

CH4
AUDIT EVIDENCE (V.V. 2012)

-> Auditing is a logical process
-> Auditor is called to assess actualities of situation
-> give expert opinion
-> has to check fr objectively

- SA500 ✓
- SA505 ✓
- SA506 ✓
- SA507 ✓
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- SA540 ✓

-> Auditor need evidence to obtain info for accounting at judgement

-> critical examination
-> scrutiny
-> check whether giving issue and fair view of fr

SA500 objective of auditor

- > To perform audit procedures in such a way to enable auditor to obtain sufficient appropriate audit evidence
- > To draw reasonable conclusion on which to base the auditor's opinion

Meaning of audit evidence

-> Audit evidence is the information by using which the conclusions of audit drawn and auditor's opinion based
-> It includes fr and other information
-> accounting records info.

Info included in accounting records

- > Initial accounting entries
- > supporting records
- > invoices
- > contracts
- > journal entries, subsidiary ledger, work sheet, etc.

Other info

- > Minutes
- > written confirmation
- > manual controlling details of internal controls.

Types of audit evidence

↓
Depending on nature

- Physical
- Verbal
- Documentary

↓
depending on source

- Internal
- External

Depending upon nature

Visual: evidence in form of observation
ex: inventory count observation
Verbal: evidence having no physical existence
ex: Discussions with management and

Documentary: form of written doc.
ex: sales invoice, purchase invoice etc.

Depending upon source

Internal: evidence originated within the organization. less reliable as compared to external evidence.

Ex: sales invoice, sales challan, goods received note, inspection report... etc.

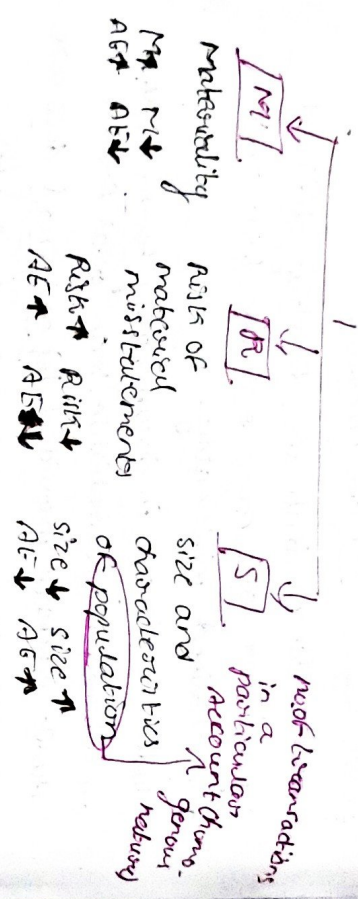
External: originated from outside the client's organization. More reliable than internal evidence.
ex: purchase invoice

Points to remember:

- Auditor should be careful before having reliance on such evidence in case of internal evidence because there are possibilities of manipulation and creation of false and misleading evidence.
 - In case of external evidence as its from outside the entity, normally third party doesn't have any interest to manipulate the entity's information. If auditor want to doubt the independence of any third party should exercise greater vigilance. in that matter.
 - As a ordinary rule,
 - auditor should try to match internal and external evidence as far as possible.
 - When external evidences are not available then try to match the internal evidences.
- ### Relevance and Reliability of audit evidence:
- #### Reliability
- Reliability of audit evidence depends on Source, nature of audit evidence and under which circumstances it was obtained and includes the control over preparation
 - Generalization of Reliability
 - Reliability increases when audit evidence is obtained from independent sources outside the entity.

- The reliability of audit evidence that is generated internally is increased when the related controls are effective.
 - Audit evidences that are directly obtained by auditor are more reliable but which are obtained indirectly.
 - Audit evidences in documentary form are considered more reliable than oral forms.
 - Audit evidence provided by original documents more reliable than photocopies, facsimiles.
- ### Appropriateness talks about quantity of evidence i.e. Relevance and Reliability.
- ### Sufficiency talks about the quantity of audit evidence.
- Audit evidences are cumulative in nature.
 - Include previous audit's information and audit evidence.
 - audit evidence consists of accounting info as well as other info.
 - audit evidence consists of both information and which supports the management's assertions and which corrects which contradicts.
 - Sometimes in some cases, absence of info will also act as audit evidence.
 - Auditor works mostly to obtain on and evaluate audit evidence to form an opinion.

Factors affecting auditor's judgment as to sufficiency of audit evidence



Assertions → Mgmt proposes IS

- Completeness - occurrence of transactions
- existence of Assets and liabilities
- Rights & obligation

Audit procedures to obtain audit evidence

- Inspection: examine records and docs, whether they may be internal, or external, e-form or physically paper form.
- Inspection of such docs may not necessarily provide audit evidence about ownership and value.
- Inspection of tangible assets gives audit evidence of existence.
- Observation: means looking at a process or procedures being performed by others. Ex: observes inventory counting by management.
- observation provides limited audit evidence as work was done under supervision.

→ External confirmation (SAS 75):

Audit evidence obtained by auditor as a direct written response from third party.

Ex: Bank balance checks even records were maintained by entity.

→ Recalculation: checking mathematical accuracy of documents and records.

In this digital world there is not such need of accuracy check as everything is done electronically. no manual work was done to check, recalculate.

→ Reperformance:

→ Invalves auditor's independent execution of procedure that were already performed by entity's management as a part of internal control, to know the effectiveness of procedures done by internal control of entity. Ex: Reperforming reconciliation of bank statement.

→ Reperforming the aging of accounts receivable (about bad debts)

→ Analytical procedures (SAS 20)

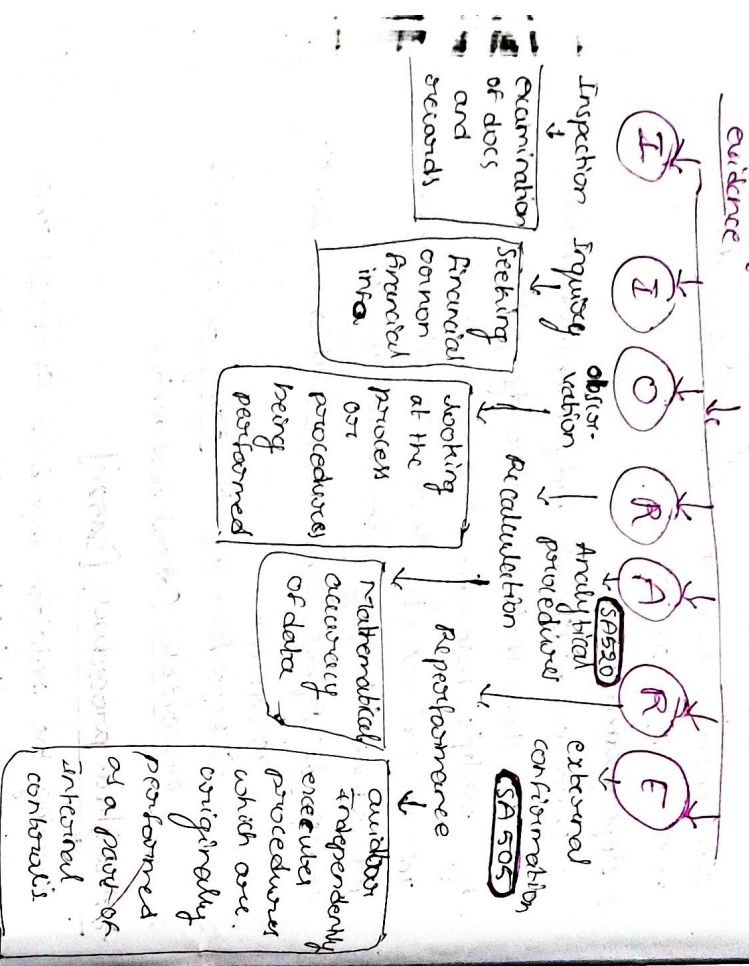
Knowing the relation ship b/w financial info and non-financial info to obtain audit evidence.

→ Inquiry: getting information

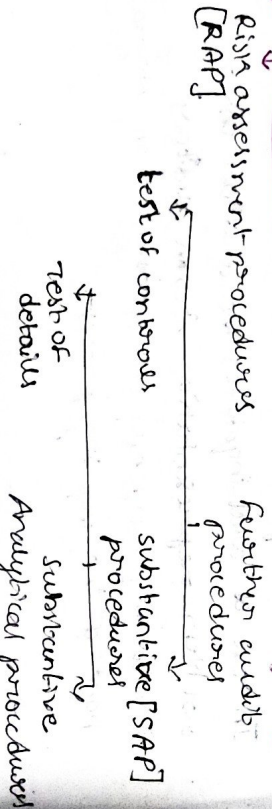
In case of oral inquiries the auditor obtain written representation from auditor. → evaluating responses on inquiries is an integral part of the inquiry process.

→ Responses might provide such info that differs significantly from other info that auditor has obtained. Like with sometimes responses may provide basis for the auditor to modify the opinion and conduct additional audit procedures.

Summary of audit procedures to obtain audit evidence



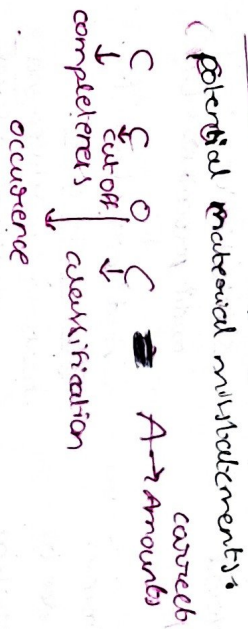
category of Audit procedures for obtaining AE classification



Risk assessment procedures (RAP)

Audit procedures performed:
 → to understand entity and entity environment in including entity internal control.
 → Identifying material misstatement due to fraud or error

Assertions about classes of transactions and events: claims by mgmt by which auditor identifies potential material misstatements.



Assertion about account balances at period end

Existence → Assets/liabilities/equity interest exist
 Rights & obligations → Entity holds controls over, liabilities completeness → All assets, liabilities and equity interests to be recorded have been recorded.

valuation and → All assets, liabilities and equity interests are included in FS at appropriate amt and recorded appropriately

Assertion about presentation and disclosure

Occurrence and → Assets and liabilities, rights and obligations equity interest exist
 completeness → all disclosures to be included are included in FS.

Classification and understandability → Financial information appropriately presented and described and disclosed.

Accuracy and valuation → If disclosures are fairly presented at appropriate amounts.

Further audit procedures

↓
Test of controls (TOC)

↓
Auditor performs audit procedures to evaluate operating efficiency of the controls to correct/prevent detect material misstatements

↓
Substantive audit procedures (SAP)

↓
Audit procedures to identify potential material misstatements

↓
Analytical procedures

↓
tests of details

Audit trail

→ Audit trail is documented flow of transactions.

Use of audit trail:

- To Investigate how the source document was translated to account entry.
- To maintain records of system and user activity ex In case of banks.

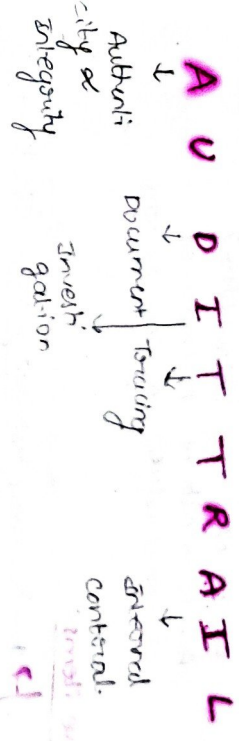
Keeping track of logon activity

→ It's a step by step record used to track many types of transactions including accounting and financial transactions.

→ Audit trail acts as second (repears) document evidences of certain events, procedures or operation. coz their purpose is to reduce fraud and errors.

→ Enhances internal controls and data security

→ Proactive areas can be detected by audit trails so it can help fixing responsibility and can rebuild events.



Limitation of audit trails:

- audit trails involves costs
- costs not only in terms of system expenditure but also in terms of time involved in analyzing data
- However use of automated tools can be made to analyze large volume of data thrown by audit trail

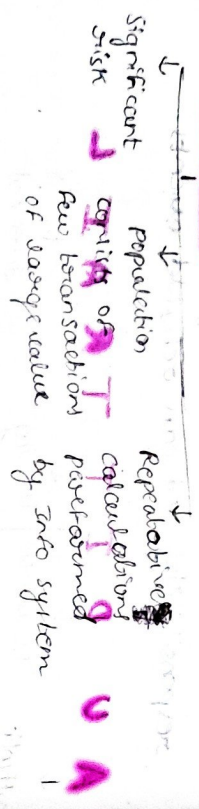
→ When using into procedures by entity
 Auditor shall evaluate whether
 info is available for

Selecting items for testing to obtain audit evidence:

→ outside designing part of controls (our) test of details
 auditor selects which items that are effective
 in meeting purpose

- a) selecting all items (100%)
- b) selecting specific items
- c) Audit sampling

100% examination: in cases where



selective items:

→ auditors may test large value items
 → Items exhibit different characteristics
 → Items through which obtain info
 about nature of entity & transactions

Audit sampling:

Draws conclusions by testing a sample of
 entire population

If audit evidence obtained from one source
 is inconsistent with another then

auditors has doubt over the reliability of
 info.

→ then he modifies opinion or add additional
 procedures and shall consider effect of
 matters on other aspects of audit.

Management's expert:

To assist the entity in preparing FS
 → who having expertise in such a field other than
 accounting and auditing.

→ expertise of such a person called management's
 expert work.

If auditors using any info provided by audit of
 management's expert auditor will
 evaluate the

- competence, capabilities and objectivity
 of expert
- evaluate appropriateness of expert's work
- understand expert's work

→ the audit will get reduced if auditor
 obtains sufficient audit evidence

SARS (101)
Audit evidence-specific consideration for selected

items:

If auditor wants to obtain sufficient and
 appropriate evidence regarding

- inventory
- litigation and claims and
- segment information

objective

To obtain sufficient and appropriate audit
 evidence regarding:

- existence and condition of inventory
- completeness of litigation and claims involving
 the entity and
- presentation and disclosure of segment
 info on per FRF

Inventory:

When inventory is material to FS then auditor shall obtain sufficient appropriate audit evidence regarding existence and condition of inventory by:

- Attendance at physical inventory counting
- Evaluate management instruction of procedures for recording & controlling results of entity's physical inventory counting
- Observe important procedures used
- Inspect inventory
- Perform test counts

Matters relevant to planning Attendance at

Physical inventory counting

W - High stages of completion

I - Inventory nature

N - Nature of internal controls related to Inventory

T - Timing of physical inventory counting

R - Risk of material misstatements

I

- P - Perpetual inventory system if maintained
- P - procedures for physical inventory counting
- L - location at which inventory held
- E

Physical inventory counting other than date of FS:

Generally physical inventory counting was done on the date of FS

But if physical inventory count was conducted other than the date of FS:

Relevant matters for consideration when designing audit procedures to obtain AF about whether inventory other than date of FS was properly recorded:

- whether perpetual inventory records are properly adjusted
- Reliability of entity's perpetual inventory records
- Reasons for significant diff b/w AF & O obtained during physical count and perpetual inventory records

Auditor unable to attend physical inventory count

due to unforeseen circumstances:

- auditor still make or observe physical counts on alternative dates and perform audit procedures
- from date to which has adopted methods after 31st month and before actual count happened

Auditor attendance to inventory count impractical

General inconvenience is not a ~~technical~~ impractical if inventory placed at a location where auditor has quick, ~~direct~~ ^{unrestricted} access then it's impractical

When performs alternative audit procedures and obtain audit evidence
→ if he is not able to obtain then gives a modified opinion as per SATON

Inventories under custody of a third party

To obtain audit evidence that whether inventory is under custody of third party or not.

to know existence and condition of inventory

→ Request confirmation from third party regarding quantities and condition of inventory.

→ Perform inspection on other audit procedures appropriate

-? suggest docs regarding inventory held by third party

→ Requesting confirmation from other parties when inventory has been pledged as collateral.

Auditor shall design and perform audit procedures to identify litigation and claims, which may lead to misstatements,

Including:

- Inquiry of management ~~concerns~~ **contributions**
- Review minutes of meetings of TGA and the entity and its external legal counsel
- Reviewing legal expenses accounts **(Capital stock)**

When audit procedures performed indicates the other material ~~misstatements~~ **litigation** or claims may exist, then auditor shall in addition to perform **required** procedures, seek direct communication with entity's external legal counsel

→ auditor may send a letter of inquiry requesting entity's external legal counsel

→ If lawyer, regulation or legal professional body prohibits the entity's external legal counsel from communicating directly with auditor, auditor shall perform alternative audit procedures.

→ If its unlikely that the entity's external legal counsel will respond appropriately to letters of general inquiry. In this case auditor may seek direct communication through a letter of ~~specific inquiry~~ **specific inquiry**.

Letter of specific inquiry includes:

- A list of litigation and claims
 - Management's assessment of the outcome of each of identified litigations and claims, their impact of financial statements
 - A request that entity's external legal counsel confirm the reasonableness of management's assessments, and provide further info that ~~is the data sufficient or incomplete~~ **is**.
- List is incomplete and incorrect.

In certain circumstances auditors may also want to meet the entity's external legal counsel to discuss litigation or claims.

For example:

- > auditor determines there is a high risk
- > whether it comply
- > Any disagreement b/w mgmt and entity's external legal counsel
- such meetings require mgmt's permission and are held with a representative of mgmt in attendance.

If in any case entity's external legal counsel or mgmt refuses to communicate with auditor, he will perform alternative audit procedures then too if he is unable to obtain audit evidence he will modify the opinion.

Segment Information

Info about different segments of an enterprise. auditor shall obtain sufficient appropriate audit evidence regarding presentation and disclosure of segment's info in accordance with applicable FRP.

- He obtains understand of methods used by mgmt in determining segment info
- > evaluate methods used by mgmt whether methods result in disclosure as per FRP.
- > perform Analytical procedures & other procedures.

External confirmation (SA 505)

SA 505 indicates reliability of audit evidence is influenced by nature and source.

- It's is more reliable when
- > obtained from independent source outside India
- > directly obtained from auditor
- > documentary form
- Scope of SA 505
- > use of external confirmation to obtain audit evidence

-> Audit evidence from external confirmation will be considered more reliable than internally generated by the entity's staff or other objective

To design and perform such procedures by using external confirmation to obtain relevant and reliable audit evidence

- > External confirmation is a direct written confirmation by third party.

Positive confirmation: Requiring to confirming party that to respond directly to auditor, whether it agree or disagree.

Negative confirmation: Requiring confirming party to respond directly to auditor only if he disagree

Non response: Failure of responding party to respond, or failure on fully responding.

Exception: The information ~~is~~ requested is different from response of confirming party called exception. In such a situation auditor will analyse because of which the difference occurred.

External confirmation procedure

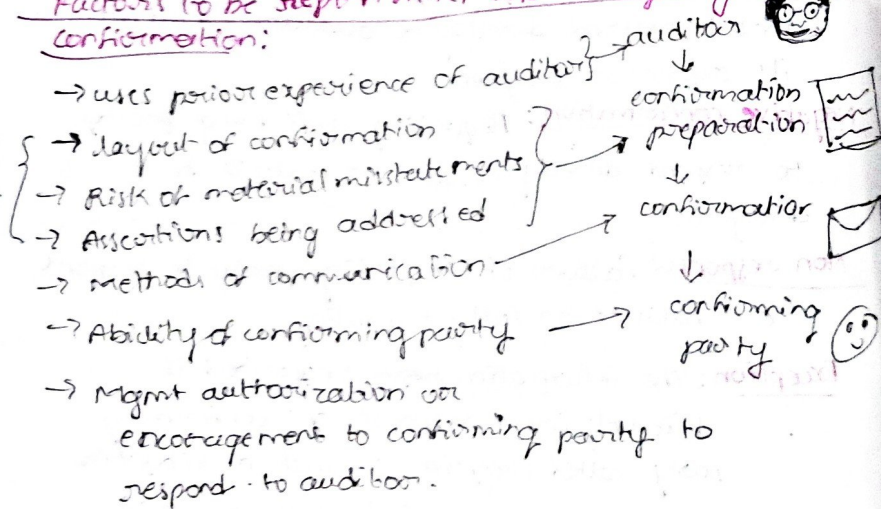
- When using external confirmation auditor shall maintain control over external confirmation.
- selecting the appropriate confirming party
- determining information to be confirmed.
- design the confirmation request
- follow up request to be sent if applicable.

Generally external confirmations are used to check balances of accounts.

They may also used to confirm the contract, agreements and transaction between entities and other parties

→ The more the quality of designing of confirmation, the more will be the quality of response too and can get reliable audit evidence.

Factors to be kept in mind while designing confirmation:



→ audit evidence obtained from positive confirmation is more reliable than negative confirmation

→ There is risk, that confirming party may reply without verifying the information

→ In such case auditor will not mention the amount balance and request the auditor to give the amount balance figure according to his bill books, so that he can reduce risk. (blank confirmation request).

→ But disadvantage of blank confirmation is that the response rate will get lower.

Followup request

If auditor hasn't received the response from the confirming party he will send an additional confirmation request to reply to a previous request. It's a reminder.

Mgmt's refusal to allow auditor to send external confirmation:

→ auditor has to inquire mgmt for reason for refusal and seek audit evidence to validity and reasonableness.

→ Evaluate implications of mgmt's refusal on auditor's assessment of relevant risks of material misstatements. Initially auditor assessed that there is low risk of material misstatement but now due to refusal it would be effected and assume that there is high risk of mm and may alter nature, timing and extent of other audit procedures

→ perform alternative audit procedures

→ If auditor concludes that request refusal is unreasonable and unable to obtain reliable audit evidence from alternative procedure then have to communicate with T.M.B. according to S. 960

Auditor shall evaluate the results of external confirmation procedures & may categorise them into

- Responses without any exception
- Responses indicate exception
- Non response
- Responses deemed unreliable.

Initial audit engagements - opening balances (SAS 10)

→ audit was not done in previous year or done by predecessor auditor.
→ as this is the first audit of entity
→ called initial audit engagements
SAS 10 states responsibilities of auditor relating to opening balances when conducting initial audit engagements.

Objective:

To obtain sufficient audit evidence about whether

→ whether opening balances contain misstatements that are material

→ Appropriate accounting policies selected in opening balances and have been consistently applied in current year also.

any changes in accounting policies are properly accounted and adequately presented and disclosed.

Obtaining sufficient audit evidence about opening balances:

→ Determining whether the prior periods' closing balances have been correctly brought forward to current period.

→ any adjustments have been disclosed as prior period items in current year's statement of profit and loss.

→ Determine whether opening balances appropriately reflect accounting policies.

→ Whether prior periods FS are audited, check prior year's audited FS and relevant documents

→ perform specific audit procedures to obtain evidence regarding opening balances

→ Evaluate audit procedures performed in current year whether it provide evidence regarding opening balances

Nature and extent of audit procedures:

depends on

→ accounting policies followed

→ nature of account balances, class of transactions and disclosures and risk of material misstatements.

→ significance of opening balances.

→ Whether prior periods financial statements were audited and whether the predecessor auditor's opinion was modified.

Conclusion

- If accounting policies reflecting in opening balances is not consistently applied in current year as per IFRS
- If changes in the accounting policies are not appropriately presented or disclosed as per IFRS
- Auditor shall modify opinion as per SA 705 whether its qualified or adverse.

Current Assets and Liabilities:

Some audit evidence about opening balances may be obtained as a part of current

Therefore additional audit procedures may be necessary.

→ observing a current physical inventory count and reconciling it to the opening inventory quantities

→ performing audit procedures on the valuation of the opening inventory items

→ performing audit procedures on gross profit and cut off.

Non current assets and liabilities:

→ Audit evidence in case of non current assets or liabilities may be obtained by examining the accounting records and other information underlying in opening balances.

→ can inspect the third party

Analytical procedures:

Evaluating any financial information through understanding the relationship b/w financial and non financial information

Analytical procedures considering comparisons of entity's financial information:

- comparable info for prior periods
- Anticipated results, expected results of audit etc
- compare with other entities with comparable size and same industry

Analytical procedures having consideration of relationships are:

- financial and non financial info.
- Elements of financial info that conform to a predictable pattern of past entity experience

Routine checks cannot be sufficient to disclose all the mistakes and manipulation certain other procedures have to be applied like comparisons and ratio analysis

→ all these collectively known as overall tests

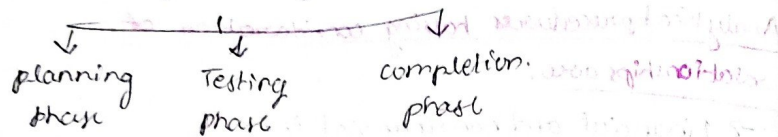
By conducting analytical procedures one can

- Identify fluctuations/relationships
- that are inconsistent with
- relevant

Objective of SA

- To obtain relevant & reliable audit evidence when using substantive analytical procedures
- To design and perform analytical procedures near the end of the audit that he have to form conclusion that entity FS were consistent with auditor's understanding

Timing of analytical procedures



Analytical procedure in planning phase:

- assist auditor in understanding the client's entity
- identify areas of potential risk
- developments in entity
- Info will assist auditor in determining nature, timing and extent of audit procedures
- use both financial and non financial data

Substantive Analytical procedures:

auditor's substantive procedures at assertion level may be tests of details, substantive analytical procedures or combination of both

- choice btw both depends on auditor's judgement about expected effectiveness, efficiency of audit procedures to reduce audit risk to acceptably low level

→ Inquiries might as to availability and reliability of information needed to apply substantive procedures

Factors to be considered for substantive audit procedures

I - Inherent Risk

P → predictability

A → Account type

N → Nature of assertion

D → Disaggregation

A → Availability of data

Availability of data: Availability of relevant and reliable data will facilitate effective analytical procedures

Disaggregation: Degree of disaggregation in available data is a degree of usefulness in detecting misstatements

Account Type:

Substantive analytical procedures are more useful for certain types of accounts than for others

Ex: they are more suitable to P&L A/c's than Balance sheet A/c's

Source: Some classes of transactions are more predictable, non routine Ad. D. expenditure are not easy to predict. Analytical are suitable when it more predictable.

predictability: Substantive analytical procedures are more appropriate when account balances or relationships btw items of data are predictable (Ex: sales and cost of sales or Trade receivables and cash receipts)

~~Substantive analytical procedures~~

Nature of assertions:

Substantive analytical procedures are more effective in providing evidence to some assertions

(eg: completeness or valuation)

than for others (eg: rights and obligations)

↓
docs dekh ke pata chalta
ke ki rights and obligations
of such assets and other
compare aur relationships samajh ke
nahi kar sakte hie

Inherent risk:

~~When significant risks occur~~

When significant risks occur, only analytical procedures are not enough/sufficient

Further test of details is required to be done to address such risks.

Techniques available as Substantive Analytical procedures:

Design of a substantive analytical procedures is limited only by availability of reliable data and the experience of auditors, creativity of audit team.

Trend analysis:

Compare trends

→ compare current year data with previous year's data called trend analysis

→ commonly used technique

→ Auditor evaluates whether current yr balances of accounts are move with trend established with previous balances.

Ratio analysis:

It's useful for analysing assets and liabilities as well as revenue and expense.

Reasonableness test:

• Unlike trend analysis, this analytical procedure doesn't rely on events of prior periods, but upon non financial data for audit period under consideration.

eg: occupancy rates to estimate rental income.
→ interest rates to estimate interest income or expense.

Structural modelling: Modelling tool constructs a statistical model from financial and non financial data of prior accounting periods to predict current yr's balances.

Analytical procedures as substantive tests

When ever wanted to perform substantive analytical procedures, either alone or combination with tests of details. He shall do following

before performing substantive analytical procedures

- Suitability of particular analytical procedures
- Determination of suitability of particular substantive analytical procedure is influenced by the nature of the assertion and risk of material misstatements.
- we use analytical procedures when there are large volume of transactions and predictable balances exist.

Evaluate reliability of data: Reliability

Depends on source, comparability, nature and relevance and controls over preparation of information.

Source: Info from independent source is more reliable

comparability: comparability of info.

example: industry data need to be supplemented to be comparable to that of an entity.

Nature and relevance of information available.

controls over the preparation of info:

By this it's known that info designed are complete, accurate and valid.

Evaluation of whether the expectation is sufficiently precise:

→ The availability of both financial and non-financial information

→ The accuracy with which expected results of substantive analytical procedures can be predicted

→ degree to which info can be disaggregated

example: analytical procedures may be more effective when they are applied on individual section of operation.

Amount of differences of recorded amounts from expected values that is acceptable.

→ Differences btw the amounts and expected amounts was the difference material will be determined by auditor.

→ consistency with desired level of assurance

High ↑ If audited risk of material misstatements low ↓ Amount of differences that can be accepted without further investigation

Investigation of Results of Analytical procedures

If analytical procedures performed in accordance with SAS 20 identify fluctuation or relationships that are inconsistent or differ from values by a significant amount.

→ Inquire the management and obtain evidence in relation to mgmt response

→ perform other audit procedures.

Audit sampling (SAS 30)

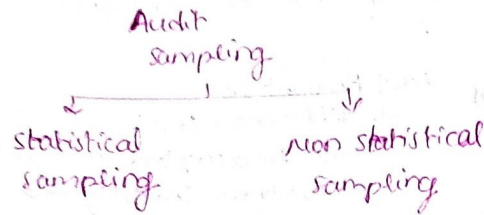
Application of audit ~~procedure~~ procedures to less than 100% of items within a population of audit on which to draw conclusions about entire population.

Objective

using audit sampling is to provide a reasonable basis for auditor to draw conclusions about population from which the sample is selected.

Population

↓
Entire set of data from which sample is selected
→ auditor shall select the sample in such a way that the sample can be expected to be representative of population.



Characteristics of population:

C Completeness **A** Appropriateness **R** Reliability

Appropriateness: Auditor will determine

that the population from which sample is drawn was appropriate for specific audit objective.

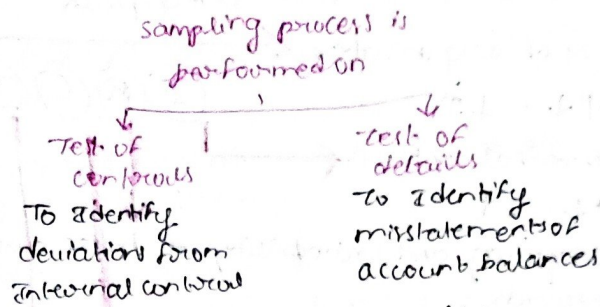
• Appropriateness means relevance for specific audit objective.

Completeness: Population needs to be complete and means population needs to include all relevant items i.e. all the activities that form part of the relevant internal control.

Reliable: Auditor performs audit procedures to ensure that information upon which audit sampling is performed is sufficiently complete and accurate.

Sampling units:

→ The individual units that make up the population known as sampling units
→ conclusion drawn from Audit sample becomes the conclusion of population



Statistical sampling: characteristics

→ Random selection of the sample units.
→ probability theory to evaluate sample results
→ Measurement of sampling risk characteristics

Non statistical sampling:

→ No random selection of samples
→ sample size and composition is determined on basis of personal experience and knowledge of auditor.

→ It has been common application for many years.
→ This approach was criticized on grounds that it's neither objective nor scientific and its risk of personal bias can't be eliminated.

Statistical sampling - more scientific

→ Involves use of mathematical laws of probability in determining size and composition of sample.
→ No personal bias here.
→ Results of sample by this approach is considered to be more reliable.

- It was used when there are large no. of similar items.
- Sampling is used as a part of test of control.

Factors to be considered in deciding the extent of checking on sampling plan

- Size of organization
↑↓ - ↓↑
- Interval control
↑↓ - ↓↑
- Adequacy and reliability of books and records
↑↓ - ↓↑
- Tolerable error range. (to what extent can auditor tolerate error)
↑↓ - ↓↑
- Degree of desired confidence
If he's getting more confidence by checking ~~more~~ less no. of transaction then he will check less. or if he is getting confidence by checking more no. of transaction he will check more.



Advantages of statistical sampling:

- Sample selection is more objective and so more defensible.
- Method provides means for estimating the minimum sample size according to specified risk.
- provides means for desiring calculated risk and accuracy.

- It's widely accepted way of sampling.
- More scientific
- No personal bias
- More reliable sample results.
- Better description of large mass of data. It makes no need of complete examination
- usage of probability theory to evaluate sample results.

Note: Sample size will not increase if ~~more~~ area is of more size.

If auditor wants to keep low RMM he will check more samples so sample size is more.

Example of factors influencing sample size for TOG:

- Auditor wants to obtain high assurance sample size will be increased
- Auditor can tolerate high rate of deviation sample size will be decreased
- Rate of deviation of population to be tested is higher than expected. sample size will be increased
- Auditor desires greater level of assurance than the tolerable rate sample size will be increased
- Size of population have no significant effect has negligible effect on size of sample.

Factors influencing sample size of TOB:

- > If auditor evaluate that the risk of material misstatement is high sample size will be increased
- > If auditor increases use of other substantive procedures (analytical ie other than TOB) sample size will be decreased
- > auditor level of tolerable misstatement is less. sample size will be increased
- > amount of misstatement is greater than the auditor expectation sample size increased.
- > There will be negligible effect on sample size to number of sampling units.

Sampling sample selection methods

Random Sampling - ensures all items in the population have known chance of selection

- (i) Simple Random sampling
all items have equal chance of being selected. No auditor bias. It's simple and easy to use. It's done either by use of random number table or picking up a number in random way

- > Nowadays there are various applications in cell phones to generate a random number
- > It's used only if it's appropriate when population consists of similar units and falls within a reasonable range. (Homogenous having similar range)

Stratified sampling:

This method involves dividing the whole population to be tested in a few separate groups called strata. No. of groups will be on basis of auditor's judgement

When population is heterogeneous it's divided into homogenous subgroups. & sample is drawn from each sub group. If auditor stratifies the population appropriately the sample size will get decreased.

Interval sampling or systematic sampling

$$= \frac{\text{Total pop sampling units}}{\text{Sample size}}$$

- > systematic selection is a method in which no. of sampling units divided by sample size to give a sampling interval.

Monetary unit sampling

-> It's a value weighted selection in ^{which} sample size, selection and evaluation of results in a conclusion in monetary amounts

Structured sampling

- No ~~structured~~ ^{structured} technique in selection
- No use of random number table.
- Doesn't involve judgement

Block sampling

- This method involves selection of block of contiguous items from within the population.

Sampling Risk

Conclusions based on sample may be different from conclusions if entire population were subjected to same audit procedures.

Value weighted selection:

- When performing TOB, identify the sampling units as the individual monetary units that make up the population.

ex: 12 → 1 units

Having selected specific monetary units from within the population.

- In this approach audit efforts are directed to larger value items, as they have chance of getting selected & hence resulting in decrease in sample size.

Sample design, size and selection (SA530)

- consider purpose of audit procedures and characteristics of the population from which sample will be drawn
- determine a sample size that to reduce sampling risk to acceptably low level
- every unit should have equal chance of getting selected

Sample design

- when designing audit sample the auditor considers, specific purpose to be achieved
- consider combinations of audit procedures to achieve objectives.
- characteristics of population
 - ex1 TOC - expected rate of deviation
 - TOB - expected state of material misstatements
- determine sample size to reduce sample risk to a acceptably low level.

SA550

Related party

- should make transaction at arm's length price.
- Auditor check whether disclosed related party transactions properly
- followed RRF
- comply AS 18 and sec 18B

Related parties are those who are defined in applicable financial reporting framework

- and an entity which has control or significant influence directly or indirectly through one or more intermediaries.
- or the reporting entity having control or

significant influence on another entity

- common controlling ownership

- owners who are close family members

- common key management

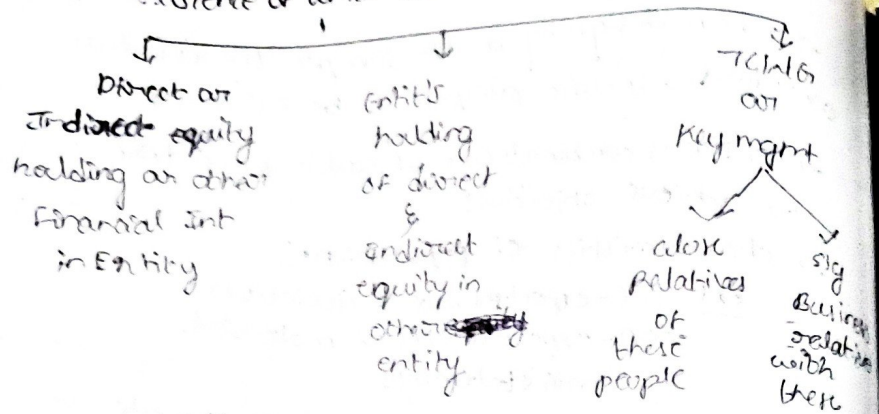
Control

↓
power to govern the financial and operating policies.

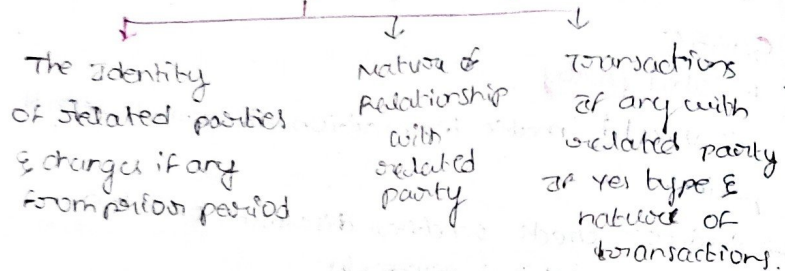
Significant influence

↓
power to participate in financial & operating decisions.

Existence of which can be through



Auditor shall inquire with mgmt



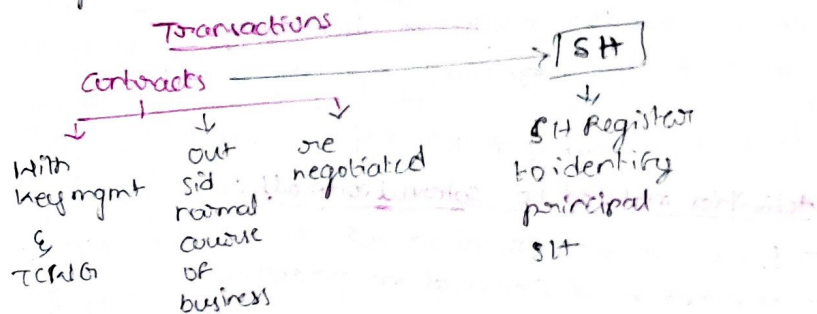
Auditor shall inquire with mgmt & others within the entity, evaluate controls and perform risk assessment procedures & whether mgmt has

- > Identified, disclosed & accounted Related party transactions
- > Authorized & Approve significant Related party transactions
- > Authorized & Approve significant related party transactions outside the normal course of business

considerations specific to smaller entities by Auditor

- > owners will be manager, if not available other manager
- > control activities in small entities is less formal
- > it may lead to either increase or decrease of risk due to the thing that owner was the manager

-> For such entities auditor may obtain an understanding of the related party relationships and transactions and any controls that may exist over these through inquiry of mgmt, combined with other procedures, such as observation of mgmt's oversight and review activities



- (I) -> Income tax Return
- > Internal auditor Report
- > Investment plan & pension plan
- > Life Insurance policy of entity
- > Invoices from professional advisors
- * Statement of conflicts of int of Key mgmt/ TC/AG

- * Doc submitted to securities regulators
- * Doc filed with regulatory authorities

Internal audit function refers to:

- function of an entity that performs assurance and consulting activities, evaluate and
- improve the effectiveness of governance process, entity's risk mgmt.

Activities related to governance

- Internal auditor function is to assess governance process and accomplishment of its objectives
- Control info and communication of risk to appropriate areas of organization
- Effectiveness of communication among TCMs, external, internal auditors and management

Activities related to risk mgmt

- Internal auditor assists in identifying and evaluating significant exposures of risk
- assist in removing Risk

Activities related to Internal controls:

- Evaluation of Internal control
 - Examination of financial and operating activities
 - Review of operating activities
 - Review of compliance with law
- ← economic efficiency effectively

Ways in which the external auditor may make use of function for purpose of the audit

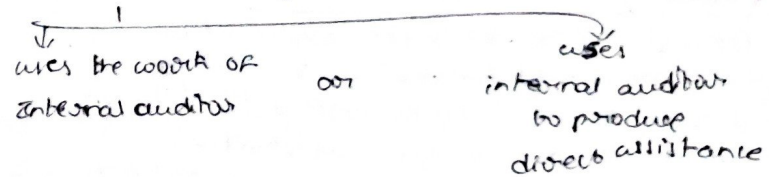
The function may perform audit procedures similar to those performed by the external auditor in an audit of FS.

So External auditor may use one or more ways of the following to make use of the function:

- To obtain info that is relevant to the external auditor's assessment of risk of error or fraud.
- unless prohibited, or restricted to some extent by law or regulation external auditor after certain evaluation may decide to use work that has been performed by internal audit function.
 - during period of partial substitution for audit evidence to be obtained directly by external auditor.
- unless prohibited or restricted to some extent by law the external auditor may also use internal auditor to perform work under direction, supervision and review of external auditor its referred as direct assistance.

Scope of SA 610

External auditor's responsibilities when he



Using the work of internal auditors: (SA 100)

External auditor's Responsibility for audit:

- External auditor has sole responsibility for audit opinion.
- External auditor and internal auditor may perform similar procedures. Neither the internal audit function nor internal auditors are independent of entity as is required of the external auditor of IS in accordance with SA 100.
- This SA defines the conditions that are necessary for external auditor to be able to use the work of internal auditors.

→ It defines the necessary work effort to obtain sufficient appropriate evidence

Objective of external auditor, where entity has an internal audit function:

- To determine whether the work of internal audit function or direct assistance from internal auditor can be used, and if so in which areas and to what extent.
- If using the work of internal auditor, to determine whether that work is adequate.
- If using direct assistance of internal auditor, to appropriately direct, supervise and review their work.

Evaluating the Internal audit function

- External auditor determines whether to use internal audit function can be used for purposes of audit by evaluating the following:
- extent to which internal audit function's organisational status and relevant policies and procedures support objectivity of internal auditor.

- level of competence of internal audit function.
- whether internal audit function applied systematic and disciplined approach, including quality control.

Objectivity and competence

- the external auditor exercises professional judgement to determine whether to use work of internal auditor for purpose of audit.

→ the extent to which the internal audit function's organisational status and relevant policies and procedures support the objectivity of internal auditor.

Factors that may affect the external auditor's evaluation in relation to objectivity including the following:

- organisational status of internal audit function
- authority and accountability
- whether he has direct access to T&A.
- whether T&A oversee employment decisions related to internal audit function
ex: determination of remuneration policy
- whether there are any constraints or restrictions placed on the internal audit function by mgmt or T&A.

Circumstances when work of internal audit function cannot be used

- Function's organisational status and relevant policies and procedures do not adequately support the objectivity of internal auditor.
- Function lacks sufficient competence.
- Function doesn't apply systematic and disciplined approach, including quality control.

Examples of internal audit function work that can be used by external auditor

- Testing of operating effectiveness of controls
- Substantive procedures involving limited judgement
- observations of inventory counts
- Tracing transactions through the info system relevant to financial reporting
- Testing compliance of regulatory requirement

Circumstances in which external auditor shall plan to use most of work of the

internal audit function and perform more of the work directly

- More judgement involved in
 - planning and performing relevant audit procedures and
 - evaluating audit evidence gathered
- Higher the assessed risk of material misstatement
- Lack of objectivity
- Lack of competence

Coordination btw external auditor and internal auditor

- Discussions take place at appropriate intervals throughout the period
- The external auditor informs internal auditor of significant matters that may affect the function.
- external auditor is advised of and has access to relevant reports of internal audit function and informed of any significant matters that come to attention of the function when such matters may affect the work of external auditor.

External auditor shall not use an internal auditor to provide direct assistance to perform procedures

that:

- involve making significant judgement
- Areas related to high risk of material misstatements
- Judgment required in performing the relevant audit procedures or evaluating audit evidence is more than limited
- Relate to work with which internal auditors have been involved and which has already been or will be reported to mgmt or TCOR.
- Relate to decision the external auditor makes in accordance with this SA regarding internal audit function and use of its work or direct assistance