

Chapter 4:- Audit Evidence

Assertions

It refers to representations by mgt, ^{clearly stated} explicit (or) otherwise, that are embodied in the F.S, as used by the auditor to consider the different types of potential misstatements that may occur.

Assertions Contained in financial statements

1. Representing that the F.S are in accordance with the applicable financial reporting framework, mgt implicitly (or) explicitly makes assertions regarding the recognition, measurement, presentation & disclosure of the various elements of F.S & related disclosures.
2. Assertions used by the auditor to consider the following different types of potential misstatements that may occur & may take the following forms:

A. ASSERTIONS ABOUT CLASSES OF TRANSACTIONS AND EVENTS FOR THE PERIOD UNDER AUDIT (FOR PROFIT & LOSS ITEMS)

Assertion	Meaning	Example
i. Occurrence (transactions recorded actually happened)	Transactions & events that have recorded have occurred & pertain to the entity	Sales recorded are Real
ii. Completeness	all transactions & events that should have been recorded have been recorded	All purchases are recorded
iii. Accuracy (Amts & data are recorded correctly)	Amts & other data relating to recorded transactions & events have been recorded appropriately.	Sales value is correctly calculated
iv. Cut-off	Transactions & events have been recorded in the correct accounting period.	Dec 31st sales recorded in same year.
v. Classification	Transactions & events have been recorded in the proper accounts	Salary exps not shown under admin. exps wrongly

B. ASSERTIONS ABOUT ACCOUNT BALANCES AT THE PERIOD END (FOR BALANCE SHEET ITEMS)

Assertion	Meaning	Example
i. Existence	Assets, liabilities & equity interest exists	Inventory shown actually exists
ii. Rights & obligations	the entity holds/controls the	Inventory belongs to

	rights to assets, & liabilities are the obligations of the entity.	the company.
iii. Completeness	All assets, liabilities & equity interests that should have been recorded have been recorded	No liability is omitted
iv. Valuation & allocation	Assets, liabilities & equity interests are included in the F.S at appropriate amts & any resulting valuation (or) allocation adjustments are appropriately recorded	Debtors are shown after deducting provisions for Bad debts.

C. ASSERTIONS ABOUT PRESENTATION AND DISCLOSURE

Assertion	Meaning	Example
i. Occurrence & rights & obligations	Disclosed events, transactions & other matters have occurred & pertain to the entity	Lease disclosed actually belongs to entity
ii. Completeness	all disclosures that should have been included in the F.S have been included	All related parties disclosed.
iii. Classification & understandability	financial info. is appropriately presented & described & disclosures are clearly expressed	Disclosures are easy to understand
iv. Accuracy & valuation	Info. disclosed is accurate & at appropriate values	Fair value of investment properly disclosed

Negative assertions are also encountered in the F.S & the same may be expressed (or) implied (omission/absence - they state that something does not exist or has not happened)

Expressed negative assertions:- directly written/stated

Implied negative assertions:- not written but understood by what's missing

Examples:

1. There is no contingent liability

- It is directly written statement.
- It tells the user clearly: the company has no guarantees / obligations
- It's an expressed negative assertion

46
2. If in the balance sheet there is no item as building, it implies the entity does not own a building

- No written statement
- But the absence of a building in assets implies the company does not have one.
- This is an implied negative assertion.

In accordance with SA 500, the objective of the auditor is to design and perform audit procedures in such a way as to enable the auditor to obtain sufficient appropriate audit evidence to draw reasonable conclusions on which to base the auditor's opinion.

Meaning of Audit Evidence as per
AS SA 500

Audit evidence may be defined as the info. used by the auditor in arriving at the conclusions on which the auditor's opinion is based. Audit evidence includes both info. contained in the accounting records underlying the f.s & other info.

There is a very imp. relationship between Audit evidence & opinion of the auditor. While conducting an audit of a co., the auditor obtains audit evidence & with the help of that audit evidence obtained, the auditor forms an audit opinion on the F.S of that co.

Why are these important for auditors?

→ Auditors don't just check what is shown, they must also consider:

- * what's not shown
- * what's denied / omitted.

This helps them evaluate the completeness & truthfulness of the F.S.

Audit evidence includes:-

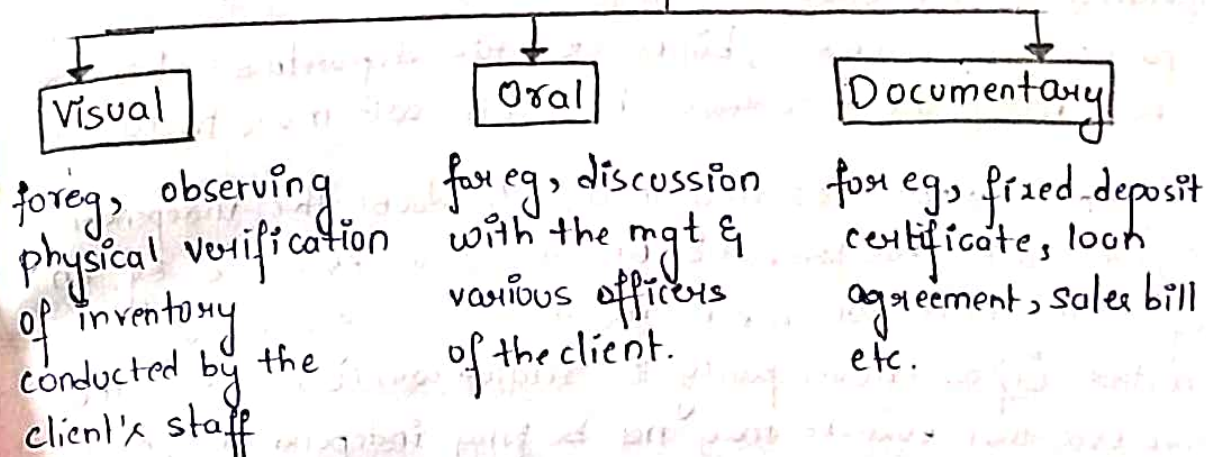
- 1) Info. contained in the accounting records. includes
 - the records of initial accounting entries & supporting records, such as cheques & records of electronic fund transfers.
 - Invoices
 - contracts.

- general & subsidiary ledgers, JE & other adjustments to the F.S that are not reflected in JE &
- records such as work sheets & spreadsheets supporting cost allocations, computations, reconciliations & disclosures.

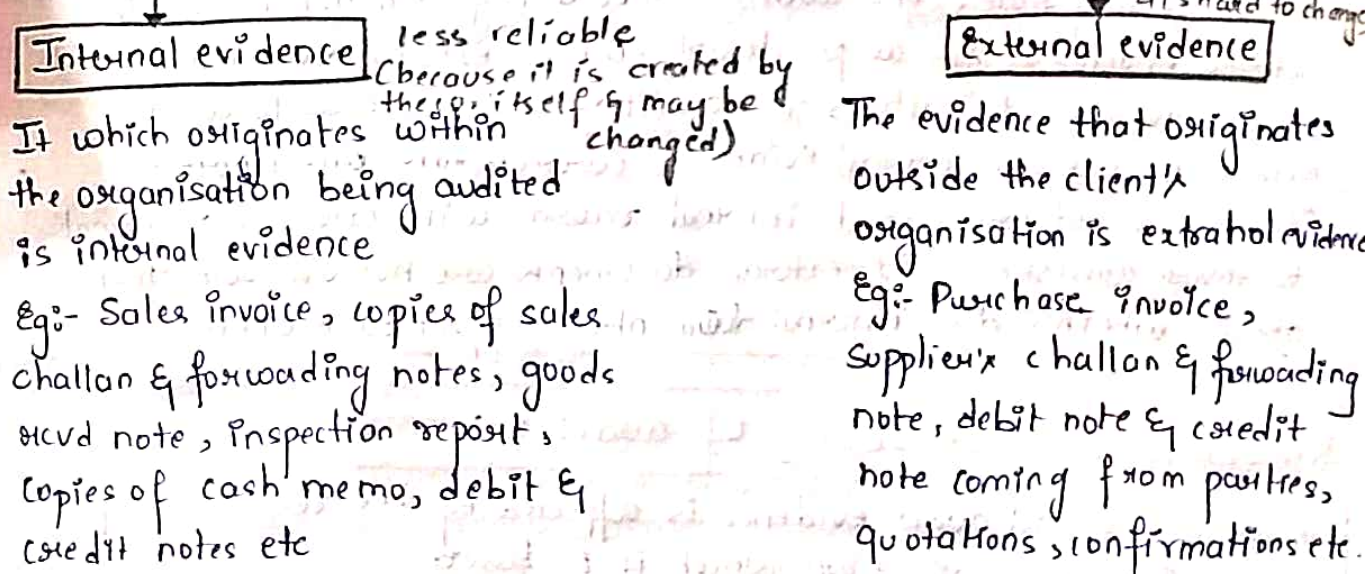
2) Other info. that authenticates the accounting records & also supports the auditor's rationale behind the true & fair presentation of F.S

*Types of Audit Evidence

A. Depending upon nature



B. Depending upon Source



In an audit situation, the bulk of evidence that an auditor gets is internal in nature. (most of the documents & records are prepared by the client itself).

However, substantial external evidence is also available to the auditor. (Auditors may also get third party evidence, like bank statements, supplier bills etc.)

Since in the origination of internal evidence, the client & his staff have the control, the auditor should be careful in putting reliance on such evidence. (Internal evidence can be manipulated, as it is created under client control! so, blind trust is risky).

It is not suggested that they are to be suspected, but an auditor has to be alive to the possibilities of manipulation & creation of false & misleading evidence to suit the client (or) his staff (Don't assume internal evidence is false, but stay alert - there may be intentional fabrication).

The external evidence is generally considered to be more reliable⁴ as they come from third parties who are not normally interested in manipulation of the accounting info. of others.

(External parties like vendors, banks etc, tax departments have no motive to help manipulate - so their documents are more trustworthy)

However, if the auditor has any reason to doubt the independence of any 2nd party who has provided any material evidence. eg. an invoice of an associated concern, he should exercise greater vigilance in that matter. (If an external party is related (or) connected to the client, then even that evidence may not be fully independent & needs extra checking).

As an ordinary rule, the auditor should try to match internal & external evidence as far as practicable. Where external evidence is not readily available to match, the auditor should see as to what extent the various internal evidences ^{to support} corroborate one another. (Auditors should cross-check internal records with external confirmations to ensure consistency. If external documents are not available, then check whether diff. internal documents support each other)

Relevance and Reliability of audit evidence

The quality of all audit evidence is affected by the relevance & reliability of the info. upon which it is based.

Relevance deals with the logical connection with, (or) bearing upon, the purpose of audit procedure &, where appropriate, the assertion under consideration. The relevance of info. to be used as audit evidence may be affected by the direction of testing.

A given set of audit procedures may provide audit ~~proof~~ evidence that is relevant to certain assertions, but not others.

Audit evidence from diff. sources (or) of a diff. nature may often be relevant to the same assertions.

Eg's: Questions	Relevant evidence	Why Relevant?
a) Does co. really own the asset shown in the B/s?	Title deed, pur. Invoice, Physical verification report	Directly proves ownership & existence
b) Is the stock valued at correct amt?	Cost sheet, NRV list, market price data	Directly related to checking correct valuation
c) Did the sales actually happen?	Sales invoice, delivery challan signed by customer, Payment receipt	Proves goods were sold & money recd

Reliability: Info. to be used as audit evidence should be reliable (it means how trustworthy & truthful the evidence is, even if evidence is relevant, it must be reliable to be useful in audit).

Reliability of info. to be used as audit evidence, & therefore of the audit evidence itself, is influenced by its source & its nature, & the circumstances under which it is obtained, including the controls over its preparation & maintenance where relevant.

Therefore, generalisations about the reliability of various kinds of audit evidence are subject to important exceptions. Even when info. to be used as audit evidence is obtained from sources external to the entity, circumstances may exist that could affect its reliability.

While recognising that exceptions may exist, the following generalisations about the reliability of audit evidence may be useful:

- It is increased when it is obtained from independent sources outside the entity.
- It is generated internally is increased when related controls imposed by the entity are effective.
- It obtained directly by the auditor is more reliable than audit evidence obtained indirectly.
- Audit evidence in documentary form is more reliable than evidence obtained orally.
- It obtained as original documents is more reliable than audit evidence obtained as photocopies (or) facsimiles. Into e-form because in these cases the reliability of which may depend on the controls over their preparation & maintenance.

Sufficient appropriate Audit Evidence

The auditor has to obtain sufficient appropriate audit evidence to draw reasonable conclusions on F.S.

The sufficiency & appropriateness of audit evidence are interrelated.

Sufficiency	Appropriateness
• It is the measure of the quantity of audit evidence. • It is affected by the auditor's assessment of the risks of misstatement (higher assessed risks, the more audit evidence is likely to be required).	• It is the measure of quality of audit evidence. • It is also affected by auditor's assessment of risks of misstatement (higher the quality, the less may be required). • Its relevance & its reliability in providing support for conclusions on which the auditor's opinion is based.

obtaining sufficient & appropriate Audit evidence by the Auditor ⁵¹

The auditor shall design & perform audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient & appropriate audit evidence.

Audit evidence is necessary to support the auditor's opinion & report. It is in nature & primarily obtained from audit procedures performed during the course of audit.

However, also include info. obtained from other sources (inside and outside the entity). Such as previous audits. Info. that may be used as audit evidence may have been prepared using the work of a mgt's expert.

Audit evidence comprises both info. that supports & corroborates mgt's assertions & any info. that contradicts such assertions.

In addition, in cases the absence of info. is used by the auditor & therefore, also constitutes audit evidence.

Most of the auditor's work in forming the auditor's opinion consists of obtaining & evaluating audit evidence. The auditor uses various audit procedures to obtain audit evidence such as inspection, observation, confirmation, recalculation, reperformance & analytical procedures, often in some combination, in addition to inquiry.

Further, auditor's judgement 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 & presentation & disclosures to the users of the F.S. Less evidence would be required in case of assertions are less material to users of the F.S. But on the other hand if assertions are more material to the users of the F.S, more evidence would be required.
- Risk of material misstatement** same as 3rd chapter
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 and characteristics of a population:** It refers to the no. of item 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.
(similar in nature, characteristics & risk)
(diverse in terms of amt, nature / risk)

Sources of audit evidence

Some audit evidence is obtained by performing audit procedures to test the accounting records.

Through the performance of such audit procedures, the auditor may determine that the accounting records are internally consistent & agree to the F.S.

More assurance is ordinarily obtained from consistent audit evidence obtained from diff. sources (or) of a diff. nature than from items of audit evidence considered individually.

Info. from sources independent of the entity's that the auditor may use as audit evidence may include confirmations from third parties, analysts reports & comparable data about competitors.

Audit procedures for obtaining Audit evidence

Audit evidence to draw reasonable conclusions on which to base the auditor's opinion is obtained by performing:

- a) Risk assessment procedures &
- b) further audit procedures, which comprise
 - i) Tests of controls, when required by the SAs (or) when the auditor has chosen to do so, &
 - ii) Substantive procedures, including tests of details & Substantive analytical procedures.

Audit procedures to Obtain Audit evidence can include:

- i. **Inspection:-** It is an audit procedure in which complete documents and records of a co. are checked in detail for the purpose of obtaining audit evidence, whether internal (or) external, in paper form, e-form (or) a physical examination.
- ii. **Observation:-** It consists of looking at a process (or) procedure being performed by others. (Eg:- the auditor's observation of inventory counting by the entity's personnel, (or) of the performance of control activities.
- iii. **External Confirmation:-** It represents audit evidence obtained by the auditor as a direct written response to the auditor from a 3rd party, in paper form (or) e-mode. It frequently relevant when addressing assertions associated with certain account balances & their elements. However, this is need not be restricted to account balances only. Eg:- auditor may request confirmation of terms of agreements / transactions an entity has with 3rd parties, the confirmation request may be designed to ask if any modifications have been made to the agreement & if so, what the relevant details are.

- iv. **Recalculation:** It consists of checking the mathematical accuracy of documents (or) records. It may be performed manually (or) electronically.
- v. **Reperformance:** It involves the auditor's independent execution of procedures (or) controls that were originally performed as part of entity's internal control.
- vi. **Analytical procedures:** It consists of evaluations of fin. info. made by a study of plausible relationships among both financial & non-financial data. It also encompasses the investigation of identified fluctuations & relationships that are inconsistent with other relevant info. (or) deviate significantly from predicted amounts.
- vii. **Inquiry:** It consists of seeking info. of knowledgeable persons, both fin. & non-financial, within the entity (or) outside the entity. It is used extensively throughout the audit in addition to other audit procedures.

In respect of some matters, the auditor may consider it necessary to obtain written representations from mgt & where appropriate, those charged with governance to confirm responses to oral inquiries.

* Although inquiry may provide important audit evidence, & 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.

* Audit Evidence - Specific Consideration for selected items (SA 501)

SA 501 - "Audit Evidence - Specific consideration for selected items" deals with specific consideration by the auditor in obtaining sufficient appropriate audit evidence with respect to certain aspects of inventory, litigation & claims involving the entity, and segment info. in an audit of F.S.

Objectives

The objective of the auditor is to obtain sufficient appropriate audit evidence regarding the:

- Existence & condition of inventory
- Completeness of litigation & claims involving the entity &
- Presentation & disclosure of segment info. in accordance with the applicable financial reporting framework

Inventory

When inventory is material to the F.S., the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by:

- I. Attendance at physical inventory counting, unless impracticable, to:
 - i. Evaluate mgt's instructions & procedures for recording & controlling the results of the entity's physical inventory counting.
 - ii. Observe the performance of mgt's count procedures.
 - iii. Inspect the inventory &
 - iv. Perform test counts.
- B. Performing audit procedures over the entity's final inventory records to determine whether they accurately reflect actual inventory count results.

Attendance at Physical Inventory Counting Involves:-

- a. Inspecting the inventory to ascertain its existence & evaluate its condition, & performing test counts.
 - b. Observing compliance with mgt's instructions & the performance of procedures for recording & controlling the results of the physical inventory count and.
 - c. obtaining Audit evidence as to the reliability of mgt's count procedures.
- These procedures may serve as test of controls (or) Substantive procedures depending on the auditor's risk assessment, planned approach & the specific procedures carried out.

Matters Relevant in planning Attendance at Physical Inventory Counting include, for eg:-

- a. Nature of inventory
- b. Stages of completion of WIP
- c. The risks of MM related to inventory
- d. The nature of the internal control related to inventory
- e. whether adequate procedures are expected to be established & proper instructions issued for physical inventory counting.
- f. The timing of physical inventory counting.
- g. whether the entity maintains a perpetual inventory system.
- h. The locations at which inventory is held, including materiality of the inventory & the risks of MM at diff. locations, in deciding at which locations attendance is appropriate.
- i. whether the assistance of an auditor's expert is needed to obtain

Physical Inventory Counting Conducted Other than at the Date of the Financial Statements.

If physical inventory counting is conducted at a date other than the date of the F.S., the auditor shall perform audit procedures to obtain audit evidence about whether changes in inventory between the count date & date of the F.S. are properly recorded.

It includes:

- whether the perpetual inventory records are properly adjusted.
- Reliability of the entity's perpetual inventory records.
- Reasons - the info. obtained during the physical count & the perpetual inventory records.

If the auditor is unable to attend physical inventory counting due to unforeseen circumstances, the auditor shall make (or) observe some physical counts on an alternative date, & perform audit procedures on intervening transactions.

If attendance at physical inventory counting is impracticable, the auditor shall perform alternative audit procedures to obtain sufficient appropriate audit evidence regarding existence & condition of inventory. In some cases, attendance at physical inventory counting may be impracticable. This may be due to factors such as the nature & location of the inventory.

In other cases, however, it may not be possible to obtain sufficient appropriate audit evidence. In such cases, SA 705 requires the auditor to modify the opinion in the auditor's report as a result of the scope limitation.

When inventory under the custody & control of a third party - what will the auditor do?

It is material to the F.S., the auditor shall obtain sufficient appropriate audit evidence regarding the existence & condition of that inventory by performing one (or) both of the fllg:-

- a) Request confirmation from the 3rd party as to the quantities & condition of inventory held on behalf of the entity.
- b) Perform inspection (or) other procedures appropriate in the circumstance

Litigation and claims

The auditor shall design and perform audit procedures in order to identify litigation & claims involving the entity which may give rise to a risk of MM, including:

- Inquiry of mgt & where applicable, others within the entity, including in-house legal counsel;
- Reviewing minutes of meetings of those charged with governance & correspondence b/w the entity & its external legal counsel &
- Reviewing legal expense accounts.

This involving the entity may have a material effect on the F/S & thus may be required to be disclosed / accounted for in the F/S

If the auditor assesses a risk of MM 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 auditor shall do so through a letter of inquiry requesting the entity's external legal counsel to communicate directly with the auditor.

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

If it is considered unlikely that the entity's external legal counsel will respond appropriately to a letter of general inquiry. For this purpose, a letter of specific inquiry includes:-

- A list of litigation & claims.
- where available, mgt's assessment of the outcome of each of the identified litigation & claims & its estimate of the financial implications, including costs involved &
- A request that the entity's external legal counsel confirm the reasonableness of mgt's assessment & provide the auditor with further info. if the list is considered by the entity's external legal counsel to be incomplete (or) inconsistent.

further if:

- mgt refuses to give the auditor permission to communicate (or) meet with entity's external legal counsel (or) the entity's external legal

counsel refuses to respond appropriately to the letter of inquiry, (ISA 501)
is prohibited from responding &

b. the auditor is unable to obtain sufficient appropriate audit evidence by performing alternative audit procedures.

the auditor shall modify the opinion in the auditor's report in accordance with SA 705.

Segment Information

It refers to info. about diff. types of products & services of an enterprise & its operation in diff. geographical areas.

The auditor shall obtain sufficient appropriate audit evidence regarding the presentation & disclosure of segment info. in accordance with the applicable financial reporting framework by:

- a. Obtaining an understanding of the methods used by mgmt in determining segment info. &
 - i) Evaluating whether such methods are likely to result in disclosure in accordance with applicable financial reporting framework &
 - ii) where appropriate, testing the application of such methods &
- b. Performing analytical procedures (or) other procedures appropriate in the circumstances

The auditor's responsibility regarding presentation & disclosure of segment info. is in relation to the F.S taken as a whole. Accordingly, the auditor is not to perform audit procedures that would be necessary to express an opinion on the segment info. presented on a stand alone basis.

Understanding of the methods used by Management, like

- Sales, transfers & charges between segments & elimination of intersegment amounts.
- Comparisons with budgets & other expected results
- The allocation of assets & costs among segments.
- Consistency with prior periods, & the adequacy of the disclosures with respect to inconsistencies.

* External Confirmations SA 505

SA 500 indicates that the reliability of audit evidence is influenced by its source & by its nature & is dependent on the individual circumstances under which it is obtained.

- It also includes the following generalisations applicable to audit evidence:
- Audit evidence is more reliable when it is obtained from independent sources outside the entity.
 - It obtained directly by the auditor is more reliable than audit evidence obtained indirectly.
 - It is more reliable when it exists in documentary form, whether paper, electronic mode.

Scope of this SA

SA 505 "External confirmations" deals with the auditor's use of external confirmation procedures to obtain audit evidence in accordance with the requirement of SA 500.

Accordingly, audit evidence in form of external confirmations received directly by the auditor from confirming parties may be more reliable than evidence generated internally by the entity.

Thus, the objective of the auditor, when using external confirmation procedures, is to design & perform such procedures to obtain relevant & reliable audit evidence.

Definitions.

- External confirmation - an audit evidence obtained as a direct written response to the auditor from a 3rd party (the confirming party), in paper form (or) by electronic (or) other medium.
- Positive confirmation request - (A request that the confirming party respond directly to the auditor) indicating whether the confirming party agrees (or) disagrees with the info. in the request.
- Negative confirmation request - only if the confirming party disagrees with the info. provided in the request.
- Non-response - A failure of the confirming party to respond, (or) fully respond, to a +ve confirmation request, (or) a confirmation request returned undelivered.
- Exception - A response that indicates a diff b/w info. requested to be confirmed, (or) contained in the entity's records, & info. provided by the confirming party.

External confirmation procedures adopted by the Auditor to Obtain Audit evidence

When using external confirmation procedures, the auditor shall maintain control over external confirmation requests including:

a) Determining the info. to be confirmed (or) requested

This will frequently performed to confirm (or) request info. regarding A/c balances & their elements. They also be used to confirm terms of agreements, contracts (or) transactions b/w an entity & other parties.

b) Selecting the appropriate confirming party

Responses to confirmation requests provide more relevant & reliable audit evidence when confirmation requests are sent to a confirming party the auditor believes is knowledgeable abt the info. to be confirmed.

c) Designing Confirmation requests.

1. Design of a confirmation request

2. factors to be considered by auditor when designing confirmation requests

- assertions being addressed.
- Specific identified risks of MM
- layout & presentation of confirmation request
- Prior experience on the audit.
- method of communication etc.

3. Positive Confirmation request.

4. Determination of properly addressed request.

d) Follow-up on Confirmation requests.

The auditor may send an additional confirmation request when a reply to a previous request has not been recd within a reasonable time.

Management's refusal to allow the auditor to send a Confirmation request - steps taken by the Auditor. shall:

a) Inquire as to mgt's reasons for the refusal, & seek audit evidence as to their validity & reasonableness.

b) Evaluate the implications of mgt's refusal. on the auditor's assessment of the relevant risks of MM, including risk of fraud & on the nature, timing & extent of other audit procedures &.

c) Perform alternative audit procedures designed to obtain relevant & reliable audit evidence.

If auditor concludes that mgt's refusal to allow the auditor to send a confirmation request is unreasonable, (or) the auditor is unable to obtain relevant & reliable AE from alternative audit procedures, the auditor shall communicate with those charged with governance in accordance with SA 260.

Negative Confirmations.

It provides less persuasive audit evidence than +ve confirmations. Accordingly, the auditor shall not use -ve confirmation requests as the sole substantive audit procedure to address an assessed risk of MM at the assertion level unless of the flg are present:

- 1) The auditor has assessed the risk of MM as low & has obtained sufficient appropriate audit evidence regarding operating effectiveness of controls relevant to the assertion.
 - 2) The population of items subject to -ve confirmation procedures comprises a large no. of small, homogeneous, A/c balances, transactions (or) conditions.
 - 3) A very low exception rate is expected.
 - 4) The auditor is not aware of circumstances / conditions that would cause recipients of -ve confirmation requests to disregard such requests.
- The failure to receive a response → does not explicitly indicate receipt by the intended confirming party of confirmation request / verification of the accuracy of the info. contained in the request.

Accordingly, a failure of a confirming party to respond to a -ve confirmation request provides significantly less persuasive audit evidence than does a response to a +ve confirmation request.

Evaluating the Evidence obtained.

The auditor shall evaluate whether the results of the external confirmation procedures provide relevant & reliable audit evidence, (or) whether performing further audit procedures is necessary.

When evaluating the results of individual external confirmation requests, the auditor may categorise the results as follows:

- a) A response by the appropriate confirming party indicating agreement with the info. provided in the confirmation request, (or) providing requested info. without exception.
- b) A response deemed unreliable.
- c) A non-response (or)
- d) A response indicating an exception.

The auditor's evaluation, may assist the auditor in concluding whether sufficient appropriate audit evidence has been obtained (or) whether performing further audit procedures is necessary, as required by SA 330

Initial Audit Engagements - Opening Balances (SA 510)

Definitions:-

1. Initial Audit Engagement - refers to an engagement in which either:
 - i) The F.S for the prior period were not audited (or)
 - ii) The F.S for the " " " audited by a predecessor auditor.
2. Predecessor Auditor - The auditor from a diff. audit firm, who audited the F.S of an entity in the prior period & who has been replaced by the current auditor.
3. Opening balances - those a/c balances that exist at the beginning of the period.

They are based upon the closing balances of prior period & reflect the effects of transactions & events of prior periods & A/cng policies applied in the prior period.

It also include matters requiring disclosure that existed at the beginning of the period such as contingencies & commitments.

Scope of this SA

SA 510 "Initial Audit Engagements - Opening Balances" deals with the auditor's responsibilities relating to opening balances when conducting an initial audit engagement.

Objective of SA 510

The main objective of the auditor under SA 510 is to obtain sufficient appropriate audit evidence about whether:

- a) Opening balances contain material misstatements that affect the current period's F.S and.
- b). Consistent accounting policies have been applied in the current period in comparison to the prior period, (or) changes have been appropriately accounted for & disclosed.

Breakdown:-

opening balances - Auditor must ensure that they are correct & free from MM.

Consistency of policies - Auditor must check if the same A/cng policies are followed (or) properly changed

Obtaining sufficient appropriate audit evidence about opening balances by the Auditor.

The auditor shall obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's F.S by:

- a) Determining whether the prior period's cl. balances have been correctly brought forward to the current period (or) any adjustments have been disclosed as prior period items in the CY's statement of P&L.
- b) Determining whether op. balances reflect the application of appropriate a/cing policies &
- c) Performing one (or) more of the fllg: :
 - i. where prior year F.S were audited, pursuing the copies of audited F.S
 - ii. Evaluating whether audit procedures performed in the current period provide evidence relevant to the op. balances (or)
 - iii. Performing specific audit procedures to obtain evidence regarding the op. balances.

If the auditor obtains audit evidence (as per 1st objective), the auditor shall perform such additional audit procedures as are appropriate in the circumstances to determine the effect on the current period's F.S.

If the auditor concludes that such misstatements exist in the current period's F.S, the auditor shall communicate the misstatements with the appropriate level of mgt & those charged the governance

Procedures adopted by the Auditor to obtain Audit evidence regarding opening balance

1. Nature & extent of Audit procedures

It depend on such matters as :-

- a/cing policies followed by the entity.
- nature → A/c balances, classes of transactions & disclosures & risks of MM
- Significance of op. balances
- whether PP's F.S were audited if so, the predecessor auditor's opinion was modified.

1. Nature & extent of audit procedures

2. If the prior period's F.S were audited by a predecessor auditor.

3. For current assets & liabilities.

4. For non-current assets & liabilities.

2. If the prior period's F.S were audited by a predecessor auditor the auditor may be able to obtain sufficient appropriate audit evidence regarding the op. balances by perusing the copies of the audited F.S including such as supporting schedules to the audited F.S (documents).

Ordinarily, the current auditor can place reliance on cl. balances contained in the F.S for preceding period except when during the performance of audit procedures for the current period the possibility of misstatements in op. balances is indicated.

3. For current assets & liabilities

In the case of inventories, it may require additional audit procedure & may provide one (or) more of the flg for sufficient appropriate audit evidence:-

- observing a current physical inventory count & reconciling it to the opening inventory quantities
- Performing audit procedures on the valuation of the op. inventory items
- Performing " " on gross profit & cut-off.

4. For non-current assets & liabilities

i) such as PPE, investments & LTD, some audit evidence may be obtained by examining the a/cng records & other info.

ii) In certain cases, auditor may be able to obtain some audit evidence regarding op. balances through confirmation with 3rd parties

^{2nd objective}
Consistency of Accounting policies relating to opening balances

If the auditor concludes that:

- a) the current period's a/cng policies are not applied consistently in relation to op. balances in accordance with the applicable financial reporting framework (or)
- b) a change in A/cng policies 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.

Related Parties SA 550

Definition of Related party

A party that is either :-

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

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

Meaning of Control and Significant influence in reference to related party

- Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.
- Significant influence is the power to participate in the financial & operating policy decisions of an entity, but is not control over those policies.

Related parties with Dominant Influence

Related parties may be in a position to exert dominant influence over the entity / its mgt. Consideration of such behaviour is relevant when identifying and assessing the risks of MM due to fraud.

Special-purpose Entities as Related party

In some circumstances, it may be a related party of the entity because the entity may in substance control it, even if the entity owns little (or) none of special-purpose entity's equity.

Scope of this SA

SA 550 - Related parties deals with the auditor's responsibilities regarding related party relationships and transactions when performing an audit of F.S. Specifically, it applies in relation to risks of MM associated with related party relationships & transactions.

Nature of Related Party Relationships and Transactions

Many related party transactions are in the normal course of business. In such circumstances, they may carry no higher risk of MM of the F.S. than similar transactions with unrelated parties.

However, the nature of related party relationships & transactions may, in some circumstances, give rise to higher risks of MM of the F.S. than transactions with unrelated parties.

Understanding the entity's Related party Relationships & Transactions

The auditor shall inquire of mgt regarding:

- Identity of entity's related parties, including changes from prior period
- nature of relationships b/w the entity & related parties &
- whether - entity entered into any transactions with these related parties & if so, the type & purpose of transactions.

The auditor shall inquire within the entity, & perform other risk assessment procedures considered appropriate, to obtain an understanding of controls, if any, that mgt has established to:-

- Identify, account for & disclose
- Authorise & approve significant transactions & arrangements
- " " " " " " outside the normal course of business.

Considerations specific to Small entities by the auditor

In particular those charged with governance may not include an outside member, & the role of governance may be undertaken directly by the owner-manager where no other owner exists.

Control activities in smaller entities are likely to be less formal & small entities may have no documented processes for dealing with related party Relationships & Transactions.

The auditor may obtain an understanding & controls that may exist over these, through inquiry of mgt combined with other procedures, such as observation of mgt's oversight, & review activities & inspection of available relevant documentation.