

Chapter 4 - Audit Evidence

SA 500 “Audit Evidence”

Part I : Descriptive Questions

Q1.	<p>On perusal of financial statements of a company, auditor of company finds that notes to accounts contain aging of trade payables in accordance with requirements of Schedule III of Companies Act, 2013. The accountant of company is responsible for ensuring proper aging of trade payables included in notes to accounts. The auditor wants to verify whether aging of trade payables made in financial statements is proper or not. Identify what he is trying to do. (ICAI Study Material - Test Your Understanding)</p>
	<p>The auditor is verifying aging of trade payables. He is “reperforming” the control which was mandated by the management. Reperformance involves the auditor’s independent execution of procedures or controls that were originally performed as part of the entity’s internal control.</p>
Q2.	<p>CA Sooryagaythri is conducting audit of an entity. During the course of audit, she has made oral inquiries from head accountant regarding preparing of bank reconciliations every month as has been laid down by the management. Discuss, whether inquiries as stated above would provide satisfaction to her that controls in respect of preparing bank reconciliations statements have operated effectively. (ICAI Study Material - Test Your Understanding)</p>
	<ul style="list-style-type: none"> • Inquiry alone ordinarily does not provide sufficient audit evidence of the absence of a material misstatement at the assertion level, nor of the operating effectiveness of controls. Mere inquiry does not lead to obtaining of sufficient appropriate audit evidence. • In the given case, CA Sooryagaythri should verify whether proper bank reconciliations have been carried out monthly as stipulated by management. Only then, she can be satisfied about operating effectiveness of controls in this regard
Q3.	<p>A company has stipulated a control that reconciliations of its records showing quantitative details of its property, plant and equipment are carried out at regular intervals with physical verification of such items. The auditor has found that such reconciliations are being carried out as stipulated. Discuss, whether above factor, increases reliability of other internally generated evidence within the company relating to existence of such items. (ICAI Study Material - Test Your Understanding)</p>
	<p>The management is carrying out reconciliations of items contained in Property, Plant and Equipment records with physical verification of such items at regular intervals. It means that controls in this regard have operated effectively. The reliability of audit evidence that is generated internally is increased when the related controls, including those over its preparation and maintenance, imposed by the entity are effective</p>
Q4.	<p>The auditor of JPJ Limited explained to the audit team members about the relationship between Audit Evidence and Opinion of Auditor. Explain what relationship exists between Audit Evidence and Opinion of Auditor. (ICAI Study Material - Illustration)</p>
	<p>Relationship between Audit Evidence and Opinion of Auditor:</p> <ul style="list-style-type: none"> • There exists a very important relationship between Audit Evidence and opinion of the Auditor. • While conducting an audit of a company, the auditor obtains audit evidence and with the help of that audit evidence obtained, the auditor forms an audit opinion on the financial statements of that company.
Q5.	<p>An audit team member of the auditors of Genuine Limited was of the view that audit evidence obtained internally from within the company under audit are more appropriate from the reliability point of view as compared to audit evidence obtained externally as evidence obtained internally are obtained from the company whose audit is being conducted. Give your views as auditor of Genuine Limited. (ICAI Study Material - Illustration)</p>
	<p>Audit evidence obtained externally is more appropriate from reliability point of view as compared to those which are obtained internally. The reason that audit evidence obtained externally is more appropriate from the point of view of reliability is that there is a very low risk that they can be altered or changed.</p>
Q6.	<p>There was a Partnership Firm of Chartered Accountants VM and Associates. Mr. M, one of the partners of VM and Associates, while explaining to his audit team members about importance of audit evidence informed them about</p>

	<p>sufficiency and appropriateness of audit evidence. Mr. A, one of the members of audit team of VM and Associates was of the view that sufficiency of audit evidence means simplicity of audit evidence and appropriateness of audit evidence means ease of obtaining audit evidence. Explain whether sufficiency and appropriateness of audit evidence mean simplicity and ease of obtaining audit evidence. (ICAI Study Material - Illustration)</p>
	<p>Sufficiency and Appropriateness of audit evidence does not mean simplicity and ease of obtaining audit evidence rather sufficiency of audit evidence is related to the quantity of audit evidence and appropriateness of audit evidence is related to quality of audit evidence.</p>
Q7.	<p>While auditing the books of accounts of AB Limited for the financial year 2023-24, the auditor of the company used an audit procedure according to which complete documents and records of the company were checked in detail in order to obtain audit evidence. Explain the audit procedure used by the auditor of Extremely Distinct Limited. (ICAI Study Material - Illustration)</p>
	<p>The audit procedure used by auditor of AB Limited is known as Inspection because inspection is an audit procedure in which complete documents and records of a company are checked in detail for the purpose of obtaining audit evidence.</p>
Q8.	<p>Discuss what is understood by “appropriateness” of audit evidence. (ICAI Study Material - Test Your Knowledge)</p>
	<p>Appropriateness is the measure of the quality of audit evidence; that is, its relevance and its reliability in providing support for the conclusions on which the auditor’s opinion is based.</p> <p>The reliability of evidence is influenced by its source and nature, and is dependent on the individual circumstances under which it is obtained.</p>
Q9.	<p>Maintaining accounts using accounting software having a feature of recording audit trail can be useful for an auditor. Discuss some of the advantages for such a feature in accounting software for auditor. (ICAI Study Material - Test Your Knowledge)</p>
	<ul style="list-style-type: none"> ● An audit trail is a documented flow of a transaction. ● It is used to investigate how a source document was translated into an account entry and from there it was inserted into financial statement of an entity. ● It is used as audit evidence to establish authentication and integrity of a transaction. ● Audit trails help in maintaining record of system and user activity. ● Like, in case of banks, there is an audit trail keeping track of log-on activity detailing record of log-on attempts and device used. ● Audit trails help to enhance internal controls and data security. ● Audit trails assist in assigning responsibility, reconstructing events, and analyzing issues ● Audit trails incur costs, both in system expenses and time spent analyzing data. Automated tools can efficiently analyze the large volume of data from audit trails. ● Audit trails boost auditor confidence by verifying if management’s controls work effectively and if authorized personnel performed transactions. They enhance data security, increasing the reliability of audit evidence obtained.
Q10.	<p>What is meant by sufficiency of Audit Evidence? Explain the factors affecting the auditor’s judgement as to the sufficiency of audit evidence. (ICAI Study Material - Test Your Knowledge) (MTP2, May 2023, 3 marks)</p> <p style="text-align: center;">OR</p> <p>The quantity of audit evidence needed is affected by the auditor’s assessment of the risks of misstatement. Auditor’s judgment as to sufficiency may be affected by a few factors. Explain. (RTP, May 2018, NA)</p> <p style="text-align: center;">OR</p> <p>The quantity of audit evidence needed is affected by the auditor’s assessment of the risks of misstatement (the higher the assessed risks, the more audit evidence is likely to be required) and also by the quality of such audit evidence (the higher the quality, the less may be required). Obtaining more audit evidence, however, may not compensate for its poor quality. Analyse and Explain stating clearly the factors affecting the auditor’s judgement as to sufficiency of audit evidence. (RTP, May 2019, NA)</p> <p style="text-align: center;">OR</p> <p>Sufficiency is the measure of the quantity of audit evidence. The quantity of audit evidence needed is affected by the auditor’s assessment of the risks of misstatement and also by the quality of such audit evidence. Obtaining more audit</p>

evidence, however, may not compensate for its poor quality. Explain also stating the factors affecting auditor's judgment as to sufficiency of audit evidence. (RTP, Nov 2020, NA)

OR

Explain the various factors affecting the auditor's judgments as to the sufficiency of the audit evidence. (RTP, May 2023, NA)

Sufficiency of Audit Evidence:

Sufficiency is the measure of the **quantity** of audit evidence. The quantity of audit evidence needed is affected by the auditor's assessment of the risks of misstatement (the higher the assessed risks, the more audit evidence is likely to be required) and also by the quality of such audit evidence (the higher the quality, the less may be required). Obtaining more audit evidence, however, may not compensate for its poor quality.

Auditor's judgment as to sufficiency may be affected by the factors such as:

- **Materiality:** It may be defined as the **significance** of **classes** of transactions, account balances and presentation and disclosures to the **users** of the financial statements. **Less evidence** would be required in case assertions are **less material** to users of the financial statements. But on the other hand if assertions are more material to the users of the financial statements, more evidence would be required.
- **Risk of material misstatement**
 - It may be defined as the risk that the financial statements are materially misstated **prior to audit**.
 - This consists of two components described as follows at the assertion level
 - **Inherent risk**—The susceptibility of an assertion to a misstatement that could be material before consideration of any related controls.
 - **Control risk**—The risk that a misstatement that could occur in an assertion that could be material will not be prevented or detected and corrected on a timely basis by the entity's internal control.
 - **Less evidence** would be required in case assertions that have a **lower risk** of material misstatement. But on the other hand if assertions have a higher risk of material misstatement, more evidence would be required.
- **Size of a population:** It refers to the **number of items** included in the population. **Less evidence** would be required in case of **smaller, more homogeneous** population but on the other hand in case of larger, more heterogeneous populations, more evidence would be required

Q11. Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence. Explain (ICAI Study Material - Test Your Knowledge) (RTP, Nov 2018, NA)

OR

Audit evidence is necessary to support the auditor's opinion and report. It is cumulative in nature and is primarily obtained from audit procedures performed during the course of the audit. Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence. Explain (RTP, Nov 2019, NA)

- Audit evidence is necessary to support the auditor's opinion and report.
- It is **cumulative** in **nature** and is **primarily obtained** from audit procedures performed during the course of the audit. It may, however, also **include information** obtained from **other sources** such as **previous audits**. In addition to other sources inside and outside the entity, the entity's accounting records are an important source of audit evidence.
- Also, information that may be used as audit evidence may have been prepared using the work of a management's expert. Audit evidence comprises **both** information that **supports** and **corroborates** management's **assertions**, and any information that contradicts such assertions. In addition, in some cases the absence of information (for example, management's refusal to provide a requested representation) is used by the auditor, and therefore, also constitutes audit evidence. Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence.
- Audit procedures to obtain audit evidence can include inspection, observation, confirmation, recalculation, re-performance and analytical procedures, often in some combination, in addition to inquiry.
- Although inquiry may provide important audit evidence, and may even produce evidence of a misstatement, **inquiry alone** ordinarily does **not provide sufficient** audit **evidence** of the absence of a material misstatement at the assertion level, nor of the operating effectiveness of controls.
- As explained in **SA 200**, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", **reasonable** assurance is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk (i.e., the risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated) to an acceptably low level. The sufficiency and appropriateness of

	audit evidence are interrelated
Q12.	<p>Evaluating responses to inquiries is an integral part of the inquiry process. Explain. (RTP, May 2018, NA)</p> <p style="text-align: center;">OR</p> <p>While conducting the audit of Pummy Limited, the statutory auditors collected written representations from the Management. The audit was finalized in addition to other audit procedures but, without making any inquiries, as the statutory auditors were short of time. In the light of this information, state the importance of inquiry as one of the methods of collecting Audit Evidence. (RTP, May 2022, NA)</p> <p>Inquiry – Audit Procedure to obtain Audit Evidence:</p> <ul style="list-style-type: none"> ● Inquiry consists of seeking information of knowledgeable persons, both financial and non- financial, within the entity or outside the entity. Inquiry is used extensively throughout the audit in addition to other audit procedures. Inquiries may range from formal written inquiries to informal oral inquiries. Evaluating responses to inquiries is an integral part of the inquiry process. ● Responses to inquiries may provide the auditor with information not previously possessed or with corroborative audit evidence. Alternatively, responses might provide information that differs significantly from other information that the auditor has obtained, for example, information regarding the possibility of management override of controls. In some cases, responses to inquiries provide a basis for the auditor to modify or perform additional audit procedures. ● Although corroboration of evidence obtained through inquiry is often of particular importance, in the case of inquiries about management intent, the information available to support management’s intent may be limited. In these cases, understanding management’s past history of carrying out its stated intentions, management’s stated reasons for choosing a particular course of action, and management’s ability to pursue a specific course of action may provide relevant information to corroborate the evidence obtained through inquiry. ● In respect of some matters, the auditor may consider it necessary to obtain written representations from management and, where appropriate, those charged with governance to confirm responses to oral inquiries.
Q13.	<p>Audit evidence includes both information contained in the accounting records underlying the financial statements and other information. Discuss. (RTP, May 2018, NA)</p> <p style="text-align: center;">OR</p> <p>Auditing is a logical process. An auditor is called upon to assess the actualities of the situation, review the statements of account and give an expert opinion about the truth and fairness of such accounts. This he cannot do unless he has examined the financial statements objectively. He needs evidence to obtain information for arriving at his judgment. Discuss explaining clearly the detailed meaning of audit evidence. (RTP, Nov 2019, NA) (MTP2, Nov 2023, 4 marks)</p> <p style="text-align: center;">OR</p> <p>SA 500 – “Audit Evidence”, explains what constitutes audit evidence in an audit of financial statements. A combination of tests of accounting records and other information is generally used by the auditor to support his opinion on the financial statements. Explain and discuss the meaning of Audit Evidence in detail. (RTP, Nov 2023, NA)</p> <p>Auditing is a logical process. An auditor is called upon to assess the actualities of the situation, review the statements of account and give an expert opinion about the truth and fairness of such accounts. This he cannot do unless he has examined the financial statements objectively. The auditor needs evidence to obtain information for arriving at his judgment.</p> <p>As per SA 500, the objective of the auditor is to design and perform audit procedures to obtain sufficient appropriate audit evidence to draw reasonable conclusions on which to base the auditor’s opinion</p> <p>Audit evidence may be defined as the information used by the auditor in arriving at the conclusions on which the auditor’s opinion is based. Audit evidence includes both information contained in the accounting records underlying the financial statements and other information.</p> <p>Explaining this further, audit evidence includes:-</p> <ul style="list-style-type: none"> ● Information contained in the accounting records: <ul style="list-style-type: none"> ○ Accounting records include <ul style="list-style-type: none"> ■ the records of initial accounting entries and supporting records, such as checks and records of electronic fund transfers; ■ invoices; ■ contracts;

	<ul style="list-style-type: none"> ■ the ledgers, journal entries and other adjustments to the financial statements ■ records such as worksheets and spreadsheets supporting cost allocations, computations, reconciliations and disclosures. <ul style="list-style-type: none"> ● Other information that authenticates the accounting records and also supports the auditor's rationale behind the true and fair presentation of the financial statements: Other information which the auditor may use as audit evidence includes, for example <ul style="list-style-type: none"> ○ minutes of the meetings, ○ written confirmations from trade receivables and trade payables, ○ manuals containing details of internal control etc. <p>A combination of tests of accounting records and other information is generally used by the auditor to support his opinion on the financial statements.</p>
Q14.	<p>"Even when information to be used as audit evidence is obtained from sources external to the entity, circumstances may exist that could affect its reliability". Explain. Also state clearly generalisations about the reliability of audit evidence. (RTP, May 2018, NA)</p> <p style="text-align: center;">OR</p> <p>The reliability of information to be used as audit evidence, and therefore of the audit evidence itself, is influenced by its source, its nature and the circumstances under which it is obtained. Explain and elucidate the guiding principles which are useful in assessing the reliability of audit evidence (MTP1, May 2022, 3 marks)</p> <p>Reliability of Audit Evidence:</p> <p>SA 500 on "Audit Evidence" provides that the reliability of information to be used as audit evidence, and therefore of the audit evidence itself, is influenced by its source and its nature, circumstances under which it is obtained, including the controls over its preparation and maintenance where relevant. Therefore, generalisations about the reliability of various kinds of audit evidence are subject to important exceptions.</p> <p>While recognising that exceptions may exist, the following generalisations about the reliability of audit evidence may be useful:</p> <ul style="list-style-type: none"> ● The reliability of audit evidence is increased when it is obtained from independent sources outside the entity. ● The reliability of audit evidence that is generated internally is increased when the related controls, including those over its preparation and maintenance, imposed by the entity are effective. ● Audit evidence obtained directly by the auditor (for example, observation of the application of a control) is more reliable than audit evidence obtained indirectly or by inference (for example, inquiry about the application of a control). ● Audit evidence in documentary form, whether paper, electronic, or other medium, is more reliable than evidence obtained orally (for example, a contemporaneously written record of a meeting is more reliable than a subsequent oral representation of the matters discussed). ● Audit evidence provided by original documents is more reliable than audit evidence provided by photocopies or facsimiles, or documents that have been filmed, digitized or otherwise transformed into electronic form, the reliability of which may depend on the controls over their preparation and maintenance.
Q15.	<p>The nature and timing of the audit procedures to be used may be affected by the fact that some of the accounting data and other information may be available only in electronic form or only at certain points or periods in time. Explain with the help of examples. (RTP, Nov 2020, NA)</p> <p>Nature and Timing of the Audit Procedures:</p> <ul style="list-style-type: none"> ● The nature and timing of the audit procedures to be used may be affected by the fact that some of the accounting data and other information may be available only in electronic form or only at certain points or periods in time. For example, source documents, such as purchase orders and invoices, may exist only in electronic form when an entity uses electronic commerce, or may be discarded after scanning when an entity uses image processing systems to facilitate storage and reference. ● Certain electronic information may not be retrievable after a specified period of time, for example, if files are changed and if backup files do not exist. Accordingly, the auditor may find it necessary as a result of an entity's data retention policies to request retention of some information for the auditor's review or to perform audit procedures at a time when the information is available.
Q16.	<p>When information to be used as audit evidence has been prepared using the work of a management's expert and having</p>

	<p>regard to the significance of the expert's work for the auditor's purposes, explain the considerations the auditor would consider for the purposes of his audit. (RTP, May 2021, NA)</p> <p style="text-align: center;">OR</p> <p>CA Amar is the statutory auditor of XYZ Ltd. for the FY 2023-24. During the course of audit, CA Amar found that a litigation is going against the company for which the company has hired an external legal team (management expert). CA Amar wanted to use the information as audit evidence which is prepared using the work of the management expert. What should CA Amar consider before using the work of such management expert? (MTP2, Nov 2022, 3 Marks)</p> <p style="text-align: center;">OR</p> <p>T Ltd has used the services of an expert for the purpose of physical verification of its inventory which is appearing in the financial statements of the company at ₹ 75 Crores. Discuss the broad parameters auditor would take into consideration while deciding about using the work performed by the Management's Expert in physical verification of company's inventory (RTP, Nov 2023, NA)</p>
	<p>Management's expert is an individual or organisation possessing expertise in a field other than accounting or auditing, whose work in that field is used by the entity to assist the entity in preparing the financial statements.</p> <p>When information to be used as audit evidence has been prepared using the work of a management's expert, the auditor shall, to the extent necessary, having regard to the significance of that expert's work for the auditor's purposes:</p> <ul style="list-style-type: none"> ● Evaluate the competence, capabilities and objectivity of that expert; ● Obtain an understanding of the work of that expert; and ● Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion
Q17.	<p>In the course of audit of SMP Limited for the financial year ended 31st March, 2024 you have observed as an auditor that the company has provided a sum of ₹ 20 Lakhs in the books of account as Gratuity payable to employees based on certificate obtained from an actuary. Give your comments with reference to the Standard on Auditing. (MTP2, Nov 2021, 3 Marks)</p> <p>Certificate from a Management's Expert:</p> <p>In the given case, SMP Limited has provided a sum of ₹ 20 lakh in the books of accounts as gratuity payable on the basis of certificate obtained from an actuary. The liability towards gratuity payable to the employees at the time of cessation of service should be ascertained and provided for in the accounts when the employees are in service, it is an ascertained present liability accruing over the period of service but payable upon cessation of service.</p> <p>The auditor should check the quantification of the gratuity liability. He should ascertain whether the same had been actuarially determined. The auditor should treat the actuary as managements' expert and conduct procedures relevant to checking the opinion of an expert in accordance with SA 500.</p> <p>As per SA 500, "Audit Evidence", when information to be used as audit evidence has been prepared using the work of a management's expert, the auditor shall, to the extent necessary, having regard to the significance of that expert's work for the auditor's purposes:</p> <ul style="list-style-type: none"> ● Evaluate the competence, capabilities and objectivity of that expert; ● Obtain an understanding of the work of that expert; and ● Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion.
Q18.	<p>CA K audited the books of accounts of E Ltd. for the financial year 2023-2024. The auditor used an audit procedure according to which all the documents and records maintained by the company were checked in detail to obtain audit evidence. Explain the audit procedure used by the auditor and its reliability (SA, Dec 2021, 3 marks)</p> <p>Audit Procedure:</p> <ul style="list-style-type: none"> ● Inspection involves examining records or documents, whether internal or external, in paper form, electronic form, or other media, or a physical examination of an asset. Inspection of records and documents provides audit evidence of varying degrees of reliability, depending on their nature and source and, in the case of internal records and documents, on the effectiveness of the controls over their production. ● Example of inspection used as a test of controls is inspection of records for evidence of authorisation. Some documents represent direct audit evidence of the existence of an asset, for example, a document constituting a financial instrument such as an inventory or bond. Inspection of such documents may not necessarily provide audit evidence about ownership or value. ● In addition, inspecting an executed contract may provide audit evidence relevant to the entity's application of accounting policies, such as revenue recognition. Inspection of tangible assets may provide reliable audit evidence

	<p>with respect to their existence, but not necessarily about the entity's rights and obligations or the valuation of the assets. Inspection of individual inventory items may accompany the observation of inventory counting.</p> <ul style="list-style-type: none"> In view of above, it can be concluded that CA K used Inspection as an audit procedure
Q19.	<p>An auditor is called upon to assess the actualities of the situation, review the statements of account and give an expert opinion about the truth and fairness of such accounts. This he cannot do unless he has examined the financial statements objectively. Explain. (RTP, Nov 2022, NA)</p> <ul style="list-style-type: none"> Auditing is a logical process. An auditor is called upon to assess the actualities of the situation, review the statements of account and give an expert opinion about the truth and fairness of such accounts. This he cannot do unless he has examined the financial statements objectively. Objective examination connotes critical examination and scrutiny of the accounting statements of the undertaking with a view to assessing how far the statements present the actual state of affairs in the correct context and whether they give a true and fair view about the financial results and state of affairs. An opinion founded on a rather reckless and negligent examination and evaluation may expose the auditor to legal action with consequential loss of professional standing and prestige. He needs evidence to obtain information for arriving at his judgment. SA 500 – "Audit Evidence", explains what constitutes audit evidence in an audit of financial statements, and deals with the auditor's responsibility to design and perform audit procedures to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion
Q20.	<p>Manya Textiles is manufacturer of bed sheets, curtain cloths, other handloom items etc. having its plant at Panipat. Auditors SJ & Co. is having doubts over the reliability of information given to him as audit evidence. Also, auditors observed inconsistent information while conducting audit. Guide the auditor as to how they should proceed in the given situation. (RTP, Nov 2022, NA)</p> <p>Inconsistency in or Doubts over Reliability of Audit Evidence:</p> <p>If:</p> <ol style="list-style-type: none"> audit evidence obtained from one source is inconsistent with that obtained from another; or the auditor has doubts over the reliability of information to be used as audit evidence, <p>the auditor shall determine what modifications or additions to audit procedures are necessary to resolve the matter, and shall consider the effect of the matter, if any, on other aspects of the audit</p>
Q21.	<p>The objective of auditing is to design and perform audit procedures in such a way as to enable the auditor to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion. This can be obtained by performing which procedures? Name the types of audit procedures the auditor can perform to obtain audit evidence? (SA, Nov 2022, 4 marks)</p> <p>Audit Procedures to Obtain Audit Evidence:</p> <p>Audit evidence to draw reasonable conclusions on which to base the auditor's opinion is obtained by performing:</p> <ol style="list-style-type: none"> Risk assessment procedures; and Further audit procedures, which comprise: <ol style="list-style-type: none"> Test of controls, when required by the SAs or when the auditor has chosen to do so; and Substantive procedures, including tests of details and substantive analytical procedures. <p>Audit procedures to obtain audit evidence can include</p> <ol style="list-style-type: none"> Inspection Observation External Confirmation Recalculation Reperformance Analytical Procedures Inquiry

Part II: Correct/Incorrect Questions

Q1.	Purchase invoice is an example of internal evidence. (ICAI Study Material - Test Your Knowledge)
	Incorrect. Internal evidence is the evidence that originates within the client's organisation. Since the purchase invoice originates outside the client's organisation, therefore, it is an example of external evidence.
Q2.	Sufficiency is the measure of the quality of audit evidence. (ICAI Study Material - Test Your Knowledge)
	Incorrect. Sufficiency is the measure of the quantity of audit evidence. On the other hand, appropriateness is the measure of the quality of audit evidence.
Q3.	When auditor inquires the management as part of the audit procedures it should be formal written form only and not informal oral inquiries. (ICAI Study Material - Test Your Knowledge)
	Incorrect. When auditor inquires the management as part of audit procedures such inquiries may range from formal written inquiries to informal oral inquiries
Q4.	Subjective examination connotes critical examination and scrutiny of the accounting statements. (RTP, Nov 2019, NA)
	Incorrect. Objective examination connotes critical examination and scrutiny of the accounting statements of the undertaking with a view to assessing how far the statements present the actual state of affairs in the correct context and whether they give a true and fair view about the financial results and state of affairs
Q5.	Inquiry alone provides sufficient audit evidence of the absence of a material misstatement at the assertion level and of the operating effectiveness of controls. (RTP, Nov 2019, NA)
	Incorrect. Although inquiry may provide important audit evidence, and may even produce evidence of a misstatement, inquiry alone ordinarily does not provide sufficient audit evidence of the absence of a material misstatement at the assertion level, nor of the operating effectiveness of controls.
Q6.	Sufficiency is the measure of the quantity of audit evidence. (SA, Jan 2021, 2 Marks)
	Correct. Sufficiency is the measure of the quantity of audit evidence. The quantity of audit evidence needed is affected by the auditor's assessment of the risks of misstatement (the higher the assessed risks, the more audit evidence is likely to be required)
Q7.	Inquiry alone ordinarily does not provide sufficient audit evidence. (MTP2, Nov 2021, 2 Marks) (MTP1, May 2022, 2 marks)
	Correct. Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence. Audit procedures to obtain audit evidence can include inspection, observation, confirmation, recalculation, re-performance and analytical procedures, often in some combination, in addition to inquiry. Although inquiry may provide important audit evidence, and may even produce evidence of a misstatement, inquiry alone ordinarily does not provide sufficient audit evidence of the absence of a material misstatement at the assertion level, nor of the operating effectiveness of controls.
Q8.	While auditing the books of accounts of ABC Ltd., the auditor of the company looked at the inventory counting process to obtain audit evidence. In the present case, audit procedure used by the auditor is known as "Inspection" (SA, Dec 2021, 2 marks) (RTP, May 2023, NA)
	Incorrect. The auditor procedure used in the given case is " Observation ". Observation consists of looking at a process or procedure being performed by others whereas Inspection involves examining records or documents , whether internal or external, in paper form, electronic form, or other media, or a physical examination of an asset.
Q9.	Audit evidence obtained through observation of the application of a control is less reliable than audit evidence obtained by inquiry about the application of a control. (MTP2, Nov 2022, 2 Marks)
	Incorrect. Audit evidence obtained directly by the auditor (for example, observation of the application of a control) is more reliable than audit evidence obtained indirectly or by inference (for example, inquiry about the application of a control).

Q10.	Appropriateness is the measure of the quantity of audit evidence. (SA, May 2023, 2 marks)
	Incorrect. Sufficiency is the measure of the quantity of audit evidence. On the other hand, appropriateness is the measure of the quality of audit evidence
Q11.	While auditing the books of accounts of XYZ Ltd., the auditor of the company was involved in examining records and documents in paper form, electronic form etc. and was also conducting physical examination of assets. In the present case, audit procedure used by the auditor is known as "Observation" (MTP1, Nov 2023, 2 marks) (MTP2, Nov 2023, 2 marks)
	Incorrect. The audit procedure used by the auditor of XYZ Ltd. is known as " Inspection ". Whereas Observation consists of looking at a process or procedure being performed by others.

Part III: Multiple Choice Questions

Q1.	Audit evidence is necessary to support the auditor's opinion and report. It is _____ in nature and is primarily obtained from audit procedures performed during the course of the audit. (a) cumulative (b) regressive (c) selective (d) objective (Sample MCQs) (RTP, Nov 2019, NA) (MTP1, Nov 2019, 1 Mark) (MTP2, May 2022, 1 mark)
	Correct answer: (a) Cumulative
Q2.	Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence. (a) obtaining audit evidence. (b) evaluating audit evidence. (c) obtaining or evaluating audit evidence. (d) obtaining and evaluating audit evidence. (Sample MCQs) (MTP2, May 2019, 1 Mark) (MTP1, Nov 2019, 1 Mark)
	Correct answer: (d) obtaining and evaluating audit evidence
Q3.	Audit procedures to obtain audit evidence can include (a) inspection, observation, confirmation, recalculation, re-performance and analytical procedures (b) inspection, observation, confirmation, recalculation and re-performance (c) inspection, observation, confirmation and analytical procedures (d) inspection, observation, recalculation, re-performance and analytical procedures (Sample MCQs)
	Correct answer: (a) inspection, observation, confirmation, recalculation, re-performance and analytical procedures
Q4.	Auditor's judgment as to sufficiency may be affected by the factors such as: (a) Materiality (b) Risk of material misstatement (c) Size and characteristics of the population. (d) All of the above (Sample MCQs) (ICAI MCQs)
	Correct answer: (d) All of the above
Q5.	Which of the following is not an Audit procedure to obtain audit evidence: (a) Inspection (b) Observation

	<p>(c) External Confirmation (d) Internal Control (ICAI MCQs)</p>
	Correct answer: (d) Internal Control
Q6.	<p>When information to be used as audit evidence has been prepared using the work of a management's expert, the auditor shall, to the extent necessary, having regard to the significance of that expert's work for the auditor's purposes:</p> <p>(i) Evaluate the competence, capabilities and objectivity of that expert (ii) Obtain an understanding of the work of that expert (iii) Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion</p> <p>(a) (i) and (ii) (b) (ii) and (iii) (c) (i) and (iii) (d) (i),(ii) and (iii) (ICAI MCQs)</p>
	Correct answer: (d) (i),(ii) and (iii)
Q7.	<p>Audit evidence includes</p> <p>(a) information contained in the accounting records underlying the financial statements (b) both information contained in the accounting records underlying the financial statements and other information. (c) other information. (d) information contained in the accounting records underlying the financial statements or other information.</p> <p>(Sample MCQs) (ICAI MCQs) (MTP2, May 2019, 1 Mark) (MTP1, Nov 2019, 1 Mark) (MTP2, May 2021, 2 Marks) (MTP2, Nov 2021, 2 Marks) (MTP2, May 2023, 1 mark)</p>
	Correct answer: (b) both information contained in the accounting records underlying the financial statements and other information.
Q8.	<p>which of the following is incorrect :</p> <p>(a) Inquiry consists of seeking information of unknown persons, both financial and non- financial, within the entity or outside the entity. (b) Inquiry is used extensively throughout the audit in addition to other audit procedures. (c) Inquiries may range from formal written inquiries to informal oral inquiries. Evaluating responses to inquiries is an integral part of the inquiry process. (d) Responses to inquiries may provide the auditor with information not previously possessed or with corroborative audit evidence.</p> <p>(MTP1, May 2019, 2 Marks)</p>
	<p>Correct answer: (a) Inquiry consists of seeking information of unknown persons, both financial and non- financial, within the entity or outside the entity.</p> <p>Explanation: Inquiry consists of seeking information of knowledgeable persons (NOT unknown persons), both financial and non-financial, within the entity or outside the entity.</p>
Q9.	<p>Mr. H and his team members carefully watched the whole process of counting of finished wooden doors by employees of Bottom Limited. This is an example of which audit procedure:</p> <p>(a) External Confirmation. (b) Observation. (c) Inquiry. (d) Inspection.</p> <p>(RTP, Nov 2021, NA)</p>
	<p>Correct answer: (b) Observation</p> <p>Explanation: Observation consists of looking at a process or procedure being performed by others.</p>

Q10.	<p>Mr. H and his team members in detail checked and evaluated the books of accounts and relevant documents of WT Limited. This is an example of which audit procedure:</p> <p>(a) Inspection. (b) Re-performance. (c) Recalculation. (d) Observation.</p> <p>(MTP1, Nov 2022, 1 Mark)</p>
<p>Correct answer: (a) Inspection Explanation: Inspection involves examining records or documents, whether internal or external, in paper form, electronic form, or other media, or a physical examination of an asset.</p>	
Q11.	<p>CA X, auditor of Green Shoots Private Ltd. is going through financial statements of the company. On perusing notes to accounts, he finds ageing of trade payables reflecting in accordance with requirements of Schedule III of Companies Act, 2013. He wants to be sure that ageing of trade payables forming part of notes of accounts is proper and carries out ageing independently to confirm its veracity. Identify audit procedure(s) being performed by CA X.</p> <p>(a) Analytical procedures (b) Recalculation (c) Re-performance (d) Observation</p> <p>(MTP2, Nov 2022, 1 Mark)</p>
<p>Correct answer: (c) Re-performance Explanation: Re-performance involves the auditor's independent execution of procedures or controls that were originally performed as part of the entity's internal control. Examples are Re-performing the reconciliation of bank statements, re-performing the aging of accounts receivable.</p>	
Q12.	<p>_____ may be defined as the information used by the auditor in arriving at the conclusions on which the auditor's opinion is based. It includes both information contained in the accounting records underlying the financial statements and other information.</p> <p>(a) Audit procedure (b) Audit evidence (c) Audit plan (d) Audit programme</p> <p>(MTP1, Nov 2023, 1 mark)</p>
<p>Correct answer: (b) Audit evidence</p>	
Q13.	<p>While auditing the books of accounts of Mehra Limited for the financial year 2023-24, the auditor of the company used an audit procedure according to which complete documents and records of the company were checked in detail in order to obtain audit evidence. Explain the audit procedure used by the auditor of company.</p> <p>(a) Recalculation (b) Analytical Procedures (c) Inquiry (d) Inspection</p> <p>(MTP1, Nov 2023, 1 mark)</p>
<p>Correct answer: (d) Inspection Explanation: Inspection involves examining records or documents, whether internal or external, in paper form, electronic form, or other media, or a physical examination of an asset</p>	

SA 610 “Using the work of internal Auditors”

Part I : Descriptive Questions

Q1.	<p>A company has stipulated a control through its automated software that interest @ 12% p.a. is charged in case of those customers who fail to make payment within a month of a sales transaction. The internal auditor of the company finds that during a certain period, software has failed to charge interest due to certain technical glitches. Does reporting of above situation fall in domain of internal auditor’s work? (ICAI Study Material - Test Your Understanding)</p>
	<ul style="list-style-type: none"> ● One of the functions of internal auditor includes responsibility for reviewing controls, evaluating their operation, and recommending improvements thereto. ● In the given case, the internal auditor has found that controls relating to levying of interest have not operated. The system has not levied stipulated interest in respect of a certain period. It can result in loss of income for the company and improper financial reporting. ● Such a matter, definitely, falls in the domain of reporting by the internal auditor.
Q2.	<p>CA Sukesh is external auditor of an entity. He comes to know that there is also an internal auditor in the entity. However, he finds that internal auditor is not reporting directly to higher echelons of the management. CA Sukesh has also assessed risk of material misstatement to be high. Discuss, whether it would be proper for CA Sukesh to rely upon work of internal auditor extensively in above situation. (ICAI Study Material - Test Your Understanding)</p>
	<p>In the given case, the organizational status of internal audit function is not commensurate with his duties. He is not reporting directly to higher echelons of management. It shows that such a function is not given its due importance in entity. Since risk of material misstatements has also been assessed as high by CA Sukesh, both the above factors suggest that he should not rely upon work of internal auditor extensively.</p>
Q3.	<p>Discuss some of circumstances when work of the internal auditor cannot be used by external auditor. (ICAI Study Material - Test Your Knowledge)</p>
	<p>The external auditor shall not use the work of the internal audit function if the external auditor determines that:</p> <ul style="list-style-type: none"> ● The function's organizational status and relevant policies and procedures do not adequately support the objectivity of internal auditors; ● The function lacks sufficient competence; or ● The function does not apply a systematic and disciplined approach, including quality control.
Q4.	<p>Moon Ltd. of which you are the statutory auditor, have an internal audit being conducted by an outside agency. State the factors that weigh considerations in opting to make use of direct assistance of the internal auditors for the purpose of statutory audit.</p>
	<p>As per SA 610 “Using the Work of Internal Auditor”, the external auditor can take direct assistance of internal auditor subject to following conditions:</p> <ol style="list-style-type: none"> a) The external auditor is not prohibited by law or regulation from obtaining direct assistance from internal auditors. b) There are no significant threats to the objectivity of the internal auditor c) The internal auditor have sufficient competence to perform the proposed work <p>Precautions to be taken while using direct assistance:</p> <p>The external auditor shall not use internal auditors to provide direct assistance to perform procedures that</p> <ol style="list-style-type: none"> i) Involve making significant judgments in the audit; ii) Relate to higher assessed risks of material misstatement; iii) Relate to work with which the internal auditors have been involved; or iv) Relate to decisions the external auditor makes in accordance with this SA regarding the internal audit function and the use of its work or direct assistance. <p>Prior to using internal auditors to provide direct assistance for purposes of the audit, the external auditor shall:</p> <ol style="list-style-type: none"> a) Obtain written agreement from an authorized representative of the entity that the internal auditors will be allowed to follow the external auditor’s instructions, and that the entity will not intervene in the work the internal auditor performs for the external auditor; and

	<p>b) Obtain written agreement from the internal auditors that they will keep confidential specific matters as instructed by the external auditor and inform the external auditor of any threat to their objectivity</p> <p>The external auditor shall direct, supervise and review the work performed by internal auditors on the engagement in accordance with SA 220.</p>
Q5.	<p>CA Amboj, a practicing chartered accountant has been appointed as an internal auditor of Textile Ltd. He conducted the physical verification of the inventory at the year-end and handed over the report of such verification to CA Kishore, the statutory auditor of the Company, for his view and reporting. Can CA Kishore rely on such report?</p> <p>As per SA 610 "Using the Work of Internal Auditors", while determining whether the work of the internal auditors can be used for the purpose of the audit, the external auditor shall evaluate-</p> <ol style="list-style-type: none"> The extent to which the internal audit function's organizational status and relevant policies and procedures support the objectivity of the internal auditors; The level of competence of the internal audit function; and Whether the internal audit function applies a systematic and disciplined approach, including quality control. <p>Further, the external auditor shall not use the work of the internal audit function if the external auditor determines that:</p> <ol style="list-style-type: none"> The function's organizational status and relevant policies and procedures do not adequately support the objectivity of internal auditors; The function lacks sufficient competence; or The function does not apply a systematic and disciplined approach, including quality control. <p>In the instant case, CA. Kishore should ascertain the internal auditor's scope of verification, area of coverage and method of verification. He should review the report on physical verification taking into consideration these factors. If possible he should also test check a few items and he can also observe the procedures performed by the internal auditors.</p> <p>Conclusion: If the statutory auditor is satisfied about the appropriateness of the verification, he can rely on the report but if he finds that the verification is not in order, he has to decide otherwise. The final responsibility to express opinion on the financial statement remains with the statutory auditor.</p>
Q6.	<p>Explain the meaning, objectives and scope of internal audit functions as per SA 610. (RTP, May 2019, NA)</p> <p>Meaning of Internal audit function: A function of an entity that performs assurance and consulting activities designed to evaluate and improve the effectiveness of the entity's governance, risk management and internal control processes.</p> <p>Objectives and scope of internal audit functions:</p> <p>The objectives and scope of internal audit functions typically include assurance and consulting activities designed to evaluate and improve the effectiveness of the entity's governance processes, risk management and internal control.</p> <ol style="list-style-type: none"> Activities Relating to Governance: Internal audit function may assess the governance process in its accomplishment of objectives on ethics and values, accountability and communicating risk to appropriate areas of the organization. Activities Relating to Risk Management: Internal audit function may assist the entity by identifying and evaluating significant exposures to risk and contributing to the improvement of risk management and internal control (including effectiveness of the financial reporting process) Activities Relating to Internal Control <ul style="list-style-type: none"> Evaluation of internal control: Internal audit function may be assigned specific responsibility for reviewing controls, evaluating their operation and recommending improvements thereto. Examination of financial and operating information: Internal audit function may be assigned to review the means used to identify, recognize, measure, classify and report financial and operating information, and to make specific inquiry into individual items, including detailed testing of transactions, balances and procedures. Review of operating activities. The internal audit function may be assigned to review the economy, efficiency and effectiveness of operating activities, including non-financial activities of an entity. Review of compliance with laws and regulations. The internal audit function may be assigned to review

	compliance with laws, regulations and other external requirements, and with management policies and directives and other internal requirements
Q7.	<p>Explain how Internal Financial Control and Internal controls over financial reporting differ?(SA, Jan 2021, 4 Marks)</p> <p style="text-align: center;">OR</p> <p>Explain clearly the difference between Internal Financial Control and Internal Controls over financial reporting. (RTP, Nov 2021, NA)</p> <p>Difference between internal financial control and internal control over financial reporting</p> <ul style="list-style-type: none"> • The term Internal Financial Controls (IFC) refers to the policies and procedures put in place by companies for ensuring reliability of financial reporting, effectiveness and efficiency of operations, compliance with applicable laws and regulations, safeguarding of assets and prevention and detection of frauds. • On the other hand, Internal controls over financial reporting is required where auditors are required to express an opinion on the effectiveness of an entity's internal controls over financial reporting, such opinion is in addition to and distinct from the opinion expressed by the auditor on the financial statements. • Therefore, "internal financial control" is a wider term whereas "internal controls over financial reporting" is a narrower term restricted to entity's internal controls over financial reporting only
Q8.	<p>Discuss the objectives and scope of internal audit functions with respect to activities relating to internal control. (SA, Jan 2021, 3 Marks)</p> <p style="text-align: center;">OR</p> <p>Saburi Textile Ltd is an established player in the textile manufacturing sector. It has developed strong internal controls in almost every area. It has appointed you as an Internal Audit team head. Internal audit has a very strong relation with internal control of the company. Internal Audit analyses the effectiveness with which the internal control of the company is operating and also makes suggestions for improvement in that internal control. Explain stating clearly activities relating to Internal Control. (RTP, May 2022, NA)</p> <p style="text-align: center;">OR</p> <p>Internal audit not only analyses the effectiveness with which the internal control of a company is operating but also improves the effectiveness of internal control. Elucidate the statement. (SA, May 2022, 4 Marks)</p> <p>Objectives and scope of internal audit functions relating to Internal Control are:</p> <ul style="list-style-type: none"> • Evaluation of internal control: The internal audit function may be assigned specific responsibility for reviewing controls, evaluating their operation and recommending improvements thereto. • Examination of financial and operating information: The internal audit function may be assigned to review the means used to identify, recognize, measure, classify and report financial and operating information, and to make specific inquiry into individual items, including detailed testing of transactions, balances and procedures. • Review of operating activities: The internal audit function may be assigned to review the economy, efficiency and effectiveness of operating activities, including non-financial activities of an entity. • Review of compliance with laws and regulations: The internal audit function may be assigned to review compliance with laws, regulations and other external requirements, and with management policies and directives and other internal requirements.

Part II: Correct/Incorrect Questions

Q1.	<p>The scope of work of an internal auditor may extend even beyond the financial accounting. (MTP1, Nov 2019, 2 Marks)</p> <p>Correct. As per SA 610 "Using the work of internal Auditors", the scope of internal auditor may include Monitoring of internal control, Examination of financial and operating information, Review of operating activities, Review of compliance with laws and regulations, Risk management and Governance</p>
Q2.	<p>The objectives and scope of internal audit functions are restricted to activities relating to evaluation of internal control only. (SA, Jan 2021, 2 marks)</p> <p>Incorrect. As per SA 610, "Using the Work of an Internal Auditor", the objectives of internal audit functions vary widely and depend on the size and structure of the entity and the requirements of management and, where applicable, those charged with governance. The objectives and scope of internal audit functions typically include assurance and consulting activities designed to evaluate and improve the effectiveness of the entity's governance processes, risk management and internal</p>

control. From the above, it can be concluded that the objective and scope of internal audit function are not restricted to activities relating to evaluation of control only

Part III: Multiple Choice Questions

Q1.	<p>Which of the following is not one of functions of internal auditor of an organization?</p> <p>(a) Performing assurance activities (b) Performing consulting activities to improve governance of organization (c) Performing risk management activities (d) Expressing independent opinion on financial statements of organization</p> <p>(ICAI Study Material - Test Your Knowledge)</p>
	<p>Correct answer: (d) Expressing independent opinion on financial statements of organization</p> <p>Explanation: The objectives and scope of internal audit functions typically include assurance and consulting activities designed to evaluate and improve the effectiveness of the entity's governance processes, risk management and internal control. The external auditor's objective is to express an independent opinion on financial statements of organization</p>
Q2.	<p>Which of the following is not an objective of a company's policies for ensuring "internal financial controls"?</p> <p>(a) Efficient conduct of business (b) Safeguarding of assets (c) Prevention and detection of frauds and errors (d) Assessing audit risk</p> <p>(ICAI Study Material - Test Your Knowledge)</p>
	<p>Correct answer: (d) Assessing audit risk</p> <p>Explanation: Internal financial controls are the policies and procedures adopted by the company for ensuring the orderly and efficient conduct of its business, including adherence to company's policies, the safeguarding of its assets, prevention and detection of frauds and errors, accuracy and completeness of the accounting records, and timely preparation of reliable financial information</p>
Q3.	<p>Which of the following is true:</p> <p>(a) The internal audit plan should be comprehensive enough to ensure that it helps in achieving of the above overall objectives of an internal audit. (b) The internal audit plan should, generally 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. (c) 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. (d) All the above</p> <p>(ICAI MCQs)</p>
	<p>Correct answer: (d) All the above</p>
Q4.	<p>CA M is internal auditor of Crayon Products Limited. Which of the following is not TRUE about scope of internal audit?</p> <p>(a) Internal audit is an independent assurance activity. (b) Internal audit helps in improving internal control of the company. (c) Internal audit cannot review non-financial activities of company. (d) Internal audit can review compliance of company with various laws and regulations.</p> <p>(MTP2, Nov 2022, 1 Mark)</p>
	<p>Correct answer: (c) Internal audit cannot review non-financial activities of company.</p> <p>Explanation: Statement 3 is incorrect as the internal audit function may be assigned to review the economy, efficiency and effectiveness of operating activities, including non financial activities of an entity.</p>

SA 530 "Audit Sampling"

Part I : Descriptive Questions

Q1.	<p>An auditor, while conducting audit of an entity, has selected samples based upon his personal experience and knowledge. Later on, it turns out that selected samples were not representative and it has led to faulty selection of samples. The auditor contends that samples were selected based upon his personal experience and knowledge. Can auditor escape from his responsibility in this regard? (ICAI Study Material - Test Your Understanding)</p>
	<ul style="list-style-type: none"> ● In the provided situation, the auditor has selected samples based upon his personal experience and knowledge. It is a case of a non-statistical sampling approach adopted by the auditor. ● Whatever may be the approach, non-statistical or statistical sampling, the sample must be representative. This means that it must be closely similar to the whole population although not necessarily exactly the same. T ● The auditor cannot escape his responsibility in this regard.
Q2.	<p>What is the meaning of Sampling? Also discuss the methods of Sampling. Explain in the light of SA 530 "Audit Sampling". (ICAI Study Material - Test Your Knowledge)</p>
	<p>Meaning of Audit Sampling: "Audit Sampling" means the application of audit procedures to less than 100% of items within a population of audit relevance such that all sampling units have a chance of selection in order to provide the auditor with a reasonable basis on which to draw conclusions about the entire population.</p> <p>The objective of the auditor when using audit sampling is to provide a reasonable basis for the auditor to draw conclusions about the population from which the sample is selected.</p> <p>Methods of Sampling:</p> <ol style="list-style-type: none"> 1. Random Sampling: Random selection ensures that all items in the population have an equal chance of selection. It may involve use of random number tables. 2. Interval Sampling or Systematic Sampling: Systematic selection is a selection method in which the number of sampling units in the population is divided by the sample size to give a sampling interval, for example 50, and having determined a starting point within the first 50, each 50th sampling unit thereafter is selected. 3. Monetary Unit Sampling: It is a type of value-weighted selection in which sample size, selection and evaluation results in a conclusion in monetary amounts 4. Haphazard sampling: Haphazard selection, in which the auditor selects the sample without following a structured technique. Although no structured technique is used, the auditor would nonetheless avoid any conscious bias or predictability. Haphazard selection is not appropriate when using statistical sampling. 5. Block Sampling: This method involves selection of a block(s) of contiguous items from within the population. Block selection cannot ordinarily be used in audit sampling because most populations are structured such that items in a sequence can be expected to have similar characteristics to each other, but different characteristics from items elsewhere in the population
Q3.	<p>With reference to Standard on Auditing 530, state the requirements relating to audit sampling, sample design, sample size and selection of items for testing. (ICAI Study Material - Test Your Knowledge)</p> <p style="text-align: center;">OR</p> <p>State the requirements relating to audit sampling, sample design, sample size and selection of items for testing. (MTP1, Nov 2021, 4 marks)</p> <p style="text-align: center;">OR</p> <p>Explain the meaning of Audit Sampling as per the relevant standard on auditing. State the requirements relating to audit sampling, sample design, sample size and selection of items for testing. (RTP, Nov 2022, NA)</p>
	<p>As per SA 530 on "Audit Sampling", the meaning of the term Audit Sampling is the application of audit procedures to less than 100% of items within a population of audit relevance such that all sampling units have a chance of selection in order to provide the auditor with a reasonable basis on which to draw conclusions about the entire population.</p> <p>The requirements relating to sample design, sample size and selection of items for testing:</p> <ul style="list-style-type: none"> ● Sample design: When designing an audit sample, the auditor shall consider the purpose of the audit procedure and the characteristics of the population from which the sample will be drawn. ● Sample Size: The auditor shall determine a sample size sufficient to reduce sampling risk to an acceptably low

	<p>level.</p> <ul style="list-style-type: none"> ● Selection of Items for Testing: The auditor shall select items for the sample in such a way that each sampling unit in the population has a chance of selection
Q4.	<p>While planning the audit of S Ltd. you want to apply sampling techniques. What are the risk factors you should keep in mind? (ICAI Study Material - Test Your Knowledge) (RTP, Nov 2018, NA) (MTP2, May 2019, 3 Marks) (RTP, May 2023, NA)</p> <p style="text-align: center;">OR</p> <p>"Sampling risk can lead to erroneous conclusions". Justify (SA, May 2019, 4 Marks) (MTP2, May 2021, 3 Marks)</p> <p style="text-align: center;">OR</p> <p>Sampling risk can lead to two types of erroneous conclusions. Explain clearly stating the meaning of sampling risk (RTP, May 2022, NA)</p> <p>Risk Factors while applying Sampling Techniques:</p> <p>As per SA 530 "Audit Sampling", sampling risk is the risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure. Sampling risk can lead to two types of erroneous conclusions-</p> <ol style="list-style-type: none"> In the case of a test of controls, that controls are more effective than they actually are, or in the case of tests of details, that a material misstatement does not exist when in fact it does. The auditor is primarily concerned with this type of erroneous conclusion because it affects audit effectiveness and is more likely to lead to an inappropriate audit opinion. In the case of test of controls, the controls are less effective than they actually are, or in the case of tests of details, that a material misstatement exists when in fact it does not. This type of erroneous conclusion affects audit efficiency as it would usually lead to additional work to establish that initial conclusions were incorrect <p>NOTE: For a student's understanding, answer is explained in simple language:</p> <ul style="list-style-type: none"> ● Situation I: The auditor determines that the controls of the entity are effective and that no misstatements in the FS exist. However, actual controls are not effective, and misstatements exist. The auditor can give an inappropriate opinion in this case, which affects audit effectiveness. (Danger situation) ● Situation II: The auditor determines that the controls of the entity are not effective and that misstatements in the FS exist. However, actual controls are effective, and misstatements do not exist. This situation would usually lead to additional work to establish that the initial conclusions were incorrect. More time and effort are required in this situation. (Loss situation)
Q5.	<p>Write a short note on Advantages of Statistical sampling in Auditing. (ICAI Study Material - Test Your Knowledge)</p> <p style="text-align: center;">OR</p> <p>Audit testing done through Statistical sampling is more scientific than testing based entirely on the auditor's own judgment because it involves use of mathematical laws of probability in determining the appropriate sample size in varying circumstances. Explain and also state advantages of Statistical sampling. (MTP1, Nov 2020, 4 Marks)</p> <p style="text-align: center;">OR</p> <p>What are the advantages of Statistical sampling technique in auditing (RTP, May 2022, NA)</p> <p>Audit testing done through this approach is more scientific than testing based entirely on the auditor's own judgment because it involves use of mathematical laws of probability in determining the appropriate sample size in varying circumstances. Statistical sampling has reasonably wide application where a population to be tested consists of a large number of similar items and more in the case of transactions involving compliance testing, trade receivables' confirmation, payroll checking, vouching of invoices and petty cash vouchers.</p> <p>The advantages of statistical sampling may be summarized as follows -</p> <ul style="list-style-type: none"> ● The amount of testing (sample size) does not increase in proportion to the increase in the size of the area (universe) tested. ● The sample selection is more objective and thereby more defensible. ● The method provides a means of estimating the minimum sample size associated with a specified risk and precision. ● It provides a means for deriving a "calculated risk" and corresponding precision (sampling error) i.e. the probable difference in result due to the use of a sample in lieu of examining all the records in the group (universe), using the same audit procedures. ● It may provide a better description of a large mass of data than a complete examination of all the data, since

	<p>non-sampling errors such as processing and clerical mistakes are not as large.</p> <ul style="list-style-type: none"> It is widely accepted way of sampling as it is more scientific, without personal bias and the result of sample can be evaluated and projected in more reliable way.
Q6.	<p>Write a short note on Stratified Sampling. (ICAI Study Material - Test Your Knowledge)</p> <p>Stratified Sampling</p> <ul style="list-style-type: none"> This method involves dividing the whole population to be tested in a few separate groups called strata and taking a sample from each of them. Each stratum is treated as if it was a separate population and items are selected from each of these stratum. The number of groups into which the whole population has to be divided is determined on the basis of auditor judgment. <p>Example: The population in the range between ₹500 to ₹ 11,50,000 say for trade receivables balances may be divided into groups as follows:-</p> <ol style="list-style-type: none"> balances in excess of ₹ 10,00,000; balances in the range of ₹ 7,75,001 to ₹ 10,00,000; balances in the range of ₹ 5,50,001 to ₹ 7,75,000 balances in the range of ₹ 2,25,001 to ₹ 5,50,000; and balances ₹ 2,25,000 and below. <p>From these above groups the auditor may pick up different percentages of items from each of the group. -</p> <ul style="list-style-type: none"> From the top group i.e. balances in excess of ₹ 10,00,000, the auditor may examine all the items; from the second group 25% of the items; from the third group 10% of the items; and from the lowest group 2% of the items may be selected
Q7.	<p>What precautions should be taken by the auditor while applying test check techniques? (ICAI Study Material - Test Your Knowledge)</p> <p style="text-align: center;">OR</p> <p>CA B is appointed as an auditor of M/s. Divine Pharmacy, a wholesale medicine supplier. While auditing for the financial year 2023-24, CA B wants to use test checking technique. Advise CA B, what kind of precautions should be taken by him in this regard. (SA, July 2021, 4 Marks)</p> <p>Precautions to be taken while applying test check techniques are</p> <ul style="list-style-type: none"> Thorough study of accounting system should be done before adopting sampling. Proper study of internal control systems. Areas which are not suitable for sampling should be carefully considered. Eg: compliance with statutory provisions, transactions of unusual nature etc. Proper planning for Sampling methods to be used and explaining the staff, Transactions and balances have to be properly classified (stratified) Sample size should be appropriately determined. Sample should be chosen in unbiased way, Errors located in the sample should be analysed properly.
Q8.	<p>Explain the factors to be considered while determining the extent of checking on a sampling plan. (ICAI Study Material - Test Your Knowledge) (SA, Nov 2018, 5 Marks) (RTP, May 2019, NA) (RTP, Nov 2020, NA)</p> <p>The factors that should be considered for deciding upon the extent of checking on a sampling plan are following:</p> <ul style="list-style-type: none"> Size of the organisation under audit. State of the internal control. Adequacy and reliability of books and records. Tolerable error range. Degree of the desired confidence.

Q9.	<p>Whatever may be the approach non-statistical or statistical sampling, the sample must be representative. Discuss explaining Statistical and Non Statistical sampling approaches. (RTP, May 2018, NA)</p> <p>Statistical sampling:</p> <ul style="list-style-type: none"> ● An approach to sampling that has the following characteristics: <ul style="list-style-type: none"> ○ Random selection of the sample items; and ○ The use of probability theory to evaluate sample results, including measurement of sampling risk. ● This method is more scientific as it involves use of mathematical laws of probability. This method has reasonably wide application where a population to be tested consists of a large number of similar items <p>Non- Statistical sampling:</p> <ul style="list-style-type: none"> ● A sampling approach that does not have characteristics of random selection and use of probability theory is considered non-statistical sampling. ● Under this approach, the sample size and its composition are determined on the basis of the personal experience and knowledge of the auditor. ● This approach has been in common application for many years because of its simplicity in operation. <p>The decision whether to use a statistical or non-statistical sampling approach is a matter for the auditor's judgment; however, sample size is not a valid criterion to distinguish between statistical and non-statistical approaches. Sample must be representative. Whatever may be the approach, non-statistical or statistical sampling, the sample must be representative. This means that it must be closely similar to the whole population although not necessarily exactly the same. The sample must be large enough to provide statistically meaningful results.</p>
Q10.	<p>XYZ Ltd is engaged in trading of electronic goods and having huge accounts receivables. For analysing the whole accounts receivables, auditor wanted to use sampling technique. In considering the characteristics of the population from which the sample will be drawn, the auditor determines that stratification or value-weighted selection technique is appropriate. SA 530 provides guidance to the auditor on the use of stratification and value - weighted sampling techniques. Advise the auditor in accordance with SA 530 (RTP, May 2018, NA) (MTP2, May 2018, 5 Marks) (MTP1, Nov 2019, 4 Marks)</p> <p style="text-align: center;">OR</p> <p>In considering the characteristics of the population from which the sample will be drawn, the auditor may determine that stratification or value-weighted selection technique is appropriate. Guide the auditor on the use of stratification and value-weighted sampling techniques. (RTP, Nov 2021, NA)</p> <p>Stratification and Value-Weighted Selection:</p> <p>As per SA 530 "Audit Sampling", the objective of the auditor when using audit sampling is to provide a reasonable basis for the auditor to draw conclusions about the population from which the sample is selected. In considering the characteristics of the population from which the sample will be drawn, the auditor may determine that stratification or value-weighted selection technique is appropriate.</p> <p>Stratification:</p> <ul style="list-style-type: none"> ● It is the process of dividing a population into sub-populations, each of which is a group of sampling units which have similar characteristics (often monetary value). ● The objective of stratification is to reduce the variability of items within each stratum and therefore allow sample size to be reduced without increasing sampling risk. ● When performing tests of details, the population is often stratified by monetary value. This allows greater audit effort to be directed to the larger value items, as these items may contain the greatest potential misstatement in terms of overstatement. ● Similarly, a population may be stratified according to a particular characteristic that indicates a higher risk of misstatement ● The results of samples from the units drawn under each subpopulation are projected to that respective stratum. In order to draw an opinion on the overall population, the auditor needs to combine the results of all the stratum to check for possible deviation or risk of material misstatement. <p>Value-Weighted Selection:</p> <ul style="list-style-type: none"> ● When performing tests of details it may be efficient to identify the sampling unit as the individual monetary units that make up the population. ● One benefit of this approach to defining the sampling unit is that audit effort is directed to the larger value items

	<p>because they have a greater chance of selection, and can result in smaller sample sizes.</p> <ul style="list-style-type: none"> This approach may be used in conjunction with the systematic method of sample selection and is most efficient when selecting items using random selection.
Q11.	<p>The level of sampling risk that the auditor is willing to accept affects the sample size required. The lower the risk the auditor is willing to accept, the greater the sample size will need to be. Explain Stating the examples of factors that the auditor may consider when determining the sample size for tests of controls. (MTP1, May 2018, 5 Marks)</p> <p style="text-align: center;">OR</p> <p>The sample size can be determined by the application of a statistically-based formula or through the exercise of professional judgment. When circumstances are similar, the effect on sample size of factors will be similar regardless of whether a statistical or non-statistical approach is chosen. Explain Stating the examples of factors (any four) that the auditor may consider when determining the sample size for tests of controls. (MTP2, Nov 2018, 5 Marks) (MTP1, May 2019, 4 Marks) (MTP1, May 2020, 3 Marks)</p> <p>Factors to be considered while determining the sample size for tests of controls:</p> <p>The level of sampling risk that the auditor is willing to accept affects the sample size required. The lower the risk the auditor is willing to accept, the greater the sample size will need to be. The sample size can be determined by the application of a statistically-based formula or through the exercise of professional judgment. When circumstances are similar, the effect on sample size of factors will be similar regardless of whether a statistical or non-statistical approach is chosen.</p> <p>Examples of Factors Influencing Sample Size for Tests of Controls:</p> <ul style="list-style-type: none"> An increase in the extent to which the auditor's risk assessment takes into account relevant controls will increase the sample size. An increase in the tolerable rate of deviation, will decrease the sample size. An increase in the expected rate of deviation of the population to be tested, will increase the sample size. An increase in the auditor's desired level of assurance that the tolerable rate of deviation is not exceeded by the actual rate of deviation in the population will increase the sample size.
Q12.	<p>The auditor is required to project misstatements for the population to obtain a broad view of the scale of misstatement. Explain (RTP, May 2019, NA) (RTP, Nov 2023, NA)</p> <p style="text-align: center;">OR</p> <p>The auditor is required to project misstatements for the population to obtain a broad view of the scale of misstatement but this projection may not be sufficient to determine an amount to be recorded. Explain (RTP, May 2020, NA)</p> <p style="text-align: center;">OR</p> <p>It is imperative for the auditor to project misstatements for the population while performing audit procedures through sampling. Comment. (SA, Nov 2020, 3 Marks) (MTP2, Nov 2023, 2 marks)</p> <ul style="list-style-type: none"> As per SA 530 "Audit Sampling", the auditor is required to project misstatements for the population to obtain a broad view of the scale of misstatement but this projection may not be sufficient to determine an amount to be recorded. When a misstatement has been established as an anomaly, it may be excluded when projecting misstatements to the population. However, the effect of any such misstatement, if uncorrected, still needs to be considered in addition to the projection of the non-anomalous misstatements. For tests of details, the auditor shall project misstatements found in the sample to the population whereas for tests of controls, no explicit projection of deviations is necessary since the sample deviation rate is also the projected deviation rate for the population as a whole.
Q13.	<p>There is a growing realisation that the traditional approach to audit is economically wasteful because all efforts are directed to check all transactions without exception. Explain (RTP, Nov 2019, NA) (MTP2, May 2022, 3 marks)</p> <ul style="list-style-type: none"> No conscious effort in human society is divested of economic considerations and auditing is no exception. There is a growing realisation that the traditional approach to audit is economically wasteful because all efforts are directed to check all transactions without exception. In the traditional approach more emphasis is placed on routine checking, which often is not necessary in view of the time and the cost involved. In routine checking, auditor considers extensive checking and vouching of all entries With the shift in favour of formal internal controls in the management of affairs of organisations, the possibilities of routine errors and frauds have greatly diminished and auditors often find extensive routine checking as nothing

	<p>more than a ritual because it seldom reveals anything material.</p> <ul style="list-style-type: none"> Now the approach to audit and the extent of checking are undergoing a progressive change in favour of more attention towards the questions of principles and controls with a curtailment of non-consequential routine checking.
Q14.	<p>The extent of the checking to be undertaken is primarily a matter of judgment of the auditor. It is in the interest of the auditor that if he decides to form his opinion on the basis of a part checking, he should adopt standards and techniques which are widely followed Explain (RTP, Nov 2019, NA)</p> <ul style="list-style-type: none"> The auditor is required to express an opinion on the financial statements. For this purpose, the auditor is required to decide the extent of the checking to be performed. The extent of the checking to be undertaken is primarily a matter of judgment of the auditor, there is nothing statutorily stated anywhere which specifies what work is to be done, how it is to be done and to what extent. It is also not obligatory that the auditor must adopt the sampling technique. To ensure a good and reasonable standard of work, he should adopt standards and techniques that can lead him to an informed professional opinion. On a consideration of this fact, it can be said that it is in the interest of the auditor that if he decides to form his opinion on the basis of a part checking, he should adopt standards and techniques which are widely followed and which have a recognised basis. Since statistical theory of sampling is based on a scientific law, it can be relied upon to a greater extent than any arbitrary technique which lacks in basis and acceptability.
Q15.	<p>Explain the sampling method which involves selection of a block(s) of contiguous items from within the population. Also give example. (RTP, May 2020, NA)</p> <p>Block Sampling:</p> <ul style="list-style-type: none"> This method involves selection of a block(s) of contiguous items from within the population. Block selection cannot ordinarily be used in audit sampling because most populations are structured such that items in a sequence can be expected to have similar characteristics to each other, but different characteristics from items elsewhere in the population. In some circumstances it may be an appropriate audit procedure to examine a block of items, it would rarely be an appropriate sample selection technique when the auditor intends to draw valid inferences about the entire population based on the sample. <p>Example: Take the first 300 sales invoices from the sales day book in the month of August; alternatively take any five blocks of 50 sales invoices. Therefore, once the first item in the block is selected, the rest of the block follows items to the completion.</p>
Q16.	<p>Sampling risk is the risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure. Sampling risk leads to erroneous conclusions. Explain in detail distinguishing it from nonsampling risk with examples. (RTP, Nov 2020, NA)</p> <p style="text-align: center;">OR</p> <p>In the context of SA 530 'Audit Sampling', explain the terms 'Sampling Risk' and 'NonSampling risk'. (SA, Jan 2021, 4 Marks)</p> <p style="text-align: center;">OR</p> <p>While designing an audit sample, the auditor shall determine a sample size sufficient to reduce the sampling risk to an acceptably low level. In this context, explain sampling risk and non-sampling risk. (SA, May 2023, 4 marks)</p> <p>As per SA 530 "Audit Sampling", sampling risk is the risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure. Sampling risk can lead to two types of erroneous conclusions-</p> <ol style="list-style-type: none"> In the case of a test of controls, that controls are more effective than they actually are, or in the case of tests of details, that a material misstatement does not exist when in fact it does. The auditor is primarily concerned with this type of erroneous conclusion because it affects audit effectiveness and is more likely to lead to an inappropriate audit opinion. In the case of test of controls, the controls are less effective than they actually are, or in the case of tests of details, that a material misstatement exists when in fact it does not. This type of erroneous conclusion affects audit efficiency as it would usually lead to additional work to establish that initial conclusions were incorrect <p>Non-Sampling Risk. The risk that the auditor reaches an erroneous conclusion for any reason not related to sampling risk.</p>

	<p>Non sampling risk can never be mathematically measured. Examples of non-sampling risk include use of inappropriate audit procedures, or misinterpretation of audit evidence and failure to recognize a misstatement or deviation.</p> <p>Sources of Non Sampling risk are :</p> <ul style="list-style-type: none"> ● Human Mistakes ● Applying audit procedures not appropriate to the objectives of audit ● Relying on erroneous information e.g. erroneous confirmation ● Misinterpreting the sample results
Q17.	<p>In most of the circumstances, the evidence available is not conclusive and the auditor always takes a calculated risk in giving his opinion. Even by undertaking hundred percent checking of the transactions, the auditor does not derive absolute satisfaction. This state of uneasiness led pragmatic auditors to adopt the statistical theory of sampling to derive the necessary satisfaction about the state of affairs by checking only a part of the total population of entries. Explain in detail. (RTP, May 2021, NA)</p> <ul style="list-style-type: none"> ● In most of the circumstances, the evidence available is not conclusive and the auditor always takes a calculated risk in giving his opinion. Even by undertaking hundred percent checking of the transactions, the auditor does not derive absolute satisfaction. This state of uneasiness led pragmatic auditors to adopt the statistical theory of sampling to derive the necessary satisfaction about the state of affairs by checking only a part of the total population of entries. ● Auditors realised that they can derive good satisfaction by undertaking a much lesser checking by adoption of this technique in the auditing process. It is a mathematical truth that the sample, if picked purely on a random basis would reveal the features and characteristics of the population. ● By adopting the sampling technique, the auditor only checks a part of the whole mass of transactions. The satisfaction he used to derive earlier, by checking all the transactions, can be derived by a sample checking provided he can put reliance on the internal controls and checks within the client's organisation because they provide the reliability of the records. Sampling is used as a part of the Test of controls. Auditors will check a few internal controls and their operating effectiveness. Based on the conclusion derived, he can then design the sample size for test of details (i.e checking of transactions and balances) ● If the internal control is satisfactory in its design and implementation, a much smaller sample can give the auditor the necessary reliability of the result he obtains. On the other hand, if in certain areas controls are slack or not properly implemented, the auditor may have to take a much larger sample for getting satisfactory result. ● Another truth about the sampling technique should be noted. It can never bring complete reliability; it cannot give precisely accurate results. It is a process of estimation. It may have some errors. What error is tolerable for a particular matter under examination is a matter of the individual's judgment in that particular case.
Q18.	<p>Explain the following terms with reference to Audit Sampling :</p> <ol style="list-style-type: none"> i) Stratification ii) Tolerable misstatement iii) Tolerable rate of deviation <p>(RTP, May 2021, NA)</p> <ul style="list-style-type: none"> ● Stratification: The process of dividing a population into sub-populations, each of which is a group of sampling units which have similar characteristics (often monetary value). ● Tolerable misstatement: A monetary amount set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that the monetary amount set by the auditor is not exceeded by the actual misstatement in the population. ● Tolerable rate of deviation: A rate of deviation from prescribed internal control procedures set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that the rate of deviation set by the auditor is not exceeded by the actual rate of deviation in the population.
Q19.	<p>CA X is not sure about the kind of Sampling method to be used for audit of a company. Advise him about the choice of methods (name of methods only) of Sampling to be used in various circumstances. Also explain briefly the advantages of the Sampling to be used by him in auditing. (MTP2, Nov 2021, 3 marks)</p> <p>Sample Selection:</p> <p>CA. X should obtain the knowledge before using the sampling methods. The principal methods are as follows:</p> <ul style="list-style-type: none"> ● Random selection.

	<ul style="list-style-type: none"> ● Systematic selection. ● Monetary Unit sampling. ● Haphazard selection. ● Block selection. <p>Advantages of Statistical Sampling in Auditing:</p> <ul style="list-style-type: none"> ● The amount of testing (sample size) does not increase in proportion to the increase in the size of the area (universe) tested. ● The sample selection is more objective and thereby more defensible. ● The method provides a means of estimating the minimum sample size associated with a specified risk and precision. ● It provides a means for deriving a "calculated risk" and corresponding precision (sampling error) i.e. the probable difference in result due to the use of a sample in lieu of examining all the records in the group (universe), using the same audit procedures. ● It may provide a better description of a large mass of data than a complete examination of all the data, since non-sampling errors such as processing and clerical mistakes are not as large. ● It is widely accepted way of sampling as it is more scientific, without personal bias and the result of sample can be evaluated and projected in more reliable way.
Q20.	<p>With reference to SA 530 "Audit Sampling", explain briefly the following factors that the auditor may consider when determining the sample size for the Test of Details –</p> <ol style="list-style-type: none"> i) The desired level of assurance ii) Stratification of the population <p>(SA, Dec 2021, 3 marks)</p> <p>Examples of factors influencing Sample Size for Test of Details:</p> <ul style="list-style-type: none"> ● Desired Level of Assurance: An increase in the auditor's desired level of assurance that tolerable misstatement is not exceeded by actual misstatement in the population will increase the sample size. Hence, greater the level of assurance that the auditor requires that the results of the sample are in fact indicative of the actual amount of misstatement in the population, the larger the sample size needs to be. ● Stratification of population: When stratification of the population is appropriate then sample size will decrease as when there is a wide range (variability) in the monetary size of items in the population, it may be useful to stratify the population. When a population can be appropriately stratified, the aggregate of the sample sizes from the strata generally will be less than the sample size that would have been required to attain a given level of sampling risk, had one sample been drawn from the whole population.
Q21.	<p>ABC Ltd is a Large Company with huge purchase and sales transactions. Which sampling approach is recommended in such a company? Explain giving features of such sampling approach along with example (MTP1, May 2022, 3 Marks)</p> <p>In larger organisations, with huge transactions, statistical sampling is always recommended as it is unbiased, and the samples selected are not prejudged.</p> <p>Features/Characteristics of Statistical Sampling:</p> <ul style="list-style-type: none"> ● Audit testing done through this approach is more scientific than testing based entirely on the auditor's own judgment because it involves use of mathematical laws of probability in determining the appropriate sample size in varying circumstances. ● Statistical sampling has reasonably wide application where a population to be tested consists of a large number of similar items and more in the case of transactions involving compliance testing, trade receivables' confirmation, payroll checking, vouching of invoices and petty cash vouchers. ● There is no personal bias of the auditor in case of statistical sampling. Since it is scientific, the results of sample can be evaluated and projected on the whole population in a more reliable manner. <p>For Example: An auditor while verifying the Purchases during the year realised that the purchase transactions in that year are more than 50,000 in number, then in such case, statistical sampling will be highly recommended in the audit programme.</p>
Q22.	<p>The approach to audit and extent of checking are undergoing a progressive change in favour of more attention towards the questions of principle and controls with a curtailment of non-consequential routine checking. Discuss the given statement. (SA, May 2022, 3 Marks)</p>

	<ul style="list-style-type: none"> No conscious effort in human society is divested of economic considerations and auditing is no exception. There is a growing realisation that the traditional approach to audit is economically wasteful because all the efforts are directed to check all transactions without any exception. This invariably leads to more emphasis on routine checking, which often is not necessary in view of the time and the cost involved. With the shift in favour of formal internal controls in the management of affairs of organisations, the possibilities of routine errors and frauds have greatly diminished. Thus, the auditors often find extensive routine checking as nothing more than a ritual because it seldom reveals anything material. Now the approach to audit and the extent of checking are undergoing a progressive change in favour of more attention towards the questions of principles and controls with a curtailment of non-consequential routine checking. By routine checking, we traditionally think of extensive checking and vouching of all the entries, disregarding the concept of materiality. The extent of the checking to be undertaken is primarily a matter of judgment of the auditor. There is nothing statutorily stated anywhere which specifies what work is to be done, how it is to be done and to what extent it has to be done. It is also not obligatory that the auditor must adopt the sampling technique. What he is to do as an auditor is to express his opinion on the financial statements and become bound by that. To ensure good and reasonable standard of work, he should adopt standards and techniques that can lead him to an informed professional opinion. This enables the auditor to make conclusions and express fair opinion without having to check all of the items within the financial statements.
Q23.	<p>This method is considered appropriate provided the population to be sampled consists of reasonably similar units and fall within a reasonable range i.e. it is suitable for a homogeneous population having a similar range. Explain about that method. (RTP, Nov 2022, NA)</p> <p>Simple Random Sampling:</p> <ul style="list-style-type: none"> Under this method each unit of the whole population e.g. purchase or sales invoice has an equal chance of being selected. Samples are selected through a random number table. Random number tables are simple and easy to use and also provide assurance that the auditors' bias does not affect the selection. Each item in a population is selected by use of a random number table either with the help of a computer or picking up a number in a random way. This method is considered appropriate provided the population to be sampled consists of reasonably similar units and fall within a reasonable range i.e it is suitable for a homogeneous population having a similar range
Q24.	<p>What are the matters that the auditor shall consider while designing an audit sample? (SA, Nov 2022, 3 marks)</p> <p>Matters to be considered while designing an Audit Sample:</p> <p>As per SA 530, "Audit Sampling", when designing an audit sample, the auditor shall</p> <ul style="list-style-type: none"> consider the purpose of the audit procedures and the characteristics of the population from which the sample will be drawn. determine a sample size sufficient to reduce sampling risk to an acceptably low level. select items for the sample in such a way that each sampling unit in the population has a chance of selection. determine that the sample selected must be representative of the population. consider including the specific purpose to be achieved and the combination of audit procedures that is likely to best achieve that purpose. consider nature of the audit evidence sought and possible deviation or misstatement conditions or other characteristics relating to that audit evidence will assist the auditor in defining what constitutes a deviation or misstatement and what population to use for sampling. perform audit procedures to obtain evidence that the population from which the audit sample is drawn is complete.
Q25.	<p>Random selection ensures that all items in the population or within each stratum have a known chance of selection. Random sampling includes two very popular methods. Explain. (RTP, May 2023, NA)</p> <p>Random selection ensures that all items in the population or within each stratum have a known chance of selection. It may involve use of random number tables. Random sampling includes two very popular methods which are discussed below–</p> <ul style="list-style-type: none"> Simple Random Sampling: <ul style="list-style-type: none"> Under this method each unit of the whole population e.g. purchase or sales invoice has an equal chance of

	<p>being selected.</p> <ul style="list-style-type: none"> ○ Samples are selected through a random number table. ○ Random number tables are simple and easy to use and also provide assurance that the auditors' bias does not affect the selection. ○ Each item in a population is selected by use of a random number table either with the help of a computer or picking up a number in a random way. ○ This method is considered appropriate provided the population to be sampled consists of reasonably similar units and fall within a reasonable range i.e it is suitable for a homogeneous population having a similar range <ul style="list-style-type: none"> ● Stratified Sampling: This method involves dividing the whole population to be tested in a few separate groups called strata and taking a sample from each of them. Each stratum is treated as if it was a separate population and if proportionate of items are selected from each of these stratum. The number of groups into which the whole population has to be divided is determined on the basis of auditor judgment
Q26.	<p>Chintamani Ltd appoints Chintan & Mani as statutory auditors for the financial year 2022-2023. Chintan & Mani seem to have different opinion on audit approach to be adopted for audit of Chintamani Ltd. Mani is of the opinion that 100% checking is not required and they can rely on Audit Sampling techniques in order to provide them a reasonable basis on which they can draw conclusions about the entire population. Chintan is concerned whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested. You are required to guide Chintan about his role if audit sampling has not provided a reasonable basis for conclusions about the population that has been tested in accordance with SA 530 (RTP, Nov 2023, NA)</p> <p>As per SA 530, "Audit Sampling", the auditor shall evaluate:</p> <ol style="list-style-type: none"> a) The results of the sample; and b) Whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested. <p>If the auditor concludes that audit sampling has not provided a reasonable basis for conclusions about the population that has been tested, the auditor may:</p> <ul style="list-style-type: none"> ● Request management to investigate misstatements that have been identified and the potential for further misstatements and to make any necessary adjustments; or ● Tailor the nature, timing and extent of those further audit procedures to best achieve the required assurance. For example, in the case of tests of controls, the auditor might extend the sample size, test an alternative control or modify related substantive procedures.
Q27.	<p>What is tolerable misstatement and total rate of deviation? (MTP1, Nov 2023, 3 marks)</p> <ul style="list-style-type: none"> ● Tolerable misstatement is a monetary amount set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that the monetary amount set by the auditor is not exceeded by the actual misstatement in the population. When designing a sample, the auditor determines tolerable misstatement in order to address the risk that the aggregate of individually immaterial misstatements may cause the financial statements to be materially misstated and provide a margin for possible undetected misstatements. ● Total rate of deviation / Tolerable rate of deviation - A rate of deviation from prescribed internal control procedures set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that the rate of deviation set by the auditor is not exceeded by the actual rate of deviation in the population

Part II: Correct/Incorrect Questions

Q1.	<p>Universe refers to the entire set of data from which a sample is selected and about which the auditor wishes to draw conclusions. (ICAI Study Material - Test Your Knowledge)</p> <p>Incorrect. Population refers to the entire set of data from which a sample is selected and about which the auditor wishes to draw conclusions.</p>
Q2.	<p>Non Statistical sampling is an approach to sampling that has the random selection of the sample items; and the use of probability theory to evaluate sample results, including measurement of sampling risk characteristics. (ICAI Study Material - Test Your Knowledge)</p>

	Incorrect. Statistical sampling is an approach to sampling that has the random selection of the sample items; and the use of probability theory to evaluate sample results, including measurement of sampling risk characteristics
Q3.	The objective of stratification is to increase the variability of items within each stratum and therefore allow sample size to be reduced without increasing sampling risk. (ICAI Study Material - Test Your Knowledge)
	Incorrect. The objective of stratification is to reduce the variability of items within each stratum and therefore allow sample size to be reduced without increasing sampling risk.
Q4.	Stratified Sampling is used for homogeneous population. (ICAI Study Material - Test Your Knowledge)
	Incorrect. Stratified sampling is used when the population is diversified i.e heterogeneous . The population is divided into sub population having similar characteristics. Sample are then chosen from these sub populations which are called Stratum. Therefore, stratified sampling is not useful in case of homogeneous population.
Q5.	Non statistical sampling is considered to be more scientific than the statistical sampling. (ICAI Study Material - Test Your Knowledge)
	Incorrect. Statistical sampling uses the scientific method of choosing samples from a given population. The use of probability theory is involved in statistical sampling so that every sampling unit has an equal chance of getting selected. In the non statistical sampling, auditors' judgment and past experience is used to choose samples without any scientific method
Q6.	In case of Statistical sampling, auditor's bias in choosing sample is involved (ICAI Study Material - Test Your Knowledge)
	Incorrect. Statistical sampling uses the scientific method choosing samples from a given population. The use of probability theory is involved in statistical sampling so that every sampling unit has an equal chance of getting selected. In the non-statistical sampling, auditor's judgment and past experience is used to choose samples without and scientific method. Hence, personal bias is involved in Non statistical sampling and not Statistical.
Q7.	When statistical sampling is used to select a sample, sample need not be representative because the statistical sampling takes care of the representation. (ICAI Study Material - Test Your Knowledge) (SA, May 2018, 2 Marks) OR Sample need not be representative. (ICAI Study Material - Test Your Knowledge)
	Incorrect. Whatever may be the approach , non-statistical or statistical sampling, the sample must be representative . This means that it must be closely similar to the whole population although not necessarily exactly the same . The sample must be large enough to provide statistically meaningful results.
Q8.	The method which involves dividing the population into groups of items is known as block sampling. (ICAI Study Material - Test Your Knowledge) (MTP1, Nov 2019, 2 Marks)
	Incorrect. The method which involves dividing the population into groups of items is known as cluster sampling whereas block sampling involves the selection of a defined block of consecutive items.
Q9.	In stratified sampling, the conclusion drawn on each stratum can be directly projected to the whole population (ICAI Study Material - Test Your Knowledge) (SA, July 2021, 2 Marks)
	Incorrect. In case of stratified sampling, the conclusions are drawn on the stratum. The combination of all the conclusions on stratum together will be used to determine the possible effect of misstatement or deviation. Hence the samples are used to derive conclusions only on the respective stratum from where they are drawn and not the whole population .
Q10.	Low acceptable sampling risk requires larger sample size. (ICAI Study Material - Test Your Knowledge) (MTP1, May 2023, 2 marks)
	Correct. Sampling risk arises from the possibility that the auditor's conclusion based upon the sample may be different from the conclusion that would have been reached if the same audit procedures were applied on the entire population . If acceptable sampling risk is low , large sample size is needed.

Q11.	<p>According to SA 530 "Audit sampling", 'audit sampling' refers to the application of audit procedures to 100% of items within a population of audit relevance. (MTP1, May 2018, 2 Marks) (MTP1, May 2019, 2 Marks)</p> <p>Incorrect. According to SA 530 "Audit sampling", 'audit sampling' refers to the application of audit procedures to less than 100% of items within a population of audit relevance such that all sampling units have a chance of selection in order to provide the auditor with a reasonable basis on which to draw conclusions about the entire population.</p>
Q12.	<p>Stratified Sampling involves dividing the whole population to be tested in a few separate groups called strata and taking a sample from each of them. (MTP2, Nov 2018, 2 Marks)</p> <p>Correct. Stratified Sampling involves dividing the whole population to be tested in a few separate groups called strata and taking a sample from each of them. Each stratum is treated as if it was a separate population and if proportionate of items are selected from each of these stratum. The number of groups into which the whole population has to be divided is determined on the basis of auditor judgment.</p>
Q13.	<p>Sample size is not a valid criterion to distinguish between statistical and non-statistical approaches. (MTP2, May 2019, 2 Marks) (RTP, Nov 2023, NA)</p> <p>Correct. The decision whether to use a statistical or non-statistical sampling approach is a matter for the auditor's judgment; however, sample size is not a valid criterion to distinguish between statistical and non-statistical approaches.</p> <p>Whatever may be the approach, non-statistical or statistical sampling, the sample must be representative. This means that it must be closely similar to the whole population although not necessarily exactly the same. The sample must be large enough to provide statistically meaningful results.</p>
Q14.	<p>The non-statistical sampling is criticized on the grounds that it is neither objective nor scientific. (SA, Nov 2019, 2 Marks)</p> <p>Correct. The non-statistical sampling is criticized on the grounds that it is neither objective nor scientific. The expected degree of objectivity cannot be assured in non-statistical sampling because the risk of personal bias in selection of sample items cannot be eliminated. The closeness of the qualities projected by the sample results with that of the whole population cannot be measured because the sample has not been selected in accordance with the mathematically based statistical techniques.</p>
Q15.	<p>Statistical sampling has narrower application where a population to be tested consists of a large number of similar items. (RTP, May 2020, NA)</p> <p>Incorrect. Statistical sampling has reasonably wide application where a population to be tested consists of a large number of similar items and more in the case of transactions involving compliance testing, trade receivables' confirmation, payroll checking, vouching of invoices and petty cash vouchers.</p>
Q16.	<p>Statistical sampling being more scientific and without personal bias bias will always be appropriate to use under all circumstances (SA, Dec 2021, 2 marks) (MTP2, May 2023, 2 marks) (MTP2, Nov 2023, 2 marks)</p> <p>Incorrect. Statistical sampling is a widely accepted way of sampling as it is more scientific, without personal bias and the result of sample can be evaluated and projected in more reliable way.</p> <p>Under some audit circumstances, statistical sampling methods may not be appropriate. The auditor should not attempt to use statistical sampling when another approach is either necessary or will provide satisfactory information in less time or with less effort. For instance, when exact accuracy is required or in case of legal requirements etc</p>
Q17.	<p>The level of sampling risk that the auditor is willing to accept will not affect the sample size. (MTP2, May 2022, 2 marks) (RTP, Nov 2022, NA)</p> <p>Incorrect. As per SA 530, "Audit Sampling" the level of sampling risk that the auditor is willing to accept affects the sample size required. The lower the risk the auditor is willing to accept, the greater the sample size will need to be.</p>
Q18.	<p>In case of stratified sampling, the conclusions are drawn on the stratum. (MTP1, Nov 2022, 2 Marks)</p> <p>Correct. In case of stratified sampling, the conclusions are drawn on the stratum. The combination of all the conclusions on stratum together will be used to determine the possible effect of misstatement or deviation. Hence the samples are used to</p>

	derive conclusion only on the respective stratum from where they are drawn and not the whole population .
Q19.	Systematic sampling means dividing heterogeneous population into homogeneous sub population, where samples are drawn from each sub population. (MTP2, Nov 2022, 2 Marks) Incorrect. Stratification means dividing a heterogeneous population into a homogeneous sub population, where samples are drawn from each sub population. Systematic sampling is a selection method in which the number of sampling units in the population is divided by the sample size to give a sampling interval , for example 50, and having determined a starting point within the first 50, each 50th sampling unit thereafter is selected.
Q20.	The higher the auditor's assessment of the risk of material misstatement, the smaller the sample size needs to be. (MTP2, Nov 2022, 2 marks) Incorrect. The higher the auditor's assessment of the risk of material misstatement, the larger the sample size needs to be. The auditor's assessment of the risk of material misstatement is affected by inherent risk and control risk. Therefore, in order to reduce audit risk to an acceptably low level, the auditor needs a low detection risk and will rely more on substantive procedures . The more audit evidence that is obtained from tests of details (that is, the lower the detection risk), the larger the sample size will need to be.

Part III: Multiple Choice Questions

Q1.	Which of the following is not an advantage of statistical sampling? (a) Sample size does not increase in proportion to size of area tested. (b) Sample selection is more objective. (c) It provides a means of deriving a calculated risk and corresponding precision. (d) In case of verifying compliance with specific legal requirements, it is suitable. (ICAI Study Material - Test Your Knowledge)
	Correct answer: (d) In case of verifying compliance with specific legal requirements, it is suitable.
Q2.	As the number of transactions of WY Limited for the financial year 2023-24 were very large, the auditor of WY Limited decided to use the technique of Audit Sampling. Before selecting the sample from Repair and Maintenance Expenses, the auditor of WY Limited wished that the entire data of Repair and Maintenance Expenses of WY Limited for financial year 2023-24 should have three characteristics. These three characteristics are: (a) Simple, Completeness, Relevant. (b) Appropriateness, Simple, Relevant. (c) Reliable, Simple, Relevant. (d) Appropriateness, Completeness, Reliable. (ICAI MCQs)
	Correct answer: (d) Appropriateness, Completeness, Reliable Explanation: Population refers to the entire set of data from which a sample is selected and about which the auditor wishes to draw conclusions. Characteristics of Population are Appropriateness, completeness and Reliable.
Q3.	The main advantage of using statistical sampling techniques is that such techniques: (a) Mathematically measure risk (b) Eliminate the need for judgmental sampling (c) Defines the values of tolerable error (d) All of the them (ICAI MCQs)
	Correct answer: (a) Mathematically measure risk
Q4.	Which of the following is more scientific: (a) Statistical

	<p>(b) Non- statistical (c) both (a) and (b) (d) none of the above (ICAI MCQs)</p>
	<p>Correct answer: (a) Statistical Explanation: Statistical sampling uses the scientific method of choosing samples from a given population. In the non-statistical sampling, auditors' judgment and past experience is used to choose samples without any scientific method.</p>
Q5.	<p>Statistical sampling has the following characteristics (a) Random selection (b) Use of Probability theory (c) both (a) and (b) (d) Judgmental approach (ICAI MCQs)</p>
	<p>Correct answer: (c) both (a) and (b)</p>
Q6.	<p>Which of the following factors is (are) considered in determining the sample size for tests of control? (a) Projected error (b) Tolerable error (c) Expected error (d) Both (b) and (c) (Sample MCQs) (ICAI MCQs)</p>
	<p>Correct answer: (d) Both (b) and (c) Explanation:</p> <ul style="list-style-type: none"> • Tolerable error means the maximum error in a population that the auditor is willing to accept. • Expected errors are errors that the auditor expects in the population based on prior audit results, changes in processes, and evidence/conclusions from other sources.
Q7.	<p>Tolerable error, is the maximum monetary error that the auditor is prepared to accept in the population and still conclude that audit objective has been achieved, is directly related to (a) Sample size (b) Audit risk (c) Materiality (d) Expected error (Sample MCQs) (ICAI MCQs)</p>
	<p>Correct answer: (c) Materiality Explanation: Tolerable error is considered during the planning stage and, for substantive procedures, is related to the auditor's judgment about materiality. The larger the tolerable error, the smaller the sample size will need to be. That means if the auditor can tolerate a high level of risk that means less checking to be done i.e. a high level of materiality will be determined by the auditor.</p>
Q8.	<p>Which of the following is source of Non Sampling risk : (a) Human Mistakes (b) Applying audit procedures not appropriate to the objectives of audit (c) Misinterpreting the sample results (d) All of the above (Sample MCQs) (ICAI MCQs)</p>
	<p>Correct answer: (d) All of the above Explanation: Sources of Non Sampling risk are Human Mistakes, Applying audit procedures not appropriate to the objectives of audit, Relying on erroneous information e.g. erroneous confirmation, Misinterpreting the sample results</p>

Q9.	<p>While auditing TEN Ltd., CA. Porky divided the whole population of trade receivables balances to be tested in a few separate groups called 'strata' and started taking a sample from each of them. He treated each stratum as if it was a separate population. He divided the trade receivables balances of TEN Ltd. for the Financial Year 2022-23 into groups on the basis of personal judgment as follows:</p> <table border="1" data-bbox="183 237 1060 510"> <thead> <tr> <th>S. No.</th> <th>Particulars</th> </tr> </thead> <tbody> <tr> <td>1</td> <td>Balances in excess of ₹ 10,00,000;</td> </tr> <tr> <td>2</td> <td>Balances in the range of ₹ 7,75,001 to ₹ 10,00,000;</td> </tr> <tr> <td>3</td> <td>Balances in the range of ₹ 5,50,001 to ₹ 7,75,000;</td> </tr> <tr> <td>4</td> <td>Balances in the range of ₹ 2,25,001 to ₹ 5,50,000;</td> </tr> <tr> <td>5</td> <td>Balances ₹ 2,25,000 and below</td> </tr> </tbody> </table> <p>From the abovementioned groups, CA. Porky picked up different percentage of items for examination from each of the groups, for example, from the top group i.e. balances in excess of ₹10,00,000, he selected all the items to be examined; from the second group, he opted for 25 % of the items to be examined; from the lowest group, he selected 2% of the items for examination; and so on from rest of the groups. Which one of the following methods of sample selection is he following?</p> <p>(a) Systematic sampling. (b) Stratified sampling. (c) Section sampling. (d) Selection sampling.</p> <p>(Sample MCQs)</p>	S. No.	Particulars	1	Balances in excess of ₹ 10,00,000;	2	Balances in the range of ₹ 7,75,001 to ₹ 10,00,000;	3	Balances in the range of ₹ 5,50,001 to ₹ 7,75,000;	4	Balances in the range of ₹ 2,25,001 to ₹ 5,50,000;	5	Balances ₹ 2,25,000 and below
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4	Balances in the range of ₹ 2,25,001 to ₹ 5,50,000;												
5	Balances ₹ 2,25,000 and below												
<p>Correct answer: (b) Stratified sampling. Explanation: Stratified sampling involves dividing the whole population to be tested in a few separate groups called strata and taking a sample from each of them.</p>													
Q10.	<p>In random Sample, each item of population has</p> <p>(a) equal chance of selection (b) has varying chance of selection depending upon placing of items. (c) may have a chance of selection based on auditors professional judgement (d) All of these</p> <p>(ICAI MCQs)</p>												
<p>Correct answer: (a) equal chance of selection</p>													
Q11.	<p>The relationship between tolerable error and sample size is</p> <p>(a) Inverse (b) Direct (c) Close (d) There is no relationship.</p> <p>(ICAI MCQs) (MTP2, May 2023, 1 mark)</p>												
<p>Correct answer: (a) Inverse Explanation:</p> <ul style="list-style-type: none"> Tolerable error is the maximum error in the population that the auditor would be willing to accept and still conclude that the result from the sample has achieved the audit objective. If there is an increase in the tolerable error, then sample size will decrease, as lower the tolerable error, larger the sample size needs to be. That means if the auditor can tolerate a high level of risk that means less checking to be done because deviation/misstatements can be accepted and less samples are drawn thus, sample size decreases. 													
Q12.	<p>In the case of tests of details</p> <p>(a) the projected misstatement plus anomalous misstatement, if any, is the auditor's best estimate of misstatement in the population. (b) the projected misstatement is the auditor's best estimate of misstatement in the population. (c) the anomalous misstatement is the auditor's best estimate of misstatement in the population.</p>												

	(d) the projected misstatement plus anomalous misstatement, if any, cannot be the auditor's best estimate of misstatement in the population. (MTP1, May 2019, 1 Mark)
	Correct answer: (a) the projected misstatement plus anomalous misstatement, if any, is the auditor's best estimate of misstatement in the population.
Q13.	Which of the following is correct : (a) When the projected misstatement exceeds tolerable misstatement, the sample does not provide a reasonable basis for conclusions about the population that has been tested. (b) When the projected misstatement plus anomalous misstatement, if any, exceeds tolerable misstatement, the sample does not provide a reasonable basis for conclusions about the population that has been tested. (c) When the anomalous misstatement exceeds tolerable misstatement, the sample does not provide a reasonable basis for conclusions about the population that has been tested. (d) When the projected misstatement plus anomalous misstatement, if any, exceeds tolerable misstatement, the sample provides a reasonable basis for conclusions about the population that has been tested. (MTP1, May 2019, 1 Mark)
	Correct answer: (b) When the projected misstatement plus anomalous misstatement, if any, exceeds tolerable misstatement, the sample does not provide a reasonable basis for conclusions about the population that has been tested.
Q14.	It is a type of value-weighted selection in which sample size, selection and evaluation results in a conclusion in monetary amounts : (a) Haphazard sampling (b) Monetary Unit Sampling (c) Stratified Sampling (d) Interval sampling (MTP2, May 2019, 1 Mark)
	Correct answer: (b) Monetary Unit Sampling
Q15.	_____ in which the auditor selects the sample without following a structured technique. (a) Haphazard selection, (b) Monetary Unit Sampling (c) Block Sampling (d) Structured Sampling (RTP, May 2021, NA)
	Correct answer: (a) Haphazard selection
	Explanation: In Haphazard selection, the auditor does not follow a structured technique but avoids bias or predictability

SA 501 "Audit Evidence- Specific Considerations for Selected Items"

Part I : Descriptive Questions

Q1.	The audit procedures performed so far by auditor of a company indicate that there is a possibility that company has not disclosed all material litigation cases involving the company. Does such a situation warrant direct communication by auditor with external lawyer of the company? (ICAI Study Material - Test Your Understanding)
	As per requirements of SA 501 , If the auditor assesses a risk of material misstatement regarding litigation or claims that have been identified, or when audit procedures performed indicate that other material litigation or claims may exist, the auditor shall, seek direct communication with the entity's external legal counsel . The above situation warrants direct communication with the company's standing external lawyer.

Q2.	<p>JK Exports Ltd is a manufacturer exporter having its own production capacity and also gets the job work done through various job workers. The auditor of JK Exports Ltd. considers that inventory held with job workers is material to the financial statements. Suggest the audit procedures in the given case. (ICAI Study Material - Illustration)</p> <p>When inventory under the custody and control of a third party is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of that inventory by performing one or both of the following:</p> <ol style="list-style-type: none"> Request confirmation from the third party as to the quantities and condition of inventory held on behalf of the entity. Perform inspection or other audit procedures appropriate in the circumstances.
Q3.	<p>Parag India Ltd is a manufacturer of various FMCG (fast moving consumable goods) range of products. The company is having several cases of litigation pending in courts. The auditor wanted to identify litigation and claims resulting to risk of material misstatements. Suggest the auditor with reference to SAs. (ICAI Study Material - Illustration) (SA, May 2019, 4 Marks) (MTP1, May 2020, 4 Marks) (MTP2, May 2021, 3 Marks)</p> <p style="text-align: center;">OR</p> <p>Pachranga International Ltd is manufacturer of pickles, ginger garlic paste, jams etc having its plant at Jaipur. Being in food industry, the company is facing many litigations in various courts across India. Auditors SPV & Co. wants to identify such litigations and claims involving the company which may give rise to risk of material misstatement. Guide the auditor as to how they should proceed for the purpose. (RTP, May 2022, NA)</p> <p>The auditor shall design and perform audit procedures in order to identify litigation and claims involving the entity which may give rise to a risk of material misstatement, including:</p> <ol style="list-style-type: none"> Inquiry of management and, where applicable, others within the entity, including in-house legal counsel; Reviewing minutes of meetings of those charged with governance and correspondence between the entity and its external legal counsel; and Reviewing legal expense accounts. <p>If the auditor assesses a risk of material misstatement regarding litigation or claims that have been identified, or when audit procedures performed indicate that other material litigation or claims may exist, the auditor shall, in addition to the procedures required by other SAs, seek direct communication with the entity's external legal counsel.</p>
Q4.	<p>Briefly mention the matters that are relevant in planning attendance at physical inventory counting. (ICAI Study Material - Test Your Knowledge) (SA, Nov 2018, 5 Marks) (RTP, May 2020, NA)</p> <p>Matters relevant in planning attendance at physical inventory counting: Matters relevant in planning attendance at physical inventory counting include, for example:</p> <ul style="list-style-type: none"> ● Nature of inventory. ● Stages of completion of work in progress. ● The risks of material misstatement related to inventory. ● The nature of the internal control related to inventory. ● Whether adequate procedures are expected to be established and proper instructions issued for physical inventory counting. ● The timing of physical inventory counting. ● Whether the entity maintains a perpetual inventory system. ● The locations at which inventory is held, including the materiality of the inventory and the risks of material misstatement at different locations, in deciding at which locations attendance is appropriate ● Whether the assistance of an auditor's expert is needed.
Q5.	<p>ABC Ltd is engaged in manufacturing of different type of yarns. On going through its financial statements for the past years, it is observed that inventory is material to the financial statements. You as an auditor of the company wanted to obtain sufficient appropriate audit evidence regarding the existence and condition of the inventory as appearing in the financial statements. Discuss, how would you proceed as an auditor. (MTP1, May 2018, 5 Marks) (MTP1, Nov 2018, 5 Marks) (MTP2, Nov 2018, 5 Marks) (MTP1, May 2019, 4 Marks) (MTP1, May 2020, 4 Marks)</p> <p>When inventory is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by:</p>

	<ul style="list-style-type: none"> ● Attendance at physical inventory counting, unless impracticable, to: <ul style="list-style-type: none"> ○ Evaluate management's instructions and procedures for recording and controlling the results of the entity's physical inventory counting; ○ Observe the performance of management's count procedures; ○ Inspect the inventory; and ○ Perform test counts; and ● Performing audit procedures over the entity's final inventory records to determine whether they accurately reflect actual inventory count results.
Q6.	<p>TRM Ltd. is a company engaged in manufacture of beauty products. It has hair care segment, skin care segment and kids' beauty products. The auditor wants to obtain sufficient appropriate audit evidence regarding the presentation and disclosure of segment information in accordance with the applicable financial reporting framework. Suggest the audit procedures in the given case. (MTP1, May 2021, 4 Marks)</p> <p>The auditor shall obtain sufficient appropriate audit evidence regarding the presentation and disclosure of segment information in accordance with the applicable financial reporting framework by:</p> <ul style="list-style-type: none"> ● Obtaining an understanding of the methods used by management in determining segment information. Further, <ul style="list-style-type: none"> ○ Evaluating whether such methods are likely to result in disclosure in accordance with the applicable financial reporting framework; and ○ Where appropriate, testing the application of such methods; and ● Performing analytical procedures or other audit procedures appropriate in the circumstances
Q7.	<p>GPS & Co, Chartered Accountants, conducting the audit of Pratibha Ltd., a listed company for the year ended 31.03.2024 is concerned with the presentation and disclosure of segment information included in Company's Annual Report. GPS & Co wanted to ensure that methods adopted by management for determining segment information have resulted in disclosure in accordance with the applicable financial reporting framework. Guide GPS & Co with 'Examples of Matters' that may be relevant when obtaining an understanding of the methods used by the management with reference to the relevant Standards on Auditing. (RTP, May 2022, NA)</p> <p>The auditors, GPS & Co wanted to ensure and obtain sufficient appropriate audit evidence regarding the presentation and disclosure of segment information in accordance with the applicable financial reporting framework by obtaining an understanding of the methods used by management in determining segment information.</p> <p>As per SA 501- "Audit Evidence—Specific Considerations for Selected Items", example of matters that may be relevant when obtaining an understanding of the methods used by management in determining segment information and whether such methods are likely to result in disclosure in accordance with the applicable financial reporting framework include:</p> <ul style="list-style-type: none"> ● Sales, transfers and charges between segments, and elimination of inter segment amounts. ● Comparisons with budgets and other expected results, for example, operating profits as a percentage of sales. ● The allocation of assets and costs among segments. ● Consistency with prior periods, and the adequacy of the disclosures with respect to inconsistencies.
Q8.	<p>SPR Ltd has been into the media business since 1990. During the F.Y 2023-2024 many notices were received by the company for hurting public sentiments and financial claims were filed against the company. As an auditor of the company, you requested the management for arranging the meeting with company's external legal counsel. Management is of the view that such meetings are necessary in some certain circumstances only. Can you list down those certain circumstances? (SA, May 2022, 3 Marks)</p> <p>Circumstances when becoming necessary to meet with external legal counsel:</p> <p>In certain circumstances, the auditor also may judge it necessary to meet with the entity's external legal counsel to discuss the likely outcome of the litigation or claims. This may be the case, for example, where:</p> <ul style="list-style-type: none"> ● The auditor determines that the matter is a significant risk. ● The matter is complex. ● There is disagreement between management and the entity's external legal counsel. Ordinarily, such meetings require management's permission and are held with a representative of management in attendance.
Q9.	<p>What auditor should do if it is impracticable to attend the physical inventory count? (SELF)</p> <ul style="list-style-type: none"> ● If attendance at physical inventory counting is impracticable, the auditor shall perform alternative audit procedures

to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory.

- If it is **not** possible to do so, the auditor shall **modify** the opinion in the auditor's report in accordance with **SA 705**.
- In some cases, attendance at physical inventory counting may be impracticable. This may be due to factors such as the nature and location of the inventory, for example, where inventory is held in a location that may pose threats to the safety of the auditor.

Part II: Correct/Incorrect Questions

Q1.	If the auditor assesses a risk of material misstatement regarding litigation or claims that have been identified, the auditor need not seek direct communication with the entity's external legal counsel. (RTP, Nov 2021, NA)
	Incorrect. If the auditor assesses a risk of material misstatement regarding litigation or claims that have been identified, or when audit procedures performed indicate that other material litigation or claims may exist, the auditor shall, in addition to the procedures required by other SAs, seek direct communication with the entity's external legal counsel .
Q2.	When inventory under the custody and control of a third party is material to the financial statements, the auditor can obtain sufficient appropriate audit evidence regarding the existence and condition of that inventory by taking written representation from management (SA, Dec 2021, 2 Marks) (RTP, May 2023, NA) (MTP2, May 2023, 2 marks)
	Incorrect. When inventory under the custody and control of a third party is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of that inventory by performing one or both of the following: <ul style="list-style-type: none"> ● Request confirmation from the third party as to the quantities and condition of inventory held on behalf of the entity. ● Perform inspection or other audit procedures appropriate in the circumstances
Q3.	When inventory under the custody and control of a third party is material to the financial statements, the auditor cannot obtain sufficient appropriate audit evidence regarding the existence and condition of that inventory by taking written representation from management. (MTP1, Nov 2023, 2 marks)
	Correct. When inventory under the custody and control of a third party is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of that inventory by performing one or both of the following: <ul style="list-style-type: none"> ● Request confirmation from the third party as to the quantities and condition of inventory held on behalf of the entity. ● Perform inspection or other audit procedures appropriate in the circumstances

Part III: Multiple Choice Questions

Q1.	Coyote Ltd. is dealing in trading of electronic goods. Huge inventory (60% approximately) of the company is lying on consignment (i.e. under the custody of a third party). CA. Star, the auditor of the company, wants to obtain sufficient appropriate audit evidence regarding the existence and condition of the inventory lying on consignment. Thus, he requested & obtained confirmation from the third party as to the quantities and condition of inventory held on behalf of the entity, however, it raised doubts about the integrity and objectivity of the third party. Which of the following other audit procedures may be performed by CA. Star to obtain sufficient appropriate audit evidence regarding the existence and condition of the inventory under the custody of a third party? (a) Attend a third party's physical counting of inventory. (b) Arrange for another auditor to attend a third party's physical counting of inventory. (c) Inspect warehouse receipts regarding inventory held by third parties. (d) All of the above. (Sample MCQs) (RTP, May 2019, NA)
	Correct answer: (d) All of the above Explanation: Where information is obtained that raises doubt about the integrity and objectivity of the third party, the auditor may consider it appropriate to perform other audit procedures instead of, or in addition to, confirmation with the third party. Examples of other audit procedures include :

	<ul style="list-style-type: none"> • Attending, or arranging for another auditor to attend, the third party's physical counting of inventory, if practicable. • Obtaining another auditor's report, or a service auditor's report, on the adequacy of the third party's internal control for ensuring that inventory is properly counted and adequately safeguarded. • Inspecting documentation regarding inventory held by third parties, for example, warehouse receipts. • Requesting confirmation from other parties when inventory has been pledged as collateral
Q2.	<p>The auditor shall design and perform audit procedures in order to identify litigation and claims involving the entity which may give rise to a risk of material misstatement, including:</p> <p>(a) Inquiry of management and, where applicable, others within the entity, including in-house legal counsel.</p> <p>(b) Reviewing minutes of meetings of those charged with governance and correspondence between the entity and its external legal counsel.</p> <p>(c) Reviewing legal expense accounts.</p> <p>(d) All of the above</p> <p>(ICAI MCQs) (MTP2, May 2019, 1 Mark)</p>
	Correct answer: (d) All of the above

SA 505 “External Confirmations”

Part I : Descriptive Questions

Q1.	<p>CA Jignesh Desai is in midst of audit of a company. The company is fairly large one and has a well -functioning internal audit department. While considering sending out external confirmation requests to trade receivables outstanding as on date of financial statements, he has delegated the process of choosing trade receivables, designing requests and receiving responses from customers to internal audit department. The responses are also received on the mail id of internal audit department. Is approach of CA Jignesh Desai proper? (ICAI Study Material - Test Your Understanding)</p>
	<p>When using external confirmation procedures, the auditor shall maintain control over external confirmation requests, including:</p> <ol style="list-style-type: none"> Determining the information to be confirmed or requested; Selecting the appropriate confirming party; Designing the confirmation requests, including determining that requests are properly addressed and contain return information for responses to be sent directly to the auditor; and Sending the requests, including follow-up requests when applicable, to the confirming party. <p>In the given case, it appears that the external auditor has delegated the entire work of sending out external confirmation requests to internal audit department over which he has no control. Further, responses to external confirmation requests are received on mail id of internal audit department. All these acts are not in line with requirements under SA 505</p>
Q2.	<p>On reviewing schedule of trade receivables of a company, CA Mary finds that in respect of one outstanding balance, the CFO of the company is not willing to allow her to send external confirmation request due to the reason that sending out such request could spoil precariously placed business relations with the customer. On further inquiry, she finds out that there is a dispute going on with the company relating to some quality issues of goods sent to the customer and matter is sub judice. Efforts are also being made by the company for out of court settlement. Reviewing correspondence with the customer, she finds that issue is near resolution and no fraud risk factors exist. Is unwillingness of CFO justifiable? (ICAI Study Material - Test Your Understanding)</p>
	<ul style="list-style-type: none"> • In terms of requirements of SA 505, if management refuses to allow the auditor to send a confirmation request, the auditor shall inquire as to management's reasons for the refusal, and seek audit evidence as to their validity and reasonableness. • A common reason advanced is the existence of a legal dispute or ongoing negotiation with the intended confirming party, the resolution of which may be affected by an untimely confirmation request. Further, fraud risk factors do not exist. • Keeping in view, unwillingness of CFO is justifiable
Q3.	<p>During the financial year 2023-24, the auditor of Healthy and Wealthy Limited asked a Trade Receivable to respond directly to the auditor whether or not the amount they were required to pay to Healthy and Wealthy Limited was ₹ 1,23,000. That trade receivable confirmed to the auditor of Healthy and Wealthy Limited, that they were required to pay an amount of ₹ 1,23,000 to</p>

	<p>Healthy and Wealthy Limited. State and explain the type of Confirmation Request as required by the auditor (ICAI Study Material - Illustration)</p> <p>This is an example of Positive Confirmation Request because in Positive Confirmation Request the party confirms the auditor of a company whether such party agrees or whether such party disagrees with the information for which the confirmation is required by the auditor of that company.</p>
Q4.	<p>While conducting the audit of AB Ltd, the auditor K of KLM and Associates, Chartered Accountants observes that there are large number of Trade payables and receivables standing in the books of accounts as on 31st March. The auditor wanted to send confirmation request to few trade receivables, but the management refused the auditor to send confirmation request. How would the auditor proceed? (ICAI Study Material - Illustration) (SA, Nov 2020, 4 Marks)</p> <p style="text-align: center;">OR</p> <p>CA P is the auditor of MN Ltd. While scrutinising the accounts of MN Ltd., he observed that the company had large volume of Trade payable outstanding in the Balance sheet as on 31st March, 2023 for which external confirmations are not available. CA P wants to send external confirmation request to selected Trade payables but management of MN Ltd. refused for the same. Discuss how CA P should deal in this regard as per relevant Standard on Auditing. (SA, May 2023, 4 marks)</p> <p>If the management refuses to allow the auditor to send a confirmation request , the auditor shall</p> <ul style="list-style-type: none"> ● Inquire as to management’s reasons for the refusal and seek audit evidence as to their validity and reasonableness. ● Evaluate the implications of management’s refusal on the auditor’s assessment of the relevant risks of material misstatement, including the risk of fraud, and on the nature, timing and extent of other audit procedures; and ● Perform alternative audit procedures designed to obtain relevant and reliable evidence. <p>If the auditor concludes that management’s refusal to allow the auditor to send a confirmation request is unreasonable, or the auditor is unable to obtain relevant and reliable audit evidence from alternative audit procedures,</p> <ul style="list-style-type: none"> ● the auditor shall communicate with those charged with governance in accordance with SA 260. ● The auditor shall also determine the implication for the audit and the auditor’s opinion in accordance with SA 705.
Q5.	<p>When using external confirmation procedures, the auditor shall maintain control over external confirmation requests including sending the requests, including follow-up requests when applicable, to the confirming party. Explain the other points as to when using external confirmation procedures, the auditor would be required to maintain control over external confirmation requests. (ICAI Study Material - Test Your Knowledge) (RTP, May 2020, NA)</p> <p>As per SA 505 “External Confirmations”, when using external confirmation procedures, the auditor shall maintain control over external confirmation requests, including:</p> <ol style="list-style-type: none"> a) Determining the information to be confirmed or requested; b) Selecting the appropriate confirming party; c) Designing the confirmation requests, including determining that requests are properly addressed and contain return information for responses to be sent directly to the auditor; and d) Sending the requests, including follow-up requests when applicable, to the confirming party.
Q6.	<p>Define the following :</p> <ol style="list-style-type: none"> i) Positive confirmation request ii) Negative confirmation request iii) Non-response iv) Exception <p>(RTP, May 2020, NA)</p> <ul style="list-style-type: none"> ● Positive confirmation request: A request that the confirming party respond directly to the auditor indicating whether the confirming party agrees or disagrees with the information in the request, or providing the requested information. ● Negative confirmation request: A request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request. ● Non-response: A failure of the confirming party to respond, or fully respond, to a positive confirmation request, or a confirmation request returned undelivered.

	<ul style="list-style-type: none"> ● Exception: A response that indicates a difference between information requested to be confirmed, or contained in the entity's records, and information provided by the confirming party.
Q7.	<p>CA Rohit is appointed as an auditor of Grace Ltd., he wants to design a suitable Confirmation request letter for a few debtors of Grace Ltd. As a senior auditor of the firm, explain to him with reference to SA 505 "External Confirmation" all the conditions that should be present to use Negative Confirmation requests as the sole substantive audit procedure to address an assessed risk of material misstatement at the assertion level. (SA, July 2021, 4 Marks)</p> <p>Negative confirmation is a request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request. Negative information provides less persuasive audit evidence than positive confirmations.</p> <p>Accordingly, CA Rohit, Auditor of Grace Ltd, shall not use negative confirmation requests as the sole substantive audit procedure to address an assessed risk of material misstatement at the assertion level unless all of the following are present:</p> <ul style="list-style-type: none"> ● The auditor has assessed the risk of material misstatement as low and has obtained sufficient appropriate audit evidence regarding the operating effectiveness of controls relevant to the assertion; ● The population of items subject to negative confirmation procedures comprises a large number of small, homogeneous, account balances, transactions or conditions; ● A very low exception rate is expected; and ● The auditor is not aware of circumstances or conditions that would cause recipients of negative confirmation requests to disregard such requests.
Q8.	<p>External confirmation procedures frequently are relevant when addressing assertions associated with account balances and their elements but need not be restricted to these items. Apart from confirmations for bank balances and accounts receivables, what are the other situations where external confirmation procedures may provide relevant audit evidence in responding to assessed risks of material misstatement? (MTP2, May 2022, 3 marks) (RTP, Nov 2022, NA)</p> <p>Examples of situations where external confirmations may be used include the following:</p> <ul style="list-style-type: none"> ● Inventories held by third parties at bonded warehouses for processing or on consignment. ● Property title deeds held by lawyers or financiers for safe custody or as security. ● Investments held for safekeeping by third parties, or purchased from stockbrokers but not delivered at the balance sheet date. ● Amounts due to lenders, including relevant terms of repayment and restrictive covenants.
Q9.	<p>What are the factors that are to be considered while designing a confirmation request? (SELF)</p> <p>As per SA 505 "External confirmation", the design of a confirmation request may directly affect the confirmation response rate, and the reliability and the nature of the audit evidence obtained from responses.</p> <p>Factors to consider when designing confirmation requests include:</p> <ul style="list-style-type: none"> ● The assertions being addressed. ● Specific identified risks of material misstatement, including fraud risks. ● The layout and presentation of the confirmation request. ● Prior experience on the audit or similar engagements. ● The method of communication [for example, in paper form, or by electronic mode (like e-mail) or other medium]. ● Management's authorisation or encouragement to the confirming parties to respond to the auditor. Confirming parties may only be willing to respond to a confirmation request containing management's authorisation. ● The ability of the intended confirming party to confirm or provide the requested information (for example, individual invoice amount versus total balance).

Part II: Correct/Incorrect Questions

Q1.	<p>A request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request is called a positive confirmation request. (MTP2, May 2018, 2 Marks)</p> <p style="text-align: center;">OR</p> <p>Positive Confirmation request is a request where the confirming party respond only if it disagrees with the information</p>
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	provided in the request. (SA, May 2019, 2 Marks)
	Incorrect. In Positive confirmation request confirming party respond directly to the auditor indicating whether the confirming party agrees or disagrees with the information in the request, or providing the requested information whereas Negative confirmation request is a request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request.
Q2.	Audit evidence obtained from external confirmation is always reliable. (SA, Nov 2018, 2 Marks) (MTP1, Nov 2021, 2 Marks)
	Incorrect. The reliability of information to be used as audit evidence, and therefore of the audit evidence itself, is influenced by its source and its nature , and the circumstances under which it is obtained, including the controls over its preparation and maintenance where relevant. Even when information to be used as audit evidence is obtained from sources external to the entity, circumstances may exist that could affect its reliability.
Q3.	External confirmation procedures are restricted to the items of addressing assertions associated with account balances & their elements only. (SA, Nov 2020, 2 Marks)
	Incorrect. External confirmation procedures frequently are relevant when addressing assertions associated with certain account balances and their elements. However, external confirmation need not be restricted to account balances only .
Q4.	R Ltd. has asked for email responses for the purpose of external confirmation. The auditor, however, feels that external confirmation received electronically involves the risk of its reliability. (MTP2, May 2022, 2 marks)
	Correct. SA 505 , "External Confirmations", responses received electronically, for example by facsimile or electronic mail, involve risks as to reliability because proof of origin and authority of the respondent may be difficult to establish , and alterations may be difficult to detect. Hence R Ltd. Should avoid using email responses as evidence for external confirmation.

Part III: Multiple Choice Questions

Q1.	<p>A company auditor receives external confirmation from an entity to whom company has sold goods. The said amount is properly classified in financial statements of company. Which of the following statements is not true in this regard?</p> <p>(a) It shows that said trade receivable exists. (b) It shows that said trade receivable is properly valued. (c) It shows that company has a right to said trade receivable. (d) It shows that amount of said trade receivable has been recorded in proper account.</p> <p>(ICAI Study Material - Test Your Knowledge)</p>
	Correct answer: (b) It shows that said trade receivable is properly valued.
Q2.	<p>Statement 1: A response that indicates a difference between information requested to be confirmed and information provided by confirming party is Negative Confirmation.</p> <p>Statement 2: A failure of the confirming party to respond, or fully respond, to a positive confirmation request, or a confirmation request returned undelivered is exception.</p> <p>(a) Statement 1 is correct (b) Statement 2 is correct (c) Both 1 & 2 are incorrect (d) Both 1 & 2 are correct</p> <p>(ICAI MCQs)</p>
	<p>Correct answer: (c) Both 1 & 2 are incorrect</p> <p>Explanation:</p> <ul style="list-style-type: none"> • A response that indicates a difference between information requested to be confirmed, or contained in the entity's records, and information provided by the confirming party is an Exception • A failure of the confirming party to respond, or fully respond, to a positive confirmation request, or a confirmation request returned undelivered is Non response.

Q3.	<p>Which of the following is not correct?</p> <p>(a) SA 230- Audit Documentation (b) SA 500- Audit Evidence (c) SA 505- Written Representation (d) SA 560- Subsequent Events (ICAI MCQs)</p>
<p>Correct answer: (c) SA 505- Written Representation Explanation: SA 580 "Written Representations" and SA 505 "External Confirmation"</p>	
Q4.	<p>A request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request is-</p> <p>(a) Positive confirmation request (b) Non-response (c) Exception (d) Negative confirmation request (ICAI MCQs) (MTP2, May 2019, 1 Mark) (MTP1, May 2020, 2 Marks)</p>
<p>Correct answer: (d) Negative confirmation request</p>	
Q5.	<p>A failure of the confirming party to respond, or fully respond, to a positive confirmation request, or a confirmation request returned undelivered is called-</p> <p>(a) Negative confirmation request (b) Non-response (c) Exception (d) Positive confirmation request (RTP, Nov 2019, NA)</p>
<p>Correct answer: (b) Non-response</p>	

SA 510 "Initial Audit Engagements-Opening Balances"

Part I : Descriptive Questions

Q1.	<p>M/s Pankaj & Associates, Chartered Accountants, have been appointed as an auditor of ABC Limited. CA Pankaj did not apply any audit procedures regarding opening balances. He argued that since financial statements were audited by the predecessor auditor therefore he is not required to verify them. Is CA Pankaj correct in his approach? (ICAI Study Material - Test Your Knowledge) (SA, Nov 2018, 5 Marks)</p>
<p>Initial audit engagement is an engagement in which either :</p> <ul style="list-style-type: none"> ● The financial statements for the prior period were not audited; or ● The financial statements for the prior period were audited by a predecessor auditor. <p>Audit Procedures regarding Opening Balances</p> <p>The auditor shall read the most recent financial statements, if any, and the predecessor auditor's report thereon, if any, for information relevant to opening balances, including disclosures.</p> <p>The auditor shall obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements by:</p> <ul style="list-style-type: none"> ● Determining whether the prior period's closing balances have been correctly brought forward to the current period or, when appropriate, any adjustments have been disclosed as prior period items in the current year's Statement of Profit and Loss; ● Determining whether the opening balances reflect the application of appropriate accounting policies; and ● Performing one or more of the following: <ul style="list-style-type: none"> ○ Where the prior year financial statements were audited, perusing the copies of the audited financial 	

	<p>statements including the other relevant documents relating to the prior period financial statements;</p> <ul style="list-style-type: none"> ○ Evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances; or ○ Performing specific audit procedures to obtain evidence regarding the opening balances <p>Conclusion: Thus, we can conclude that CA Pankaj is not correct in his approach and therefore would be required to follow the initial audit engagement and also apply audit procedures regarding opening balances.</p>
Q2.	<p>An auditor is appointed for the first time for audit of accounts of an entity. The accounts of previous year were unaudited. He is unable to obtain sufficient appropriate audit evidence regarding the opening balances. What is his responsibility in this regard? (ICAI Study Material - Test Your Knowledge)</p> <ul style="list-style-type: none"> ● If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor shall express a qualified opinion or a disclaimer of opinion, as appropriate, in accordance with SA 705. ● If the auditor concludes that the opening balances contain a misstatement that materially affects the current period's financial statements, and the effect of the misstatement is not properly accounted for or not adequately presented or disclosed, the auditor shall express a qualified opinion or an adverse opinion, as appropriate, in accordance with SA 705.
Q3.	<p>Discuss the objective of Auditor with respect to Opening balances in conducting an initial audit engagement. (ICAI Study Material - Test Your Knowledge)</p> <p style="text-align: center;">OR</p> <p>M/s PQR and associates are the statutory auditors of TUV Ltd. for the FY 2023-24. They have been appointed as statutory auditors of TUV Ltd. for the first time. What is the objective of the engagement partner in terms of SA 510? (ICAI Study Material - Test Your Knowledge)</p> <p style="text-align: center;">OR</p> <p>What is the objective of the auditor with respect to the opening balances when conducting an initial audit engagement as per the relevant SA? (RTP, May 2023, NA)</p> <p>Objective of auditor with respect to opening balances As per SA 510 "Initial Audit Engagements – Opening Balances", in conducting an initial audit engagement, the objective of the auditor with respect to opening balances is to obtain sufficient appropriate audit evidence about whether-</p> <ul style="list-style-type: none"> ● Opening balances contain misstatements that materially affect the current period's financial statements; and ● Appropriate accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, or changes thereto are properly accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.
Q4.	<p>Auditors of M/s Tender India (P) Ltd. were changed for the accounting year 2023-24. The closing inventory of the company as on 31.3.2023 amounting to ₹ 100 lacs continued as it is and became closing inventory as on 31.3.2024. The auditors of the company propose to exclude from their audit programme the audit of closing inventory of ₹ 100 lacs on the understanding that it pertains to the preceding year which was audited by another auditor. (MTP1, Nov 2019, 4 Marks)</p> <p>Verification of Inventory:</p> <ul style="list-style-type: none"> ● As per SA 510 "Initial Audit Engagements – Opening Balances", in conducting an initial audit engagement, the objective of the auditor with respect to opening balances is to obtain sufficient appropriate audit evidence about whether- <ul style="list-style-type: none"> ○ Opening balances contain misstatements that materially affect the current period's financial statements; and ○ Appropriate accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, or changes thereto are properly accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework. ● When the financial statements for the preceding period were audited by predecessor auditor, the current auditor may be able to obtain sufficient appropriate audit evidence regarding opening balances by perusing the copies of the audited financial statements including the other relevant documents relating to the prior period financial statements such as supporting schedules to the audited financial statements. Ordinarily, the current auditor can place reliance on the closing balances contained in the financial statements for the preceding period, except when

	<p>during the performance of audit procedures for the current period the possibility of misstatements in opening balances is indicated.</p> <ul style="list-style-type: none"> • General principles governing verification of assets require that the auditor should confirm that assets have been correctly valued as on the Balance Sheet date. • The contention of the management that the inventory has not undergone any change cannot be accepted, it forms part of normal duties of auditor to ensure that the figures on which he is expressing opinion are correct and properly valued. Moreover, it is also quite likely that the inventory lying as it is might have deteriorated and the same need to be examined. The auditor is advised not to exclude the audit of closing inventory from his audit programme.
Q5.	<p>The newly appointed auditor of BTN Limited wants to obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements. What audit procedures should he perform for this purpose? (SA, May 2022, 3 Marks) (MTP2, May 2023, 3 marks)</p> <p>The newly appointed auditor of BTN Ltd shall read the most recent financial statements, if any, and the predecessor auditor's report thereon, if any, for information relevant to opening balances, including disclosures.</p> <p>The auditor of BTN Ltd shall obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements by:</p> <ul style="list-style-type: none"> • Determining whether the prior period's closing balances have been correctly brought forward to the current period or, when appropriate, any adjustments have been disclosed as prior period items in the current year's Statement of Profit and Loss; • Determining whether the opening balances reflect the application of appropriate accounting policies; and • Performing one or more of the following: <ul style="list-style-type: none"> ○ Where the prior year financial statements were audited, perusing the copies of the audited financial statements including the other relevant documents relating to the prior period financial statements; ○ Evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances; or ○ Performing specific audit procedures to obtain evidence regarding the opening balances

Part II: Correct/Incorrect Questions

Q1.	<p>An auditor is not concerned with consistency of accounting policies relating to opening balances. (SA, Nov 2018, 2 Marks)</p> <p>Incorrect. In conducting an initial audit engagement, one of the objective of the auditor with respect to opening balances is to obtain sufficient appropriate audit evidence about whether appropriate accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, or changes thereto are properly accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.</p>
Q2.	<p>If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor shall include an Emphasis of Matter paragraph in the auditor's report. (MTP1, May 2020, 2 marks) (MTP2, May 2021, 2 marks)</p> <p>Incorrect. As per SA 510, if the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor shall express a qualified opinion or a disclaimer of opinion, as appropriate, in accordance with SA 705</p>

Part III: Multiple Choice Questions

Q1.	<p>If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor shall express :</p> <p>(a) a disclaimer opinion (b) a qualified opinion (c) a qualified opinion or a disclaimer of opinion, as appropriate, in accordance with SA 705. (d) unmodified opinion</p> <p>(ICAI MCQs) (MTP2, May 2019, 1 Mark) (RTP, Nov 2019) (MTP1, May 2020, 2 Marks)</p> <p>Correct answer: (c) a qualified opinion or a disclaimer of opinion, as appropriate, in accordance with SA 705.</p>
Q2.	<p>If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances,</p>

- (a) the auditor shall express a qualified opinion in accordance with SA 705.
 (b) the auditor shall express a disclaimer of opinion in accordance with SA 705.
 (c) the auditor shall express a qualified opinion or adverse opinion, as appropriate, in accordance with SA 705.
 (d) the auditor shall express a qualified opinion or a disclaimer of opinion, as appropriate, in accordance with SA 705.
(MTP1, Nov 2019, 2 Marks)

Correct answer: (d) the auditor shall express a qualified opinion or a disclaimer of opinion, as appropriate, in accordance with SA 705

Explanation:

- If the auditor is unable to obtain SAAE regarding the opening balances, the auditor shall express a qualified opinion or a disclaimer of opinion, as appropriate, in accordance with SA 705
- If the auditor concludes that the opening balances contain a misstatement that materially affects the current period's FS, and the effect of the misstatement is not properly accounted for or not adequately presented or disclosed, the auditor shall express a qualified opinion or an adverse opinion, as appropriate.

SA 550 "Related Parties"

Part I : Descriptive Questions

Q1.	<p>Many related party transactions are in the normal course of business. However, the nature of related party relationships and transactions may, in some circumstances, give rise to higher risks of material misstatement of the financial statements than transactions with unrelated parties. Give few examples of such areas. (ICAI Study Material - Test Your Knowledge) (RTP, May 2020, NA)</p>
	<p>Many related party transactions are in the normal course of business. In such circumstances, they may carry no higher risk of material misstatement of the financial statements than similar transactions with unrelated parties. However, the nature of related party relationships and transactions may, in some circumstances, give rise to higher risks of material misstatement of the financial statements than transactions with unrelated parties.</p> <p>Example</p> <ul style="list-style-type: none"> • Related parties may operate through an extensive and complex range of relationships and structures, with a corresponding increase in the complexity of related party transactions. • Information systems may be ineffective at identifying or summarising transactions and outstanding balances between an entity and its related parties. • Related party transactions may not be conducted under normal market terms and conditions; for example, some related party transactions may be conducted with no exchange of consideration
Q2.	<p>How can an auditor verify the existence of related party relationships and transactions? (ICAI Study Material)</p> <p style="text-align: center;">OR</p> <p>The auditor has a responsibility to perform audit procedures to identify, assess and respond to the risks of material misstatement arising from the entity's failure to appropriately account for related party relationships, transactions or balances. During the audit, the auditor should maintain alertness for related party information while reviewing records and documents. He may inspect the records or documents that may provide information about related party relationships and transactions. Explain in detail with examples. (RTP, Nov 2021, NA)</p> <p style="text-align: center;">OR</p> <p>During the audit, the auditor should maintain alertness for related party information while reviewing records and documents. He may inspect the records or documents that may provide information about related party relationships and transactions. Explain in detail with examples. (MTP2, Nov 2023, 4 marks)</p> <p>During the audit, the auditor should maintain alertness for related party information while reviewing records and documents. He may inspect the following records or documents that may provide information about related party relationships and transactions, for example:</p> <ol style="list-style-type: none"> 1. Entity income tax returns. 2. Information supplied by the entity to regulatory authorities. 3. Documents associated with the entity's filings with a securities regulator e.g, prospectuses) 4. Statements of conflicts of interest from management and those charged with governance.

	<ol style="list-style-type: none"> 5. Contracts and agreements with key management or those charged with governance. 6. Significant contracts and agreements not in the entity's ordinary course of business. 7. Significant contracts re-negotiated by the entity during the period. 8. Specific invoices and correspondence from the entity's professional advisors. 9. Internal auditors' reports. 10. Shareholder registers to identify the entity's principal shareholders. 11. Life insurance policies acquired by the entity. 12. Records of the entity's investments and those of its pension plans.
Q3.	<p>P Ltd. is a company from a business group "ABCD" and is engaged in trading of garments. The promoters of the company are promoters and directors of some other group companies also. You have been appointed as an auditor of P Ltd. P Ltd has entered into various inter company transactions (within group companies) during the year which are outside its normal course of business. What will be your duties as an auditor in relation to those transactions? (SA, May 2022, 4 Marks)</p> <p>SA 550 "Related Parties" deals with the auditor's responsibilities regarding related party relationships and transactions when performing an audit of financial statements.</p> <p>For identified significant related party transactions outside the P Ltd.'s normal course of business, the auditor shall:</p> <ul style="list-style-type: none"> ● Inspect the underlying contracts or agreements, if any, and evaluate whether: <ul style="list-style-type: none"> ○ The business rationale (or lack thereof) of the transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets; ○ The terms of the transactions are consistent with management's explanations; and ○ The transactions have been appropriately accounted for and disclosed in accordance with the applicable financial reporting framework; and ● Obtain audit evidence that the transactions have been appropriately authorised and approved.

Part II: Correct/Incorrect Questions

Q1.	<p>All entities that are under common control by a state (i.e., national, regional or local government) are considered related party. (SA, Nov 2019, 2 marks)</p> <p>Incorrect. Entities that are under common control by a state (i.e., a national, regional or local government) are not considered related unless they engage in significant transactions or share resources to a significant extent with one another</p>
Q2.	<p>In the context of related parties, the potential effects of inherent limitations on the auditor's ability to detect material misstatements are greater. (SA, July 2021, 2 marks)</p> <p>Correct: In the context of related parties, the potential effects of inherent limitations on the auditor's ability to detect material misstatements are greater for such reasons as the following:</p> <ul style="list-style-type: none"> ● Management may be unaware of the existence of all related party relationships. ● Related party relationships may present a greater opportunity for collusion, concealment or manipulation by management.

Part III: Multiple Choice Questions

Q1.	<p>An auditor finds during course of an audit that the entity has entered into many related party transactions. Which of the following statements is true?</p> <ol style="list-style-type: none"> (a) The risk that management may override controls in respect of related party transactions is lower. (b) The risk that management may override controls in respect of related party transactions is higher. (c) There is no effect on the risk that management may override controls in respect of related party transactions. (d) Risk of overriding of controls by management has no relationship at all with related party transactions. <p>(ICAI Study Material - Test Your Knowledge)</p> <p>Correct answer: (b) The risk that management may override controls in respect of related party transactions is higher.</p>
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SA 520 “Analytical Procedures”

Part I : Descriptive Questions

Q1.	<p>An auditor of a company intends to apply analytical procedures for verifying revenue. Discuss any two analytical procedures which may be performed by auditor relating to revenues. (ICAI Study Material - Test Your Understanding)</p>																								
	<p>Analytical procedures in relation to revenue can include:-</p> <ul style="list-style-type: none"> • Comparing revenue of current year with previous year and investigating significant fluctuations • Comparing revenue of current year with budgeted targets and investigating significant fluctuations. 																								
Q2.	<p>CA Aarav wants to verify the payments made by XYZ Ltd. on account of building rent during the FY 2023-24. The rent amounts to ₹ 50,000/- per month for the year. The monthly rent payments are consistent with the rent agreement. However, the other companies in the similar industry are paying rent of ₹ 10,000/- per month for a similar location. How will applying the analytical procedures impact the verification process of such rental payments by XYZ Ltd.? (ICAI Study Material - Illustration) (MTP2, May 2021, 3 Marks)</p>																								
	<p>If CA Aarav checks in detail the monthly rent payments, he may find that such payments are consistent with the rent agreement i.e. XYZ Ltd. paid ₹ 50,000/- per month as rent and the same is getting reflected in the rent agreement. Here, CA Aarav may not be able to find out the inconsistency in the rent payment with respect to rent payment prevalent in the similar industry for rent of the similar location.</p> <p>If CA Aarav applies analytical procedure i.e. compares the rent payment by XYZ Ltd. with the similar payments made by companies in similar industry and similar area, he will notice an inconsistency in such rent payments as the other companies are paying a very less monthly rent in similar industry for similar area.</p> <p>However, if CA Aarav does not make such comparison and only checks the monthly payments and rent agreement of XYZ Ltd., he would not have found such inconsistency and as such the misstatement may remain undetected.</p>																								
Q3.	<p>Analytical procedure involves analysis of relationship among financial and nonfinancial data. Explain with the help of an example as to how, the statutory auditor of ABC Ltd. will analyse such relationship with respect to the total wages paid by ABC Ltd. during the FY 2023-24. (ICAI Study Material - Illustration)</p>																								
	<p>As per SA 520, Analytical Procedures means evaluations of financial information through analysis of plausible relationships among both financial and non-financial data. The following example explains the analysis of relationship between financial and non-financial data while applying analytical procedures.</p> <p>The statutory auditor of ABC Ltd. has to verify the total wages paid by the company having factories in various states. He can verify the same by analyzing the relationship between wages per worker and total number of workers across all the factories.</p> <p>i.e. Total wages = Wages per worker x Total number of workers.</p> <p>Here wages per worker is financial data i.e. in ₹ and total number of workers is a number which is a non financial data. Thus, the statutory auditor of ABC Ltd. is evaluating financial information i.e. total wages paid (in ₹) by analyzing the relationship between wages per worker (in ₹) which is financial data and number of workers which is a non financial data</p>																								
Q4.	<p>Enumerate various analytical procedures that can be used from below data:</p> <table border="1" data-bbox="188 1608 1024 1791"> <thead> <tr> <th rowspan="2">Particulars</th> <th colspan="2">Client</th> <th colspan="2">Industry</th> </tr> <tr> <th>2021-22</th> <th>2022-23</th> <th>2021-22</th> <th>2022-23</th> </tr> </thead> <tbody> <tr> <td>Year</td> <td>2021-22</td> <td>2022-23</td> <td>2021-22</td> <td>2022-23</td> </tr> <tr> <td>Inventory Turnover</td> <td>2.8</td> <td>2.9</td> <td>3.1</td> <td>2.8</td> </tr> <tr> <td>Gross Margin</td> <td>22.5%</td> <td>22.7%</td> <td>23.6%</td> <td>22.2%</td> </tr> </tbody> </table> <p>(ICAI Study Material - Illustration)</p>	Particulars	Client		Industry		2021-22	2022-23	2021-22	2022-23	Year	2021-22	2022-23	2021-22	2022-23	Inventory Turnover	2.8	2.9	3.1	2.8	Gross Margin	22.5%	22.7%	23.6%	22.2%
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	<ul style="list-style-type: none"> • Various methods may be used to perform analytical procedures. These methods range from performing simple comparisons to performing complex analyses using advanced statistical techniques. • Analytical procedures may be applied to consolidated financial statements, components and individual elements 																								

	<p>of information.</p> <ul style="list-style-type: none"> • Analytical Procedures may be segregated into the following major types: <ul style="list-style-type: none"> ○ comparison of client and industry data, ○ comparison of client data with similar prior period data, ○ comparison of client data with client-determined expected results, ○ comparison of client data with auditor-determined expected results and ○ comparison of client data with expected results, using non financial data.
Q5.	<p>Define Analytical Procedures. (ICAI Study Material - Test Your Knowledge)</p> <p>Meaning of Analytical Procedures:</p> <p>As per SA 520 "Analytical Procedures" the term "analytical procedures" means evaluations of financial information through analysis of plausible relationships among both financial and non-financial data. Analytical procedures also encompass such investigation as is necessary of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount.</p> <p>Thus, analytical procedures include the consideration of comparisons of the entity's financial information with as well as consideration of relationships.</p>
Q6.	<p>While applying the Substantive Analytical Procedures what techniques can be used by the statutory auditor of a company to obtain sufficient and appropriate audit evidence? (ICAI Study Material - Test Your Knowledge) (MTP1, May 2022, 4 marks) (RTP, May 2023, NA)</p> <p style="text-align: center;">OR</p> <p>Ratio analysis is useful for analysing asset and liability accounts as well as revenue and expense accounts. An individual balance sheet account is difficult to predict on its own, but its relationship to another account is often more predictable (e.g., the trade receivables balance related to sales). Explain stating the techniques available as substantive analytical procedures (RTP, May 2018, NA) (MTP1, Nov 2019, 3 Marks)</p> <p style="text-align: center;">OR</p> <p>Explain techniques available as substantive analytical procedures. (SA, May 2018, 5 Marks) (RTP, May 2019, NA) (SA, Jan 2021, 3 Marks)</p> <p style="text-align: center;">OR</p> <p>The design of a substantive analytical procedure is limited only by the availability of reliable data and the experience and creativity of the audit team. Explain clearly stating the techniques available as substantive analytical procedures. (MTP1, Nov 2018, 5 Marks) (RTP, May 2021, NA)</p> <p>Techniques available as substantive analytical procedures:</p> <ol style="list-style-type: none"> a) Trend analysis: Trend analysis is a commonly used technique. It is the comparison of current data with the prior period balance or with a trend in two or more prior period balances. The auditor evaluates whether the current balance of an account moves in line with the trend established with previous balances for that account, after adjusting for relevant factors responsible for changes b) Ratio analysis: Ratio analysis is useful for analysing asset and liability accounts as well as revenue and expense accounts. An individual balance sheet account is difficult to predict on its own, but its relationship to another account is often more predictable (e.g., the trade receivables balance related to sales). Ratios can also be compared over time or to the ratios of separate entities within the group, or with the ratios of other companies in the same industry. c) Reasonableness tests: Unlike trend analysis, this analytical procedure does not rely on events of prior periods, but uses non-financial data for the audit period under consideration (e.g., occupancy rates to estimate rental income or interest rates to estimate interest income or expense). These tests are generally more applicable to income statement accounts and certain accrual or prepayment accounts. d) Structural modelling: A modelling tool constructs a statistical model from financial and/or non-financial data of prior accounting periods to predict current account balances (e.g., linear regression). <p>The statutory auditor may use any of the above mentioned techniques while applying substantive analytical procedures depending upon the availability of data and requirements of the case.</p>
Q7.	<p>Explain how a statutory auditor of a company can apply analytical procedures at the planning phase of audit. (ICAI Study Material - Test Your Knowledge) (MTP2, Nov 2021, 3 Marks)</p>

	<p style="text-align: center;">OR</p> <p>In the planning stage, analytical procedures assist the auditor in understanding the client's business and in identifying areas of potential risk. Explain (RTP, Nov 2020, NA)</p> <p>Analytical Procedures in Planning the Audit</p> <ul style="list-style-type: none"> ● In the planning stage, analytical procedures assist the auditor in understanding the client's business and in identifying areas of potential risk by indicating aspects of and developments in the entity's business of which he was previously unaware. ● This information will assist the auditor in determining the nature, timing and extent of his other audit procedures. ● Analytical procedures in planning the audit use both financial data and non-financial information, such as number of employees, square feet of selling space, volume of goods produced and similar information. <ul style="list-style-type: none"> ○ For example, analytical procedures may help the auditor during the planning stage to determine the nature, timing and extent of audit procedures that will be used to obtain audit evidence for specific account balances or classes of transactions
Q8.	<p>The statutory auditor of MNO Ltd., CA Kishore identifies certain inconsistencies while applying analytical procedures to the financial and non financial data of MNO Ltd. What should CA Kishore do in this case with reference to SA 520 on "Analytical Procedures"? (ICAI Study Material - Test Your Knowledge)</p> <p>While performing analytical procedures on financial statements of ABC Ltd., auditor identifies fluctuations or relationships that are inconsistent with other relevant information and also that differs from expected values by a significant amount, the auditor seeks your advise as to how should he proceed (MTP2, May 2018, 5 marks)</p> <p style="text-align: center;">OR</p> <p>If analytical procedures performed in accordance with SA 520 identify fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, explain how would the auditor investigate such differences. (RTP, May 2019, NA) (RTP, May 2022, NA) (RTP, May 2023, NA) (MTP2, Nov 2023, 3 marks)</p> <p style="text-align: center;">OR</p> <p>The statutory auditor of ABC Ltd., CA Raj identifies certain inconsistencies while applying analytical procedures to the financial and non-financial data of ABC Ltd. With reference to SA 520 on "Analytical Procedures", how CA Raj shall investigate such differences? (SA, July 2021, 3 Marks)</p> <p>As per SA 520- "Analytical Procedures" If while applying analytical procedures in accordance with SA 520, the statutory auditor identifies fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, the auditor shall investigate such differences by:</p> <ol style="list-style-type: none"> i) Inquiring of management and obtaining appropriate audit evidence relevant to management's responses: Audit evidence relevant to management's responses may be obtained by evaluating those responses taking into account the auditor's understanding of the entity and its environment, and with other audit evidence obtained during the course of the audit. ii) Performing other audit procedures as necessary in the circumstances: The need to perform other audit procedures may arise when, for example, management is unable to provide an explanation, or the explanation, together with the audit evidence obtained relevant to management's response, is not considered adequate. <p>In the present case, the auditor identifies certain inconsistencies while applying analytical procedures to the financial and non financial data of the company. The auditor should inquire the management of the company and obtain sufficient and appropriate audit evidence relevant to management response. Further, the auditor should also perform other audit procedures if required in the circumstances of the case to obtain further sufficient and appropriate audit evidence.</p>
Q9.	<p>What are the factors that determine the extent of reliance that the auditor places on results of analytical procedures? Explain with reference to SA 520 on "Analytical procedures". (ICAI Study Material - Test Your Knowledge)</p> <p>The reliability of data is influenced by its source and nature and is dependent on the circumstances under which it is obtained. Accordingly, explain the factors that are relevant when determining whether data is reliable for purposes of designing substantive analytical procedures. (MTP1, May 2018, 5 marks) (MTP2, Nov 2018, 5 marks) (SA, May 2023, 3 marks)</p> <p style="text-align: center;">OR</p> <p>CA A, auditor of ABC Ltd. wants to design substantive analytical procedure and for that he wants to check whether the data is reliable or not. Mention the relevant points which he has to consider whether data is reliable for purpose of designing the substantive analytical procedures. (SA, Nov 2019, 3 Marks)</p>

	<p style="text-align: center;">OR</p> <p>Discuss with examples the factors that are relevant when determining whether data is reliable for purposes of designing substantive analytical procedures. (RTP, Nov 2022, NA)</p> <p>The reliability of data is influenced by its source and nature and is dependent on the circumstances under which it is obtained. Accordingly, the following are the relevant points while determining whether data is reliable for purposes of designing substantive analytical procedures:</p> <ul style="list-style-type: none"> ● Source of the information available. For example, information may be more reliable when it is obtained from independent sources outside the entity. ● Comparability of the information available. For example, broad industry data may need to be supplemented to be comparable to that of an entity that produces and sells specialized products. ● Nature and relevance of the information available. For example, whether budgets have been established as results to be expected rather than as goals to be achieved. ● Controls over the preparation of the information that are designed to ensure its completeness, accuracy and validity. For example, controls over the preparation, review and maintenance of budgets.
Q10.	<p>Analytical procedures use comparisons and relationships to assess whether account balances or other data appear reasonable. Explain stating the purpose of analytical procedures with examples. (RTP, May 2018, NA)</p> <p>Purpose of analytical procedures</p> <ul style="list-style-type: none"> ● Analytical procedures involve comparing and relating data to determine if data in the financial statements seems reasonable. ● These are helpful in the detection of unusual state of affairs and mistakes in accounts ● It will assist the auditor in identifying risks of material misstatement, especially risks of material misstatement due to fraud. ● Few Examples <ul style="list-style-type: none"> ○ Comparing Profit and Loss Statement balances of an entity with another similar entity in the same trade can reveal reasons for variations in profitability rates. ○ Comparing current Profit and Loss Statement balances with the previous period can identify reasons for profit increases or decreases over the years. ○ Establishing expense ratios from the Profit and Loss Statement and comparing them with previous years helps ascertain the extent of changes in expenditure relative to sales and trading profit's relation to sales. ○ The cost of importing goods subject to a uniform ad-valorem duty can be verified through the amount of duty paid. ○ The quantity of sugar sold by a mill can be independently verified through the amount of GST paid. ○ Income or expenses directly tied to profits or sales can be independently verified, like commission on net profits or sales percentage. The process of calculating ratios, trends, and comparisons is also known as analytical review.
Q11.	<p>Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time. Explain (RTP, Nov 2018, NA) (MTP2, May 2019, 4 Marks) (MTP2, May 2022, 4 marks)</p> <ul style="list-style-type: none"> ● Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time. ● The application of planned analytical procedures is based on the expectation that relationships among data exist and continue in the absence of known conditions to the contrary. However, the suitability of a particular analytical procedure will depend upon the auditor's assessment of how effective it will be in detecting a misstatement that, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated. ● In some cases, even an unsophisticated predictive model may be effective as an analytical procedure. <ul style="list-style-type: none"> ○ For example, where an entity has a known number of employees at fixed rates of pay throughout the period, it may be possible for the auditor to use this data to estimate the total payroll costs for the period with a high degree of accuracy, thereby providing audit evidence for a significant item in the financial statements and reducing the need to perform tests of details on the payroll. ● The use of widely recognised trade ratios (such as profit margins for different types of retail entities) can often be used effectively in substantive analytical procedures to provide evidence to support the reasonableness of recorded amounts.

Q12.	<p>Routine checks cannot be depended upon to disclose all the mistakes or manipulation that may exist in accounts, certain other procedures also have to be applied like trend and ratio analysis. Analyse and Explain stating clearly the meaning of analytical procedures (RTP, Nov 2019, NA)</p> <p>Routine checks cannot be depended upon to disclose all the mistakes or manipulation that may exist in accounts, certain other procedures also have to be applied like trend and ratio analysis in addition to reasonable tests. These collectively are known as overall tests. With the passage of tests, analytical procedures have acquired a lot of significance as substantive audit procedures. SA 520 on Analytical Procedures discusses the application of analytical procedures during an audit.</p> <p>Meaning of Analytical Procedures: As per SA 520 "Analytical Procedures" the term "analytical procedures" means evaluations of financial information through analysis of plausible relationships among both financial and non-financial data. Analytical procedures also encompass such investigation as is necessary of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount.</p>
Q13.	<p>Give examples of Analytical Procedures having consideration of comparisons of the entity's financial information (RTP, Nov 2019, NA)</p> <p>Examples of Analytical Procedures having consideration of comparisons of the entity's financial information with are:</p> <ul style="list-style-type: none"> ● Comparable information for prior periods. ● Anticipated results of the entity, such as budgets or forecasts, or expectations of the auditor, such as an estimation of depreciation. ● Similar industry information, such as a comparison of the entity's ratio of sales to accounts receivable with industry averages or with other entities of comparable size in the same industry
Q14.	<p>Explain the commonly used technique in the comparison of current data with the prior period balance or with a trend in two or more prior period balances. (RTP, May 2020, NA)</p> <ul style="list-style-type: none"> ● Trend analysis is the most commonly used technique which involves comparison of current data with the prior period balance or with a trend in two or more prior period balances. ● The auditor evaluates whether the current balance of an account moves in line with the trend established with previous balances for that account, or based on an understanding of factors that may cause the account to change. ● For example, the auditor may compare the rent paid by the company during the year under audit with the rent paid by the company for several earlier years. There may be some percentage increase in the rent expense over the years. However, an unusual increase in such expense amounts may indicate that fraudulent payments are being made
Q15.	<p>When designing and performing substantive analytical procedures, either alone or in combination with tests of details, as substantive procedures in accordance with SA 330, the auditor shall determine the suitability of particular substantive analytical procedures for given assertions, taking account of the assessed risks of material misstatement and tests of details, if any, for these assertions. Explain the other relevant points in this context. (RTP, May 2020, NA)</p> <p style="text-align: center;">OR</p> <p>Explain the aspects to be considered by an auditor when designing and performing substantive analytical procedures, either alone or in combination with test of details, as substantive procedures in accordance with SA 330. (RTP, Nov 2022, NA)</p> <p>When designing and performing substantive analytical procedures, either alone or in combination with tests of details, as substantive procedures in accordance with SA 330, the auditor shall:</p> <ul style="list-style-type: none"> ● Determine the suitability of particular substantive analytical procedures for given assertions, taking account of the assessed risks of material misstatement and tests of details, if any, for these assertions; ● Evaluate the reliability of data from which the auditor's expectation of recorded amounts or ratios is developed, taking account of source, comparability, and nature and relevance of information available, and controls over preparation; ● Develop an expectation of recorded amounts or ratios and evaluate whether the expectation is sufficiently precise to identify a misstatement that, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated; and ● Determine the amount of any difference of recorded amounts from expected values that is acceptable without further investigation.

Q16.	<p>The decision about which audit procedures to perform, including whether to use substantive analytical procedures, is based on the auditor's judgment. Explain (RTP, Nov 2020, NA)</p> <p>Use of substantive analytical procedures:</p> <ul style="list-style-type: none"> • The substantive procedures at the assertion level may be tests of details, substantive analytical procedures, or a combination of both. • The decision about which audit procedures to perform, including whether to use substantive analytical procedures, is based on the auditor's judgment about the expected effectiveness and efficiency of the available audit procedures to reduce audit risk at the assertion level to an acceptably low level. • The auditor may inquire of management as to the availability and reliability of information needed to apply substantive analytical procedures, and the results of any such analytical procedures performed by the entity. It may be effective to use analytical data prepared by management, provided the auditor is satisfied that such data is properly prepared.
Q17.	<p>With respect to SA 520 "Analytical procedures", explain the following factors to be considered by the auditor for substantive audit procedures. (i) Account type (ii) Predictability (iii) Nature of Assertion (SA, Nov 2020, 3 Marks)</p> <p>The auditor should consider the following factors for Substantive Audit Procedures:</p> <ul style="list-style-type: none"> • Account Type: Substantive analytical procedures are more useful for certain types of accounts than for others. Income statement accounts tend to be more predictable because they reflect accumulated transactions over a period, whereas balance sheet accounts represent the net effect of transactions at a point in time or are subject to greater management judgment. • Predictability: Substantive analytical procedures are more appropriate when an account balance or relationships between items of data are predictable (e.g., between sales and cost of sales or between trade receivables and cash receipts). A predictable relationship is one that may reasonably be expected to exist and continue over time. • Nature of Assertion: Substantive analytical procedures may be more effective in providing evidence for some assertions (e.g., completeness or valuation) than for others (e.g., rights and obligations). Predictive analytical procedures using data analytics can be used to address completeness, valuation/ measurement and occurrence.
Q18.	<p>For the purposes of the SAs, the term "analytical procedures" means evaluations of financial information through analysis of plausible relationships among both financial and non-financial data. Explain giving examples of both. (RTP, Nov 2021, NA)</p> <p>Analytical procedures include the consideration of comparisons of the entity's financial information with</p> <ul style="list-style-type: none"> • Comparable information for prior periods. • Anticipated results of the entity, such as budgets or forecasts, or expectations of the auditor, such as an estimation of depreciation. • Similar industry information, such as a comparison of the entity's ratio of sales to accounts receivable with industry averages or with other entities of comparable size in the same industry. <p>Analytical procedures also include consideration of relationships</p> <ul style="list-style-type: none"> • Among elements of financial information that would be expected to conform to a predictable pattern based on the entity's experience, such as gross margin percentages. • Between financial information and relevant non-financial information, such as payroll costs to number of employees.
Q19.	<p>Whether it is possible to independently verify the correctness of some of the items of expenses included in the statement of profit and loss? Explain with the help of some examples. (SA, Dec 2021, 3 Marks)</p> <ul style="list-style-type: none"> • Often it is possible to independently verify the correctness of some of the items of expenses included in the Statement of Profit and Loss. • For instance, the cost of importing goods which are subjected to an ad-valorem duty at uniform rate can be verified from the amount of duty paid. Similarly, a quantity of sugar sold by a sugar mill can be verified independently from the amount of excise duty/ GST paid. • Similarly, the amount of any income or expenses which has a direct relationship with the amount of profits or that

	<p>of sales can be verified independently, e.g., commission paid to a manager calculated on the basis of net profits, commission paid to a selling agent as percentage of sales, etc. Such calculation of ratios, trends and comparisons is also termed as analytical review.</p> <ul style="list-style-type: none"> Thus, it is important to note that Analytical procedures may help identify the existence of unusual transactions or events, and amounts, ratios, and trends that might indicate matters that have audit implications. Unusual or unexpected relationships that are identified may assist the auditor in identifying risks of material misstatement, especially risks of material misstatement due to fraud.
Q20.	<p>Discuss the matters relevant to the auditor's evaluation of whether the expectation can be developed sufficiently precisely to identify a misstatement that, when aggregated with other misstatements, may cause the financial statements to be materially misstated. (RTP, May 2022, NA)</p> <p>Matters relevant to the auditor's evaluation of whether the expectation can be developed sufficiently precisely to identify a misstatement that, when aggregated with other misstatements, may cause the financial statements to be materially misstated, include:</p> <ul style="list-style-type: none"> The accuracy with which the expected results of substantive analytical procedures can be predicted. For example, the auditor may expect greater consistency in comparing gross profit margins from one period to another than in comparing discretionary expenses, such as research or advertising. The degree to which information can be disaggregated. For example, substantive analytical procedures may be more effective when applied to financial information on individual sections of an operation or to financial statements of components of a diversified entity, than when applied to the financial statements of the entity as a whole. The availability of the information, both financial and non-financial. For example, the auditor may consider whether financial information, such as budgets or forecasts, and non-financial information, such as the number of units produced or sold, is available to design substantive analytical procedures. If the information is available, the auditor may also consider the reliability of the information.
Q21.	<p>Tree Limited presented its financial statements for the F.Y. 2022-2023 to its auditor for expressing an opinion thereon. The auditor while carrying out the audit started comparing various items of profit and loss account of the year under audit with previous financial years. What is auditor trying to achieve by carrying out those comparisons? (SA, May 2022, 4 Marks) (RTP, Nov 2023, NA)</p> <p>Purpose of Applying Analytical Procedure: Analytical procedures use comparisons and relationships to assess whether account balances or other data appear reasonable. The auditor of Tree Ltd. would achieve the following by carrying out the comparison stated in the question:</p> <ul style="list-style-type: none"> If balances included in the Statement of Profit and Loss of an entity are compared with those contained in the Statement of Profit and Loss with that of the previous period, it would be possible to find out the reasons for increase or decrease in the amount of profits of those years. By setting up certain expenses' ratios on the basis of balances included in the Statement of Profit and Loss, for the year under audit, comparing them with the same ratios for the previous year, it is possible to ascertain the extent of increase or decrease in various items of expenditure in relation to sales and that of trading profit in relation to sales. If differences are found to be material, the auditor would ascertain the reasons thereof and assess whether the accounts have been manipulated to inflate or suppress profits. It would be possible to identify the existence of unusual transactions, amounts, ratios and trends that might indicate matters that have audit implications.
Q22.	<p>As per the Standard on Auditing (SA) 520 "Analytical Procedures", what are the examples of analytical procedures having consideration of relationships? (SA, Nov 2022, 3 marks)</p> <p>Examples of Analytical Procedure having consideration of relationship: As per the Standard on Auditing (SA) 520 "Analytical Procedures", examples of Analytical Procedures having consideration of relationships are:</p> <ul style="list-style-type: none"> Among elements of financial information that would be expected to conform to a predictable pattern based on the entity's experience, such as gross margin percentages. Between financial information and relevant non-financial information, such as payroll costs to number of employees.
Q23.	<p>When designing and performing substantive analytical procedures, either alone or in combination with tests of details as</p>

substantive procedures in accordance with SA 330, the auditor shall determine the suitability of particular substantive analytical procedures for given assertions, taking account of the assessed risks of material misstatement and tests of details, if any, for these assertions. Discuss. (RTP, Nov 2023, NA)

- Substantive analytical procedures are generally **more applicable to large volumes of transactions** that tend to be predictable over time.
 - The application of planned analytical procedures is based on the expectation that relationships among data exist and continue in the absence of known conditions to the contrary.
 - However, the suitability of a particular analytical procedure will depend upon the **auditor's assessment** of how **effective** it will be in **detecting a misstatement** that, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated.
 - In some cases, even an **unsophisticated predictive model** may be effective as an analytical procedure.
- **Different types of analytical procedures provide different levels of assurance.**
 - For example, prediction of total rental income on a building divided into apartments, taking the rental rates, the number of apartments and vacancy rates into consideration, can provide persuasive evidence and may eliminate the need for further verification by means of tests of details, provided the elements are appropriately verified.
 - In contrast, calculation and comparison of gross margin percentages as a means of confirming a revenue figure may provide less persuasive evidence, but may provide useful corroboration if used in combination with other audit procedures.
- The determination of the suitability of particular substantive analytical procedure is influenced by the **nature** of the **assertion** and the auditor's assessment of the **risk of material misstatement**.
 - For example, if controls over sales order processing are weak, the auditor may place more reliance on tests of details rather than on substantive analytical procedures for assertions related to receivables.
- Particular substantive analytical procedures may also be considered suitable when tests of details are performed on the same assertion.
 - For example, when obtaining audit evidence regarding the valuation assertion for accounts receivable balances, the auditor may apply analytical procedures to an aging of customers' accounts in addition to performing tests of details on subsequent cash receipts to determine the collectability of the receivables.

Part II: Correct/Incorrect Questions

Q1.	As per the Standard on Auditing (SA) 520 "Analytical Procedures" "the term "analytical procedures" means evaluations of financial information through analysis of plausible relationships among financial data only. (ICAI Study Material - Test Your Knowledge)
	Incorrect. As per the Standard on Auditing (SA) 520 "Analytical Procedures" the term "analytical procedures" means evaluations of financial information through analysis of plausible relationships among both financial and non-financial data.
Q2.	Auditor can depend on routine checks to disclose all the mistakes or manipulation that may exist in accounts. (ICAI Study Material - Test Your Knowledge)
	OR
	During the audit process, the auditor can easily identify all mistakes or manipulations that may exist in the accounts through routine checking processes. (SA, May 2018, 2 marks)
	Incorrect. Routine checks cannot be depended upon to disclose all the mistakes or manipulation that may exist in accounts, certain other procedures also have to be applied like trend and ratio analysis in addition to reasonable tests.
Q3.	Only purpose of analytical procedures is to obtain relevant and reliable audit evidence when using substantive analytical procedures. (ICAI Study Material - Test Your Knowledge)
	Incorrect. Analytical procedures use comparisons and relationships to assess whether account balances or other data appear reasonable. Analytical procedures are used for the following purposes: <ul style="list-style-type: none"> ● To obtain relevant and reliable audit evidence when using substantive analytical procedures; and ● To design and perform analytical procedures near the end of the audit that assist the auditor when forming an overall conclusion as to whether the financial statements are consistent with the auditor's understanding of the entity

Q4.	<p>Analytical Procedures are required in the planning phase only. (ICAI Study Material - Test Your Knowledge)</p> <p>Incorrect. Analytical Procedures are required in the planning phase and it is often done during the testing phase. In addition these are also required during the completion phase.</p>
Q5.	<p>Substantive analytical procedures are generally less applicable to large volumes of transactions that tend to be predictable over time. (ICAI Study Material - Test Your Knowledge) (MTP1, Nov 2018, 2 marks)</p> <p>Incorrect. Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time.</p>
Q6.	<p>Ratio analysis is useful in analyzing revenue and expense account only (ICAI Study Material - Test Your Knowledge)</p> <p>Incorrect. Ratio analysis is useful for analysing asset and liability accounts as well as revenue and expense accounts</p>
Q7.	<p>Reasonableness test rely only on the events of the prior period like other analytical procedures. (ICAI Study Material - Test Your Knowledge)</p> <p>Incorrect. Unlike trend analysis, Reasonableness test does not rely on events of prior periods, but upon non-financial data for the audit period under consideration</p>
Q8.	<p>The statutory auditor of the company can apply analytical procedures to the standalone financial statements of a company only and not to the consolidated financial statements. (ICAI Study Material - Test Your Knowledge)</p> <p>Incorrect. Analytical procedures may be applied to consolidated financial statements, components and individual elements of information.</p>
Q9.	<p>A modelling tool constructs a statistical model from financial data only of prior accounting periods to predict current account balances. (MTP1, May 2018, 2 marks) (MTP1, May 2019, 2 marks)</p> <p>Incorrect. A modelling tool constructs a statistical model from financial and/or non-financial data of prior accounting periods to predict current account balances (e.g., linear regression).</p>
Q10.	<p>When we are designing audit procedures to address an inherent risk or “what can go wrong”, we consider the nature of the risk of material misstatement in order to determine if a substantive analytical procedure can be used to obtain audit evidence. (MTP1, May 2018, 2 marks) (MTP1, May 2019, 2 marks)</p> <p style="text-align: center;">OR</p> <p>When we are designing audit procedures to address an inherent risk or “what can go wrong”, we consider the nature of the risk of material misstatement. (RTP, Nov 2020, NA)</p> <p>Correct. When we are designing audit procedures to address an inherent risk or “what can go wrong”, we consider the nature of the risk of material misstatement in order to determine if a substantive analytical procedure can be used to obtain audit evidence. When inherent risk is higher, we may design tests of details to address the higher inherent risk. When significant risks have been identified, audit evidence obtained solely from substantive analytical procedures is unlikely to be sufficient</p>
Q11.	<p>Ratio analysis is a commonly used technique in the comparison of current data with the prior period balance or with a trend in two or more prior period balances. (MTP2, Nov 2018, 2 marks)</p> <p>Incorrect. Trend analysis is the most commonly used technique in the comparison of current data with the prior period balance or with a trend in two or more prior period balances. The auditor evaluates whether the current balance of an account moves in line with the trend established with previous balances for that account, after adjusting for relevant factors responsible for changes. Ratio analysis is useful for analysing asset and liability accounts as well as revenue and expense accounts.</p>
Q12.	<p>When we are designing audit procedures to address an inherent risk or “what can go wrong”, we do not consider the nature of the risk of material misstatement in order to determine if a substantive analytical procedure can be used to obtain audit evidence. (MTP2, Nov 2018, 2 marks)</p>

	Incorrect. When we are designing audit procedures to address an inherent risk or “what can go wrong”, we consider the nature of the risk of material misstatement in order to determine if a substantive analytical procedure can be used to obtain audit evidence. When inherent risk is higher , we may design tests of details to address the higher inherent risk. When significant risks have been identified, audit evidence obtained solely from substantive analytical procedures is unlikely to be sufficient
Q13.	The auditor's substantive procedure at the assertion level means substantive analytical procedures only. (SA, Nov 2019, 2 Marks)
	Incorrect. The auditor's substantive procedures at the assertion level may be tests of details , substantive analytical procedures, or a combination of both. The decision about which audit procedures to perform, including whether to use substantive analytical procedure, is based on the auditor's judgment about the expected effectiveness and efficiency of the available audit procedures to reduce audit risk at the assertion level to an acceptably low level.
Q14.	In the planning stage, analytical procedures would not in any way assist the auditor. (RTP, May 2020, NA)
	Incorrect. In the planning stage, analytical procedures assist the auditor in understanding the client's business and in identifying areas of potential risk by indicating aspects of and developments in the entity's business of which he was previously unaware. This information will assist the auditor in determining the nature , timing and extent of his other audit procedures . Analytical procedures in planning the audit use both financial data and non-financial information, such as number of employees, square feet of selling space, volume of goods produced and similar information
Q15.	If an entity has a known number of employees at fixed rates of pay throughout the period, there would be more need to perform tests of details on the payroll. (RTP, Nov 2020, NA)
	Incorrect. If an entity has a known number of employees at fixed rates of pay throughout the period, it may be possible for the auditor to use this data to estimate the total payroll costs for the period with a high degree of accuracy, thereby providing audit evidence for a significant item in the financial statements and reducing the need to perform tests of details on the payroll.
Q16.	SA 520 deals with the auditor's use of analytical procedures as substantive procedures (“substantive analytical procedures”), and as procedures near the end of the audit, that assist the auditor in preparation of the financial statements. (SA, May 2022, 2 Marks)
	Incorrect. SA 520 deals with the auditor's use of analytical procedures as substantive procedures (“substantive analytical procedures”), and as procedures near the end of the audit that assist the auditor when forming an overall conclusion on the financial statements.
Q17.	The term “Analytical Procedures” means evaluation of financial information through analysis of plausible relationships among financial data and non-financial data. (SA, Nov 2022, 2 marks)
	Correct. As per SA 520 “Analytical Procedures”, the term “analytical procedures” means evaluations of financial information through analysis of plausible relationships among both financial and non-financial data. Analytical procedures also encompass such investigation as is necessary of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount
Q18.	Analytical procedures are used in all stages of audit by experienced auditors. (SA, May 2023, 2 marks)
	Correct. Experienced auditors use analytical procedures in all stages of the audit. Analytical Procedures are required in the planning phase and it is often done during the testing phase. In addition these are also required during the completion phase.

Part III: Multiple Choice Questions

Q1.	What are analytical procedures? (a) Substantive tests designed to assess control risk (b) Substantive tests designed to evaluate the validity of management's representation letter (c) Substantive tests designed to study relationships between financial and non-financial data
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	<p>(d) All of the above (Sample MCQs) (ICAI MCQs)</p> <p>Correct answer: (c) Substantive tests designed to study relationships between financial and non-financial data Explanation: As per SA 520, the term “analytical procedures” means evaluations of financial information through analysis of plausible relationships among both financial and non-financial data</p>
Q2.	<p>Analytical procedures issued in the planning stage of an audit, generally:</p> <p>(a) helps to determine the nature, timing and extent of other audit procedures (b) directs attention to potential risk areas (c) indicates important aspects of business (d) All of the above (Sample MCQs) (ICAI MCQs)</p> <p>Correct answer: (d) All of the above Explanation: Analytical procedures may help the auditor during the planning stage to determine NTE of audit procedures that will be used to obtain audit evidence for specific account balances or classes of transactions. Also, analytical procedures assist the auditor in understanding the client’s business and in identifying areas of potential risk by indicating aspects of and developments in the entity’s business of which he was previously unaware.</p>
Q3.	<p>Statement 1: Analytical procedures are more useful while conducting the audit and at the completion phase and are of no use at the planning stage. Statement 2: In the planning stage, audit procedures assist the auditor in understanding the client’s business and identifying the areas of potential risks.</p> <p>(a) Statement 1 & 2 are correct (b) Statement 1 & 2 are incorrect (c) Only Statement 1 is correct (d) Only Statement 2 is correct (ICAI MCQs)</p> <p>Correct answer: (d) Only Statement 2 is correct Explanation: Statement 1 is incorrect. Analytical procedures can be used in all the stages of the audit (planning, testing and completion)</p> <ul style="list-style-type: none"> Analytical procedures can be a part of the planning process. For example : During the planning process, current year financial statements can be compared with last year financial statements and changes can be determined. In case of any major variations in a specific area (say fixed assets) the auditor can put more focus on that area while conducting the audit. Analytical procedures can be often done during the testing phase (Execution stage) Analytical procedures can be applied in many areas. For example : an increase in sales can be compared with an increase in packaging expenditure, production and power and fuel expenditure. Analytical procedures are also required during the completion phase (Reporting stage). For example : During the reporting stage, company’s data can be compared with industry data.
Q4.	<p>Marvin Ltd. is a renowned food chain supplier in a posh area providing restaurant facility along with food delivering. CA. Felix was appointed as an auditor of the company for the Financial Year 2023-24. While examining the books of accounts of the company, CA. Felix came to know about one of the major expenses of the company i.e. rent expense of ₹ 1,20,000 per month, for which he applied substantive analytical procedure for verification purpose. Explain, how would CA. Felix performs a substantive analytical procedure in the given scenario?</p> <p>(a) CA. Felix would inspect every single rent invoice per month of ₹ 1,20,000 and verify other elements appropriately. (b) CA. Felix would compare the rental expense of the company with that of another nearby company having corresponding dimensions, for high degree of accuracy. (c) CA. Felix would select the first month rent invoice of ₹ 1,20,000 and appropriately verifying other elements would predict that the rent for the whole year would be ₹ 14,40,000 (i.e. ₹ 1,20,000 * 12). Thereafter, he would compare the actuals with his prediction and follow-up for any fluctuation. (d) (a) and (b), both. (Sample MCQs) (RTP, May 2019, NA)</p>

	<p>Correct answer: (c) CA. Felix would select the first month rent invoice of ₹ 1,20,000 and appropriately verifying other elements would predict that the rent for the whole year would be ₹ 14,40,000 (i.e. ₹ 1,20,000 * 12). Thereafter, he would compare the actuals with his prediction and follow-up for any fluctuation.</p>
Q5.	<p>The basic assumption underlying the use of analytical procedures is:</p> <p>(a) It helps the auditor to study relationship among elements of financial information (b) Relationship among data exist and continue in the absence of known condition to the contrary (c) Analytical procedures will not be able to detect unusual relationships (d) None of the above</p> <p>(ICAI MCQs)</p>
	<p>Correct answer: (b) Relationship among data exist and continue in the absence of known condition to the contrary Explanation: The application of planned analytical procedures is based on the expectation that relationships among data exist and continue in the absence of known conditions to the contrary.</p>
Q6.	<p>Which of the following is not an analytical procedure?</p> <p>(a) Tracing of purchases recurred in the purchase book to purchase invoices. (b) Comparing aggregate wages paid to number of employees (c) Comparing the actual costs with standard costs (d) All of them are analytical procedure</p> <p>(Sample MCQs) (ICAI MCQs) (MTP1, Nov 2019, 1 Mark)</p>
	<p>Correct answer: (a) Tracing of purchases recurred in the purchase book to purchase invoices. Explanation:</p> <ul style="list-style-type: none"> Tracing purchases recorded in the purchase book to purchase invoices is not an analytical procedure; this is a substantive procedure used in audit testing to verify the completeness and accuracy of recorded transactions. Analytical procedures, on the other hand, involve the evaluation of financial information through analysis of plausible relationships and trends in data. Options (b) and (c) are examples of analytical procedures:
Q7.	<p>Auditor Compares Gross Profit Ratio with that of Previous year and it is discovered that there has been a fall in the ratio. This is an example of :</p> <p>(a) Analytical Procedure (b) Test of Controls (c) Walk Through Test (d) Audit Sampling</p> <p>(ICAI MCQs) (RTP, Nov 2020, NA) (MTP2, May 2022, 1 mark) (MTP2, May 2023, 1 mark)</p>
	<p>Correct answer: (a) Analytical Procedure</p>
Q8.	<p>When significant risk had been identified by the auditor, then:</p> <p>(a) Audit evidence obtained solely from substantive analytical procedures is sufficient. (b) Audit evidence obtained solely from substantive analytical procedures is unlikely to be sufficient. (c) Auditor will perform test of details also. (d) Both b and c</p> <p>(ICAI MCQs)</p>
	<p>Correct answer: (d) Both b and c Explanation: When we are designing audit procedures to address an inherent risk or "what can go wrong", we consider the nature of the risk of material misstatement in order to determine if a SAP can be used to obtain audit evidence. When inherent risk is higher, we may design tests of details to address the higher inherent risk. When significant risks have been identified, audit evidence obtained solely from SAP is unlikely to be sufficient.</p>
Q9.	<p>_____ is the comparison of current data with the prior period balance.</p> <p>(a) Ratio Analysis (b) Trend analysis</p>

	<p>(c) Reasonableness test (d) Structural Modelling (ICAI MCQs)</p>
	<p>Correct answer: (b) Trend analysis Explanation: In trend analysis, the auditor evaluates whether the current balance of an account moves in line with the trend established with previous balances for that account, after adjusting for relevant factors responsible for changes. It is the comparison of current data with the prior period balance or with a trend in two or more prior period balances.</p>
Q10.	<p>Which of the following statement is correct :</p> <p>(a) Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time (b) Substantive analytical procedures are generally less applicable to large volumes of transactions that tend to be predictable over time (c) Substantive analytical procedures are generally more applicable to small volumes of transactions that tend to be predictable over time (d) All statements are correct (Sample MCQs)</p> <p style="text-align: center;">OR</p> <p>Which of the following statement is correct :</p> <p>(a) Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time (b) Substantive analytical procedures are generally less applicable to large volumes of transactions that tend to be predictable over time (c) Substantive analytical procedures are generally more applicable to small volumes of transactions that tend to be predictable over time (d) None of the above (RTP, Nov 2019, NA)</p>
	<p>Correct answer: (a) Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time</p>
Q11.	<p>Substantive Analytical Procedures are generally more applicable to:</p> <p>(a) Large volumes of transactions. (b) Transactions predictable over time (c) Both a and b (d) None of a and b (ICAI MCQs)</p>
	<p>Correct answer: (c) Both a and b Explanation: Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time.</p>
Q12.	<p>What is the primary objective of analytical procedures used in the overall review stage of an audit?</p> <p>(a) To help to corroborate the conclusions drawn from individual components of financial statements (b) To reduce specific detection risk (c) To direct attention to potential risk areas (d) To satisfy doubts when questions arise about a client's ability to continue. (ICAI MCQs)</p>
	<p>Correct answer: (a) To help to corroborate the conclusions drawn from individual components of financial statements Explanation: The conclusions drawn from the results of analytical procedures designed and performed in accordance with, are intended to corroborate conclusions formed during the audit of individual components or elements of the financial statements. This assists the auditor to draw reasonable conclusions on which to base the auditor's opinion.</p>
Q13.	<p>Which of the following is correct :</p>

	<p>(a) As per the Standard on Auditing (SA) 520 "Analytical Procedure" the term "analytical procedures" means evaluations of financial information through analysis of financial data.</p> <p>(b) As per the Standard on Auditing (SA) 520 "Analytical Procedure" the term "analytical procedures" means evaluations of financial information through analysis of non-financial data.</p> <p>(c) As per the Standard on Auditing (SA) 520 "Analytical Procedure" the term "analytical procedures" means evaluations of financial information through analysis of plausible relationships among both financial and non-financial data.</p> <p>(d) As per the Standard on Auditing (SA) 520 "Analytical Procedure" the term "analytical procedures" means evaluations of financial information through ratio analysis.</p> <p>(MTP1, May 2019, 1 Mark)</p>
	<p>Correct answer: (c) As per the Standard on Auditing (SA) 520 "Analytical Procedure" the term "analytical procedures" means evaluations of financial information through analysis of plausible relationships among both financial and non-financial data.</p>
Q14.	<p>which of the following is correct :</p> <p>(a) Different types of analytical procedures provide different levels of assurance.</p> <p>(b) Different types of analytical procedures provide similar levels of assurance.</p> <p>(c) Similar type of analytical procedures provide different levels of assurance.</p> <p>(d) All are correct</p> <p>(MTP1, Nov 2019, 2 Marks)</p>
	<p>Correct answer: (a) Different types of analytical procedures provide different levels of assurance.</p>
Q15.	<p>Which of the following is not an example of Analytical Procedures having consideration of comparisons of the entity's financial information:</p> <p>(a) Comparable information for prior periods.</p> <p>(b) Anticipated results of the entity, such as budgets or forecasts, or expectations of the auditor, such as an estimation of depreciation.</p> <p>(c) Similar industry information, such as a comparison of the entity's ratio of sales to accounts receivable with industry averages or with other entities of comparable size in the same industry.</p> <p>(d) Among elements of financial information that would be expected to conform to a predictable pattern based on the entity's experience, such as gross margin percentages.</p> <p>(RTP, May 2020, NA)</p>
	<p>Correct answer: (d) Among elements of financial information that would be expected to conform to a predictable pattern based on the entity's experience, such as gross margin percentages.</p> <p>Explanation:</p> <ul style="list-style-type: none"> • Among elements of financial information that would be expected to conform to a predictable pattern based on the entity's experience, such as gross margin percentages is an example of Analytical Procedures having consideration of relationships • Comparable information for prior periods, Anticipated results of the entity and Similar industry information are examples of analytical Procedures having consideration of comparisons of the entity's financial information
Q16.	<p>Statement I As per the Standard on Auditing (SA) 520 "Analytical Procedures", the term "analytical procedures" means evaluations of financial information through analysis of plausible relationships among financial data.</p> <p>Statement II Analytical procedures also encompass such investigation as is necessary of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount.</p> <p>(a) Only Statement I is correct</p> <p>(b) Only Statement II is correct</p> <p>(c) Both statements are correct</p> <p>(d) Both Statements are incorrect</p> <p>(RTP, May 2020, NA) (MTP2, May 2022, 1 mark) (MTP1, Nov 2022, 1 Mark)</p>
	<p>Correct answer: (b) Only Statement II is correct</p> <p>Explanation: Statement 1 is incorrect. As per "SA 520 Analytical Procedures", the term "analytical procedures" means evaluations of financial information through analysis of plausible relationships among both financial and non-financial data.</p>

Q17.	<p>_____ implies analysing account fluctuations by comparing current year to prior year information and, also, to information derived over several years.</p> <p>(a) Trend analysis (b) Ratio analysis (c) Structural modelling (d) Account fluctuations analysis</p> <p>(MTP1, May 2022, 1 mark)</p>
	<p>Correct answer: (a) Trend analysis</p> <p>Explanation: Trend analysis implies analysing account fluctuations by comparing current year to prior year information and, also, to information derived over several years. For example, the auditor may compare the salary paid by the company during the year under audit with the salary paid by the company for several earlier years. An unusual increase in such expense amount may indicate that fraudulent payments are being made to fake employees</p>
Q18.	<p>The auditor of Vishwas Ltd wants to know from you which of the following methods are analytical procedures</p> <p>I. Comparison of client and industry data II. Comparison of client data with similar prior period data III. Comparison of client data with client-determined expected results IV. Comparison of client data with auditor-determined expected results</p> <p>(a) I, II and III only (b) I &, II only (c) III &, IV only (d) I, II, III and IV</p> <p>(MTP1, Nov 2022, 1 Mark)</p>
	<p>Correct answer: (d) I, II, III and IV</p> <p>Explanation: Analytical Procedures may be segregated into the following major types - comparison of client and industry data, comparison of client data with similar prior period data, comparison of client data with client-determined expected results, comparison of client data with auditor-determined expected results and comparison of client data with expected results, using non financial data.</p>