

Standard on Internal Audit (SIA) 1

Planning an Internal Audit

The following is the text of the Standard on Internal Audit (SIA) 1, "Planning an Internal Audit", issued by the Council of the Institute of Chartered Accountants of India. This Standard should be read in conjunction with the Preface to the Standards and Guidance Notes on Internal Audit, issued by the Institute.

In terms of the decision of the Council of the Institute of Chartered Accountants of India taken at its 260th meeting held in June 2006, the following Standard on Internal Audit shall be recommendatory in nature in the initial period. The Standard shall become mandatory from such date as notified by the Council.

Objectives of Planning

1. The purpose of this Standard on Internal Audit is to establish standards and provide guidance in respect of planning an internal audit. An internal audit plan is a document defining the scope, coverage and resources, including time, required for an internal audit over a defined period. **The internal auditor should, in consultation with those charged with governance, including the audit committee, develop and document a plan for each internal audit engagement to help him conduct the engagement in an efficient and timely manner.** Adequate planning ensures that appropriate attention is devoted to significant areas of audit, potential problems are identified, and that the skills and time of the staff are appropriately utilised. Planning also ensures that the work is carried out in accordance with the applicable pronouncements of the Institute of Chartered Accountants of India.
2. The overall objectives of an internal audit, as defined in the Preface to the Standards and Guidance Notes on Internal Audit are:
 - to suggest improvements to the functioning of the entity; and
 - to strengthen the overall governance mechanism of the entity, including its strategic risk management as well as internal control system.
3. Internal audit, therefore, helps *inter alia* in:
 - (i) Understanding and assessing the risks and evaluate the adequacies of the prevalent internal controls.
 - (ii) Identifying areas for systems improvement and strengthening controls.
 - (iii) Ensuring optimum utilisation of the resources of the entity, for example, human resources, physical resources, etc.
 - (iv) Ensuring proper and timely identification of liabilities, including contingent liabilities of the entity.
 - (v) Ensuring compliance with internal and external guidelines and policies of the entity as well as the applicable statutory and regulatory requirements.
 - (vi) Safeguarding the assets of the entity.
 - (vii) Reviewing and ensuring adequacy of information systems security and control.
 - (viii) Reviewing and ensuring adequacy, relevance, reliability and timeliness of management information system.
4. **The internal audit plan should be comprehensive enough to ensure that it helps in achieving of the above overall objectives of an internal audit. The internal audit plan should, generally, also be consistent with the goals and objectives**

of the internal audit function as listed out in the internal audit charter as well as the goals and objectives of the organisation. An internal audit charter is an important document defining the position of the internal audit *vis a vis* the organisation. The internal audit charter also outlines the scope of internal audit as well as the duties, responsibilities and powers of the internal auditor(s). In case the entire internal audit or the particular internal audit engagement has been outsourced, the internal auditor should also ensure that the plan is consistent with the terms of the engagement.

5. Planning involves developing an overall plan for the expected scope and conduct of audit and developing an audit programme showing the nature, timing and extent of audit procedures. Planning is a continuous exercise. **A plan once prepared should be continuously reviewed by the internal auditor to identify any modifications required to bring the same in line with the changes, if any, in the audit environment. However, any major modification to the internal audit plan should be done in consultation with those charged with governance. Further, the internal auditor should also document the changes to the internal audit plan.**
6. The internal auditor may also discuss the significant elements of his overall plan, including important procedures, with those charged with governance. This would help the internal auditor as well as the client to assess whether the internal audit is directed to achieve the objectives as set out in the terms of engagement. The discussion would also help the internal auditor to gauge whether the client's perception of the role and responsibilities of the internal auditor is appropriate. The internal auditor should also assess the client expectations as to the assurance level on different aspect of entity's operations and controls. For instance, the

client may feel assured if inventories are verified once in a quarter, while for cash verification, monthly interval may be specified. This will enable the auditor to plan the frequency and extent of audit procedures to be adopted.

Factors Affecting the Planning Process

7. The internal audit plan should be based on the knowledge of the entity's business. While developing the internal audit plan, the internal auditor should have regard to the objectives of the internal audit engagement as well as the time and resources required for conducting the engagement. In addition, the internal audit plan should also reflect the risk management strategy of the entity. Planning an internal audit involves establishing the overall strategy for the engagement so as to keep the risks associated with the assignment at the acceptable level. Therefore, the planning process is also influenced by the internal auditor's understanding and assessment of:
 - The objectives of the activity being subjected to internal audit.
 - The significant risks associated with the above activity.
 - The risk management and internal control system instituted in the organisation to reduce the above risks to an acceptable level.
 - The possible areas in which the internal audit can suggest improvement to the risk management and/ or internal control system associated with the concerned activity.
 - The selection of engagement team (including, where necessary, the engagement team quality control reviewer) and the assignment of audit work to the team members, including the assignment of appropriately experienced team members.
 - Business developments affecting the

entity, including changes in information technology and business processes, changes in key management, and acquisitions, mergers and divestments.

- Industry developments such as changes in industry regulations and new reporting requirements.
- Changes in the financial reporting framework, such as changes in accounting standards.
- Other significant relevant developments, such as changes in the legal environment affecting the entity.

Scope of Planning

8. Internal audit plan should cover areas such as:

- **Obtaining the knowledge of the legal and regulatory framework within which the entity operates.**
- **Obtaining the knowledge of the entity's accounting and internal control systems and policies.**
- **Determining the effectiveness of the internal control procedures adopted by the entity.**
- **Determining the nature, timing and extent of procedures to be performed.**
- **Identifying the activities warranting special focus based on the materiality and criticality of such activities, and their overall effect on operations of the entity.**
- **Identifying and allocating staff to the different activities to be undertaken.**
- **Setting the time budget for each of the activities.**
- **Identifying the reporting responsibilities.**

The internal audit plan should also identify the benchmarks against which

the actual results of the activities, the actual time spent, the cost incurred would be measured.

9. The scope of an internal audit is normally affected by factors such as:

- Terms of the engagement.
- Nature of accounting system – manual or IT-based - and the degree of reliance placed by the auditor on the same.
- Accounting policies adopted by the entity.
- Nature of information technology system used by the client in the various business processes and the exception reports generated by the system.
- Authorisation and delegation of authority in the systems environment and data entry checks and data security measures including generation of day end logs of security and authorisation violations.
- The nature of management information system in vogue and the extent to which the management information system reports are used by the client in establishing and reviewing internal controls.
- Expected audit coverage, including identification of areas of audit requiring special attention, number and locations to be included, nature of business segments to be audited and the need, if any, for specialised knowledge.
- Materiality thresholds established in respect of various areas of audit especially, those areas requiring special attention.
- Nature and extent of audit evidence to be obtained.
- Experience and skills of the staff and the need for supervising, directing, coordinating and reviewing their work.
- Requirements of the applicable pronouncements of the Institute of Chartered Accountants of India.

- Statutory or regulatory framework in which the entity operates.

Planning Process

Obtaining Knowledge of the Business

10. **The internal auditor should obtain a level of knowledge of the entity sufficient to enable him to identify events, transactions, policies and practices that may have a significant effect on the financial information.** Following are some of the sources wherefrom the internal auditor can obtain such knowledge:

- Previous experience, if any, with the entity and the industry.
- Legislation and regulations that significantly affect the entity.
- Entity's policy and procedures manual.
- Minutes of the meetings of the shareholders, board of directors, and important committees of the board such as the audit committee, remuneration committee, shareholders' grievances committee.
- Management reports/ internal audit reports of prior periods.
- Newspaper/ industry journals.
- Discussion with client's management and staff.
- Visits to entity's plant facilities etc., to obtain first hand information regarding the production processes of the entity.
- Visits to the entity's department where the accounting and other documents are generated, maintained, and the administrative procedures followed.
- Other documents produced by the entity, for example, material sent to the shareholders and the regulatory authorities, management policy manuals, manuals relating to accounting and internal controls, organisational charts, job description charts, etc.

Knowledge of the entity's business, among other things, helps the internal auditor to identify areas requiring special focus, evaluate the appropriateness of the accounting policies and disclosures, accounting estimates and management representations. Knowledge of the business would also help the auditor to identify the priorities of the business, critical factors or constraints in the smooth running of the business as also understand the trends in respect of various financial and operating ratios, etc.

Establishing the Audit Universe

11. The next step in audit planning is establishment of the audit universe or the audit territory. Audit universe comprises the activities, operations, units etc., to be subjected to audit during the planning period. The audit universe is designed to reflect the overall business objectives and therefore includes components from the strategic plan of the entity. Thus, the audit universe is affected by the risk management process of the client. **The audit universe and the related audit plan should also reflect changes in the management's course of action, corporate objectives, etc.**
12. As discussed in paragraph 4, planning is a continuous exercise. **The internal auditor should periodically, say half yearly, review the audit universe to identify any changes therein and make necessary amendments, to make the audit plan responsive to those changes.**

Establishing the Objectives of the Engagement

13. The next stage in planning is establishing the specific objectives of the internal audit engagement. **The establishment of such objectives should be based on the auditor's knowledge of the client's business, especially a preliminary understanding and review of the risks**

and controls associated with the activities forming subject matter of the internal audit engagement. The preliminary understanding and review involves gathering necessary information by means of a combination of the following procedures:

- Observation of the activity being performed.
- Inquiry of the staff associated with performing the activity.
- Discussion with the client.
- Reading through the internal audit reports, management reports etc., of previous periods.
- Performing analytical procedures.
- Performing actual walk-through tests.

14. The internal auditor would use the information so gathered to determine the objective(s) of the engagement as also to decide the nature, timing and extent of his procedures. **The internal auditor should also document the results of his preliminary review so conducted.** The documented results would, normally, cover aspects such as:

- Preliminary assessment and understanding the risks and controls associated with the activity, *viz.*, sufficiency and appropriateness of the controls, procedures for identification and management of risks associated with the activity.
- Significant issues thrown up by such a review, for example, significant errors, non-compliance with any significant law.
- Procedures proposed to be adopted by the internal auditor to resolve the above issues.
- Preliminary time budget for completing the engagement.

Establishing the Scope of the Engagement

15. The next stage in planning an internal audit is establishing the scope of the engagement.

The scope of the engagement should be sufficient in coverage so as to meet the objectives of the engagement. The internal auditor should consider the information gathered during the preliminary review stage to determine the scope of his audit procedures. The nature and extent of the internal auditor's procedures would also be affected by the terms of the engagement. In case the internal auditor is of the view that circumstances exist which would restrict the auditor from carrying out the procedures, including any alternative procedures, considered necessary by him, he should discuss the matter with the client to reach a conclusion whether or not to continue the engagement. The scope of his engagement should be documented comprehensively to avoid misunderstanding on the areas covered for audit. The internal auditors are often confronted with a situation where client denies access to certain information or has a negative list of areas where internal audit is not desired. There are also situations where while the client requires internal audit procedures to be carried but findings are not to form part of the report but to be reported separately.

16. Further, in case of information technology based environment, the scope of engagement would include the extent to which internal auditor are permitted to access the system and reports which can be viewed and those which can be exported. Further, system based audit tools that an internal auditor can use to draw and analyze the data should be clearly understood in the scope of his engagement.

Deciding the Resource Allocation

17. Once the scope of the internal audit procedures is established, the next phase is that of deciding upon the resource allocation. Efficient resource allocation is essential to achieve the desired objective, within the constraints of time and cost as well as optimum utilisation of resources. **For**

this purpose, the internal auditor should prepare an audit work schedule, detailing aspects such as:

- activities/ procedures to be performed;
- engagement team responsible for performing these activities/ procedures; and
- time allocated to each of these activities/ procedures.

18. While preparing the work schedule, the internal auditor should have regard to aspects such as:

- any significant changes to the entity's missions and objectives, business processes, and management's strategies to counter these changes, for example, changes in the entity's controls structure or changes in the risk assessment and management structures
- any changes or proposed changes to the governance structure of the entity
- composition of the engagement team in terms of skills and experience and any changes thereto

The engagement work schedule should, however, be flexible enough to accommodate any unanticipated changes as well as professional judgment of the engagement team in the components of the audit universe as discussed above. The work schedule should also reflect the internal auditor's assessment of risks associated with various areas covered by the particular internal audit engagement and the priority attached thereto.

Preparation of Audit Programme

19. The internal auditor should also prepare a formal internal audit programme listing the procedures essential for meeting the objective of the internal audit plan.

Though the form and content of the audit programme and the extent of its details would vary with the circumstances of each case, yet the internal audit programme should be so designed as to achieve the objectives of the engagement and also provide assurance that the internal audit is carried out in accordance with the Standards on Internal Audit. As a corollary, the audit plan developed by the internal auditor would need to be a risk-based plan, appropriately reflecting and addressing the priorities of the internal audit activity, consistent with the organisation's goals. **The internal audit programme should also be finalised in consultation with the appropriate authority before the commencement of the work.** The internal audit programme identifies, in appropriate details, the objectives of the internal audit in respect of each area, the procedures to be performed to achieve those objectives, the staff responsible for carrying out the particular activity, the time allocated to each activity as also the sufficiently detailed, instructions to the staff as to how to carry out those procedures. The internal audit programme may also have provision for information such as the procedures actually performed, reasons for not performing the originally identified procedures, actual time consumed in carrying out the relevant procedure, reasons for deviations from budgeted time etc. A well prepared, comprehensive audit programme helps proper execution of the work as well as of the proper supervision, direction and control of the performance of the engagement team.

Effective Date

20. **This Standard on Internal Audit is applicable to all internal audits commencing on or after _____.** Earlier application of the SIA is encouraged.

Exposure Draft

Standard on Internal Audit

Basic Principles of Internal Audit

*The Committee on Internal Audit of the Institute of Chartered Accountants of India invites comments on the Exposure Draft of the Standard on Internal Audit (SIA), Basic Principles of Internal Audit. Comments are most helpful if they indicate the specific paragraph(s) to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording. Comments should be submitted in writing to the Secretary, Committee on Internal Audit, The Institute of Chartered Accountants of India, C-1, Sector-1, NOIDA-201 301 so as to be received not later than **October 13, 2006**. Comments can also be sent by e-mail at cia@icai.org.*

Introduction

1. The purpose of this Standard on Internal Audit (SIA) is to establish standards and provide guidance on the general principles governing internal audit.

2. Paragraph 3.1 of The Preface to the Standards and Guidance Notes on Internal Audit, issued by the Institute of Chartered Accountants of India defines internal audit as follows:

“Internal audit is an independent management function, which involves a continuous and critical appraisal of the functioning of an entity with a view to suggest improvements thereto and add value to and strengthen the overall governance mechanism of the entity, including the entity’s risk management and internal control system.”

3. The other Standards on Internal Audit to be issued by the Institute of Chartered Accountants of India will elaborate the principles set out herein to give guidance on auditing procedures and reporting practices. Compliance with the basic principles requires the application of auditing procedures and reporting

practices appropriate to the particular circumstances.

Basic Principles of Internal Audit

Integrity, Objectivity and Independence

4. **The internal auditor should be straightforward, honest and sincere in his approach to his professional work.** He must be fair and must not allow prejudice or bias to override his objectivity. **He should maintain an impartial attitude. He should not only be independent in fact but also appear to be independent. The internal auditor should not, therefore, undertake activities which are or might appear to be incompatible with his independence and objectivity. The internal auditor should, therefore, be independent of the activities as well as the internal control processes of the entity. Management should take steps necessary for providing an environment conducive to enable the internal auditor to discharge his responsibilities independently and also report his findings etc., without any management interference. Any conflict of interest should be reported by the internal auditor to an appropriate**

authority for necessary remedial action.

Confidentiality

5. **The internal auditor should respect the confidentiality of the information acquired in the course of his work and should not disclose any such information to a third party without the specific authority of the management/ client or unless there is a legal or a professional responsibility to do so. The internal auditor should, therefore, ensure that there are well laid out policies and controls to protect confidentiality of the information.**

Due Professional Care, Skills and Competence

6. **The internal auditor should exercise due professional care, competence and diligence expected of him while carrying out the internal audit.** Due professional care signifies that the internal auditor should exercise reasonable care in carrying out the work entrusted to him. Due professional care, however, neither implies nor guarantees infallibility, nor does it require the internal auditor to travel beyond the scope of his engagement.
7. **Internal audit requires skills and competence, which are acquired through a combination of general education, technical knowledge obtained through study and formal course(s). The internal auditor should either have or obtain such skills and competence as are necessary for the purpose of discharging his responsibilities.**
8. The internal auditor also has a continuing duty to maintain professional knowledge and skills at a level required to ensure that the client or the employer receives the advantage of competent professional service based on the latest developments in the profession, the overall economy and the relevant industry and legislation.

Work Performed by Others

9. When the internal auditor delegates work to assistants or uses work performed by other auditors or experts, he will continue to be responsible for forming his opinion on the activity(ies) being subject to internal audit or his findings. However, the internal auditor will be entitled to rely on the work performed by others, provided he exercises adequate skill and care in ascertaining the competence and skills of such other experts. He must also look into the assumptions, if any, made by other expert. **He should be satisfied that he has no reasons to believe that he should not have relied on the work of the expert. The internal auditor should also carefully direct, supervise and review the work delegated to assistants. He should also obtain reasonable assurance that the work performed by other auditor or expert is adequate for his purpose.**

Documentation

10. **The internal auditor should document matters, which are important in providing evidence that the audit was carried out in accordance with the Standards on Internal Audit and support his findings or the report submitted by him.** In addition, the working papers also help in properly planning and performing the internal audit, review and supervise the work and most importantly, provide evidence of the work performed to support his opinion or findings.

Planning

11. **The internal auditor should plan his work to enable him to conduct an effective internal audit in a timely and efficient manner, ensuring that appropriate attention is devoted to significant areas of audit, identification of potential problems and appropriate utilisation of skills and time of the staff.**

12. **The internal audit plan should be based on the knowledge of the business of the client/ employer.** The internal audit plan would normally cover aspects such as:

- (i) obtaining the knowledge of the legal and regulatory framework within which the entity operates
- (ii) obtaining the knowledge of the entity's accounting and internal control systems and policies
- (iii) determining the effectiveness of the internal control procedures adopted by the entity
- (iv) identifying the activities warranting special focus based on the materiality and criticality of such activities, and its overall effect on presentation of the financial statements of the entity
- (v) identifying and allocating staff to each of the above activities
- (vi) determining the nature, timing and extent of procedures to be performed
- (vii) setting the time budget for each of the above activities
- (viii) identifying the reporting responsibilities
- (ix) benchmark against which the actual results of the activities, the actual time spent, the cost incurred would be measured.

13. **A plan once prepared should be continuously reviewed by the internal auditor to identify any modifications to the plan required to bring the same in line with the changes, if any, to the audit universe.**

Evidence

14. **The internal auditor should obtain sufficient appropriate evidence to enable him to draw reasonable conclusions therefrom on which to base his opinion or findings.** The nature and amount of evidence required depends on

the professional judgment of the internal auditor. Factors affecting the judgment include the activity under audit, possible errors and their materiality and the risk of occurrence of such errors.

Internal control and risk management systems

15. While the management is responsible for establishment and operation of appropriate internal control and risk management systems, the role of the internal auditor is to suggest improvements to those systems. **For this purpose, the internal auditor should:**

- (i) **obtain an understanding of the risk management and internal control framework instituted by the management**
- (ii) **perform steps for assessing the adequacy of the framework developed in relation to the organisational set up**
- (iii) **review the adequacy of the framework**
- (iv) **perform risk based audits on the basis of risk assessment process**

16. Internal auditor may, however, also undertake work involving identification of risks as well as recommend design of controls or gaps in existing controls to address those risks.

Reporting

17. **The internal auditor should carefully review and assess the conclusions drawn from the audit evidence obtained, as the basis for his findings contained in his report and suggest remedial action.**

Effective Date

18. **This Standard on Internal Audit is effective for all internal audits beginning on or after _____.** Early application of the SIA is encouraged.

Exposure Draft

FRAMEWORK FOR ASSURANCE ENGAGEMENTS

(Effective for assurance reports issued on or after _____)

Invitation To Comments

The Auditing and Assurance Standards Board of the Institute of Chartered Accountants of India invites comments on the Exposure Draft of the Framework for Assurance Engagements. Comments are most helpful if they indicate the specific paragraph(s) to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.

Comments should be submitted in writing to the Secretary, Auditing and Assurance Standards Board, The Institute of Chartered Accountants of India, C-1, Sector-1, NOIDA-201301, so as to be received not later than **October 13, 2006**. Comments can also be sent by e-mail at aasb@icai.org.

Note for the Readers

The Auditing and Assurance Standards Board had in July 2001 published the Framework of Statements on Standard Auditing Practices and Guidance Notes on Related Services. The said Framework, *inter alia*, described the various types of engagements

generally undertaken by the members viz., audits and related services. In terms of the Framework, the related services constituted the review engagements, engagements to perform agreed upon procedures and engagement to compile financial information. The Framework also outlined the levels of assurance attached with as well as the type of report issued in the aforementioned types of engagements.

The Board had in May 2006 issued the exposure draft of the revised Preface for the Standards applicable to the various types of engagements. In terms of the proposed modifications to the exposure draft of the revised Preface, since engagements to perform agreed upon procedures and the engagements to compile financial information do not provide any assurance, they would not be covered by the following revised Framework. Further, in terms of proposed revised Preface as well as this following Revised Framework, "review" would no longer constitute a related service but an assurance service. Related services would, therefore, cover only engagements to perform agreed upon procedures as well as the engagements to compile financial information.

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) apply¹. It provides a frame of reference for:

- (a) Professional accountants in public practice² ("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;³
- (b) Others involved with assurance en-

¹ The terms, Standards on Auditing (SAs), Standards on Review Engagements (SREs) and Standards on Assurance Engagements (SAEs) were explained in the Exposure Draft of the revised Preface to the Auditing and Assurance Standards, Statements on Auditing and Guidance Notes, published in May 2006.

² The term "professional accountants in public practice (practitioners)" refers to the members of the Institute of Chartered Accountants of India who are 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.

³ If a professional accountant not in public practice, for example an internal auditor, 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.

gements, 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 to perform agreed upon procedures and engagements to compile financial information since the members do not express any assurance on the financial information or any other subject matter of his 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. The relationship between the Framework and the SAs, SREs and SAEs is illustrated in **Appendix 1** to this Framework.

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”).
- *Definition and objective of an assurance engagement:* This section defines assurance engagements and identifies the objectives of the two types of assurance engagement a practitioner is permitted to perform. This Framework calls these two types reasonable assurance engagements and limited assurance engagements.⁴

- *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 assurance engagements 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 2** 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 engagement.

- *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, as amended by the (Amendment) Act of 2006;
 - (b) The *Code of Ethics* (the Code), issued by the Institute, which establishes fundamental ethical principles for professional accountants;

⁴ For assurance engagements relating to historical financial information in particular, such engagement which provide reasonable assurance are called audits, and those engagements which provide limited assurance are called reviews.

- (c) Other relevant pronouncements of the Institute of Chartered Accountants of India⁵; and
 - (d) Standards on Quality Control (SQC), which establish standards and provide guidance on a firm's system of quality control.⁶
5. The Code of Ethics sets out the fundamental ethical principles that all professional accountants are required to observe, including:
- (a) Integrity;
 - (b) Objectivity;
 - (c) Professional competence and due care;
 - (d) Confidentiality; and
 - (e) Professional behaviour.
- 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.

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).
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

⁵ Attention of the members is invited to the Guidance Note on Independence of Auditors, issued by the Committee on Ethical Standards of the Institute of Chartered Accountants of India.

⁶ As and when released.

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 engagement a practitioner is 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 engagement⁷ 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,⁸ 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 7, 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:
 - (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

⁷ 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.

⁸ 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.

- (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 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 specialised 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 under-

standing 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 organisation engages a practitioner to perform an assurance engagement regarding a report about a private company's sustainability practices that the organisation 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.

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.

can be evaluated or measured against criteria; and

- (b) The persuasiveness of available evidence.

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

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.
- (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 authorised or recognised 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.⁹

⁹ 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.

Evidence

38. The practitioner plans and performs an assurance engagement with an attitude of 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 recognising 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 generalising 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, digitised 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. Generalisations about the reliability of various kinds of evidence can be made; however, such generalisations 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 recognising that exceptions may exist, the following generalisations 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 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.¹⁰ In

¹⁰ (a) 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.

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 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.¹¹

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;

¹¹ 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.

- (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.
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, AAS 33, "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 32); 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 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,¹²

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.

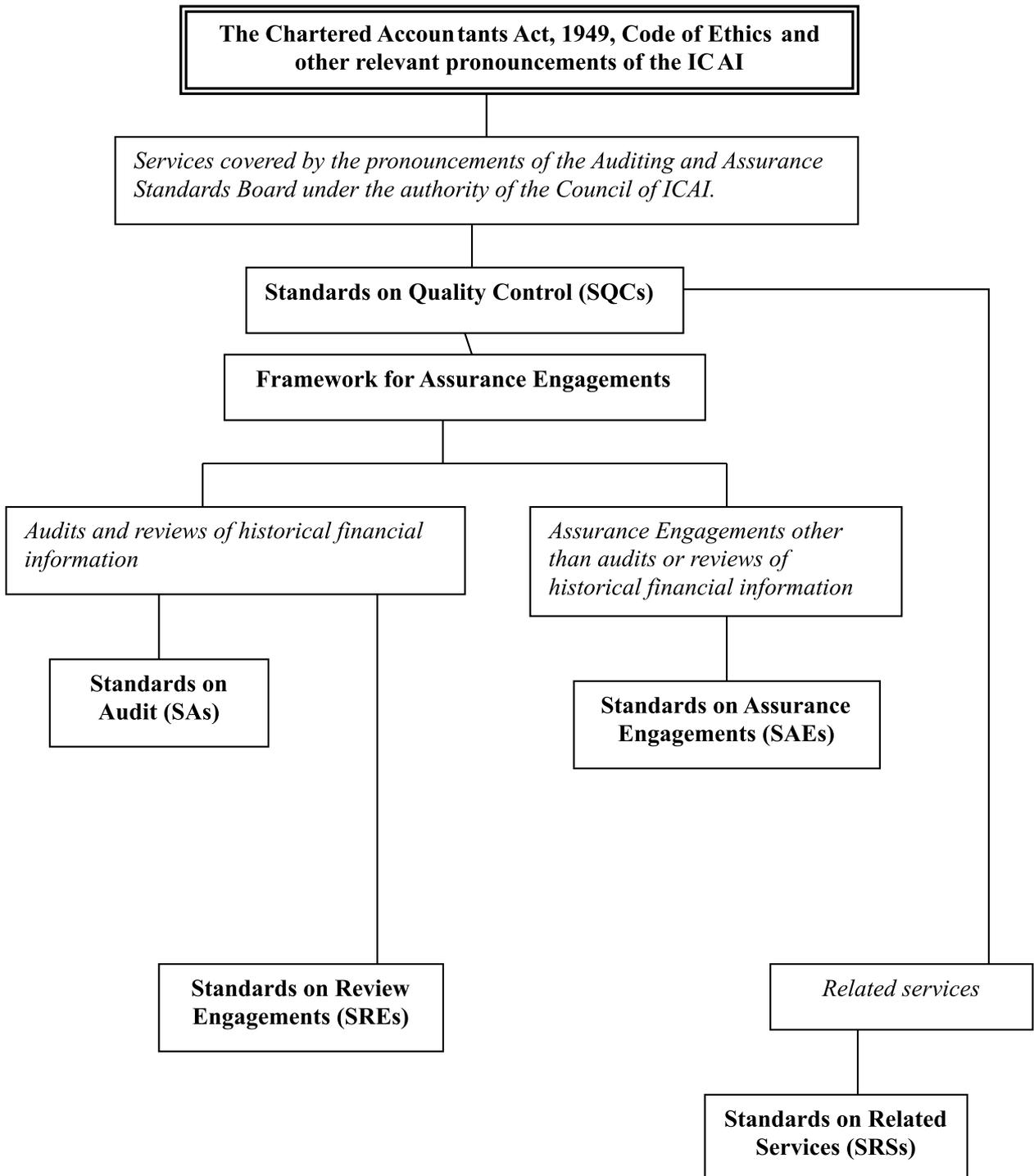
In some cases, the practitioner considers withdrawing from the engagement.

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.

¹² 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 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).

A Diagrammatic Representation of the Relationship Between the Framework and the SAs, SREs and SAEs



Appendix 2**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).

Type of Engagement	Objective	Evidence-gathering procedures¹³	The assurance Report
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)	Sufficient appropriate evidence is obtained as part of a systematic engagement process that includes: <ul style="list-style-type: none"> ● Obtaining an understanding of the engagement circumstances; ● Assessing risks; ● Responding to assessed risks; ● 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 ● Evaluating the evidence obtained (Paragraphs 50 and 51) 	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 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)	Sufficient appropriate evidence is obtained as part of a systematic engagement process that includes obtaining an understanding of the subject matter and other engagement circumstances, but in which procedures are deliberately limited relative to reasonable assurance engagement (Paragraph 52)	Description of the engagement circumstances, and a negative form of expression of the conclusion (Paragraph 58)

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

Exposure Draft

Revised Auditing and Assurance Standard (AAS) 19 SUBSEQUENT EVENTS

Invitation to Comments

The Auditing and Assurance Standards Board of the Institute of Chartered Accountants of India invites comments on the Exposure Draft of the Revised Auditing and Assurance Standard (AAS) 19, Subsequent Events. Comments are most helpful if they indicate the specific paragraph(s) to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.

*Comments should be submitted in writing to the Secretary, Auditing and Assurance Standards Board, The Institute of Chartered Accountants of India, C-1, Sector-1, NOIDA – 201 301, so as to be received not later than **October 13, 2006**. Comments can also be sent by e-mail at aasb@icai.org.*

Introduction

1. The purpose of this Auditing and Assurance Standard (AAS) is to establish standards and provide guidance on the auditor's responsibility regarding subsequent events. In this AAS, the term "subsequent events" is used to refer to both events occurring between the date of the financial statements and the date of the auditor's report, and facts discovered after the date of the auditor's report.
2. **The auditor should consider the effect of subsequent events on the financial statements and on the auditor's report.**
3. Accounting Standard 4, "Contingencies and Events Occurring After the Balance Sheet Date" deals with the treatment in financial statements of events, both favourable and unfavourable, that occur between the

balance sheet date and the date on which the financial statements are approved by the Board of Directors in the case of a company, and by the corresponding approving authority in the case of any other entity and identifies two types of events:

- a) Those that provide further evidence of conditions that existed at the balance sheet date; and
- b) Those that are indicative of conditions that arose subsequent to the balance sheet date.

Definitions

4. The following terms have the meanings attributed below:
 - (a) "Date of the financial statements" is the date of the end of the latest period covered by the financial statements, which is normally the date of the most recent balance sheet in the financial statements subject to audit.
 - (b) "Date of approval of the financial statements" is the date on which those with the recognised authority assert that they have prepared the entity's complete set of financial statements, including the related notes, and that they have taken responsibility for them. The date of approval of the financial statements for purposes of the AASs is the earlier date on which those with the recognised authority determine that a complete set of financial statements has been prepared.
 - (c) "Date of the auditor's report" is the date when the auditor signs the report on the financial statements. The auditor's

report is not dated earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the opinion on the financial statements. Sufficient appropriate audit evidence includes evidence that the entity's complete set of financial statements has been prepared and that those with the recognised authority have asserted that they have taken responsibility for them, i.e., the date of approval of the financial statements.

- (d) "Date the financial statements are issued" is the date that the auditor's report and audited financial statements are made available to stakeholders or other third parties. For example, in the case of unlisted corporate entities, this date could be the date when the annual general meeting notice for approval of annual accounts are received by the shareholders or the date when the financial statements were posted on the web-site or the date the financial statements were submitted to the bankers if that was earlier. In the case of listed corporate entities, the audited financial statements, when approved by the board of directors are immediately filed with the stock exchanges. Under these circumstances that date would be the date the financial statements are issued. In the case of a partnership entity, this date could be earlier of the date when the financial statements are submitted to the bankers or filed with the income-tax authority.

Events Occurring up to the Date of the Auditor's Report

5. **The auditor should perform procedures designed to obtain sufficient appropriate audit evidence that all events up to the date of the auditor's report that may require adjustment of, or disclosure in, the financial statements have been**

identified. These procedures are in addition to routine procedures which may be applied to specific transactions occurring after the date of the financial statements to obtain audit evidence as to account balances as at the date of the financial statements, for example, the testing of inventory cut-off and payments to creditors. The auditor is not, however, expected to conduct a continuing review of all matters to which previously applied procedures have provided satisfactory conclusions.

6. The procedures to identify events that may require adjustment of, or disclosure in, the financial statements would be performed as near as practicable to the date of the auditor's report and ordinarily include the following:
- Reviewing procedures management has established to ensure that subsequent events are identified.
 - Reading minutes of the meetings of shareholders, the board of directors and audit and executive committees held after the date of the financial statements and inquiring about matters discussed at meetings for which minutes are not yet available.
 - Reading the entity's latest available interim financial statements and, as considered necessary and appropriate, budgets, cash flow forecasts and other related management reports.
 - Inquiring, or extending previous oral or written inquiries, of the entity's lawyers concerning litigation and claims.
 - Inquiring of management as to whether any subsequent events have occurred which might affect the financial statements. Examples of inquiries of management on specific matters affecting the financial statements under audit are:

- ❖ The current status of items that were accounted for on the basis of preliminary or inconclusive data.
 - ❖ Whether new commitments, borrowings or guarantees have been entered into.
 - ❖ Whether sales of assets have occurred or are planned.
 - ❖ Whether the issue of new shares or debentures or an agreement to merge or liquidate has been made or is planned.
 - ❖ Whether any assets have been appropriated by government or destroyed, for example, by fire or flood.
 - ❖ Whether there have been any developments regarding risk areas and contingencies, for example, fraud or embezzlement.
 - ❖ Whether any unusual accounting adjustments have been made or contemplated.
 - ❖ Whether any events have occurred or are likely to occur which will bring into question the appropriateness of accounting policies used in the financial statements as would be the case, for example, if such events call into question the validity of the going concern assumption.
7. When a component, such as a division, branch or subsidiary, is audited by another auditor, the auditor would consider the other auditor's procedures regarding events after the date of the financial statements and the need to inform the other auditor of the planned date of the auditor's report.
8. **When the auditor becomes aware of events which materially affect the financial statements, the auditor should consider whether such events are properly accounted for and adequately disclosed in the financial statements.**

Facts Discovered After the Date of the Auditor's Report but Before the Date the Financial Statements are Issued

9. The auditor does not, ordinarily, have any responsibility to perform procedures or make any inquiry regarding the financial statements after the date of the auditor's report. During the period from the date of the auditor's report to the date the financial statements are issued, the responsibility to inform the auditor of facts which may affect the financial statements rests with management.
10. **When, after the date of the auditor's report but before the date the financial statements are issued, the auditor becomes aware of a fact which may materially affect the financial statements, the auditor should consider whether the financial statements need amendment, should discuss the matter with management, and should take the action appropriate in the circumstances.**
11. When management amends the financial statements, the auditor would carry out the procedures necessary in the circumstances and would provide management with a new report on the amended financial statements. The new auditor's report would be dated not earlier than the date of approval of the amended financial statements and, accordingly, the procedures referred to in paragraph 5 would be extended to the date of the new auditor's report. The report issued by the auditor on such amended financial statements will be in substitution of the report issued on the financial statements before amendment. All the printed copies of the original financial statements and reports must be returned to the auditor and all copies of the same that are hosted on different websites must be removed from there. Also, if the original financial statements were sent through e-mail, another e-mail must also be sent to all those persons specifically

mentioning therein that the financial statements and the reports e-mailed earlier have been substituted and, therefore, those should not be used by any person for any purpose whatsoever. The auditor should also obtain a representation from the management that all these requirements have been completely fulfilled. An adequate disclosure of the fact of the revision on the financial statements already approved by the appropriate approving authority and reported upon by the auditors must appear as a specific note on the amended financial statements. The auditor should expressly refer to the fact of revision of the financial statements in his report.

12. **When management does not amend the financial statements in circumstances where the auditor believes they need to be amended and the auditor's report has not been released to the entity, the auditor should express a qualified opinion or an adverse opinion, as described in AAS 28 "The Auditor's Report on Financial Statements".**
13. When the auditor's report has been released to the entity, the auditor would notify those persons ultimately responsible for the overall direction of the entity not to issue the financial statements and the auditor's report thereon. If the financial statements are subsequently released, the auditor needs to take appropriate action to prevent reliance on the auditor's report as released by the entity.

Facts Discovered After the Financial Statements have been Issued

14. After the financial statements have been issued, the auditor has no obligation to make any inquiry regarding such financial statements.
15. **When, after the financial statements have been issued, the auditor becomes aware of a fact which existed at the date of the**

auditor's report and which, if known at that date, may have caused the auditor to modify the auditor's report, the auditor should consider whether the financial statements need revision, should discuss the matter with management, and should take the action appropriate in the circumstances.

16. When management revises the financial statements, the auditor would carry out the audit procedures necessary in the circumstances, would review the steps taken by management to ensure that anyone in receipt of the previously issued financial statements together with the auditor's report thereon is informed of the situation, and would issue a new report on the revised financial statements.
17. **The new auditor's report should include an emphasis of a matter paragraph referring to a note to the financial statements that more extensively discusses the reason for the revision of the previously issued financial statements and to the earlier report issued by the auditor.** The new auditor's report would be dated not earlier than the date of approval of the revised financial statements. The procedures referred to in paragraphs 5 would not be extended to the date of the new auditor's report. The auditor should restrict the audit procedures regarding the revised financial statements to the effects of the subsequent event that necessitated the revision of financial statements. A statement to that effect should be given in the audit report.
18. **When management does not take the necessary steps to ensure that anyone in receipt of the previously issued financial statements together with the auditor's report thereon is informed of the situation and does not revise the financial statements in circumstances where the auditor believes they need to be revised, the auditor should communicate in**

writing those persons ultimately responsible for the overall direction of the entity that action will be taken by the auditor to prevent future reliance on the auditor's report. The action taken will depend on the auditor's legal rights and obligations and the recommendations of the auditor's lawyers.

19. It may not be necessary to revise the financial statements and issue a new auditor's report when issue of the financial statements for the following period is imminent, provided appropriate disclosures are to be made in such statements.

Effective Date

20. This AAS is effective for auditor's reports dated on or after _____.

Examples

Example 1: New audit report issued after the date of the earlier Auditor's Report but before the date the financial statements are issued

Introduce following paragraph after the Introductory Paragraph (Matter of Emphasis)

"We have considered the earlier audit report dated ----- of M/s ----- (in case there is a change in auditors) on the original financial statements approved by the Board of Directors of the Company on ----- and have examined the changes made therein, which are as follows. Reference is invited to (refer to the note in the revised financial statements),"

(Deal with the changes and their effect – if as a result of the revision the auditor's new opinion is qualified or a qualification in the previous opinion is omitted disclose this fact.)

Example 2: New audit report issued after the date the financial statements are issued

Introduce following paragraph after the Introductory Paragraphs (Qualificatory)

"We have considered the earlier audit report dated ----- of M/s ----- (in case there is a change in auditors) on the original financial statements adopted by the shareholders of the Company at the Annual General Meeting held on ----- and have examined the changes made therein, which are as follows. Reference is invited to (refer to the note in the revised financial statements),

(Deal with the changes and their effect – if as a result of the revision the auditor's new opinion is qualified or a qualification in the previous opinion is omitted disclose this fact.)

The Department of Company Affairs (DCA) (now known as the Ministry of Company Affairs) vide its Circular No.1/2003 dated 13.1.2005 has clarified that a Company can reopen and revise its accounts after their adoption by the shareholders and filing with the Registrar of Companies only in order to comply with the technical requirements of laws to achieve the object of exhibiting a true and fair view. In our opinion the revisions detailed above and more extensively explained in (refer to the note in the revised financial statements) are not of the nature envisaged by the (DCA)^{1,2}."

Introduce following statement at the end of the Scope Paragraph

"We have not carried out any audit procedures between ----- the date of the earlier audit report and ----- the date of this report other than for the matters relating to the revision of the financial statements dealt with above."

¹ The Department of Company Affairs has vide General Circular No. 1/2003 dated 13.1.2005 clarified that a company could reopen and revise its account even after their adoption in the annual general meeting and filing with the Registrar of Companies in order to comply with the technical requirements of any other law (i.e. besides taxation laws already covered by the DCA circular dated 28.7.1987) to achieve the objective of exhibiting true and fair view. The revised annual accounts would be required to be adopted either in the extraordinary general meeting or in the subsequent annual general meeting and filed with the Registrar of Companies. Accordingly, where change is as per aforesaid circular, the auditor will have to make an appropriate modification in the wordings of his report

² Not applicable to non-corporate entities.