entity or outside the entity.

**Inspection (as an audit procedure)** - Examining records or documents, whether internal or external, in paper form, electronic form, or other media, or a physical examination of an asset.

**Inspection (in relation to quality control)** - In relation to completed engagements, procedures designed to provide evidence of compliance by engagement teams with the firm's quality control policies and procedures.

**Intended users** - The person, persons or class of persons for whom the practitioner prepares the assurance report. The responsible party can be one of the intended users, but not the only one.

**Interim financial information or statements** - Financial information that is prepared and presented in accordance with an applicable financial reporting framework and comprises either a complete or a condensed set of financial statements for a period that is shorter than the entity's financial year.

**Internal audit function** - An appraisal activity established or provided as a service to the entity. Its functions include, amongst other things, examining, evaluating and monitoring the adequacy and effectiveness of internal control.

**Internal auditors** - Those individuals who perform the activities of the internal audit function. Internal auditors may belong to an internal audit department or equivalent function.

**Internal control** - The process designed, implemented and maintained by those charged with governance, management and other personnel to provide reasonable assurance about the achievement of an entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, safeguarding of assets and compliance with applicable laws and regulations. The term "controls" refers to any aspects of one or more of the components of internal control.

**International Financial Reporting Standards** - The International Financial Reporting Standards issued by the International Accounting Standards Board.

**Investigate** - Inquire into matters arising from other procedures to resolve them.

**IT environment** - The policies and procedures that the entity implements and the IT infrastructure (hardware, operating systems, etc.) and application software that it uses to support business operations and achieve business strategies.

**Limited assurance engagement** - (see *Assurance engagement*)

**Listed entity** - An entity whose shares, stock or debt are quoted or listed on a recognized stock exchange, or are traded under the regulations of a recognized stock exchange or other equivalent body.

**Material Weakness** - A weakness in internal control that could have a material effect on the financial statements.

**Management** - The person(s) with executive responsibility for the conduct of the entity's operations. For some entities, management includes some or all of those charged with governance, for example, executive members of a governance board, or an owner-manager.

**Management bias** - A lack of neutrality by management in the preparation and presentation of information.

**Management's expert** - An individual or organization possessing expertise in a field other than accounting or auditing, whose work in that field is used by the entity to assist the entity in preparing the financial statements.

**Management's point estimate** - The amount selected by management for recognition or disclosure in the financial statements as an accounting estimate

**Misappropriation of assets** - Involves the theft of an entity's assets and is often perpetrated by employees in relatively small and immaterial amounts. However, it can also involve management who are usually more capable of disguising or concealing misappropriations in ways that are difficult to detect.

**Misstatement** - A difference between the amount, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework. Misstatements can arise from error or fraud.

Where the auditor expresses an opinion on whether the financial statements are presented fairly, in all material respects, or give a true and fair view, misstatements also include those adjustments of amounts, classifications, presentation, or disclosures that, in the auditor's

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judgment, are necessary for the financial statements to be presented fairly, in all material respects, or to give a true and fair view.

**Misstatement of fact** - Other information that is unrelated to matters appearing in the audited financial statements that is incorrectly stated or presented. A material misstatement of fact may undermine the credibility of the document containing audited financial statements.

**Modified opinion** - A qualified opinion, an adverse opinion or a disclaimer of opinion.

**Monitoring (in relation to quality control)** - A process comprising an ongoing consideration and evaluation of the firm's system of quality control, including a periodic inspection of a selection of completed engagements, designed to provide the firm with reasonable assurance that its system of quality control is operating effectively.

**Monitoring of controls** - A process to assess the effectiveness of internal control performance over time. It includes assessing the design and operation of controls on a timely basis and taking necessary remedial actions modified for changes in conditions. Monitoring of controls is a component of internal control.

**Monetary Unit Sampling** - Monetary Unit Sampling is a type of value-weighted sample selection method in which sample size, selection and evaluation results in a conclusion in monetary amounts.

**Nature of Audit Procedure** - The nature of an audit procedure refers to its purpose (i.e., test of controls or substantive procedures) and its type (i.e., inspection, observation, inquiry, confirmation, recalculation, reperformance, or analytical procedure).

**Negative confirmation request** - A request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request.

**Network** - A larger structure:

- (a) That is aimed at cooperation, and
- (b) That is clearly aimed at profit or cost-sharing or shares common ownership, control or management, common quality control policies and procedures, common business strategy, the use of a common brand name, or a significant part of professional resources.

**Network firm** - A firm or entity that belongs to a network.

**Non-compliance (in the context of SA 250<sup>10</sup>)** - Acts of omission or commission by the entity, either intentional or unintentional, which are contrary to the prevailing laws or regulations. Such acts include transactions entered into by, or in the name of, the entity, or on its behalf, by those charged with governance, management or employees. Non-compliance does not include personal misconduct (unrelated to the business activities of the entity) by those charged with governance, management or employees of the entity.

**Non-response** - A failure of the confirming party to respond, or fully respond, to a positive confirmation request, or a confirmation request returned undelivered.

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<sup>10</sup> SA 250, "Consideration of Laws and Regulations in an Audit of Financial Statements".

**Non-sampling risk** - The risk that the auditor reaches an erroneous conclusion for any reason not related to sampling risk.

**Objectivity (of management's expert)** - Objectivity relates to the possible effects that bias, conflict of interest or the influence of others may have on the professional or business judgment of the management's expert.

**Observation** - Consists of looking at a process or procedure being performed by others, for example, the auditor's observation of inventory counting by the entity's personnel, or of the performance of control activities.

**Occurrence Assertion** - Transactions and events that have been recorded have occurred and pertain to the entity.

**Opening balances** - Those account balances that exist at the beginning of the period. Opening balances are based upon the closing balances of the prior period and reflect the effects of transactions and events of prior periods and accounting policies applied in the prior period. Opening balances also include matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments.

**Other information** - Financial and non-financial information (other than the financial statements and the auditor's report thereon) which is included, either by law, regulation, or custom, in a document containing audited financial statements and the auditor's report thereon.

**Other Matter paragraph** - A paragraph included in the auditor's report that refers to a matter other than those presented or disclosed in the financial statements that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.

**Outcome of an accounting estimate** - The actual monetary amount which results from the resolution of the underlying transaction(s), event(s) or condition(s) addressed by the accounting estimate.

**Outcome of the evaluation or measurement of a subject matter** - The information that results from applying the criteria to the subject matter.

**Overall audit strategy** - Sets the scope, timing and direction of the audit, and guides the development of the more detailed audit plan.

**Partner** - Any individual with authority to bind the firm with respect to the performance of a professional services engagement.

**Performance materiality** - The amount or amounts set by the auditor at less than materiality for the financial statements as a whole to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole. If applicable, performance materiality also refers to the amount or amounts set by the auditor at less than the materiality level or levels for particular classes of transactions, account balances or disclosures.

**Personnel** - Partners and staff.

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**Pervasive** - A term used, in the context of misstatements, to describe the effects on the financial statements of misstatements or the possible effects on the financial statements of misstatements, if any, that are undetected due to an inability to obtain sufficient appropriate audit evidence. Pervasive effects on the financial statements are those that, in the auditor's judgment:

- (a) Are not confined to specific elements, accounts or items of the financial statements;
- (b) If so confined, represent or could represent a substantial proportion of the financial statements; or
- (c) In relation to disclosures, are fundamental to users' understanding of the financial statements.

**Population** - The entire set of data from which a sample is selected and about which the auditor wishes to draw conclusions.

**Positive confirmation request** - A request that the confirming party respond directly to the auditor indicating whether the confirming party agrees or disagrees with the information in the request, or providing the requested information.

**Practitioner** - A professional accountant in public practice.

**Practitioner's Association with Subject Matter** - A practitioner is associated with a subject matter when the practitioner reports on information about the subject matter or consents to the use of the practitioner's name in a professional connection with that subject matter.

**Preconditions for an audit** - The use by management of an acceptable financial reporting framework in the preparation of the financial statements and the agreement of management and, where appropriate, those charged with governance to the premise<sup>11</sup> on which an audit is conducted.

**Predecessor auditor** - The auditor from a different audit firm, who audited the financial statements of an entity in the prior period and who has been replaced by the current auditor.

**Premise, relating to the responsibilities of management and, where appropriate, those charged with governance, on which an audit is conducted** - That management and, where appropriate, those charged with governance have acknowledged and understand that they have the following responsibilities that are fundamental to the conduct of an audit in accordance with ISAs. That is, responsibility:

- (a) For the preparation of the financial statements in accordance with the applicable financial reporting framework, including where relevant their fair presentation;
- (b) For such internal control as management and, where appropriate, those charged with governance determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and
- (c) To provide the auditor with:

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<sup>11</sup> SA 200, paragraph 13(j).

- (i) Access to all information of which management and, where appropriate, those charged with governance are aware that is relevant to the preparation of the financial statements such as records,
- (ii) documentation and other matters;
- (iii) Additional information that the auditor may request from management and, where appropriate, those charged with governance for the purpose of the audit; and
- (iv) Unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

In the case of a fair presentation framework, (a) above may be restated as “for the preparation and *fair* presentation of the financial statements in accordance with the financial reporting framework,” or “for the preparation of financial statements *that give a true and fair view* in accordance with the financial reporting framework.”

The “premise, relating to the responsibilities of management and, where appropriate, those charged with governance, on which an audit is conducted” may also be referred to as the “premise.”

**Professional accountant** - Member of the Institute of Chartered Accountants of India.

**Professional accountant in public practice** - Refers to the member of the Institute of Chartered Accountants of India who is in practice in terms of section 2 of the Chartered Accountants Act, 1949. The term is also used to refer to a firm of chartered accountants in public practice.

**Professional judgment** - The application of relevant training, knowledge and experience, within the context provided by auditing, accounting and ethical standards, in making informed decisions about the courses of action that are appropriate in the circumstances of the audit engagement.

**Professional skepticism** - An attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of evidence.

**Professional standards** - Engagement Standards as defined in the AASB’s “Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services”, and relevant ethical requirements as contained in the Code.

**Projection** - Prospective financial information prepared on the basis of:

- (a) Hypothetical assumptions about future events and management actions which are not necessarily expected to take place, such as when some entities are in a start-up phase or are considering a major change in the nature of operations; or
- (b) A mixture of best-estimate and hypothetical assumptions.

**Prospective financial information** - Financial information based on assumptions about events that may occur in the future and possible actions by an entity. It is highly subjective in nature and its preparation requires exercise of considerable judgment. Prospective financial information can be in the form of a forecast, a projection or a combination of both. (See *Forecast* and *Projection*)

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**Public sector** - National governments, regional (for example, state, provincial, territorial) governments, local (for example, city, town) governments and related governmental entities (for example, agencies, boards, commissions and enterprises).

**Random Selection** - It is a sample selection method involving application of random number generators, for example, random number tables.

**Reasonable assurance (in the context of assurance engagements, including audit engagements, and quality control)** - A high, but not absolute, level of assurance.

**Reasonable assurance engagement** - (see *Assurance engagement*)

**Recalculation** - Consists of checking the mathematical accuracy of documents or records.

**Related party** - A party that is either:

- (a) A related party as defined in the applicable financial reporting framework; or
- (b) Where the applicable financial reporting framework establishes minimal or no related party requirements:
  - (i) A person or other entity that has control or significant influence, directly or indirectly through one or more intermediaries, over the reporting entity;
  - (ii) Another entity over which the reporting entity has control or significant influence, directly or indirectly through one or more intermediaries; or
  - (iii) Another entity that is under common control with the reporting entity through having:
    - a. Common controlling ownership;
    - b. Owners who are close family members; or
    - c. Common key management.

However, entities that are under common control by a state (that is, a national, regional or local government) are not considered related unless they engage in significant transactions or share resources to a significant extent with one another.

**Related services** - Comprise agreed-upon procedures and compilations.

**Relevant ethical requirements** - Ethical requirements to which the engagement team and engagement quality control reviewer are subject, which ordinarily comprise Code of Ethics issued by Institute of Chartered Accountants of India (ICAI) together with other relevant pronouncements issued by the Institute.

**Reperformance** - The auditor's independent execution of procedures or controls that were originally performed as part of the entity's internal controls.

**Report on the description and design of controls at a service organization (referred to in SA 402<sup>12</sup> (Revised) as a Type 1 report)** - A report that comprises:

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<sup>12</sup> SA 402, "Audit Considerations Relating to an Entity Using a Service Organization".

- (a) A description, prepared by management of the service organization, of the service organization's system, control objectives and related controls that have been designed and implemented as at a specified date; and
- (b) A report by the service auditor with the objective of conveying reasonable assurance that includes the service auditor's opinion on the description of the service organization's system, control objectives and related controls and the suitability of the design of the controls to achieve the specified control objectives.

**Report on the description, design, and operating effectiveness of controls at a service organization (referred to in SA 402) as a Type 2 report)** - A report that comprises:

- (a) A description, prepared by management of the service organization, of the service organization's system, control objectives and related controls, their design and implementation as at a specified date or throughout a specified period and, in some cases, their operating effectiveness throughout a specified period; and
- (b) A report by the service auditor with the objective of conveying reasonable assurance that includes:
  - (i) The service auditor's opinion on the description of the service organization's system, control objectives and related controls, the suitability of the design of the controls to achieve the specified control objectives, and the operating effectiveness of the controls; and
  - (ii) A description of the service auditor's tests of the controls and the results thereof.

**Responsible party** - The person (or persons) who:

- (a) In a direct reporting engagement, is responsible for the subject matter; or
- (b) In an assertion-based engagement, is responsible for the subject matter information (the assertion), and may be responsible for the subject matter.

The responsible party may or may not be the party who engages the practitioner (the engaging party).

**Review (in relation to quality control)** - Appraising the quality of the work performed and conclusions reached by others.

**Review engagement** - The objective of a review engagement is to enable an auditor to state whether, on the basis of procedures which do not provide all the evidence that would be required in an audit, anything has come to the auditor's attention that causes the auditor to believe that the financial statements are not prepared, in all material respects, in accordance with an applicable financial reporting framework.

**Review procedures** - The procedures deemed necessary to meet the objective of a review engagement, primarily inquiries of entity personnel and analytical procedures applied to financial data.

**Rights and Obligations Assertion** - The entity holds or controls the rights to assets, and liabilities are the obligations of the entity.

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**Risk assessment procedures** - The audit procedures performed to obtain an understanding of the entity and its environment, including the entity's internal control, to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels.

**Risk of material misstatement** - The risk that the financial statements are materially misstated prior to audit. This consists of two components, described as follows at the assertion level:

- (a) **Inherent risk**—The susceptibility of an assertion about a class of transaction, account balance or disclosure to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls.
- (b) **Control risk**—The risk that a misstatement that could occur in an assertion about a class of transaction, account balance or disclosure and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity's internal control.

**Sampling** - (see *Audit sampling*)

**Sampling risk** - The risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure. Sampling risk can lead to two types of erroneous conclusions:

- (a) In the case of a test of controls, that controls are more effective than they actually are, or in the case of a test of details, that a material misstatement does not exist when in fact it does. The auditor is primarily concerned with this type of erroneous conclusion because it affects audit effectiveness and is more likely to lead to an inappropriate audit opinion.
- (b) In the case of a test of controls, that controls are less effective than they actually are, or in the case of a test of details, that a material misstatement exists when in fact it does not. This type of erroneous conclusion affects audit efficiency as it would usually lead to additional work to establish that initial conclusions were incorrect.

**Sampling unit** - The individual items constituting a population.

**Scope of a review** - The review procedures deemed necessary in the circumstances to achieve the objective of the review.

**Service auditor** - An auditor who, at the request of the service organization, provides an assurance report on the controls of a service organization.

**Service organization** - A third-party organization (or segment of a third-party organization) that provides services to user entities that are part of those entities' information systems relevant to financial reporting.

**Service organization's system** - The policies and procedures designed, implemented and maintained by the service organization to provide user entities with the services covered by the service auditor's report.

**Significance** - The relative importance of a matter, taken in context. The significance of a matter is judged by the practitioner in the context in which it is being considered. This might include, for example, the reasonable prospect of its changing or influencing the decisions of intended

users of the practitioner's report; or, as another example, where the context is a judgment about whether to report a matter to those charged with governance, whether the matter would be regarded as important by them in relation to their duties. Significance can be considered in the context of quantitative and qualitative factors, such as relative magnitude, the nature and effect on the subject matter and the expressed interests of intended users or recipients

**Significant component** - A component identified by the group engagement team (i) that is of individual financial significance to the group, or (ii) that, due to its specific nature or circumstances, is likely to include significant risks of material misstatement of the group financial statements.

**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.

**Significant risk** - An identified and assessed risk of material misstatement that, in the auditor's judgment, requires special audit consideration.

**Single financial statement (for example, a cash flow statement) or to a specific element of a financial statement (for example, cash and bank balances)** - Includes the related notes. The related notes ordinarily comprise a summary of significant accounting policies and other explanatory information relevant to the financial statement or to the element.

**Smaller entity** - An entity which typically possesses qualitative characteristics such as:

- (a) Concentration of ownership and management in a small number of individuals (often a single individual – either a natural person or another enterprise that owns the entity provided the owner exhibits the relevant qualitative characteristics); and
- (b) One or more of the following:
  - (i) Straightforward or uncomplicated transactions;
  - (ii) Simple record-keeping;
  - (iii) Few lines of business and few products within business lines;
  - (iv) Few internal controls;
  - (v) Few levels of management with responsibility for a broad range of controls; or
  - (vi) Few personnel, many having a wide range of duties.

These qualitative characteristics are not exhaustive, they are not exclusive to smaller entities, and smaller entities do not necessarily display all of these characteristics.

**Special purpose financial statements** - Financial statements prepared in accordance with a special purpose framework.

**Special purpose framework** - A financial reporting framework designed to meet the financial information needs of specific users. The financial reporting framework may be a fair presentation framework or a compliance framework.<sup>13</sup>

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<sup>13</sup> SA 200, paragraph 13(a).

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**Staff** - Professionals, other than partners, including any experts the firm employs.

**Statistical sampling** - An approach to sampling that has the following characteristics:

- (a) Random selection of the sample items; and
- (b) The use of probability theory to evaluate sample results, including measurement of sampling risk.

A sampling approach that does not have characteristics (a) and (b) is considered non-statistical sampling.

**Stratification** - The process of dividing a population into sub-populations, each of which is a group of sampling units which have similar characteristics (often monetary value).

**Subject matter information** - The outcome of the evaluation or measurement of a subject matter. It is the subject matter information about which the practitioner gathers sufficient appropriate evidence to provide a reasonable basis for expressing a conclusion in an assurance report.

**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.

**Subservice organization** - A service organization used by another service organization to perform some of the services provided to user entities that are part of those user entities' information systems relevant to financial reporting.

**Substantive procedure** - An audit procedure designed to detect material misstatements at the assertion level. Substantive procedures comprise:

- (a) Tests of details (of classes of transactions, account balances, and disclosures); and
- (b) Substantive analytical procedures.

**Sufficiency (of audit evidence)** - The measure of the quantity of audit evidence. The quantity of the audit evidence needed is affected by the auditor's assessment of the risks of material misstatement and also by the quality of such audit evidence.

**Suitable criteria** - (see *Criteria*)

**Suitably qualified external person** - An individual outside the firm with the competence and capabilities to act as an engagement partner, for example a partner of another firm, or an employee (with appropriate experience) of another firm.

**Summary financial statements (in the context of ISA 810)** - Historical financial information that is derived from financial statements but that contains less detail than the financial statements, while still providing a structured representation consistent with that provided by the financial statements of the entity's economic resources or obligations at a point in time or the changes therein for a period of time.<sup>14</sup> Different jurisdictions may use different terminology to describe such historical financial information.

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<sup>14</sup> SA 200, paragraph 13(f).

**Supplementary information** - Information that is presented together with the financial statements that is not required by the applicable financial reporting framework used to prepare the financial statements, normally presented in either supplementary schedules or as additional notes.

**Systematic Selection** - Systematic selection is a sample selection method, in which the number of sampling units in the population is divided by the sample size to give a sampling interval, for example 50, and having determined a starting point within the first 50, each 50<sup>th</sup> sampling unit thereafter is selected.

**Test** - The application of procedures to some or all items in a population.

**Tests of controls** - An audit procedure designed to evaluate the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements at the assertion level.

**Those charged with governance** - The person(s) or organization(s) (for example, 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 in some jurisdictions, 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.<sup>15</sup>

**Timing of Audit Procedure** - Timing of an audit procedure refers to when it is performed, or the period to date to which the audit evidence applies.

**Tolerable misstatement** - A monetary amount set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that the monetary amount set by the auditor is not exceeded by the actual misstatement in the population.

**Total rate of deviation** - A rate of deviation from prescribed internal control procedures set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that the rate of deviation set by the auditor is not exceeded by the actual rate of deviation in the population.

**Uncertainty** - A matter whose outcome depends on future actions or events not under the direct control of the entity but that may affect the financial statements.

**Uncorrected misstatements** - Misstatements that the auditor has accumulated during the audit and that have not been corrected.

**Unmodified opinion** - The opinion expressed by the auditor when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.<sup>16</sup>

**User auditor** - An auditor who audits and reports on the financial statements of a user entity.

**User entity** - An entity that uses a service organization and whose financial statements are being audited.

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<sup>15</sup> For discussion of the diversity of governance structures, see paragraphs A1-A8 of SA 260, "Communication with Those Charged with Governance."

<sup>16</sup> SA 700 (Revised), paragraphs 35-36, deal with the phrases used to express this opinion in the case of a fair presentation framework and a compliance framework respectively.

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**Valuation and Allocation Assertion** - Assets, liabilities and equity interest are included in the financial statements at appropriate amounts and any resulting valuation or allocation adjustments are appropriately recorded.

**Walk-through test** - Involves tracing a few transactions through the financial reporting system.

**Written representation** - 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.

## Standard on Quality Control (SQC) 1

### Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements\*

*(Effective for all engagements relating to accounting periods beginning on or after April 1, 2009)*

#### Introduction

1. The purpose of this Standard on Quality Control (SQC) is to establish standards and provide guidance regarding a firm's responsibilities for its system of quality control for audits and reviews of historical financial information, and for other assurance and related services engagements. This SQC is to be read in conjunction with the requirements of the Chartered Accountants Act, 1949, the Code of Ethics and other relevant pronouncements of the Institute<sup>1</sup> (hereinafter referred to as "the Code").

2. Additional standards and guidance on the responsibilities of firm personnel regarding quality control procedures for specific types of engagements are set out in other pronouncements of the Auditing and Assurance Standards Board (AASB) issued under the authority of the Council. For example, Standard on Auditing (SA) 220, "Quality Control for an Audit of Financial Statements", establishes standards and provides guidance on quality control procedures for audits of historical financial information.

**3. The firm should establish a system of quality control designed to provide it with reasonable assurance that the firm and its personnel comply with professional standards and regulatory and legal requirements, and that reports issued by the firm<sup>2</sup> or engagement partner(s) are appropriate in the circumstances.**

4. A system of quality control consists of policies designed to achieve the objectives set out in paragraph 3 and the procedures necessary to implement and monitor compliance with those policies.

5. This SQC applies to all firms. The nature of the policies and procedures developed by individual firms to comply with this SQC will depend on various factors such as the size and operating characteristics of the firm, and whether it is part of a network.

#### Definitions

6. In this SQC, the following terms have the meanings attributed below:

- (a) *Engagement documentation* – the record of work performed, results obtained, and conclusions the practitioner reached (terms such as "working papers" or "workpapers")

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\* Published in October, 2007 issue of the Journal.

<sup>1</sup> Attention of the members is invited, for instance, to the *Guidance Note on Independence of Auditors*, issued by the Committee on Ethical Standards.

<sup>2</sup> It is clarified that in India the reports are not issued/signed in the firm's name, rather they are issued/signed on behalf of the firm by the sole practitioner, proprietor or a partner of the firm, as the case may be, in his individual name. The definition of a 'firm' has been given in paragraph 6(f) of this Standard.

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are also sometimes used). The documentation for a specific engagement is assembled in an engagement file;

- (b) *Engagement partner* – the partner or other person in the firm who is a member of the Institute of Chartered Accountants of India and is in full time practice and is responsible for the engagement and its performance, and for the report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body.
- (c) *Engagement quality control review* – a process designed to provide an objective evaluation, before the report is issued, of the significant judgments the engagement team made and the conclusions they reached in formulating the report.
- (d) *Engagement quality control reviewer* – a partner, other person<sup>3</sup> in the firm, suitably qualified external person, or a team made up of such individuals, with sufficient and appropriate experience and authority to objectively evaluate, before the report is issued, the significant judgments the engagement team made and the conclusions they reached in formulating the report. However, in case the review is done by a team of individuals, such team should be headed by a member of the Institute.
- (e) *Engagement team* – all personnel performing an engagement, including any experts contracted by the firm in connection with that engagement.
- (f) *Firm* – a sole practitioner/proprietor, partnership, or any such entity of professional accountants, as may be permitted by law.
- (g) *Inspection* – in relation to completed engagements, procedures designed to provide evidence of compliance by engagement teams with the firm’s quality control policies and procedures.
- (h) *Listed entity* – an entity whose shares, stock or debt are quoted or listed on a recognized stock exchange, or are traded under the regulations of a recognized stock exchange or other equivalent body.
- (i) *Monitoring* – a process comprising an ongoing consideration and evaluation of the firm’s system of quality control, including a periodic inspection of a selection of completed engagements, designed to enable the firm to obtain reasonable assurance that its system of quality control is operating effectively.
- (j) *Network firm*– A firm or entity that belongs to a network.
- (k) *Network* – A larger structure:
  - (i) That is aimed at cooperation, and
  - (ii) That is clearly aimed at profit or cost-sharing or shares common ownership, control or management, common quality control policies and procedures, common business strategy, the use of a common brand name, or a significant part of professional resources.

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<sup>3</sup> Such other person should be a member of the Institute of Chartered Accountants of India.

- (l) *Partner* – any individual with authority to bind the firm with respect to the performance of a professional services engagement.
- (m) *Personnel* – partners and staff.
- (n) *Professional standards* – engagement standards, as defined in the AASB’s “Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services,” and relevant ethical requirements as contained in the Code.
- (o) *Reasonable assurance* – in the context of this SQC, a high, but not absolute, level of assurance.
- (p) *Staff* – professionals, other than partners, including any experts which the firm employs.
- (q) *Suitably qualified external person* – an individual outside the firm with the capabilities and competence to act as an engagement partner, for example a partner or an employee<sup>4</sup> (with appropriate experience) of another firm.

#### **Elements of a System of Quality Control**

**7. The firm’s system of quality control should include policies and procedures addressing each of the following elements:**

- (a) Leadership responsibilities for quality within the firm.**
- (b) Ethical requirements.**
- (c) Acceptance and continuance of client relationships and specific engagements.**
- (d) Human resources.**
- (e) Engagement performance.**
- (f) Monitoring.**

**8. The quality control policies and procedures should be documented and communicated to the firm’s personnel.** Such communication describes the quality control policies and procedures and the objectives they are designed to achieve, and includes the message that each individual has a personal responsibility for quality and is expected to comply with these policies and procedures. In addition, the firm recognizes the importance of obtaining feedback on its quality control system from its personnel. Therefore, the firm encourages its personnel to communicate their views or concerns on quality control matters.

#### **Leadership Responsibilities for Quality within the Firm**

**9. The firm should establish policies and procedures designed to promote an internal culture based on the recognition that quality is essential in performing engagements. Such policies and procedures should require the firm’s chief executive officer (or equivalent) or, if appropriate, the firm’s managing partners (or equivalent), to assume ultimate responsibility for the firm’s system of quality control.**

10. The firm’s leadership and the examples it sets significantly influence the internal culture of

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<sup>4</sup> Such employee should be a member of the Institute of Chartered Accountants of India.

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the firm. The promotion of a quality-oriented internal culture depends on clear, consistent and frequent actions and messages from all levels of the firm's management emphasizing the firm's quality control policies and procedures, and the requirement to:

- (a) Perform work that complies with professional standards and regulatory and legal requirements; and
- (b) Issue reports that are appropriate in the circumstances.

Such actions and messages encourage a culture that recognizes and rewards high quality work. They may be communicated by training seminars, meetings, formal or informal dialogue, mission statements, newsletters, or briefing memoranda. They are incorporated in the firm's internal documentation and training materials, and in partner and staff appraisal procedures such that they will support and reinforce the firm's view on the importance of quality and how, practically, it is to be achieved.

11. Of particular importance is the need for the firm's leadership to recognize that the firm's business strategy is subject to the overriding requirement for the firm to achieve quality in all the engagements that the firm performs. Accordingly:

- (a) The firm assigns its management responsibilities so that commercial considerations do not override the quality of work performed;
- (b) The firm's policies and procedures addressing performance evaluation, compensation, and promotion (including incentive systems) with regard to its personnel, are designed to demonstrate the firm's overriding commitment to quality; and
- (c) The firm devotes sufficient resources for the development, documentation and support of its quality control policies and procedures.

**12. Any person or persons assigned operational responsibility for the firm's quality control system by the firm's chief executive officer or managing board of partners should have sufficient and appropriate experience and ability, and the necessary authority, to assume that responsibility.**

13. Sufficient and appropriate experience and ability enables the responsible person or persons to identify and understand quality control issues and to develop appropriate policies and procedures. Necessary authority enables the person or persons to implement those policies and procedures.

### **Ethical Requirements**

**14. The firm should establish policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with relevant ethical requirements.**

15. Ethical requirements relating to audits and reviews of historical financial information, and other assurance and related services engagements are contained in the Code. The Code establishes the fundamental principles of professional ethics, which include:

- (a) Integrity;
- (b) Objectivity;

- (c) Professional competence and due care;
- (d) Confidentiality; and
- (e) Professional behavior.

16. The Code includes a conceptual approach to independence for assurance engagements, including aspects such as threats to independence, accepted safeguards and the public interest.

**17. The firm's policies and procedures should emphasize the fundamental principles, which are reinforced in particular by (a) the leadership of the firm, (b) education and training, (c) monitoring, and (d) a process for dealing with non-compliance.** Independence for assurance engagements is so significant that it is addressed separately in paragraphs 18-27 below. These paragraphs need to be read in conjunction with the Code.

### **Independence**

**18. The firm should establish policies and procedures designed to provide it with reasonable assurance that the firm, its personnel and, where applicable, others subject to independence requirements (including experts contracted by the firm and network firm personnel), maintain independence where required by the Code. Such policies and procedures should enable the firm to:**

- (a) **Communicate its independence requirements to its personnel and, where applicable, to others subject to them; and**
- (b) **Identify and evaluate circumstances and relationships that create threats to independence, and to take appropriate action to eliminate those threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the engagement.**

**19. Such policies and procedures should require:**

- (a) **Engagement partners to provide the firm with relevant information about client engagements, including the scope of services, to enable the firm to evaluate the overall impact, if any, on independence requirements;**
- (b) **Personnel to promptly notify the firm of circumstances and relationships that create a threat to independence so that appropriate action can be taken; and**
- (c) **The accumulation and communication of relevant information to appropriate personnel so that:**
  - (i) **The firm and its personnel can readily determine whether they satisfy independence requirements;**
  - (ii) **The firm can maintain and update its records relating to independence; and**
  - (iii) **The firm can take appropriate action regarding identified threats to independence.**

**20. The firm should establish policies and procedures designed to provide it with reasonable assurance that it is notified of breaches of independence requirements, and to enable it to take appropriate actions to resolve such situations. The policies and**

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procedures should include requirements for:

- (a) **All who are subject to independence requirements to promptly notify the firm of independence breaches of which they become aware;**
- (b) **The firm to promptly communicate identified breaches of these policies and procedures to:**
  - (i) **The engagement partner who, with the firm, needs to address the breach; and**
  - (ii) **Other relevant personnel in the firm and those subject to the independence requirements who need to take appropriate action; and**
- (c) **Prompt communication to the firm, if necessary, by the engagement partner and the other individuals referred to in subparagraph (b)(ii) of the actions taken to resolve the matter, so that the firm can determine whether it should take further action.**

21. Comprehensive guidance on threats to independence and safeguards, including application to specific situations are contained in the Code.

22. A firm receiving notice of a breach of independence policies and procedures promptly communicates relevant information to engagement partners, others in the firm, as appropriate and, where applicable, experts contracted by the firm and network firm personnel, for appropriate action. Appropriate action by the firm and the relevant engagement partner includes applying appropriate safeguards to eliminate the threats to independence or to reduce them to an acceptable level, or withdrawing from the engagement. In addition, the firm provides independence education to personnel who are required to be independent.

**23. At least annually, the firm should obtain written confirmation of compliance with its policies and procedures on independence from all firm personnel required to be independent in terms of the requirements of the Code.**

24. Written confirmation may be in paper or electronic form. By obtaining confirmation and taking appropriate action on information indicating non-compliance, the firm demonstrates the importance that it attaches to independence and makes the issue current for, and visible to, its personnel.

25. The Code discusses the familiarity threat that may be created by using the same senior personnel on an assurance engagement over a long period of time and the safeguards that might be appropriate to address such a threat. **Accordingly, the firm should establish policies and procedures:**

- (a) **Setting out criteria for determining the need for safeguards to reduce the familiarity threat to an acceptable level when using the same senior personnel on an assurance engagement over a long period of time; and**
- (b) **For all audits of financial statements of listed entities, requiring the rotation of the engagement partner after a specified period in compliance with the Code.**

26. Using the same senior personnel on assurance engagements over a prolonged period may create a familiarity threat or otherwise impair the quality of performance of the engagement. Therefore, the firm should establish criteria for determining the need for safeguards to address

this threat. In determining appropriate criteria, the firm considers such matters as (a) the nature of the engagement, including the extent to which it involves a matter of public interest, and (b) the length of service of the senior personnel on the engagement. Examples of safeguards include rotating the senior personnel or requiring an engagement quality control review.

27. The familiarity threat is particularly relevant in the context of financial statement audits of listed entities. **For these audits, the engagement partner should be rotated after a pre-defined period, normally not more than seven years<sup>5</sup>.**

#### **Acceptance and Continuance of Client Relationships and Specific Engagements**

**28. The firm should establish policies and procedures for the acceptance and continuance of client relationships and specific engagements, designed to provide it with reasonable assurance that it will undertake or continue relationships and engagements only where it:**

- (a) **Has considered the integrity of the client and does not have information that would lead it to conclude that the client lacks integrity;**
- (b) **Is competent to perform the engagement and has the capabilities, time and resources to do so; and**
- (c) **Can comply with the ethical requirements.**

**The firm should obtain such information as it considers necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client. Where issues have been identified, and the firm decides to accept or continue the client relationship or a specific engagement, it should document how the issues were resolved.**

29. With regard to the integrity of a client, matters that the firm considers include, for example:

- The identity and business reputation of the client's principal owners, key management, related parties and those charged with its governance.
- The nature of the client's operations, including its business practices.
- Information concerning the attitude of the client's principal owners, key management and those charged with its governance towards such matters as aggressive interpretation of accounting standards and the internal control environment.
- Whether the client is aggressively concerned with maintaining the firm's fees as low as

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<sup>5</sup> The provision of rotation of partners shall not be applicable in case the audit of listed entities is being done by a sole practitioner/proprietor. However, in order to ensure that appropriate system of quality control exists in the firm and that appropriate reports are issued in the circumstances by sole practitioners/proprietors, such practice unit(s) shall be compulsorily reviewed under the process of peer review. The complete text of the Announcement is published in Paragraph 'C', "Announcements/Clarifications" of Section 1, "Announcements of the Council regarding Status of Various Documents issued by the Institute of Chartered Accountants of India", included in Volume I.A of the Handbook.

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possible.

- Indications of an inappropriate limitation in the scope of work.
- Indications that the client might be involved in money laundering or other criminal activities.
- The reasons for the proposed appointment of the firm and non-reappointment of the previous firm.

The extent of knowledge a firm will have regarding the integrity of a client will generally grow within the context of an ongoing relationship with that client.

30. Information on such matters that the firm obtains may come from, for example:

- Communications with existing or previous providers of professional accountancy services to the client in accordance with the Code, and discussions with other third parties.
- Inquiry of other firm personnel or third parties such as bankers, legal counsel and industry peers.
- Background searches of relevant databases.

31. In considering whether the firm has the capabilities, competence, time and resources to undertake a new engagement from a new or an existing client, the firm reviews the specific requirements of the engagement and existing partner and staff profiles at all relevant levels. Matters the firm considers include whether:

- Firm personnel have knowledge of relevant industries or subject matters;
- Firm personnel have experience with relevant regulatory or reporting requirements, or the ability to gain the necessary skills and knowledge effectively;
- The firm has sufficient personnel with the necessary capabilities and competence;
- Experts are available, if needed;
- Individuals meeting the criteria and eligibility requirements to perform engagement quality control review are available, where applicable; and
- The firm would be able to complete the engagement within the reporting deadline.

32. The firm also considers whether accepting an engagement from a new or an existing client may give rise to an actual or perceived conflict of interest<sup>6</sup>. Where a potential conflict is identified, the firm considers whether it is appropriate to accept the engagement.

33. Deciding whether to continue a client relationship includes consideration of significant matters that have arisen during the current or previous engagements, and their implications for continuing the relationship. For example, a client may have started to expand its business operations into an area where the firm does not possess the necessary knowledge or expertise.

**34. Where the firm obtains information that would have caused it to decline an engagement if that information had been available earlier, policies and procedures on**

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<sup>6</sup> Attention of the members is invited to the 'Code of Ethics' and the 'Guidance Note on Independence of Auditors' issued by the ICAI.

**the continuance of the engagement and the client relationship should include consideration of:**

- (a) **The professional and legal responsibilities that apply to the circumstances, including whether there is a requirement for the firm to report to the person or persons who made the appointment or, in some cases, to regulatory authorities; and**
- (b) **The possibility of withdrawing from the engagement or from both the engagement and the client relationship.**

35. Policies and procedures on withdrawal from an engagement or from both the engagement and the client relationship address issues that include the following:

- Discussing with the appropriate level of the client's management and those charged with its governance regarding the appropriate action that the firm might take based on the relevant facts and circumstances.
- If the firm determines that it is appropriate to withdraw, discussing with the appropriate level of the client's management and those charged with its governance withdrawal from the engagement or from both the engagement and the client relationship, and the reasons for the withdrawal.
- Considering whether there is a professional, regulatory or legal requirement for the firm to remain in place, or for the firm to report the withdrawal from the engagement, or from both the engagement and the client relationship, together with the reasons for the withdrawal, to regulatory authorities.
- Documenting significant issues, consultations, conclusions and the basis for the conclusions.

#### **Human Resources**

**36. The firm should establish policies and procedures designed to provide it with reasonable assurance that it has sufficient personnel with the capabilities, competence, and commitment to ethical principles necessary to perform its engagements in accordance with professional standards and regulatory and legal requirements, and to enable the firm or engagement partners to issue reports that are appropriate in the circumstances.**

37. Such policies and procedures address the following personnel issues:

- (a) Recruitment;
- (b) Performance evaluation;
- (c) Capabilities;
- (d) Competence;
- (e) Career development;
- (f) Promotion;
- (g) Compensation; and
- (h) Estimation of personnel needs.

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Addressing these issues enables the firm to ascertain the number and characteristics of the individuals required for the firm's engagements. The firm's recruitment processes include procedures that help the firm select individuals of integrity as well as the capacity to develop the capabilities and competence necessary to perform the firm's work.

38. Capabilities and competence are developed through a variety of methods, including the following:

- Professional education.
- Continuing professional development, including training.
- Work experience.
- Coaching by more experienced staff, for example, other members of the engagement team.

39. The continuing competence of the firm's personnel depends to a significant extent on an appropriate level of continuing professional development so that personnel maintain and also enhance their knowledge and capabilities. The firm therefore emphasizes in its policies and procedures, the need for continuing training for all levels of firm personnel, and provides the necessary training resources and assistance to enable personnel to develop and maintain the required capabilities and competence. Where internal technical and training resources are unavailable, or for any other reason, the firm may use a suitably qualified external person for that purpose.

40. The firm's performance evaluation, compensation and promotion procedures give due recognition and reward to the development and maintenance of competence and commitment to ethical principles. In particular, the firm:

- (a) Makes personnel aware of the firm's expectations regarding performance and ethical principles;
- (b) Provides personnel with evaluation of, and counseling on, performance, progress and career development; and
- (c) Helps personnel understand that advancement to positions of greater responsibility depends, among other things, upon performance quality and adherence to ethical principles, and that failure to comply with the firm's policies and procedures may result in disciplinary action.

41. The size and circumstances of the firm will influence the structure of the firm's performance evaluation process. Smaller firms, in particular, may employ less formal methods of evaluating the performance of their personnel.

### **Assignment of Engagement Teams**

**42. The firm should assign responsibility for each engagement to an engagement partner. The firm should establish policies and procedures requiring that:**

- (a) **The identity and role of the engagement partner are communicated to key members of the client's management and those charged with governance;**
- (b) **The engagement partner has the appropriate capabilities, competence, authority**

**and time to perform the role; and**

(c) **The responsibilities of the engagement partner are clearly defined and communicated to that partner.**

43. Policies and procedures include systems to monitor the workload and availability of engagement partners so as to enable these individuals to have sufficient time to adequately discharge their responsibilities.

**44. The firm should also assign appropriate staff with the necessary capabilities, competence and time to perform engagements in accordance with professional standards and regulatory and legal requirements, and to enable the firm or engagement partners to issue reports that are appropriate in the circumstances.**

45. The firm establishes procedures to assess its staff's capabilities and competence. The capabilities and competence considered when assigning engagement teams, and in determining the level of supervision required, include the following:

- An understanding of, and practical experience with, engagements of a similar nature and complexity through appropriate training and participation.
- An understanding of professional standards and regulatory and legal requirements.
- Appropriate technical knowledge, including knowledge of relevant information technology.
- Knowledge of the relevant industries in which the clients operate.
- Ability to apply professional judgment.
- An understanding of the firm's quality control policies and procedures.

#### **Engagement Performance**

**46. The firm should establish policies and procedures designed to provide it with reasonable assurance that engagements are performed in accordance with professional standards and regulatory and legal requirements, and that the firm or the engagement partner issues reports that are appropriate in the circumstances.**

47. Through its policies and procedures, the firm seeks to establish consistency in the quality of engagement performance. This is often accomplished through written or electronic manuals, software tools or other forms of standardized documentation, and industry or subject matter-specific guidance materials. Matters addressed include the following:

- How engagement teams are briefed on the engagement to obtain an understanding of the objectives of their work.
- Processes for complying with applicable engagement standards.
- Processes of engagement supervision, staff training and coaching.
- Methods of reviewing the work performed, the significant judgments made and the form of report being issued.
- Appropriate documentation of the work performed and of the timing and extent of the review.

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- Processes to keep all policies and procedures current.

48. It is important that all members of the engagement team understand the objectives of the work they are to perform. Appropriate team-working and training are necessary to assist less experienced members of the engagement team to clearly understand the objectives of the assigned work.

49. Supervision includes the following:

- Tracking the progress of the engagement.
- Considering the capabilities and competence of individual members of the engagement team, whether they have sufficient time to carry out their work, whether they understand their instructions and whether the work is being carried out in accordance with the planned approach to the engagement.
- Addressing significant issues arising during the engagement, considering their significance and appropriately modifying the planned approach appropriately.
- Identifying matters for consultation or consideration by more experienced engagement team members during the engagement.

50. Review responsibilities are determined on the basis that more experienced engagement team members, including the engagement partner, review work performed by less experienced team members. Reviewers consider whether:

- (a) The work has been performed in accordance with professional standards and regulatory and legal requirements;
- (b) Significant matters have been raised for further consideration;
- (c) Appropriate consultations have taken place and the resulting conclusions have been documented and implemented;
- (d) There is a need to revise the nature, timing and extent of work performed;
- (e) The work performed supports the conclusions reached and is appropriately documented;
- (f) The evidence obtained is sufficient and appropriate to support the report; and
- (g) The objectives of the engagement procedures have been achieved.

### **Consultation**

**51. The firm should establish policies and procedures designed to provide it with reasonable assurance that:**

- (a) Appropriate consultation takes place on difficult or contentious matters;**
- (b) Sufficient resources are available to enable appropriate consultation to take place;**
- (c) The nature and scope of such consultations are documented; and**
- (d) Conclusions resulting from consultations are documented and implemented.**

52. Consultation includes discussion, at the appropriate professional level, with individuals within or outside the firm who have specialized expertise, to resolve a difficult or contentious matter.

53. Consultation uses appropriate research resources as well as the collective experience and technical expertise of the firm. Consultation helps to promote quality and improves the application of professional judgment. The firm seeks to establish a culture in which consultation is recognized as a strength and encourages personnel to consult on difficult or contentious matters.

54. Effective consultation with other professionals requires that those consulted be given all the relevant facts that will enable them to provide informed advice on technical, ethical or other matters. Consultation procedures require consultation with those having appropriate knowledge, seniority and experience within the firm (or, where applicable, outside the firm) on significant technical, ethical and other matters, and appropriate documentation and implementation of conclusions resulting from consultations.

55. A firm needing to consult externally, for example, a firm without appropriate internal resources, may take advantage of advisory services provided by (a) other firms, or (b) professional and regulatory bodies. Before contracting for such services, the firm considers whether the external provider is suitably qualified for that purpose.

56. The documentation of consultations with other professionals that involve difficult or contentious matters is agreed by both the individual seeking consultation and the individual consulted. The documentation is sufficiently complete and detailed to enable an understanding of:

- (a) The issue on which consultation was sought; and
- (b) The results of the consultation, including any decisions taken, the basis for those decisions and how they were implemented.

#### **Differences of Opinion**

**57. The firm should establish policies and procedures for dealing with and resolving differences of opinion within the engagement team, with those consulted and, where applicable, between the engagement partner and the engagement quality control reviewer. Conclusions reached should be documented and implemented.**

58. Such procedures encourage identification of differences of opinion at an early stage, provide clear guidelines as to the successive steps to be taken thereafter, and require documentation regarding the resolution of the differences and the implementation of the conclusions reached. **The report should not be issued until the matter is resolved.**

59. A firm using a suitably qualified external person(s) to conduct an engagement quality control review recognizes that differences of opinion can occur and establishes procedures to resolve such differences, for example, by consulting with another practitioner or firm, or a professional or regulatory body.

#### **Engagement Quality Control Review**

**60. The firm should establish policies and procedures requiring, for appropriate engagements, an engagement quality control review that provides an objective evaluation of the significant judgments made by the engagement team and the conclusions reached in formulating the report. Such policies and procedures should:**

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- (a) **Require an engagement quality control review for all audits of financial statements of listed entities;**
- (b) **Set out criteria against which all other audits and reviews of historical financial information, and other assurance and related services engagements should be evaluated to determine whether an engagement quality control review should be performed; and**
- (c) **Require an engagement quality control review for all engagements meeting the criteria established in compliance with subparagraph (b).**

**61. The firm's policies and procedures should require the completion of the engagement quality control review before the report is issued.**

62. Criteria that a firm considers when determining which engagements other than audits of financial statements of listed entities are to be subject to an engagement quality control review include the following:

- The nature of the engagement, including the extent to which it involves a matter of public interest.
- The identification of unusual circumstances or risks in an engagement or class of engagements.
- Whether laws or regulations require an engagement quality control review.

**63. The firm should establish policies and procedures setting out:**

- (a) **The nature, timing and extent of an engagement quality control review;**
- (b) **Criteria for the eligibility of engagement quality control reviewers; and**
- (c) **Documentation requirements for an engagement quality control review.**

### ***Nature, Timing and Extent of the Engagement Quality Control Review***

64. An engagement quality control review ordinarily involves discussion with the engagement partner, a review of the financial statements or other subject matter information and the report, and, in particular, consideration of whether the report is appropriate. It also involves a review of selected working papers relating to the significant judgments that the engagement team made and the conclusions they reached. The extent of the review depends on the complexity of the engagement and the risk that the report might not be appropriate in the circumstances. The review does not reduce the responsibilities of the engagement partner.

65. An engagement quality control review for audits of financial statements of listed entities includes considering the following:

- The engagement team's evaluation of the firm's independence in relation to the specific engagement.
- Significant risks identified during the engagement and the responses to those risks.
- Judgments made, particularly with respect to materiality and significant risks.
- Whether appropriate consultation has taken place on matters involving differences of opinion or other difficult or contentious matters, and the conclusions arising from those

consultations.

- The significance and disposition of corrected and uncorrected misstatements identified during the engagement.
- The matters to be communicated to management and those charged with governance and, where applicable, other parties such as regulatory bodies.
- Whether working papers selected for review reflect the work performed in relation to the significant judgments and support the conclusions reached.
- The appropriateness of the report to be issued.

Engagement quality control reviews for engagements other than audits of financial statements of listed entities may, depending on the circumstances, include some or all of these considerations.

66. The engagement quality control reviewer conducts the review in a timely manner at appropriate stages during the engagement so that significant matters may be promptly resolved to the reviewer's satisfaction before the report is issued.

67. Where the engagement quality control reviewer makes recommendations that the engagement partner does not accept and the matter is not resolved to the reviewer's satisfaction, the report is not issued until the matter is resolved by following the firm's procedures for dealing with differences of opinion.

***Criteria for the Eligibility of Engagement Quality Control Reviewers***

**68. The firm's policies and procedures should address the appointment of engagement quality control reviewers and establish their eligibility through:**

- (a) **The technical qualifications required to perform the role, including the necessary experience and authority; and**
- (b) **The degree to which an engagement quality control reviewer can be consulted on the engagement without compromising the reviewer's objectivity.**

69. The firm's policies and procedures on the technical qualifications of engagement quality control reviewers address the technical expertise, experience and authority necessary to perform the role. What constitutes sufficient and appropriate technical expertise, experience and authority depends on the circumstances of the engagement. In addition, the engagement quality control reviewer for an audit of the financial statements of a listed entity is an individual with sufficient and appropriate experience and authority to act as an audit engagement partner on audits of financial statements of listed entities.

70. The firm's policies and procedures are designed to maintain the objectivity of the engagement quality control reviewer. For example, the engagement quality control reviewer:

- (a) Is not selected by the engagement partner;
- (b) Does not otherwise participate in the engagement during the period of review;
- (c) Does not make decisions for the engagement team; and
- (d) Is not subject to other considerations that would threaten the reviewer's objectivity.

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71. The engagement partner may consult the engagement quality control reviewer during the engagement. Such consultation need not compromise the engagement quality control reviewer's eligibility to perform the role. Where the nature and extent of the consultations become significant, however, care is taken by both the engagement team and the reviewer to maintain the reviewer's objectivity. Where this is not possible, another individual within the firm or a suitably qualified external person is appointed to take on the role of either the engagement quality control reviewer or the person to be consulted on the engagement. The firm's policies provide for the replacement of the engagement quality control reviewer where the ability to perform an objective review may be impaired.

72. Suitably qualified external persons may be contracted where sole practitioners or small firms identify engagements requiring engagement quality control reviews. Alternatively, some sole practitioners or small firms may wish to use other firms to facilitate engagement quality control reviews. Where the firm contracts suitably qualified external persons, the firm follows the requirements and guidance in paragraphs 69-72.

### ***Documentation of the Engagement Quality Control Review***

**73. Policies and procedures on documentation of the engagement quality control review should require documentation that:**

- (a) **The procedures required by the firm's policies on engagement quality control review have been performed;**
- (b) **The engagement quality control review has been completed before the report is issued; and**
- (c) **The reviewer is not aware of any unresolved matters that would cause the reviewer to believe that the significant judgments the engagement team made and the conclusions they reached were not appropriate.**

### **Engagement Documentation**

#### ***Completion of the Assembly of Final Engagement Files***

**74. The firm should establish policies and procedures for engagement teams to complete the assembly of final engagement files on a timely basis after the engagement reports have been finalized.**

75. Law or regulation may prescribe the time limits by which the assembly of final engagement files for specific types of engagement should be completed. Where no such time limits are prescribed in law or regulation, the firm establishes time limits appropriate to the nature of the engagements that reflect the need to complete the assembly of final engagement files on a timely basis. In the case of an audit, for example, such a time limit is ordinarily not more than 60 days after the date of the auditor's report.

76. Where two or more different reports are issued in respect of the same subject matter information of an entity, the firm's policies and procedures relating to time limits for the assembly of final engagement files address each report as if it were for a separate engagement. This may, for example, be the case when the firm issues an auditor's report on a component's financial information for group consolidation purposes and, at a subsequent date, an auditor's

report on the same financial information for statutory purposes.

***Confidentiality, Safe Custody, Integrity, Accessibility and Retrievability of Engagement Documentation***

**77. The firm should establish policies and procedures designed to maintain the confidentiality, safe custody, integrity, accessibility and retrievability of engagement documentation.**

78. Relevant ethical requirements establish an obligation for the firm's personnel to observe at all times the confidentiality of information contained in engagement documentation, unless specific client authority has been given to disclose information, or there is a legal or professional duty to do so. Specific laws or regulations may impose additional obligations on the firm's personnel to maintain client confidentiality, particularly where data of a personal nature are concerned.

79. Whether engagement documentation is in paper, electronic or other media, the integrity, accessibility or retrievability of the underlying data may be compromised if the documentation could be altered, added to or deleted without the firm's knowledge, or if it could be permanently lost or damaged. Accordingly, the firm designs and implements appropriate controls for engagement documentation to:

- (a) Enable the determination of when and by whom engagement documentation was created, changed or reviewed;
- (b) Protect the integrity of the information at all stages of the engagement, especially when the information is shared within the engagement team or transmitted to other parties *via* the Internet;
- (c) Prevent unauthorized changes to the engagement documentation; and
- (d) Allow access to the engagement documentation by the engagement team and other authorized parties as necessary to properly discharge their responsibilities.

80. Controls that the firm may design and implement to maintain the confidentiality, safe custody, integrity, accessibility and retrievability of engagement documentation include, for example:

- The use of a password among engagement team members to restrict access to electronic engagement documentation to authorized users.
- Appropriate back-up routines for electronic engagement documentation at appropriate stages during the engagement.
- Procedures for properly distributing engagement documentation to the team members at the start of engagement, processing it during engagement, and collating it at the end of engagement.
- Procedures for restricting access to, and enabling proper distribution and confidential storage of, hardcopy engagement documentation.

81. For practical reasons, original paper documentation may be electronically scanned for inclusion in engagement files. In that case, the firm implements appropriate procedures

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requiring engagement teams to:

- (a) Generate scanned copies that reflect the entire content of the original paper documentation, including manual signatures, cross-references and annotations;
- (b) Integrate the scanned copies into the engagement files, including indexing and signing off on the scanned copies as necessary; and
- (c) Enable the scanned copies to be retrieved and printed as necessary.

The firm considers whether to retain original paper documentation that has been scanned for legal, regulatory or other reasons.

### ***Retention of Engagement Documentation***

**82. The firm should establish policies and procedures for the retention of engagement documentation for a period sufficient to meet the needs of the firm or as required by law or regulation.**

83. The needs of the firm for retention of engagement documentation, and the period of such retention, will vary with the nature of the engagement and the firm's circumstances, for example, whether the engagement documentation is needed to provide a record of matters of continuing significance to future engagements. The retention period may also depend on other factors, such as whether local law or regulation prescribes specific retention periods for certain types of engagements, or whether there are generally accepted retention periods in the jurisdiction in the absence of specific legal or regulatory requirements. In the specific case of audit engagements, the retention period ordinarily is no shorter than seven years<sup>7</sup> from the date of the auditor's report, or, if later, the date of the group auditor's report.

84. Procedures that the firm adopts for retention of engagement documentation include those that:

- Enable the retrieval of, and access to, the engagement documentation during the retention period, particularly in the case of electronic documentation since the underlying technology may be upgraded or changed over time.
- Provide, where necessary, a record of changes made to engagement documentation after the engagement files have been completed.
- Enable authorized external parties to access and review specific engagement documentation for quality control or other purposes.

### ***Ownership of Engagement Documentation***

85. Unless otherwise specified by law or regulation, engagement documentation is the

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<sup>7</sup> The Council of the Institute had in August 2009, pursuant to the provisions of Rule 12 of the Chartered Accountants (Procedures of Investigations of Professional and Other Misconduct and Cases) Rules, 2007 had amended the audit documentation retention period appearing as ten years in paragraph 83 of SQC 1 to seven years. As a consequence of above decision of the Council, the audit documentation retention period appearing as ten years in paragraph A23 of SA 230, 'Audit Documentation', issued in January 2009, shall also stand amended to seven years. The complete text of the Announcement is published in Paragraph 'C', "Announcements/Clarifications" of Section 1, "Announcements of the Council regarding Status of Various Documents issued by the Institute of Chartered Accountants of India", included in Volume I.A of the Handbook.

property of the firm. The firm may, at its discretion, make portions of, or extracts from, engagement documentation available to clients, provided such disclosure does not undermine the validity of the work performed, or, in the case of assurance engagements, the independence of the firm or its personnel.

### **Monitoring**

**86. The firm should establish policies and procedures designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate, operating effectively and complied with in practice. Such policies and procedures should include an ongoing consideration and evaluation of the firm's system of quality control, including a periodic inspection of a selection of completed engagements.**

87. The purpose of monitoring compliance with quality control policies and procedures is to provide an evaluation of:

- (a) Adherence to professional standards and regulatory and legal requirements;
- (b) Whether the quality control system has been appropriately designed and effectively implemented; and
- (c) Whether the firm's quality control policies and procedures have been appropriately applied, so that reports that are issued by the firm or engagement partners are appropriate in the circumstances.

88. The firm entrusts responsibility for the monitoring process to a partner or partners or other persons with sufficient and appropriate experience and authority in the firm to assume that responsibility. Monitoring of the firm's system of quality control is performed by competent individuals and covers both the appropriateness of the design and the effectiveness of the operation of the system of quality control.

89. Ongoing consideration and evaluation of the system of quality control includes matters such as the following:

- Analysis of:
  - New developments in professional standards and regulatory and legal requirements, and how they are reflected in the firm's policies and procedures where appropriate;
  - Written confirmation of compliance with policies and procedures on independence;
  - Continuing professional development, including training; and
  - Decisions related to acceptance and continuance of client relationships and specific engagements.
- Determination of corrective actions to be taken and improvements to be made in the system, including the provision of feedback into the firm's policies and procedures relating to education and training.
- Communication to appropriate firm personnel of weaknesses identified in the system, in the level of understanding of the system, or compliance with it.

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- Follow-up by appropriate firm personnel so that necessary modifications are promptly made to the quality control policies and procedures.

90. The inspection of a selection of completed engagements is ordinarily performed on a cyclical basis. Engagements selected for inspection include at least one engagement for each engagement partner over an inspection cycle, which ordinarily spans no more than three years. The manner in which the inspection cycle is organized, including the timing of selection of individual engagements, depends on many factors, including the following:

- The size of the firm.
- The number and geographical location of offices.
- The results of previous monitoring procedures.
- The degree of authority both personnel and offices have (for example, whether individual offices are authorized to conduct their own inspections or whether only the head office may conduct them).
- The nature and complexity of the firm's practice and organization.
- The risks associated with the firm's clients and specific engagements.

91. The inspection process includes the selection of individual engagements, some of which may be selected without prior notification to the engagement team. Those inspecting the engagements are not involved in performing the engagement or the engagement quality control review. In determining the scope of the inspections, the firm may take into account the scope or conclusions of an independent external inspection program. However, an independent external inspection program does not act as a substitute for the firm's own internal monitoring program.

92. Small firms and sole practitioners may wish to use a suitably qualified external person or another firm to carry out engagement inspections and other monitoring procedures. Alternatively, they may wish to establish arrangements to share resources with other appropriate organizations to facilitate monitoring activities.

**93. The firm should evaluate the effect of deficiencies noted as a result of the monitoring process and should determine whether they are either:**

- (a) Instances that do not necessarily indicate that the firm's system of quality control is insufficient to provide it with reasonable assurance that it complies with professional standards and regulatory and legal requirements, and that the reports issued by the firm or engagement partners are appropriate in the circumstances; or**
- (b) Systemic, repetitive or other significant deficiencies that require prompt corrective action.**

**94. The firm should communicate to relevant engagement partners and other appropriate personnel deficiencies noted as a result of the monitoring process and recommendations for appropriate remedial action.**

**95. The firm's evaluation of each type of deficiency should result in recommendations for one or more of the following:**

- (a) **Taking appropriate remedial action in relation to an individual engagement or member of personnel;**
- (b) **The communication of the findings to those responsible for training and professional development;**
- (c) **Changes to the quality control policies and procedures; and**
- (d) **Disciplinary action against those who fail to comply with the policies and procedures of the firm, especially those who do so repeatedly.**

**96. Where the results of the monitoring procedures indicate that a report may be inappropriate or that procedures were omitted during the performance of the engagement, the firm should determine what further action is appropriate to comply with relevant professional standards and regulatory and legal requirements. It should also consider obtaining legal advice.**

**97. At least annually, the firm should communicate the results of the monitoring of its quality control system to engagement partners and other appropriate individuals within the firm, including the firm's chief executive officer or, if appropriate, its managing partner(s). Such communication should enable the firm and these individuals to take prompt and appropriate action where necessary in accordance with their defined roles and responsibilities. Information communicated should include the following:**

- (a) **A description of the monitoring procedures performed.**
- (b) **The conclusions drawn from the monitoring procedures.**
- (c) **Where relevant, a description of systemic, repetitive or other significant deficiencies and of the actions taken to resolve or amend those deficiencies.**

98. The reporting of identified deficiencies to individuals other than the relevant engagement partners ordinarily does not include an identification of the specific engagements concerned, unless such identification is necessary for the proper discharge of the responsibilities of the individuals other than the engagement partners.

99. Some firms operate as part of a network and, for consistency, may implement some or all of their monitoring procedures on a network basis. Where firms within a network operate under common monitoring policies and procedures designed to comply with this SQC, and these firms place reliance on such a monitoring system:

- (a) At least annually, the network communicates the overall scope, extent and results of the monitoring process to appropriate individuals within the network firms;
- (b) The network communicates promptly any identified deficiencies in the quality control system to appropriate individuals within the relevant network firm or firms so that the necessary action can be taken; and
- (c) Engagement partners in the network firms are entitled to rely on the results of the monitoring process implemented within the network, unless the firms or the network advises otherwise.

100. Appropriate documentation relating to monitoring:

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- (a) Sets out monitoring procedures, including the procedure for selecting completed engagements to be inspected;
- (b) Records the evaluation of:
  - (i) Adherence to professional standards and regulatory and legal requirements;
  - (ii) Whether the quality control system has been appropriately designed and effectively implemented; and
  - (iii) Whether the firm's quality control policies and procedures have been appropriately applied, so that reports that are issued by the firm or engagement partners are appropriate in the circumstances; and
- (c) Identifies the deficiencies noted, evaluates their effect, and sets out the basis for determining whether and what further action is necessary.

### **Complaints and Allegations**

**101. The firm should establish policies and procedures designed to provide it with reasonable assurance that it deals appropriately with:**

- (a) **Complaints and allegations that the work performed by the firm fails to comply with professional standards and regulatory and legal requirements; and**
- (b) **Allegations of non-compliance with the firm's system of quality control.**

102. Complaints and allegations (which do not include those that are clearly frivolous) may originate from within or outside the firm. They may be made by firm personnel, clients or other third parties. They may be received by engagement team members or other firm personnel.

103. As part of this process, the firm establishes clearly defined channels for firm personnel to raise any concerns in a manner that enables them to come forward without fear of reprisals.

104. The firm investigates such complaints and allegations in accordance with established policies and procedures. The investigation is supervised by a partner with sufficient and appropriate experience and authority within the firm but who is not otherwise involved in the engagement, and includes involving legal counsel as necessary. Small firms and sole practitioners may use the services of a suitably qualified external person or another firm to carry out the investigation. Complaints, allegations and the responses to them are documented.

105. Where the results of the investigations indicate deficiencies in the design or operation of the firm's quality control policies and procedures, or non-compliance with the firm's system of quality control by an individual or individuals, the firm takes appropriate action as discussed in paragraph 95.

### **Documentation**

**106. The firm should establish policies and procedures requiring appropriate documentation to provide evidence of the operation of each element of its system of quality control.**

107. How such matters are documented is the firm's decision. For example, large firms may use electronic databases to document matters such as independence confirmations, performance

evaluations and the results of monitoring inspections. Smaller firms may use more simpler and informal methods such as manual notes, checklists and forms.

108. Factors to consider when determining the form and content of documentation evidencing the operation of each of the elements of the system of quality control include the following:

- The size of the firm and the number of offices.
- The degree of authority both personnel and offices have.
- The nature and complexity of the firm's practice and organization.

109. The firm retains this documentation for a period of time sufficient to permit those performing monitoring procedures to evaluate the firm's compliance with its system of quality control, or for a longer period if required by law or regulation.

#### **Effective Date**

110. This Standard on Quality Control is recommendatory for all engagements relating to accounting periods beginning on or after April 1, 2008 and is mandatory for all engagements relating to accounting periods beginning on or after April 1, 2009.

#### **Material Modifications to the International Standard on Quality Control (ISQC) 1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements"**

##### **Additions**

1. Paragraph 6(d) of the ISQC 1, dealing with the definition of "engagement quality control reviewer" mentions that "other person in the firm" with sufficient and appropriate experience and authority can also act as quality control reviewer. The SQC 1 has retained this concept subject to the condition that such "other person in the firm" should also be a member of the Institute of Chartered Accountants of India.
2. Paragraph 6(d) of the ISQC 1, while defining the "engagement quality control reviewer" provides that the review can be done by a team of individuals comprising the partner, other person in the firm and/or the suitably qualified external person. The SQC 1 has retained this concept subject to the condition that in case of review by a team of individuals, such team should be headed by a member of the Institute.
3. Paragraph 6(f) of the ISQC 1 defines "firm" as "a sole practitioner, partnership, corporation or other entity of professional accountants". Since in India an individual can practice in his individual name and also in the name of the firm as proprietor of that firm, accordingly, the term 'Proprietor' has been added to the definition of the firm.
4. Paragraph 83 of the ISQC 1 prescribes the minimum period of engagement documentation as five years. The SQC 1 prescribes the minimum period of retention of engagement documentation as seven years since, as per the provisions of the Chartered Accountants Act, 1949, including regulations therein, prescribes the minimum period of retention of working papers as seven years.

##### **Deletions**

1. Paragraph 6(f) of the ISQC 1 defines "firm" as "a sole practitioner, partnership, corporation

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or other entity of professional accountants". Since in India, the practitioners establish any corporate entity for practice, the word 'Corporation' has been deleted from the definition.

2. In terms of paragraph 6(p) of the ISQC 1, defining a "suitably qualified external person" as a partner of another firm, or an employee (with appropriate experience) of either a professional accountancy body whose members may perform audits and reviews of historical financial information, or other assurance or related services engagements, or of an organisation that provides relevant quality control services. Since, in India only the Institute of Chartered Accountants of India is the professional body whose members can carry out an audit or a review of historical financial information or other assurance engagement, a specific reference to this fact appearing in the context of "partner of another firm or an employee" has been deleted from the definition of "suitably qualified external person".

3. Paragraph 6(p) lays down that "an organisation that provides relevant quality control services" can also act as a suitably qualified person. The SQC does not include any such requirement since it is felt that a review of a firm of accountants should be done by a similar firm of accountants only.

4. Paragraph 27 of the ISQC 1 requires that in all engagements of audit of listed companies, the engagement partner of the firm should be rotated within a period of seven years in order to avoid the familiarity threat. The SQC 1 does not mandate such a provision in the audit engagements of the listed entities that are audited by the sole practitioners/proprietors as it is not possible to apply the provision in such cases. However, the SQC 1 provides for peer review of those firms in order to mitigate familiarity threat.

5. The ISQC 1 also deals with the public sector perspective. However, since the Standards, Statements, General Clarifications and Guidance Notes issued by the ICAI are equally applicable in case of all engagements, irrespective of the form, nature and size of the entity, this Standard does not specifically mention that aspect.

## Framework for Assurance Engagements\*

(Effective From April 1, 2008)

### Introduction

1. This Framework defines and describes the elements and objectives of an assurance engagement, and identifies engagements to which Standards on Auditing (SAs), Standards on Review Engagements (SREs) and Standards on Assurance Engagements (SAEs) apply. It provides a frame of reference for:

- (a) Professional accountants in public practice<sup>1</sup> (practitioners) when performing assurance engagements. Professional accountants who are neither in public practice nor in the public sector are encouraged to consider the Framework when performing assurance engagements<sup>2</sup>
- (b) Others involved with assurance engagements, including the intended users of an assurance report and the responsible party; and
- (c) The Auditing and Assurance Standards Board (AASB) in its development of SAs, SREs and SAEs.

This Framework does not cover engagements covered by Standards on Related Services (SRSs), such as engagements to perform agreed-upon procedures and engagements to compile financial or other information since the members do not express any assurance on the financial information or any other subject matter of their report.

2. This Framework does not itself establish standards or provide procedural requirements for the performance of assurance engagements. SAs, SREs and SAEs contain basic principles, essential procedures and related guidance, consistent with the concepts in this Framework, for the performance of assurance engagements.

3. The following is an overview of this Framework:

- *Introduction:* This Framework deals with assurance engagements performed by practitioners. It provides a frame of reference for practitioners and others involved with assurance engagements, such as those engaging a practitioner (the “engaging party”).

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\* Published in July, 2007 issue of the Journal.

<sup>1</sup> As defined in the Preface, the term “professional accountant” refers to the member of the Institute of Chartered Accountants of India. Further, the term “professional accountant in public practice (practitioner)” refers to the member of the Institute of Chartered Accountants of India who is in practice in terms of section 2 of the Chartered Accountants Act, 1949. The term is also used to refer to a firm of chartered accountants in public practice.

<sup>2</sup> If a professional accountant not in public practice applies this Framework, and (a) this Framework, the SAs, SREs or the SAEs are referred to in the professional accountant’s report; and (b) the professional accountant or other members of the assurance team and, when applicable, the professional accountant’s employer, are not independent of the entity in respect of which the assurance engagement is being performed, the lack of independence and the nature of the relationship(s) with the entity are prominently disclosed in the professional accountant’s report. Also, that report does not include the word “independent” in its title, and the purpose and users of the report are restricted.

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- *Definition and objective of an assurance engagement:* This section defines assurance engagements and identifies the objectives of the two types of assurance engagements a practitioner is permitted to perform. This Framework calls these two types reasonable assurance engagements and limited assurance engagements.<sup>3</sup>
- *Scope of the Framework:* This section distinguishes assurance engagements from other engagements, such as consulting engagements.
- *Engagement acceptance:* This section sets out characteristics that must be exhibited before a practitioner can accept an assurance engagement.
- *Elements of an assurance engagement:* This section identifies and discusses five elements that assurance engagement performed by practitioners' exhibit: a three party relationship, a subject matter, criteria, evidence and an assurance report. It explains important distinctions between reasonable assurance engagements and limited assurance engagements (also outlined in **Appendix** to the Framework). This section also discusses, for example, the significant variation in the subject matters of assurance engagements, the required characteristics of suitable criteria, the role of risk and materiality in assurance engagements, and how conclusions are expressed in each of the two types of assurance engagements.
- *Inappropriate use of the practitioner's name:* This section discusses implications of a practitioner's association with a subject matter.

### **Ethical Principles and Quality Control Standards**

4. In addition to this Framework and SAs, SREs and SAEs, practitioners who perform assurance engagements are governed by:
  - (a) The requirements of the Chartered Accountants Act, 1949;
  - (b) The Code of Ethics (the Code), issued by the Institute, which establishes fundamental ethical principles for professional accountants;
  - (c) Other relevant pronouncements of the Institute of Chartered Accountants of India<sup>4</sup>; and
  - (d) Standards on Quality Control (SQCs), which establish standards and provide guidance on a firm's system of quality control<sup>5</sup>.
5. The Code of Ethics sets out the fundamental ethical principles that all professional accountants are required to observe, including:
  - (a) Integrity;

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<sup>3</sup> For assurance engagements relating to historical financial information in particular, such engagements which provide reasonable assurance are called audits, and those engagements which provide limited assurance are called reviews.

<sup>4</sup> Attention of the members is invited, for instance, to the *Guidance Note on Independence of Auditors*, issued by the Institute of Chartered Accountants of India.

<sup>5</sup> Additional Standards and guidance on quality control procedures for specific types of assurance engagements are set out in SAs, SREs and SAEs.

- (b) Objectivity;
- (c) Professional competence and due care;
- (d) Confidentiality; and
- (e) Professional behaviour.

**Definition and Objective of an Assurance Engagement**

6. "Assurance engagement" means an engagement in which a practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria.

7. The outcome of the evaluation or measurement of a subject matter is the information that results from applying the criteria to the subject matter. For example:

- The recognition, measurement, presentation and disclosure represented in the financial statements (outcome) result from applying a financial reporting framework for recognition, measurement, presentation and disclosure, such as the Accounting Standards, (criteria) to an entity's financial position, financial performance and cash flows (subject matter).
- An assertion about the effectiveness of internal control (outcome) results from applying a framework for evaluating the effectiveness of internal control, (criteria) to internal control, a process (subject matter).

In the remainder of this Framework, the term "subject matter information" will be used to mean the outcome of the evaluation or measurement of a subject matter. It is the subject matter information about which the practitioner gathers sufficient appropriate evidence to provide a reasonable basis for expressing a conclusion in an assurance report.

8. Subject matter information can fail to be properly expressed in the context of the subject matter and the criteria, and can therefore be misstated, potentially to a material extent. This occurs when the subject matter information does not properly reflect the application of the criteria to the subject matter, for example, when an entity's financial statements do not give a true and fair view of (or present fairly, in all material respects) its financial position, financial performance and cash flows in accordance with the generally accepted accounting principles, or when an entity's assertion that its internal control is effective is not fairly stated, in all material respects, based on the established internal control framework.

9. In some assurance engagements, the evaluation or measurement of the subject matter is performed by the responsible party, and the subject matter information is in the form of an assertion by the responsible party that is made available to the intended users. These engagements are called "assertion-based engagements". In other assurance engagements, the practitioner either directly performs the evaluation or measurement of the subject matter, or obtains a representation from the responsible party that has performed the evaluation or measurement that is not available to the intended users. The subject matter information is provided to the intended users in the assurance report. These engagements are called "direct reporting engagements".

10. Under this Framework, there are two types of assurance engagements a practitioner is

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permitted to perform: a reasonable assurance engagement and a limited assurance engagement. The objective of a reasonable assurance engagement is a reduction in assurance engagement risk to an acceptably low level in the circumstances of the engagement<sup>6</sup> as the basis for a positive form of expression of the practitioner's conclusion. The objective of a limited assurance engagement is a reduction in assurance engagement risk to a level that is acceptable in the circumstances of the engagement, but where that risk is greater than for a reasonable assurance engagement, as the basis for a negative form of expression of the practitioner's conclusion.

### **Scope of the Framework**

11. Not all engagements performed by practitioners are assurance engagements. Other frequently performed engagements that do not meet the above definition (and therefore are not covered by this Framework) include:

- Engagements covered by Standards for Related Services, such as agreed-upon procedures engagements and compilations of financial or other information.
- The preparation of tax returns where no conclusion conveying assurance is expressed.
- Consulting (or advisory) engagements<sup>7</sup>, such as management and tax consulting.

12. An assurance engagement may be part of a larger engagement, for example, when a business acquisition consulting engagement includes a requirement to convey assurance regarding historical or prospective financial information. In such circumstances, this Framework is relevant only to the assurance portion of the engagement.

13. The following engagements, which may meet the definition in paragraph 6, need not be performed in accordance with this Framework:

- (a) Engagements to testify in legal proceedings regarding accounting, auditing, taxation or other matters; and
- (b) Engagements that include professional opinions, views or wording from which a user may derive some assurance, if all of the following apply:

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<sup>6</sup> Engagement circumstances include the terms of the engagement, including whether it is a reasonable assurance engagement or a limited assurance engagement, the characteristics of the subject matter, the criteria to be used, the needs of the intended users, relevant characteristics of the responsible party and its environment, and other matters, for example events, transactions, conditions and practices, that may have a significant effect on the engagement.

<sup>7</sup> Consulting engagements employ a professional accountant's technical skills, education, observations, experiences and knowledge of the consulting process. The consulting process is an analytical process that typically involves some combination of activities relating to: objective-setting, fact-finding, definition of problems or opportunities, evaluation of alternatives, development of recommendations including actions, communication of results and sometimes implementation and follow-up. Reports (if issued) are generally written in a narrative (or "long form") style. Generally the work performed is only for the use and benefit of the client. The nature and scope of work is determined by agreement between the professional accountant and the client. Any service that meets the definition of an assurance engagement is not a consulting engagement but an assurance engagement.

- (i) Those opinions, views or wording are merely incidental to the overall engagement;
- (ii) Any written report issued is expressly restricted for use by only the intended users specified in the report;
- (iii) Under a written understanding with the specified intended users, the engagement is not intended to be an assurance engagement; and
- (iv) The engagement is not represented as an assurance engagement in the professional accountant's report.

#### **Reports on Non-Assurance Engagements**

14. A practitioner reporting on an engagement that is not an assurance engagement within the scope of this Framework, clearly distinguishes that report from an assurance report. So as not to confuse users, a report that is not an assurance report avoids, for example:

- Implying compliance with this Framework, SAs, SREs or SAEs.
- Inappropriately using the words "assurance," "audit" or "review."
- Including a statement that could reasonably be mistaken for a conclusion designed to enhance the degree of confidence of intended users about the outcome of the evaluation or measurement of a subject matter against criteria.

15. The practitioner and the responsible party may agree to apply the principles of this Framework to an engagement when there are no intended users other than the responsible party but where all other requirements of the SAs, SREs or SAEs are met. In such cases, the practitioner's report includes a statement restricting the use of the report to the responsible party.

#### **Engagement Acceptance**

16. A practitioner accepts an assurance engagement only where the practitioner's preliminary knowledge of the engagement circumstances indicates that:

- (a) Relevant ethical requirements, such as independence and professional competence will be satisfied, and
- (b) The engagement exhibits all of the following characteristics:
  - (i) The subject matter is appropriate;
  - (ii) The criteria to be used are suitable and are available to the intended users;
  - (iii) The practitioner has access to sufficient appropriate evidence to support the practitioner's conclusion;
  - (iv) The practitioner's conclusion, in the form appropriate to either a reasonable assurance engagement or a limited assurance engagement, is to be contained in a written report; and
  - (v) The practitioner is satisfied that there is a rational purpose for the engagement. If there is a significant limitation on the scope of the practitioner's work (see paragraph 54), it may be unlikely that the engagement has a rational purpose. Also, a practitioner

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may believe the engaging party intends to associate the practitioner's name with the subject matter in an inappropriate manner (see paragraph 60).

Specific SAs, SREs or SAEs may include additional requirements that need to be satisfied prior to accepting an engagement.

17. When a potential engagement cannot be accepted as an assurance engagement because it does not exhibit all the characteristics in the previous paragraph, the engaging party may be able to identify a different engagement that will meet the needs of intended users. For example:

- (a) If the original criteria were not suitable, an assurance engagement may still be performed if:
  - (i) the engaging party can identify an aspect of the original subject matter for which those criteria are suitable, and the practitioner could perform an assurance engagement with respect to that aspect as a subject matter in its own right. In such cases, the assurance report makes it clear that it does not relate to the original subject matter in its entirety; or
  - (ii) alternative criteria suitable for the original subject matter can be selected or developed.
- (b) The engaging party may request an engagement that is not an assurance engagement, such as a consulting or an agreed-upon procedures engagement.

18. Having accepted an assurance engagement, a practitioner may not change that engagement to a non-assurance engagement, or from a reasonable assurance engagement to a limited assurance engagement without reasonable justification. A change in circumstances that affects the intended users' requirements, or a misunderstanding concerning the nature of the engagement, ordinarily will justify a request for a change in the engagement. If such a change is made, the practitioner does not disregard evidence that was obtained prior to the change.

### **Elements of an Assurance Engagement**

19. The following elements of an assurance engagement are discussed in this section:

- (a) A three party relationship involving a practitioner, a responsible party, and intended users;
- (b) An appropriate subject matter;
- (c) Suitable criteria;
- (d) Sufficient appropriate evidence; and
- (e) A written assurance report in the form appropriate to a reasonable assurance engagement or a limited assurance engagement.

### **Three Party Relationship**

20. Assurance engagements involve three separate parties: a practitioner, a responsible party and intended users.

21. The responsible party and the intended users may be from different entities or the same entity. As an example of the latter case, in a two-tier board structure, the supervisory board

may seek assurance about information provided by the management board of that entity. The relationship between the responsible party and the intended users needs to be viewed within the context of a specific engagement and may differ from more traditionally defined lines of responsibility. For example, an entity's senior management (an intended user) may engage a practitioner to perform an assurance engagement on a particular aspect of the entity's activities that is the immediate responsibility of a lower level of management (the responsible party), but for which senior management is ultimately responsible.

***Practitioner***

22. The term "practitioner" as used in this Framework is broader than the term "auditor" as used in SAs and SREs, which relates only to practitioners performing audit or review engagements with respect to historical financial information.

23. A practitioner may be requested to perform assurance engagements on a wide range of subject matters. Some subject matters may require specialized skills and knowledge beyond those ordinarily possessed by an individual practitioner. As noted in paragraph 17 (a), a practitioner does not accept an engagement if preliminary knowledge of the engagement circumstances indicates that ethical requirements regarding professional competence will not be satisfied. In some cases this requirement can be satisfied by the practitioner using the work of persons from other professional disciplines, referred to as experts. In such cases, the practitioner is satisfied that those persons carrying out the engagement collectively possess the requisite skills and knowledge, and that the practitioner has an adequate level of involvement in the engagement and understanding of the work for which any expert is used.

***Responsible Party***

24. The responsible party is the person (or persons) who:

- (a) in a direct reporting engagement, is responsible for the subject matter; or
- (b) in an assertion-based engagement, is responsible for the subject matter information (the assertion), and may be responsible for the subject matter. An example of when the responsible party is responsible for both the subject matter information and the subject matter, is when an entity engages a practitioner to perform an assurance engagement regarding a report it has prepared about its own sustainability practices. An example of when the responsible party is responsible for the subject matter information but not the subject matter, is when a government organization engages a practitioner to perform an assurance engagement regarding a report about a private company's sustainability practices that the organization has prepared and is to distribute to intended users.

The responsible party may or may not be the party who engages the practitioner (the engaging party).

25. The responsible party ordinarily provides the practitioner with a written representation that evaluates or measures the subject matter against the identified criteria, whether or not it is to be made available as an assertion to the intended users. In a direct reporting engagement, the practitioner may not be able to obtain such a representation when the engaging party is different from the responsible party.

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### ***Intended Users***

26. The intended users are the person, persons or class of persons for whom the practitioner prepares the assurance report. The responsible party can be one of the intended users, but not the only one.

27. Whenever practical, the assurance report is addressed to all the intended users, but in some cases there may be other intended users. The practitioner may not be able to identify all those who will read the assurance report, particularly where there is a large number of people who have access to it. In such cases, particularly where possible readers are likely to have a broad range of interests in the subject matter, intended users may be limited to major stakeholders with significant and common interests. Intended users may be identified in different ways, for example, by agreement between the practitioner and the responsible party or engaging party, or by law.

28. Whenever practical, intended users or their representatives are involved with the practitioner and the responsible party (and the engaging party, if different) in determining the requirements of the engagement. Regardless of the involvement of others however, and unlike an agreed-upon procedures engagement (which involves reporting findings based upon the procedures, rather than a conclusion):

- (a) The practitioner is responsible for determining the nature, timing and extent of procedures; and
- (b) The practitioner is required to pursue any matter the practitioner becomes aware of that leads the practitioner to question whether a material modification should be made to the subject matter information.

29. In some cases, intended users (for example, bankers and regulators) impose a requirement on, or request the responsible party (or the engaging party, if different) to arrange for, an assurance engagement to be performed for a specific purpose. When engagements are designed for specified intended users or a specific purpose, the practitioner considers including a restriction in the assurance report that limits its use to those users or that purpose.

### **Subject Matter**

30. The subject matter, and subject matter information, of an assurance engagement can take many forms, such as:

- Financial performance or conditions (for example, historical or prospective financial position, financial performance and cash flows) for which the subject matter information may be the recognition, measurement, presentation and disclosure represented in financial statements.
- Non-financial performance or conditions (for example, performance of an entity) for which the subject matter information may be key indicators of efficiency and effectiveness.
- Physical characteristics (for example, capacity of a facility) for which the subject matter information may be a specifications document.
- Systems and processes (for example, an entity's internal control or IT system) for which the subject matter information may be an assertion about effectiveness.

- Behaviour (for example, corporate governance, compliance with regulation, human resource practices) for which the subject matter information may be a statement of compliance or a statement of effectiveness.

31. Subject matters have different characteristics, including the degree to which information about them is qualitative versus quantitative, objective versus subjective, historical versus prospective, and relates to a point in time or covers a period. Such characteristics affect the:

- (a) precision with which the subject matter can be evaluated or measured against criteria; and
- (b) the persuasiveness of available evidence.

The assurance report notes characteristics of particular relevance to the intended users.

32. An appropriate subject matter is:

- (a) identifiable, and capable of consistent evaluation or measurement against the identified criteria; and
- (b) such that the information about it can be subjected to procedures for gathering sufficient appropriate evidence to support a reasonable assurance or limited assurance conclusion, as appropriate.

### **Criteria**

33. Criteria are the benchmarks used to evaluate or measure the subject matter including, where relevant, benchmarks for presentation and disclosure. Criteria can be formal, for example in the preparation of financial statements, the criteria may be Accounting Standards issued by the Institute; when reporting on internal control, the criteria may be an established internal control framework or individual control objectives specifically designed for the engagement; and when reporting on compliance, the criteria may be the applicable law, regulation or contract. Examples of less formal criteria are an internally developed code of conduct or an agreed level of performance (such as the number of times a particular committee is expected to meet in a year).

34. Suitable criteria are required for reasonably consistent evaluation or measurement of a subject matter within the context of professional judgment. Without the frame of reference provided by suitable criteria, any conclusion is open to individual interpretation and misunderstanding. Suitable criteria are context-sensitive, that is, relevant to the engagement circumstances. Even for the same subject matter there can be different criteria. For example, one responsible party might select the number of customer complaints resolved to the acknowledged satisfaction of the customer for the subject matter of customer satisfaction; another responsible party might select the number of repeat purchases in the three months following the initial purchase.

35. Suitable criteria exhibit the following characteristics:

- (a) *Relevance*: relevant criteria contribute to conclusions that assist decision-making by the intended users.

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- (b) *Completeness*: criteria are sufficiently complete when relevant factors that could affect the conclusions in the context of the engagement circumstances are not omitted. Complete criteria include, where relevant, benchmarks for presentation and disclosure.
- (c) *Reliability*: reliable criteria allow reasonably consistent evaluation or measurement of the subject matter including, where relevant, presentation and disclosure, when used in similar circumstances by similarly qualified practitioners.
- (d) *Neutrality*: neutral criteria contribute to conclusions that are free from bias.
- (e) *Understandability*: understandable criteria contribute to conclusions that are clear, comprehensive, and not subject to significantly different interpretations.

The evaluation or measurement of a subject matter on the basis of the practitioner's own expectations, judgments and individual experience would not constitute suitable criteria.

36. The practitioner assesses the suitability of criteria for a particular engagement by considering whether they reflect the above characteristics. The relative importance of each characteristic to a particular engagement is a matter of judgment. Criteria can either be established or specifically developed. Established criteria are those embodied in laws or regulations, or issued by authorized or recognized bodies of experts that follow a transparent due process. Specifically developed criteria are those designed for the purpose of the engagement. Whether criteria are established or specifically developed affects the work that the practitioner carries out to assess their suitability for a particular engagement.

37. Criteria need to be available to the intended users to allow them to understand how the subject matter has been evaluated or measured. Criteria are made available to the intended users in one or more of the following ways:

- (a) Publicly.
- (b) Through inclusion in a clear manner in the presentation of the subject matter information.
- (c) Through inclusion in a clear manner in the assurance report.
- (d) By general understanding, for example the criterion for measuring time in hours and minutes.

Criteria may also be available only to specific intended users, for example, the terms of a contract, or criteria issued by an industry association that are available only to those in the industry. When identified criteria are available only to specific intended users, or are relevant only to a specific purpose, use of the assurance report is restricted to those users or for that purpose.<sup>8</sup>

### **Evidence**

38. The practitioner plans and performs an assurance engagement with an attitude of

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<sup>8</sup> While an assurance report may be restricted whenever it is intended only for specified intended users or for a specific purpose, the absence of a restriction regarding a particular reader or purpose, does not itself indicate that a legal responsibility is owed by the practitioner in relation to that reader or for that purpose. Whether a legal responsibility is owed will depend on the circumstances of each case and the relevant jurisdiction.

professional skepticism to obtain sufficient appropriate evidence about whether the subject matter information is free of material misstatement. The practitioner considers materiality, assurance engagement risk, and the quantity and quality of available evidence when planning and performing the engagement, in particular when determining the nature, timing and extent of evidence-gathering procedures.

***Professional Skepticism***

39. The practitioner plans and performs an assurance engagement with an attitude of professional skepticism recognizing that circumstances may exist that cause the subject matter information to be materially misstated. An attitude of professional skepticism means the practitioner makes a critical assessment, with a questioning mind, of the validity of evidence obtained and is alert to evidence that contradicts or brings into question the reliability of documents or representations by the responsible party. For example, an attitude of professional skepticism is necessary throughout the engagement process for the practitioner to reduce the risk of overlooking suspicious circumstances, of over generalizing when drawing conclusions from observations, and of using faulty assumptions in determining the nature, timing and extent of evidence-gathering procedures and evaluating the results thereof.

40. An assurance engagement rarely involves the authentication of documentation, nor is the practitioner trained as or expected to be an expert in such authentication. However, the practitioner considers the reliability of the information to be used as evidence, for example, photocopies, facsimiles, filmed, digitized or other electronic documents, including consideration of controls over their preparation and maintenance where relevant.

***Sufficiency and Appropriateness of Evidence***

41. Sufficiency is the measure of the quantity of evidence. Appropriateness is the measure of the quality of evidence; that is, its relevance and its reliability. The quantity of evidence needed is affected by the risk of the subject matter information being materially misstated (the greater the risk, the more evidence is likely to be required) and also by the quality of such evidence (the higher the quality, the less may be required). Accordingly, the sufficiency and appropriateness of evidence are interrelated. However, merely obtaining more evidence may not compensate for its poor quality.

42. The reliability of evidence is influenced by its source and by its nature, and is dependent on the individual circumstances under which it is obtained. Generalizations about the reliability of various kinds of evidence can be made; however, such generalizations are subject to important exceptions. Even when evidence is obtained from sources external to the entity, circumstances may exist that could affect the reliability of the information obtained. For example, evidence obtained from an independent external source may not be reliable if the source is not knowledgeable. While recognizing that exceptions may exist, the following generalizations about the reliability of evidence may be useful:

- Evidence is more reliable when it is obtained from independent sources outside the entity.
- Evidence that is generated internally is more reliable when the related controls are effective.
- Evidence obtained directly by the practitioner (for example, observation of the application

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of a control) is more reliable than evidence obtained indirectly or by inference (for example, inquiry about the application of a control).

- Evidence is more reliable when it exists in documentary form, whether paper, electronic, or other media (for example, a contemporaneously written record of a meeting is more reliable than a subsequent oral representation of what was discussed).
- Evidence provided by original documents is more reliable than evidence provided by photocopies or facsimiles.

43. The practitioner ordinarily obtains more assurance from consistent evidence obtained from different sources or of a different nature than from items of evidence considered individually. In addition, obtaining evidence from different sources or of a different nature may indicate that an individual item of evidence is not reliable. For example, corroborating information obtained from a source independent of the entity may increase the assurance the practitioner obtains from a representation from the responsible party. Conversely, when evidence obtained from one source is inconsistent with that obtained from another, the practitioner determines what additional evidence-gathering procedures are necessary to resolve the inconsistency.

44. In terms of obtaining sufficient appropriate evidence, it is generally more difficult to obtain assurance about subject matter information covering a period than about subject matter information at a point in time. In addition, conclusions provided on processes ordinarily are limited to the period covered by the engagement; the practitioner provides no conclusion about whether the process will continue to function in the specified manner in the future.

45. The practitioner considers the relationship between the cost of obtaining evidence and the usefulness of the information obtained. However, the matter of difficulty or expense involved is not in itself a valid basis for omitting an evidence-gathering procedure for which there is no alternative. The practitioner uses professional judgment and exercises professional skepticism in evaluating the quantity and quality of evidence, and thus its sufficiency and appropriateness, to support the assurance report.

### ***Materiality***

46. Materiality is relevant when the practitioner determines the nature, timing and extent of evidence-gathering procedures, and when assessing whether the subject matter information is free of misstatement. When considering materiality, the practitioner understands and assesses what factors might influence the decisions of the intended users. For example, when the identified criteria allow for variations in the presentation of the subject matter information, the practitioner considers how the adopted presentation might influence the decisions of the intended users. Materiality is considered in the context of quantitative and qualitative factors, such as relative magnitude, the nature and extent of the effect of these factors on the evaluation or measurement of the subject matter, and the interests of the intended users. The assessment of materiality and the relative importance of quantitative and qualitative factors in a particular engagement are matters for the practitioner's judgment.

### ***Assurance Engagement Risk***

47. Assurance engagement risk is the risk that the practitioner expresses an inappropriate conclusion when the subject matter information is materially misstated<sup>9</sup>. In a reasonable assurance engagement, the practitioner reduces assurance engagement risk to an acceptably low level in the circumstances of the engagement to obtain reasonable assurance as the basis for a positive form of expression of the practitioner's conclusion. The level of assurance engagement risk is higher in a limited assurance engagement than in a reasonable assurance engagement because of the different nature, timing or extent of evidence-gathering procedures. However, in a limited assurance engagement, the combination of the nature, timing and extent of evidence-gathering procedures is at least sufficient for the practitioner to obtain a meaningful level of assurance as the basis for a negative form of expression. To be meaningful, the level of assurance obtained by the practitioner is likely to enhance the intended users' confidence about the subject matter information to a degree that is clearly more than inconsequential.

48. In general, assurance engagement risk can be represented by the following components, although not all of these components will necessarily be present or significant for all assurance engagements:

- (a) The risk that the subject matter information is materially misstated, which in turn consists of:
  - (i) *Inherent risk*: the susceptibility of the subject matter information to a material misstatement, assuming that there are no related controls; and
  - (ii) *Control risk*: the risk that a material misstatement that could occur will not be prevented, or detected and corrected, on a timely basis by related internal controls. When control risk is relevant to the subject matter, some control risk will always exist because of the inherent limitations of the design and operation of internal control; and
- (b) *Detection risk*: the risk that the practitioner will not detect a material misstatement that exists.

The degree to which the practitioner considers each of these components is affected by the engagement circumstances, in particular by the nature of the subject matter and whether a reasonable assurance or a limited assurance engagement is being performed.

### ***Nature, Timing and Extent of Evidence-gathering Procedures***

49. The exact nature, timing and extent of evidence-gathering procedures will vary from one

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<sup>9(a)</sup> This includes the risk, in those direct reporting engagements where the subject matter information is presented only in the practitioner's conclusion, that the practitioner inappropriately concludes that the subject matter does, in all material respects, conform with the criteria, for example: "In our opinion, internal control is effective, in all material respects, based on XYZ criteria".

(b) In addition to assurance engagement risk, the practitioner is exposed to the risk of expressing an inappropriate conclusion when the subject matter information is not materially misstated, and risks through loss from litigation, adverse publicity, or other events arising in connection with a subject matter reported on. These risks are not part of assurance engagement risk.

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engagement to the next. In theory, infinite variations in evidence-gathering procedures are possible. In practice, however, these are difficult to communicate clearly and unambiguously. The practitioner attempts to communicate them clearly and unambiguously and uses the form appropriate to a reasonable assurance engagement or a limited assurance engagement.<sup>10</sup>

50. "Reasonable assurance" is a concept relating to accumulating evidence necessary for the practitioner to conclude in relation to the subject matter information taken as a whole. To be in a position to express a conclusion in the positive form required in a reasonable assurance engagement, it is necessary for the practitioner to obtain sufficient appropriate evidence as part of an iterative, systematic engagement process involving:

- (a) Obtaining an understanding of the subject matter and other engagement circumstances which, depending on the subject matter, includes obtaining an understanding of internal control;
- (b) Based on that understanding, assessing the risks that the subject matter information may be materially misstated;
- (c) Responding to assessed risks, including developing overall responses, and determining the nature, timing and extent of further procedures;
- (d) Performing further procedures clearly linked to the identified risks, using a combination of inspection, observation, confirmation, recalculation, re-performance, analytical procedures and inquiry. Such further procedures involve substantive procedures including, where applicable, obtaining corroborating information from sources independent of the responsible party, and depending on the nature of the subject matter, tests of the operating effectiveness of controls; and
- (e) Evaluating the sufficiency and appropriateness of evidence.

51. "Reasonable assurance" is less than absolute assurance. Reducing assurance engagement risk to zero is very rarely attainable or cost beneficial as a result of factors such as the following:

- The use of selective testing.
- The inherent limitations of internal control.
- The fact that much of the evidence available to the practitioner is persuasive rather than conclusive.
- The use of judgment in gathering and evaluating evidence and forming conclusions based on that evidence.
- In some cases, the characteristics of the subject matter when evaluated or measured against the identified criteria.

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<sup>10</sup> Where the subject matter information is made up of a number of aspects, separate conclusions may be provided on each aspect. While not all such conclusions need to relate to the same level of evidence-gathering procedures, each conclusion is expressed in the form that is appropriate to either a reasonable assurance or a limited assurance engagement.

52. Both reasonable assurance and limited assurance engagements require the application of assurance skills and techniques and the gathering of sufficient appropriate evidence as part of an iterative, systematic engagement process that includes obtaining an understanding of the subject matter and other engagement circumstances. The nature, timing and extent of procedures for gathering sufficient appropriate evidence in a limited assurance engagement are, however, deliberately limited relative to a reasonable assurance engagement. For some subject matters, there may be specific pronouncements to provide guidance on procedures for gathering sufficient appropriate evidence for a limited assurance engagement. For example, SRE 2400<sup>11</sup> (Revised), "Engagements to Review Financial Statements" establishes that sufficient appropriate evidence for reviews of financial statements is obtained primarily through analytical procedures and inquiries. In the absence of a relevant pronouncement, the procedures for gathering sufficient appropriate evidence will vary with the circumstances of the engagement, in particular, the subject matter, and the needs of the intended users and the engaging party, including relevant time and cost constraints. For both reasonable assurance and limited assurance engagements, if the practitioner becomes aware of a matter that leads the practitioner to question whether a material modification should be made to the subject matter information, the practitioner pursues the matter by performing other procedures sufficient to enable the practitioner to report.

***Quantity and Quality of Available Evidence***

53. The quantity or quality of available evidence is affected by:

- (a) The characteristics of the subject matter and subject matter information. For example, less objective evidence might be expected when information about the subject matter is future-oriented rather than historical (see paragraph 31); and
- (b) Circumstances of the engagement other than the characteristics of the subject matter, when evidence that could reasonably be expected to exist is not available because of, for example, the timing of the practitioner's appointment, an entity's document retention policy, or a restriction imposed by the responsible party.

***Ordinarily, available evidence will be persuasive rather than conclusive.***

54. An unqualified conclusion is not appropriate for either type of assurance engagement in the case of a material limitation on the scope of the practitioner's work, that is, when:

- (a) Circumstances prevent the practitioner from obtaining evidence required to reduce assurance engagement risk to the appropriate level; or
- (b) The responsible party or the engaging party imposes a restriction that prevents the practitioner from obtaining evidence required to reduce assurance engagement risk to the appropriate level.

**Assurance Report**

55. The practitioner provides a written report containing a conclusion that conveys the assurance obtained about the subject matter information. SAs, SREs and SAEs establish basic

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<sup>11</sup> Published in May 2010 issue of the Journal.

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elements for assurance reports. In addition, the practitioner considers other reporting responsibilities, including communicating with those charged with governance when it is appropriate to do so.

56. In an assertion-based engagement, the practitioner's conclusion can be worded either:

- (a) In terms of the responsible party's assertion (for example: "In our opinion *the responsible party's* assertion that internal control is effective, in all material respects, based on *XYZ criteria*, is fairly stated"); or
- (b) Directly in terms of the subject matter and the criteria (for example: "In our opinion internal control is effective, in all material respects, based on *XYZ criteria*").

In a direct reporting engagement, the practitioner's conclusion is worded directly in terms of the subject matter and the criteria.

57. In a reasonable assurance engagement, the practitioner expresses the conclusion in the positive form, for example: "In our opinion internal control is effective, in all material respects, based on *XYZ criteria*". This form of expression conveys "reasonable assurance". Having performed evidence-gathering procedures of a nature, timing and extent that were reasonable given the characteristics of the subject matter and other relevant engagement circumstances described in the assurance report, the practitioner has obtained sufficient appropriate evidence to reduce assurance engagement risk to an acceptably low level.

58. In a limited assurance engagement, the practitioner expresses the conclusion in the negative form, for example, "based on our work described in this report, nothing has come to our attention that causes us to believe that internal control is not effective, in all material respects, based on *XYZ criteria*". This form of expression conveys a level of "limited assurance" that is proportional to the level of the practitioner's evidence-gathering procedures given the characteristics of the subject matter and other engagement circumstances described in the assurance report.

59. A practitioner does not express an unqualified conclusion for either type of assurance engagement when the following circumstances exist and, in the practitioner's judgment, the effect of the matter is or may be material:

- (a) There is a limitation on the scope of the practitioner's work (see paragraph 54). The practitioner expresses a qualified conclusion or a disclaimer of conclusion depending on how material or pervasive the limitation is. In some cases the practitioner considers withdrawing from the engagement.
- (b) In those cases where:
  - (i) The practitioner's conclusion is worded in terms of the responsible party's assertion, and that assertion is not fairly stated, in all material respects; or
  - (ii) The practitioner's conclusion is worded directly in terms of the subject matter and the criteria, and the subject matter information is materially misstated,<sup>12</sup>

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<sup>12</sup> In those direct reporting engagements where the subject matter information is presented only in the practitioner's conclusion, and the practitioner concludes that the subject matter does not, in all material

The practitioner expresses a qualified or adverse conclusion depending on how material or pervasive the matter is.

- (c) When it is discovered after the engagement has been accepted, that the criteria are unsuitable or the subject matter is not appropriate for an assurance engagement. The practitioner expresses:
- (i) A qualified conclusion or adverse conclusion depending on how material or pervasive the matter is, when the unsuitable criteria or inappropriate subject matter is likely to mislead the intended users; or
  - (ii) A qualified conclusion or a disclaimer of conclusion depending on how material or pervasive the matter is, in other cases.

In some cases, the practitioner considers withdrawing from the engagement.

### **Inappropriate Use of the Practitioner's Name**

60. A practitioner is associated with a subject matter when the practitioner reports on information about that subject matter or consents to the use of the practitioner's name in a professional connection with that subject matter. If the practitioner is not associated in this manner, third parties can assume no responsibility of the practitioner. If the practitioner learns that a party is inappropriately using the practitioner's name in association with a subject matter, the practitioner requires the party to cease doing so. The practitioner also considers what other steps may be needed, such as informing any known third party users of the inappropriate use of the practitioner's name or seeking legal advice.

### **Material Modifications to International Framework for Assurance Engagements**

#### **Deletions**

1. The International Framework issued by the IAASB specifically makes it clear that such Framework is also relevant to professional accountants in public sector. However, since the Standards, Statements, General Clarifications and Guidance Notes issued by the ICAI are equally applicable in case of all engagements, irrespective of the form, nature and size of the entity, this Framework does not specifically mention that aspect.
2. Paragraph 6 of the International Framework issued by the IAASB refers to Part B of the International Code of Ethics regarding threats to independence, accepted safeguards and the public interest, which is applicable to professional accountants in public practice, has been deleted since the Code of Ethics issued by the ICAI is woven around the Chartered Accountants Act, 1949 and Schedules annexed thereto.

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respects, conform with the criteria, for example: "In our opinion, except for [...], internal control is effective, in all material respects, based on XYZ criteria," such a conclusion would also be considered to be qualified (or adverse as appropriate).

**Differences Between Reasonable Assurance Engagements and Limited Assurance Engagements**

This Appendix outlines the differences between a reasonable assurance engagement and a limited assurance engagement discussed in the Framework (see in particular the referenced paragraphs).

<b>Type of Engagement</b>	<b>Objective</b>	<b>Evidence-gathering procedures<sup>13</sup></b>	<b>The Assurance Report</b>
Reasonable Assurance Engagement	A reduction in assurance engagement risk to an acceptably low level in the circumstances of the engagement as the basis for a positive form of expression of the practitioner's conclusion (Paragraph 10)	<ul style="list-style-type: none"> <li>➤ Sufficient appropriate evidence is obtained as part of a systematic engagement process that includes:</li> <li>➤ Obtaining an understanding of the engagement circumstances;</li> <li>➤ Assessing risks;</li> <li>➤ Responding to assessed risks;</li> <li>➤ Performing further procedures using a combination of inspection, observation, confirmation, recalculation, re-performance, analytical procedures and inquiry. Such further procedures involve substantive procedures, including, where applicable, obtaining corroborating information, and depending on the nature of the subject matter, tests of the operating effectiveness of controls; and</li> <li>➤ Evaluating the evidence obtained (Paragraphs 50 and 51)</li> </ul>	Description of the engagement circumstances and a positive form of expression of the conclusion (Paragraph 57)
Limited Assurance Engagement	A reduction in assurance engagement risk to a level	Sufficient appropriate evidence is obtained as part of a systematic engagement process that includes obtaining an understanding of the	Description of the engagement circumstances, and a

<sup>13</sup> A detailed discussion of evidence-gathering requirement is only possible within SAEs for specific subject matters.

	that is acceptable in the circumstances of the engagement but where that risk is greater than for a reasonable assurance engagement, as the basis for a negative form of expression of the practitioner's conclusion (Paragraph 10)	subject matter and other engagement circumstances, but in which procedures are deliberately limited relative to reasonable assurance engagement (Paragraph 52)	negative form of expression of the conclusion (Paragraph 58)
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