

6. AUDIT EVIDENCE AND DOCUMENTATION

UNIT 1: AUDIT EVIDENCE

KEEP THESE POINTS IN MIND

DEAR STUDENTS,

- 1) THIS IS A VERY IMPORTANT SUBJECT FOR YOUR EXAMS & CAREER. FOCUS WELL.
- 2) YOU CAN'T QUALIFY THIS SUBJECT JUST BY MUGGING UP. IN THE EXAM THE QUESTIONS ARE GENERALLY TRICKY AND WILL MAKE THE STUDENT GET CONFUSED ABOUT WHICH ANSWER TO BE WRITTEN. THE ONLY OPTION IS TO LISTEN TO THE CLASSES WITH UTMOST ATTENTION AND TRY TO REVISE THE SUBJECT AS MUCH AS POSSIBLE.
- 3) WE DON'T HAVE A LUXURIOUS TIME, SO THAT FACULTY CAN DICTATE THE RUNNING NOTES. YOU NEED TO MAINTAIN THE SAME ON YOUR OWN.
- 4) TRUE OR FALSE STATEMENTS AND MCQs WILL BE PROVIDED IN SEPARATE MATERIAL. AFTER COMPLETION OF EACH CHAPTER, STUDENTS SHALL PREPARE THEM ON THEIR OWN.
- 5) WE HAVE CLASSIFIED THE CONCEPT QUESTIONS INTO 3 CATEGORIES & TYK QUESTIONS INTO 2 CATEGORIES:
 - a) CONCEPT QUESTIONS (CRD) & TYK (CRD): STUDENTS NEED TO NOTE THE ANSWERS EXPLAINED BY THE FACULTY IN THE CLASSROOM. WE WILL NOT PROVIDE THESE SOLUTIONS FOR ANY REASON.
 - b) CONCEPT QUESTIONS (SP) & TYK (SP): STUDENTS NEED TO SOLVE THEM ON THEIR OWN. WE WILL PROVIDE THESE SOLUTIONS IN WORKBOOK SOLUTIONS.
 - c) ADVANCED CONCEPT QUESTIONS (CRD): STUDENTS NEED TO NOTE BOTH QUESTIONS AND ANSWERS EXPLAINED BY THE FACULTY IN THE CLASSROOM. WE WILL NOT PROVIDE THESE QUESTIONS AND ANSWERS FOR ANY REASON.
- 6) SELF-LEARNING IS MANDATORY TO CRACK THIS SUBJECT. AS AND WHEN YOUR FACULTY TEACHES A TOPIC, TRY TO ANSWER CORRESPONDING CONCEPT QUESTIONS FOR SP, PRACTICAL QUESTIONS FOR SELF-PRACTICE & TYK +FOR SELF-PRACTICE ON YOUR OWN.
- 7) CONTENT GIVEN UNDER THE HEADING ADDITIONAL EXPLANATION:
 - a) IF IT IS SUFFICIENT TO UNDERSTAND AND NOT REQUIRED TO REPRODUCE THE SAME IN THE EXAMS THEN IT IS GIVEN IN 'ITALICS'.
 - b) IF IT IS REQUIRED FOR THE STUDENTS TO READ, UNDERSTAND AND REPRDOCUE THEN WE HAVE NOT USED ANY 'ITALICS'. IN INTERNAL AS WELL AS PUBLIC EXAMS YOU CAN EXPECT QUESTIONS ON THIS CONTENT.

LEARNING OBJECTIVES

AFTER STUDYING THIS CHAPTER, YOU WOULD BE ABLE TO UNDERSTAND:

- 1) Audit Evidence (SA 500)- Meaning, types, relevance and reliability, sufficiency and appropriateness and sources of audit evidence, audit procedures, nature and timing of audit procedures, Assertions, selecting items for testing, relying on the work of management expert and evaluation of audit evidence.
- 2) Using the work of internal Auditors (SA 610)- Meaning, scope and objective, nature, and extent of work of internal audit function, their activities, external auditor's responsibility for audit and objective having internal audit function, coordination between external auditor and internal auditor.

- 3) Audit Evidence- Specific Considerations for Selected Items (SA 501)- inventory, litigation and claims involving the entity, and segment information.
- 4) External Confirmations (SA 505)- meaning, definition of external, positive, and negative confirmations.
- 5) Related Parties (SA 550)- Definition, meaning and nature of related parties' relationship and transactions.
- 6) Practicality of above concepts by studying through examples and case studies.

CHAPTER OVERVIEW

DIVISION	TOPIC
1)	THEORY FOR CLASSROOM DISCUSSION (CRD)
2)	THEORY FOR SELF STUDY
3)	TEST YOUR KNOWLEDGE (CRD)
4)	TEST YOUR KNOWLEDGE (SELF STUDY)
5)	IDENTICAL QUESTIONS (SELF STUDY)
6)	IMPORTANT TECHNICAL TERMS (SELF STUDY)
7)	CONCEPTS THAT ARE RESHUFFLED

DIVISION 1: THEORY FOR CLASSROOM DISCUSSION

SA 500: AUDIT EVIDENCE

Q.No.1. Explain the Meaning and types of audit procedures to be performed by the Auditor?

(N19-3M)

OR

Explain the test of controls & substantive procedures as audit procedure of obtaining sufficient appropriate audit evidence for forming an audit opinion. Explain the compliance procedure & also substantive procedures as audit methods of collecting evidence for forming an audit opinion. OR What are the two basic types of audit tests? Give examples of each type & explain the purpose of each test?

(N16-RTP, N15-RTP, N09-RTP)

- A) MEANING OF AUDIT PROCEDURES:** It is a broad framework of audit through which the audit is carried out to obtain sufficient appropriate evidence in order to express the opinion on financial statements.
- B) TYPES:** The audit procedures are performed in two parts as below:
- 1) Risk Audit/ Assessment procedures; and
 - 2) Further audit procedures which consist of:
 - a) Compliance Procedures / Test of controls and
 - b) Substantive procedures (analytical procedures and test of details),
- C) RISK AUDIT/ ASSESSMENT PROCEDURES:**
- 1) **Meaning:** The audit procedures are performed to obtain an understanding of the entity and its environment including the Internal control system,
 - 2) **Purpose:** To identify and assess the risks of material misstatements in financial statements arising from fraud or error.
 - 3) Knowledge of client business is essential for proper conduct of audit.

D) FURTHER AUDIT PROCEDURES:**1) Compliance Procedures / Test of Controls**

- a) **Meaning:** Test of controls may be defined as an audit procedure designed to evaluate the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements at the assertion level.
- b) **Purpose:** To conclude whether to rely or not on the Internal Controls when conducting Substantive Procedures.

ADDITIONAL EXPLANATION (CRD):

- If the auditor obtains positive confirmations in compliance procedures, generally the timing and extent of substantive procedures will reduce.
- When more persuasive audit evidence is needed regarding the effectiveness of a control, it may be appropriate to increase the extent of testing of the control as well as the degree of reliance on controls.
- Test of Controls include:
 - How the controls were applied at relevant times during the period under audit.
 - The consistency with which they were applied.
- By whom or by what means they were applied.

2) SUBSTANTIVE PROCEDURES

- a) **Meaning:** Substantive procedure may be defined as an audit procedure designed to detect material misstatements at the assertion level. It involves examination of accounting records including financial statements to determine the reliability of information therein
- b) **Types:** They comprise tests of details and substantive analytical procedures.
- c) **Test of Details:**
- **Test of transactions:** It deals with vouching of transactions recorded in the accounting records.
 - **Test of balances:** It deals with the verification of balances in the accounting records.
- d) **ANALYTICAL PROCEDURES:** Analytical procedures consist of evaluation of financial information by understanding the relationships among the financial and non-financial data.

E) CONCLUSION:**1) Depending on the circumstances, the auditor may determine that:**

- a) Performing only substantive analytical procedures will be sufficient to reduce audit risk to an acceptably low level. or
- b) Only tests of details are appropriate.
- c) A combination of substantive analytical procedures and tests of details are most responsive to the assessed risks.
- 2) Irrespective of the assessed risks of material misstatement, the auditor shall design and perform substantive procedures for each material class of transactions, account balance, and disclosure.
- 3) The Compliance Procedures and substantive procedures must complement each other.
- 4) The absence of misstatements (non-identification) in substantive procedures does not indicate that the controls are effective.
- 5) The presence of material misstatement strongly indicates that there is a significant deficiency in the internal controls.

CONCEPT QUESTIONS (CRD):

- 1) 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 the 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. (NEW SM-EX) (N)
- 2) 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. (NEW SM-EX) (N)
- 3) 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. (NEW SM-EX) (N)

ADVANCED CONCEPT QUESTIONS: Faculty Shall Discuss 4 CQ Here.

(NON-ICAI SOURCES) (N)

Q.No.2. What Does Audit Evidence Refers to as per SA 500?**(L to L)**

- 1) **MEANING:** 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.
- 2) The auditor cannot express opinion unless he has examined the financial statements objectively. Further he shall obtain sufficient appropriate evidence.
- 3) It is cumulative in nature and is obtained from audit procedures performed.
- 4) "Audit evidence" is the very core on the basis of which conclusions are drawn and opinion is formed by an auditor.
- 5) Information that may be used as audit evidence may have been prepared using the work of a management's expert.
- 6) Audit evidence comprises both information that supports and corroborates management's assertions, and any information that contradicts such assertions.
- 7) 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.

ADDITIONAL EXPLANATION (SP):

- 1) Information contained in the accounting records.

Accounting records include.

- a) The records of initial accounting entries and supporting records, such as cheques and records of electronic fund transfers.
- b) Invoices.
- c) Contracts.
- d) The general and subsidiary ledgers, journal entries and other adjustments to the financial statements that are not reflected in journal entries; and
- e) Records such as work sheets and spreadsheets supporting cost allocations, computations, reconciliations, and disclosures.

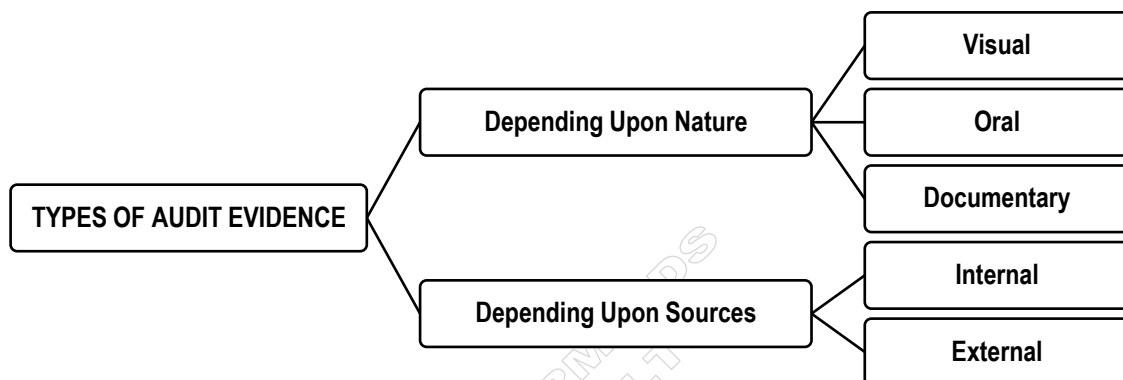
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- 2) Other information that authenticates the accounting records and also supports the auditor's rationale behind the true and fair presentation of the financial statements Other information which the auditor may use as audit evidence includes, for example
- Minutes of the meetings,
 - Written confirmations from trade receivables and trade payables,
 - Manuals containing details of internal control etc.

CONCEPT QUESTION (CRD):

- 1) 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. (NEW SM-EX)

Q.No.3. What are the Different types of Audit Evidence?



1) BASED ON FORM / NATURE:

- Documentary:** Evidence obtained in paper or electronic form. **E.g.:** Registration documents, title deeds, vouchers, Bills, fixed deposit certificate, loan agreement and sales bill etc.
- Oral:** Evidence which is obtained through inquiry. **E.g.:** Response to Inquiries made by auditor.
- Visual:** Evidence obtained by the auditor through actual observation. **E.g.:** Physical inspection of Fixed Assets, Cash, etc.

2) BASED ON SOURCE:

- Internal evidence:** Evidence which originates within the entity being audited is called internal evidence. **E.g.:** Sales invoice, Copies of sales challan and forwarding notes, goods received note, inspection report, copies of cash memo, debit and credit notes, etc.
- External evidence:** Evidence, which originates outside the entity being audited, is called external evidence. **E.g.:** Purchase invoice, supplier's challan and forwarding note, debit notes and credit notes coming from parties, quotations, confirmations, etc.

- 3) **AVAILABILITY:** The bulk of evidence that an auditor gets is internal in nature. However, Substantial external evidence is also available to the auditor but lesser in comparison to internal audit evidence.

4) RELIABILITY:

- The external evidence is generally considered to be more reliable compared with Internal evidence. As Client's staff will have control on the internal evidence.
- It does not mean that all the internal evidence needs to be suspected every time. But the auditor shall be alert to the possibilities of manipulation, creation of false and misleading evidence.

- 5) **CONCLUSION:** As an ordinary rule the auditor should try to match internal and external evidence as far as practicable. Where external evidence is not readily available to match, the auditor should try to match various internal evidence in support of each other.

ADDITIONAL EXPLANATION (CRD):**1) Depending Upon Impact:**

- a) **Persuasive Evidence:** Whatever management is asserting through accounting records & financial statements is most likely to be true than not.
- b) **Conclusive Evidence:** Evidence of such strength & quality that what management asserts is only true & any other possibility is ruled out is said to be conclusive evidence.
- c) **Corroborative Audit Evidence:** To confirm or support by further evidence. E.g., Debtors' confirmation & subsequent receipt, Fixed Deposit Receipt & confirmation from bank

ADDITIONAL EXPLANATION (SP):

	MADE BY	HELD BY	EXAMPLE
External	Third party	Third Party	Confirmation directly received by the Auditor.
External - Internal	Third party	Entity	Purchase invoices, Bills for services/Exp.
Internal - External	Entity	Third party	Sales invoices Delivery challans
Internal	Entity	Entity	Goods received note, Journal Voucher.
More reliable is External-External, then External-Internal, Internal-Internal			

CONCEPT QUESTIONS (CRD):

- 4) An audit team member of the auditors of Extremely 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 Extremely Genuine Limited. (OLD SM-EX)
- 5) 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. (NEW SM-EX)
- 6) Which of the following types of audit evidence is the most persuasive? (NON-ICAI SOURCES) (N)
 - a) Prenumbered client purchase order forms.
 - b) Client work sheets supporting cost allocations.
 - c) Bank statements obtained from the client.
 - d) Client representation letter.

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CONCEPT QUESTIONS (SP):

- 1) Purchase invoice is an example of internal evidence. Determine Whether the sentence is Correct/Incorrect. (NEW SM-T/F) (N)

Q.No.4. The Audit Evidence on which auditor bases his opinion shall be sufficient & appropriate. Explain.

(Or)

State various factors that help the auditor to ascertain as to what is sufficient & appropriate audit evidence?

(Or)

What do you mean by the term 'Sufficient Appropriate Audit Evidence? State various factors that help the auditor to ascertain as to what is sufficient appropriate audit evidence?

(NEW SM -TQ) (N17- 4M, N10 - 6M) (M15-RTP, N13-RTP, M23-RTP, M23-MTP II-3M) (L to L)

The auditor has to obtain sufficient appropriate audit evidence to draw reasonable conclusions on financial statements.

- 1) **SUFFICIENCY OF AUDIT EVIDENCE:** Sufficiency is the measure of the Quantity of audit evidence. The following factors influence the auditor's judgement of sufficiency:

a) **Materiality:**

- It's all about 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.

b) **Risk of Material Misstatements:**

- 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.

c) **Size & Characteristics of Population:**

- Size refers to the number of items included in the population. Less evidence would be required in the case of smaller, more homogeneous population but on the other hand in case of larger, more heterogeneous populations, more evidence would be required.

ADDITIONAL EXPLANATION (SP):

- 1) Nature and Size of organization.
- 2) **Source:** The quantum of evidence to be obtained is affected by their Source.
E.g.: Generally external evidence is more reliable than internal evidence.
- 3) **Internal Control:** If the controls are more effective then quantum of audit procedures decreases and resultantly the number of evidence also decreases.
- 4) Nature Of Exceptions Identified (contradicting evidence)
- 5) Circumstances Resulting in Change in The Initially Assessed Risk of Material Misstatement.

- 2) **APPROPRIATENESS OF AUDIT EVIDENCE:** It's a measure of quality i.e., Relevance & Reliability

- a) Auditors shall consider the relevance and reliability of the information to be used as audit evidence and he has to express opinion on the truth and fairness on the financial statements.
- b) **Relevance:** It deals with the logical connection with, or bearing upon, the purpose of the audit procedure and, where appropriate, the assertion under consideration. The relevance of information to be used as audit evidence may be affected by the direction of testing.

ADDITIONAL EXPLANATION (CRD):

- If the purpose of an audit procedure is to test for overstatement in the existence or valuation of accounts payable, testing the recorded accounts payable may be a relevant audit procedure.

- On the other hand, when testing for understatement in the existence or valuation of accounts payable, testing the recorded accounts payable would not be relevant, but testing such information as subsequent disbursements, unpaid invoices, suppliers' statements, and unmatched receiving reports may be relevant.
- A given set of audit procedures may provide audit evidence that is relevant to certain assertions, but not others. For example, inspection of documents related to the collection of receivables after the period end may provide audit evidence regarding existence and valuation, but not necessarily cut-off.
- Obtaining audit evidence regarding a particular assertion, for example, the existence of inventory, is not a substitute for obtaining audit evidence regarding another assertion, for example, the valuation of that inventory.
- On the other hand, audit evidence from different sources or of a different nature may often be relevant to the same assertion.

ADDITIONAL EXPLANATION (SP):

- *Tests of controls are designed to evaluate the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements at the assertion level. Designing tests of controls to obtain relevant audit evidence includes identifying conditions (characteristics or attributes) that indicate performance of a control, and deviation in conditions which indicate departures from adequate performance. The presence or absence of those conditions can then be tested by the auditor.*
- *Substantive procedures are designed to detect material misstatements at the assertion level. They comprise tests of details and substantive analytical procedures. Designing substantive procedures includes identifying conditions relevant to the purpose of the test that constitute a misstatement in the relevant assertion.*

- c) **Reliability:** 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.

Therefore, generalizations about the reliability of various kinds of audit evidence are subject to important exceptions. 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.

For example,

Information obtained from an independent external source may not be reliable if the source is not knowledgeable, or a management's expert may lack objectivity.

- 3) **SUFFICIENCY AND APPROPRIATENESS ARE INTERRELATED:** The sufficiency and appropriateness of audit evidence are interrelated. Sufficiency is the measure of the quantity of audit evidence. Appropriateness is the measure of the quality of audit evidence.

CONCEPT QUESTIONS (CRD):

- 7) 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 the importance of audit evidence informed them about sufficiency and appropriateness of audit evidence. Mr. A, one of the members of the 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. (NEW SM-EX) (N)

CONCEPT QUESTION (SP):

- 1) Appropriateness is the measure of the quantity of. audit evidence (M23-T/F-2M) (N)

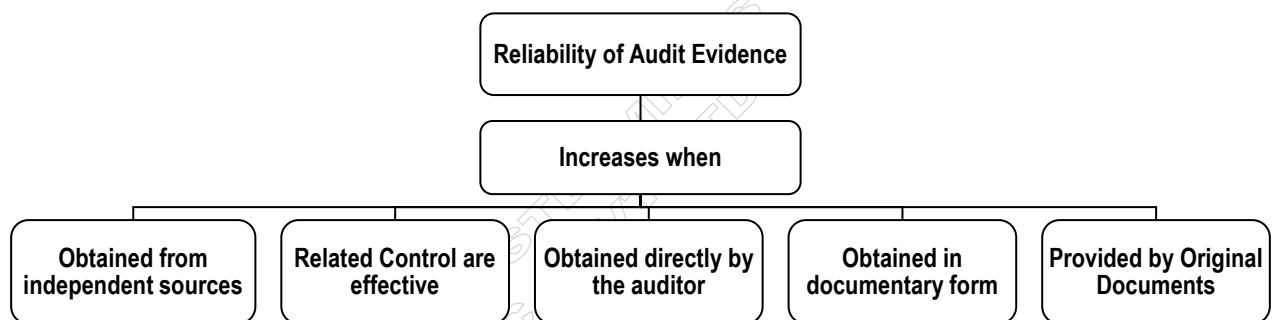
ADVANCED CONCEPT QUESTION: Faculty Shall Discuss 1 CQ Here

(NON-ICAI SOURCES) (N)

Q.No.5. Discuss the principles, which are useful in assessing the reliability of audit evidence.

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

- 1) **INDEPENDENT SOURCES:** The reliability of audit evidence is increased when it is obtained from independent sources outside the entity.
- 2) **EFFECTIVE INTERNAL CONTROLS:** 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.
- 3) **DIRECTLY OBTAINED BY AUDITOR:** 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).
- 4) **WRITTEN EVIDENCE:** 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).
- 5) **ORIGINAL DOCUMENTS:** Audit evidence provided by original documents is more reliable than audit evidence provided by photocopies or facsimiles, or documents that have been filmed, digitised or otherwise transformed into electronic form, the reliability of which may depend on the controls over their preparation and maintenance.

**ADDITIONAL EXPLANATION (CRD):**

INCONSISTENCY IN OR DOUBTS OVER RELIABILITY OF AUDIT EVIDENCE: 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 If:

- a) Audit evidence obtained from one source is inconsistent with that obtained from another:
or

- b) The auditor has doubts over the reliability of information to be used as audit evidence,

SA 230 includes a specific documentation requirement if the auditor identified information that is inconsistent with the auditor's final conclusion regarding a significant matter.

CONCEPT QUESTIONS (CRD):

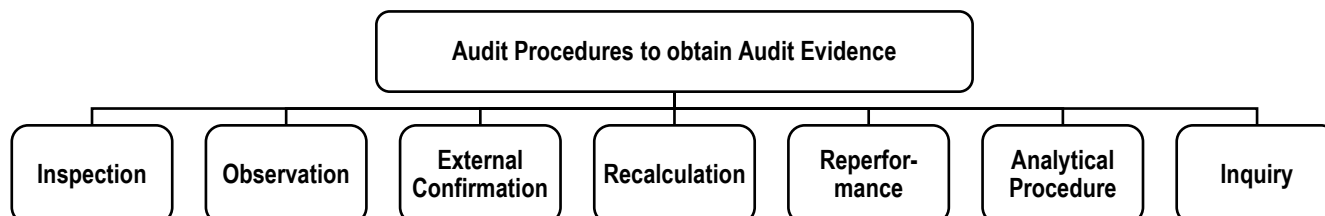
- 8) There was a Partnership Firm of Chartered Accountants WT and Associates. Mr. W, one of the partners of WT and Associates, while explaining to his audit team members about importance of audit evidence informed them about sufficiency and appropriateness of audit evidence. Mr. H, one of the members of audit team of WT 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. (OLD SM-EX)

ADVANCED CONCEPT QUESTIONS: Faculty Shall Discuss 2 CQ Here

(NON-ICAI SOURCES) (N)

Q.No.6. Explain Various Techniques/Methods/Tools/Procedures for obtaining Audit Evidence. (L to L)

Audit Procedures are broad framework within which the audit shall be carried out. Sometimes audit procedures and the term audit techniques are used interchangeably. Typically, techniques are tools for performing audit. The following are various Procedures/Methods of obtaining audit evidence.



- **INSPECTION:**

- 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:**

- An 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 a stock or bond. Inspection of such documents may not necessarily provide audit evidence about ownership or value.
- 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 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.
- Inspection of documents like bond/ fixed certificate for evidence related to existence of an asset.
- 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 with respect to their existence.

- **OBSERVATION:**

- Observation consists of looking at a process or procedure being performed by others,
- For example, the auditor's observation of inventory counting by the entity's internal controls.
- Observation provides audit evidence about the performance of a process or procedure but is limited to the point in time at which the observation takes place, and by the fact that the act of being observed may affect how the process or procedure is performed.

- **EXTERNAL CONFIRMATION: (SA 505)**

- An external confirmation represents audit evidence obtained by the auditor as a direct written response to the auditor from a third party (the confirming party).
- It can be obtained in paper form or by electronic or other medium.
- External confirmation procedures frequently are relevant when addressing assertions associated with certain account balances and their elements.

- d) However, external confirmations need not be restricted to account balances only.

E.g., The auditor may request confirmation of the terms of agreements or transactions an entity has with third parties; the confirmation request may be designed to ask if any modifications have been made to the agreement and, if so, what the relevant details are.

- e) External confirmation procedures also are used to obtain audit evidence about the absence of certain conditions.

E.g., The absence of a "side agreement" that may influence revenue recognition.

- **RE-CALCULATION:** Recalculation consists of checking the arithmetical accuracy of documents or records. Recalculation may be performed manually or electronically.

- **RE-PERFORMANCE:** Re-performance involves the auditor's independent execution of procedures or controls that were originally performed by the entity's internal control.

E.g., Re-performing the reconciliation of bank statement, re-performing the aging of accounts receivable.

- **ANALYTICAL PROCEDURES:**

- a) Analytical procedures consist of evaluations of financial information made by a study of plausible relationships among both financial and non-financial data.

- b) Analytical procedures also encompass the investigation of identified fluctuations and relationships that are inconsistent with other relevant information or deviate significantly from predicted amounts

- **INQUIRY:**

- a) Inquiry consists of seeking information of knowledgeable 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.

- d) Evaluating responses to inquiries is an integral part of the inquiry process.

- e) Through inquiry the auditor may obtain following four types of information:

- New information which auditor originally not aware of.
- Information that differs significantly from other information that the auditor has obtained; and
- Additional information in support for existing information which is corroborative in nature.
- Basis for the auditor to modify or perform additional audit procedures

- f) 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.

- g) 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.

- h) 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.

- i) 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.

- j) The evidence often comes from inquires may not be persuasive as it is less reliable.

ADDITIONAL EXPLANATION (CRD):

- Audit evidence obtained from previous audits may, in certain circumstances, provide appropriate audit evidence where the auditor performs audit procedures to establish its continuing relevance.
- 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.

CONCEPT QUESTIONS (CRD):

- 9) While auditing the books of accounts of Extremely Distinct Limited for the financial year 2020-21, 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. (OLD SM-EX)
- 10) While auditing the books of accounts of AB Limited for the financial year 2022 -23, 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. (NEW SM-EX)
- 11) CA K audited the books of accounts of E Ltd., for the financial year 2020-21. 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. (DEC21- 3M)
- 12) The auditor shall assemble the audit documentation in the audit file and complete the administrative process of assembling the final audit file before the date of the auditor's report. (N22-T/F)

CONCEPT QUESTIONS (SP):

- 2) 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". (DEC21-2M)
- 3) Whether Inquiry alone is sufficient to test the operating effectiveness of controls or not. (NEW SM-T/F) (N)
- 4) When auditor inquires the management as part of the audit procedures it should be formal written form only and not informal oral inquiries. (NEW SM-T/F) (N)

ADVANCED CONCEPT QUESTIONS: Faculty Shall Discuss 7 CQ Here

(NON-ICAI SOURCES) (N)

Q.No.7. What are the factors that affect the nature, timing, and extent of audit procedures, when information to be used as audit evidence has been prepared using the work of a management's expert? (L to L)

When information to be used as audit evidence has been prepared using the work of a management's expert, the nature, timing, and extent of audit procedures may be affected by such matters.

- 1) Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion.
- 2) Evaluate the competence, capabilities, and objectivity of that expert.
- 3) Obtain an understanding of the work of that expert; and

- 4) The nature and complexity of the matter to which the management's expert relates.
- 5) The risks of material misstatement in the matter.
- 6) The availability of alternative sources of audit evidence.
- 7) The nature, scope, and objectives of the management's expert's work.
- 8) Whether the management's expert is employed by the entity, or is a party engaged by it to provide relevant services.
- 9) The extent to which management can exercise control or influence over the work of the management's expert.
- 10) Whether the management's expert is subject to technical performance standards or other professional or industry requirements.
- 11) The nature and extent of any controls within the entity over the management's expert's work.
- 12) The auditor's knowledge and experience of the management's expert's field of expertise.
- 13) The auditor's previous experience of the work of that expert.

SA 610: USING THE WORK OF INTERNAL AUDITORS

Q.No.8. What are the objectives of SA 610?

The objectives of the external auditor, where the entity has an internal audit function and the external auditor expects to use the work of the function to modify the nature or timing, or reduce the extent, of audit procedures to be performed directly by the external auditor, or to use internal auditors to provide direct assistance, are:

- 1) To determine whether the work of the internal audit function or direct assistance from internal auditors can be used, and
- 2) If so decided to use, in which areas and to what extent; and having made that determination:
- 3) If using the work of the internal audit function, to determine whether that work is adequate for purposes of the audit; and
- 4) If using internal auditors to provide direct assistance, to appropriately direct, supervise and review their work.

Q.No.9. What are the ways in which the external auditor may make use of the function for purposes of the audit.? (L to L)

- 1) While the objectives of an entity's internal audit function and the external auditor differ, the internal audit function may perform audit procedures similar to those performed by the external auditor in an audit of financial statements.
- 2) If so, the external auditor may make use of the function for purposes of the audit in one or more of the following ways:
 - a) To obtain information that is relevant to the external auditor's assessments of the risks of material misstatement.
 - b) **Using the work of the internal auditor:** Unless prohibited, or restricted to some extent, by law or regulation, the external auditor, after appropriate evaluation, may decide to use work that has been performed by the internal audit function during the period in partial substitution for audit evidence to be obtained directly by the external auditor.
 - c) **Direct Assistance:** Unless prohibited, or restricted to some extent, by law or regulation, the external auditor may use internal auditors to perform audit procedures under the direction, supervision and review of the external auditor (referred to as "direct assistance").

ADDITIONAL EXPLANATION (CRD): The external auditor has sole responsibility for the audit opinion expressed, and that responsibility is not reduced by the external auditor's use of the work of the internal audit function or internal auditors to provide direct assistance on the engagement.

Q.No.10. The external auditor shall determine whether the work of the internal audit function can be used for purposes of the audit. Explain the evaluations? (NEW SM-TQ)(L to L)

(Or)

Discuss some of circumstances when work of the internal auditor cannot be used by external auditor.

- A)** The external auditor shall determine whether the work of the internal audit function can be used for purposes of the audit by evaluating the following:
- 1) The extent to which the internal audit function's organizational status and relevant policies and procedures support the objectivity of the internal auditors.
 - 2) The level of competence of the internal audit function and
 - 3) Whether the internal audit function applies a systematic and disciplined approach, including quality control.

ADDITIONAL EXPLANATION (CRD):

- a) *The external auditor exercises professional judgment in determining whether the work of the internal audit function can be used for purposes of the audit, and the nature and extent to which the work of the internal audit function can be used in the circumstances.*
- b) The external auditor shall not use the work of the internal audit function if the external auditor determines that:
 - 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.

B) OBJECTIVITY AND ITS EVALUATION:

- 1) Objectivity refers to the ability to perform those tasks without allowing bias, conflict of interest or undue influence of others to override professional judgments.
- 2) Factors that may affect the external auditor's evaluation in relation to Objectivity include
 - a) Whether the organizational status of the internal audit function, including the function's authority and accountability, supports the ability of the function to be free from bias, conflict of interest or undue influence of others to override professional judgments.

ADDITIONAL EXPLANATION (CRD):

For example, whether the internal audit function reports to those charged with governance or an officer with appropriate authority, or if the function reports to management, whether it has direct access to those charged with governance.

- b) Whether those charged with governance oversee employment decisions related to the internal audit function. For example, determining the appropriate remuneration policy.
- c) Whether there are any constraints or restrictions placed on the internal audit function by management or those charged with governance, for example, in communicating the internal audit function's findings to the external auditor.
- d) Whether the internal audit function is free of any conflicting responsibilities, for example, having managerial or operational duties or responsibilities that are outside of the internal audit function.

C) COMPETENCE AND ITS EVALUATION

- 1) Competence of the internal audit function refers to the attainment and maintenance of knowledge and skills of the function as a whole at the level required to enable assigned tasks to be performed diligently and in accordance with applicable professional standards.
- 2) Factors that may affect the external auditor's determination in relation to competence include
 - a) Whether the internal audit function is adequately and appropriately resourced relative to the size of the entity and the nature of its operations.
 - b) Whether there are established policies for hiring, training and assigning internal auditors to internal audit engagements.
 - c) Whether the internal auditors have adequate technical training and proficiency in auditing.
 - d) Whether the internal auditors possess the required knowledge relating to the entity's financial reporting and the applicable financial reporting framework.

ADDITIONAL EXPLANATION (CRD):

- Objectivity and competence may be viewed as a continuum (continuous Sequence).
- The more the internal audit function's organizational status and relevant policies and procedures adequately support the objectivity of the internal auditors and the higher the level of competence of the function, the more likely the external auditor may make use of the work of the function and in more areas.
- However, an organizational status and relevant policies and procedures that provide strong support for the objectivity of the internal auditors cannot compensate for the lack of sufficient competence of the internal audit function.
- Equally, a high level of competence of the internal audit function cannot compensate for an organizational status and policies and procedures that do not adequately support the objectivity of the internal auditors.

D) APPLICATION OF A SYSTEMATIC AND DISCIPLINED APPROACH:

- 1) The application of a systematic and disciplined approach to planning, performing, supervising, reviewing and documenting its activities distinguishes the activities of the internal audit function from other monitoring control activities that may be performed within the entity.
- 2) Factors that may affect the external auditor's determination of whether the internal audit function applies a systematic and disciplined approach include
 - a) The existence, adequacy and use of documented internal audit procedures or guidance covering such areas as risk assessments, work programs, documentation and reporting, the nature and extent of which is commensurate with the size and circumstances of an entity.
 - b) Whether the internal audit function has appropriate quality control policies and procedures.

Q.No.11. Write some examples of work of the internal audit function that can be used by the external auditor?

- 1) For determining the areas and the extent to which the work of the internal audit function can be used, the external auditor shall consider the nature and scope of the work performed or planned to be performed, by the internal audit function and its relevance to the external auditor's overall audit strategy and plan.
- 2) Examples of work of the internal audit function that can be used by the external auditor include the following:
 - a) Testing of the operating effectiveness of controls.
 - b) Substantive procedures involving limited judgment.

- c) Observations of inventory counts.
- d) Tracing transactions through the information system relevant to financial reporting.
- e) Testing compliance with regulatory requirements.

Q.No.12. External auditor plans to use the work of the internal audit function. State his responsibilities?

- 1) Discuss the planned use of its work with the function as a basis for coordinating their respective activities.
 - a) **Discussions may be useful to address the following:**
 - The timing of such work.
 - The nature of the work performed.
 - The extent of audit coverage.
 - Materiality for the financial statements as a whole and performance materiality.
 - Proposed methods of item selection and sample sizes.
 - Documentation of the work performed.
 - Review and reporting procedures.
 - b) **Coordination between the external auditor and the internal audit function is**
 - Discussions take place at appropriate intervals throughout the period.
 - The external auditor informs the internal audit function of significant matters that may affect the function.
 - The external auditor is advised of and has access to relevant reports of the internal audit function and is informed of any significant matters that come to the attention of the function when such matters may affect the work of the external auditor so that the external auditor is able to consider the implications of such matters for the audit engagement.
- 2) Read the reports of the internal audit function relating to the work of the function that the external auditor plans to use to obtain an understanding of the nature and extent of audit procedures it performed and the related findings.
- 3) Perform sufficient audit procedures on the body of work of the internal audit function as a whole that the external auditor plans to use to determine its adequacy for purposes of the audit.

Q.No.13. Determine whether, in Which Areas, and to What Extent Internal Auditors Can Be Used to Provide Direct Assistance?

- 1) Direct assistance refers to the use of internal auditors to perform audit procedures under the direction, supervision and review of the external auditor.
- 2) If using internal auditors to provide direct assistance is not prohibited by law or regulation, and the external auditor plans to use internal auditors to provide direct assistance on the audit, the external auditor shall evaluate the existence and significance of threats to objectivity and the level of competence of the internal auditors who will be providing such assistance.
- 3) The external auditor's evaluation of the existence and significance of threats to the internal auditors' objectivity shall include inquiry of the internal auditors regarding interests and relationships that may create a threat to their objectivity.

- 4) The external auditor shall not use an internal auditor to provide direct assistance if:
- a) There are significant threats to the objectivity of the internal auditor; or
 - b) The internal auditor lacks sufficient competence to perform the proposed work.
- 5) The external auditor shall not use internal auditors to provide direct assistance to perform procedures that:
- a) Involve making significant judgments in the audit;
 - b) Relate to higher assessed risks of material misstatement where the judgment required in performing the relevant audit procedures or evaluating the audit evidence gathered is more than limited;
 - c) Relate to work with which the internal auditors have been involved and which has already been, or will be, reported to management or those charged with governance by the internal audit function; or
 - d) 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.
- 6) Prior to using internal auditors to provide direct assistance for purposes of the audit, the external auditor shall:
- 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
 - 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.

SA 501: AUDIT EVIDENCE-SPECIFIC CONSIDERATIONS FOR SELECTED ITEMS

Q.No.14. What are the objectives of the auditor under SA 501?

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

- a) Existence and condition of Inventory.
- a) Completeness of litigation and claims involving the entity; and
- b) Presentation and disclosure of segment information in accordance with the applicable financial reporting framework.

Q.No.15. Write about the audit procedures for checking the existence and condition of inventory? (L TO L)

1) Attend Management Inventory Counting:

- a) When inventory is material to the financial statements the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of inventory as at year end i.e., Date of financial statements by:
 - a) Attendance at physical inventory counting performed by management to:
 - 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
 - Inspect the inventory; and
 - Perform test counts; and
 - Reconcile the physical inventory with the inventory records to identify any discrepancies.

These procedures may serve as test of controls or substantive procedures depending on the auditor's risk assessment, planned approach and the specific procedures carried out

2) Physical Inventory Counting Conducted other than at the Date of the Financial Statements:

- a) If physical inventory counting is conducted at a date other than the date of the financial statements, the auditor shall, in addition to the procedures required above, perform audit procedures to obtain audit evidence about whether changes in inventory between the count date and the date of the financial statements are properly recorded.
- b) Relevant matters for consideration when designing audit procedures to obtain audit evidence about whether changes in inventory amounts between the count date, or dates, and the final inventory records are properly recorded include:
 - Whether the perpetual inventory records are properly adjusted.
 - Reliability of the entity's perpetual inventory records.
 - Reasons for significant differences between the information obtained during the physical count and the perpetual inventory records.

3) If the auditor unable to Attend Physical Inventory Counting due to Unforeseen Circumstances: If the auditor is unable to attend physical inventory counting by management due to unforeseen circumstances, the auditor shall make or observe some physical counts on an alternative date, and perform audit procedures on intervening transactions.

4) Physical Inspection Impracticability:

- a) If attendance at physical inventory counting is impracticable (due to factors such as the nature and location of the inventory), the auditor shall perform alternative audit procedures to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory.
- b) Example, inspection of documentation of the subsequent sale of specific inventory items acquired or purchased prior to the physical inventory counting, may provide sufficient appropriate audit evidence about the existence and condition of inventory.
- c) If alternative procedures are not possible to do so, the auditor shall modify the opinion in the auditor's report in accordance with SA 705.
- d) The matter of inconvenience, difficulty, time, or cost involved is not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative or to be satisfied with audit evidence that is less than persuasive.
- e) 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
- f) Example, where inventory is held in a location that may pose threats to the safety of the auditor.

5) Inventory in the Custody of Third Party: When inventory under the custody and control of a third party the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of that inventory by performing one or both of the following:

- a) Request confirmation from the third party as to the quantities and condition of inventory held on behalf of the entity. (SA 505)
- b) Perform inspection or other audit procedures appropriate in the circumstances
- c) Other audit procedure may include
 - Inspecting documentation regarding inventory held by third parties, for example, warehouse receipts.
 - Requesting confirmation from other parties when inventory has been pledged as collateral.

- 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.

CONCEPT QUESTIONS (CRD):

- 1) Paramount 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 Paramount Exports Ltd. Considers that inventory held with job workers is material to the financial statements. Suggest the audit procedures in the given case. (OLD SM-EX)
- 2) Pride 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. (M20-MTP1-4M) (M21-MTP2-4M) (M19-4M)

Q.No.16. What are the Matters Relevant in Planning Attendance at Physical Inventory Counting?**(Or)**

Explain clearly the examples of matters relevant in planning attendance at physical inventory counting.

- a) Nature of Inventory
- b) Stages of completion of WIP
- c) Internal Controls related to Inventory
- d) Whether adequate instructions are given for physical inventory counting
- e) Timing of physical inventory counting
- f) Whether the entity is maintaining perpetual inventory system
- g) Whether assistance of auditors expert is needed
- h) The location at which inventory is held and related risks
- i) Whether the assistance of an auditor's expert is needed

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CONCEPT QUESTIONS (CRD):

- 13) 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. You are Required to Suggest the audit procedures in the given case. (NEW SM-EX)

Q.No.17. Write about the audit procedures for checking the completeness of Litigations & Claims? (L TO L)

- 1) Litigation and claims involving the entity may have a material effect on the financial statements and thus may be required to be disclosed or accounted for in the financial statements
- 2) 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:
 - a) Inquiry of management and, where applicable, others within the entity, including in-house legal counsel.
 - b) Reviewing minutes of meetings of those charged with governance and correspondence between the entity and its external legal counsel; and

- c) Reviewing legal expense accounts.
- d) In addition to the procedures identified above, auditor may perform other relevant procedures which may include using information obtained through risk assessment procedures carried out as part of obtaining an understanding of the entity and its environment to assist the auditor to become aware of litigation and claims involving the entity.
- e) **If the auditor assesses a risk of material misstatement regarding litigation or claims:**
- i) The auditor shall, in addition to the procedures required by other SAs, seek direct communication with the entity's external legal counsel.
 - ii) The auditor shall do so through a letter of inquiry, prepared by management and sent by the auditor, requesting the entity's external legal counsel to communicate directly with the auditor.
 - iii) The auditor shall perform alternative audit procedures if law, regulation or the respective legal professional body prohibits the entity's external legal counsel from communicating directly with the auditor.
 - iv) If it is considered unlikely that the entity's external legal counsel will respond appropriately to a letter of general inquiry, for example if the professional body to which the external legal counsel belongs prohibits response to such a letter, the auditor may seek direct communication through a letter of specific inquiry.
 - v) For this purpose, a letter of specific inquiry includes.
 - A list of litigation and claims.
 - Where available, management's assessment of the outcome of each of the identified litigation and claims and its estimate of the financial implications, including costs involved. and
 - A request that the entity's external legal counsel confirm the reasonableness of management's assessments and provide the auditor with further information if the list is considered by the entity's external legal counsel to be incomplete or incorrect.
 - vi) 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:
 - 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.
 - vii) Further if:
 - Management refuses to give the auditor permission to communicate or meet with the entity's external legal counsel, or the entity's external legal counsel refuses to respond appropriately to the letter of inquiry, or is prohibited from responding; and
 - 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.
 - viii) If the auditor is unable to obtain sufficient appropriate audit evidence by performing alternative audit procedures, then the auditor shall modify the opinion in the auditor's report in accordance with SA 705.

CONCEPT QUESTIONS (CRD):

- 14) 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. Required Suggest the auditor with reference to SAs. (NEW SM-EX) (N)
- 15) The audit procedures performed so far by the 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? (NEW SM-EX) (N)
- 16) 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. (M22-RTP)

CONCEPT QUESTIONS (SP):

- 5) SPR Ltd has been into the media business since 1990. During F.Y 2021-2022 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? (M22-3M)

Q.no.18. Write about the audit procedures for checking the presentation & disclosure of Segment Information? (L TO L)

(Or)

Explain clearly the examples of matters relevant in planning attendance at physical inventory counting. (OLD SM-TYK)

- 1) **SEGMENT INFORMATION:** Segment Information refers to information about different types of products and services of an enterprise and its operations in different geographical areas.
- 2) **AUDIT PROCEDURES:** 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:
- a) Obtaining an understanding of the methods used by management in determining segment information, and:
 - i) Evaluating whether such methods are likely to result in disclosure in accordance with the applicable financial reporting framework; and
 - ii) Where appropriate, testing the application of such methods; and
 - b) Performing analytical procedures or other audit procedures appropriate in the circumstances.
- 3) **AUDITOR'S RESPONSIBILITY REGARDING SEGMENT INFORMATION:**
- a) The auditor's responsibility regarding the presentation and disclosure of segment information is in relation to the financial statements taken as a whole.
 - b) Accordingly, the auditor is not required to perform audit procedures that would be necessary to express an opinion on the segment information presented on a standalone basis.
- 4) **UNDERSTANDING OF THE METHODS USED BY MANAGEMENT:** Depending on the circumstances, 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.
- i) Sales, transfers and charges between segments, and elimination of intersegment amounts.
 - ii) Comparisons with budgets and other expected results, for example, operating profits as a percentage of sales.

- iii) The allocation of assets and costs among segments.
- iv) Consistency with prior periods, and the adequacy of the disclosures with respect to inconsistencies.

CONCEPT QUESTIONS (CRD):

- 17) ABC Ltd is engaged in the 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 you would proceed as an auditor. (M18-MTP1-5M) (N18-MTP2-5M) (M19-MTP1-5M)
- 18) The matter of difficulty, time, or cost involved is in itself a valid basis for impracticability of physical verification of inventory. (OLD SM-EX)

SA 505: EXTERNAL CONFIRMATIONS

Q.No.19. What is External Confirmation, its types and Objective of SA 505?

DEFINITIONS:

- 1) **External Confirmation:** Audit evidence obtained as a direct written response to the auditor from a third party (AKA the confirming party), in paper form, or by electronic or other medium.
 - a) **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.
 - b) **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.
- 2) **Objective:** The objective of the auditor, when using external confirmation procedures, is to design and perform such procedures to obtain relevant and reliable audit evidence.

CONCEPT QUESTION (CRD):

- 1) During the financial year 2022-23, 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 Healthy and Wealthy Limited. State and explain the type of Confirmation Request as required by the auditor. (NEW SM-EX) (N)

Q.No.20. Write about External Confirmation Procedures to be adopted by the Auditor to Obtain Audit Evidence?

(Or)

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. (NEW SM-TQ)

- 1) **EXTERNAL CONFIRMATION PROCEDURES:** When using external confirmation procedures, the auditor shall maintain control over external confirmation requests, including:
 - 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.
 - d) Sending the requests, including follow-up requests when applicable, to the confirming party.

2) Determining The Information To Be Confirmed Or Requested:

- a) External confirmation procedures frequently are performed to confirm or request information regarding account balances and their elements.
- b) They may also be used to confirm terms of agreements, contracts, or transactions between an entity and other parties, or to confirm the absence of certain conditions, such as a “side agreement”.
- c) External confirmation can be obtained not only for account balances at yearend but also for above details

3) Selecting The Appropriate Confirming Party:

- a) Responses to confirmation requests provide more relevant and reliable audit evidence when confirmation requests are sent to a confirming party the auditor believes is knowledgeable about the information to be confirmed.
- b) For example, a financial institution official who is knowledgeable about the transactions or arrangements for which confirmation is requested may be the most appropriate person at the financial institution from whom to request confirmation.

4) Designing The Confirmation:

- a) **Design of a confirmation request:** 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. (Positive confirmation vs. Negative confirmation)

- b) **Factors to consider when designing confirmation requests include:**

- 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 authorization 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 authorization.
- The ability of the intended confirming party to confirm or provide the requested information (for example, individual invoice amount versus total balance).

- c) **Positive confirmation request:**

- A positive external confirmation request asks the confirming party to reply to the auditor in all cases, either by indicating the confirming party's agreement with the given information, or by asking the confirming party to provide information.
- A response to a positive confirmation request ordinarily is expected to provide reliable audit evidence.
- There is a risk, however, that a confirming party may reply to the confirmation request without verifying that the information is correct.
- The auditor may reduce this risk by using positive confirmation requests that do not state the amount (or other information) on the confirmation request and ask the confirming party to fill in the amount or furnish other information.
- On the other hand, use of this type of “blank” confirmation request may result in lower response rates because additional effort is required of the confirming parties.

- d) **Determination of properly addressed requests:** Determining that requests are properly addressed includes testing the validity of some or all of the addresses on confirmation requests before they are sent out.

5) Sending The Requests, Including Follow-Up Requests When Applicable, To Confirming Party:

- a) The auditor may send an additional confirmation request when a reply to a previous request has not been received within a reasonable time.
- b) For example, the auditor may, having re-verified the accuracy of the original address, send an additional or follow-up request.

ADDITIONAL EXPLANATION (CRD):

- a) **Non-Response:** A failure of the confirming party to respond, or fully respond, to a positive confirmation request, or a confirmation request returned undelivered.
- b) **Exception:** A response indicates a difference between information requested to be confirmed, or contained in the entity's records, and information provided by the confirming party. The exception needs to be assessed to the entire population after analyzing the reason for difference.
- c) **Reliability of responses to confirmation requests:**
 - If the auditor identifies factors that give rise to doubts about the reliability of the response to a confirmation request, the auditor shall obtain further audit evidence to resolve those doubts.
 - If the auditor determines that a response to a confirmation request is not reliable, the auditor shall evaluate the implications on the assessment of the relevant risks of material misstatement, including the risk of fraud, and on the related nature, timing and extent of other audit procedures.

CONCEPT QUESTIONS (CRD):

- 19) 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. (OLD SM-TYK)

Q.No.21. Where Management refuses to allow the auditor to send a confirmation request what are the steps to be taken by the Auditor? (L TO L)

1) If management refuses to allow the auditor to send a confirmation request, the auditor shall:

- a) Inquire as to management's reasons for the refusal and seek audit evidence as to their validity and reasonableness.

ADDITIONAL EXPLANATION (CRD):**Reasonableness of Management's Refusal:**

- A refusal by management to allow the auditor to send a confirmation request is a limitation on the audit evidence the auditor may wish to obtain. The auditor is therefore required to inquire as to the reasons for the limitation.
 - 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.
 - The auditor is required to seek audit evidence as to the validity and reasonableness of the reasons because of the risk that management may be attempting to deny the auditor access to audit evidence that may reveal fraud or error.
- b) 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

ADDITIONAL EXPLANATION (CRD):

- If management's request to not confirm is unreasonable, this may indicate a fraud risk factor that requires evaluation in accordance with SA 240.
 - The auditor may conclude that it would be appropriate to revise the assessment of the risks of material misstatement at the assertion level and modify planned audit procedures.
- c) Perform alternative audit procedures designed to obtain relevant and reliable audit evidence.

ADDITIONAL EXPLANATION (CRD): Examples of alternative audit procedures the auditor may perform include:

- **For accounts receivable balances:** Examining specific subsequent cash receipts, shipping documentation, and sales near the period-end.
 - **For accounts payable balances:** Examining subsequent cash disbursements or correspondence from third parties, and other records, such as goods received notes.
- d) 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, the auditor shall communicate with those charged with governance in accordance with SA 260.
- e) The auditor also shall determine the implications for the audit and the auditor's opinion in accordance with SA 705.

CONCEPT QUESTION (CRD):

- 1) 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 requests to few trade receivables, but the management refused the auditor to send confirmation request.

Required

How would the auditor proceed?

(OLD SM-EX) (M23-4M)

Q.No.22. What is Negative Confirmation, when it can be used? (L TO L)
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- 1) Negative confirmations provide less persuasive audit evidence than positive confirmations.
- 2) Accordingly, the auditor shall not use negative confirmation requests as the sole substantive audit procedure when auditor assessed high risk of material misstatement.
- 3) Generally negative confirmations are used when the following conditions are present:
 - a) 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.
 - b) The population of items subject to negative confirmation procedures comprises many small, homogeneous, account balances, transactions or conditions.
 - c) A very low exception rate is expected; and
 - d) The auditor is not aware of circumstances or conditions that would cause recipients of negative confirmation requests to disregard such requests.
- 4) The failure to receive a response to a negative confirmation request does not explicitly indicate receipt by the intended confirming party of the confirmation request or verification of the accuracy of the information contained in the request.
- 5) Accordingly, a failure of a confirming party to respond to a negative confirmation request provides significantly less persuasive audit evidence than does a response to a positive confirmation request.

- 6) Confirming parties also may be more likely to respond indicating their disagreement with a confirmation request when the information in the request is not in their favour, and less likely to respond otherwise.
- 7) For example, Holders of bank deposit accounts may be more likely to respond if they believe that the balance in their account is understated in the confirmation request but may be less likely to respond when they believe the balance is overstated.
- 8) Therefore, sending negative confirmation requests to holders of bank deposit accounts may be a useful procedure in considering whether such balances may be understated, but is unlikely to be effective if the auditor is seeking evidence regarding overstatement.

ADVANCED CONCEPT QUESTIONS: faculty Shall Discuss 4 CQ Here

(NON-ICAI SOURCES) (N)

Q.No.23. Write about Evaluating the Evidence Obtained through External Confirmation? (L TO L)

- 1) The auditor shall evaluate whether the results of the external confirmation procedures provide relevant and reliable audit evidence, or whether performing further audit procedures is necessary.
- 2) When evaluating the results of individual external confirmation requests, the auditor may categorise such results as follows:
 - a) A response by the appropriate confirming party indicating agreement with the information provided in the confirmation request or providing requested information without exception.
 - b) A response deemed unreliable.
 - c) A non-response; or
 - d) A response indicating an exception.
- 3) The auditor's evaluation, when taken into account with other audit procedures the auditor may have performed, 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.

CONCEPT QUESTIONS (CRD):

- 20) 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 the approach of CA Jignesh Desai proper? (NEW SM-EX)
- 21) 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 the issue is near resolution and no fraud risk factors exist. Is the unwillingness of CFO justifiable? (NEW SM-EX)

CONCEPT QUESTIONS (SP):

- 6) During the financial year 2020-21, the auditor of Delicious and Healthy Limited asked Trade Receivable to respond directly to the auditor whether the amount they were required to pay to Delicious and Healthy Limited was Rs. 79,000. That trade receivable confirmed to the auditor of Delicious and Healthy Limited that they were required to pay an amount of Rs. 79,000 to Delicious and Healthy Limited. State and explain the type of Confirmation Request as required by the auditor. (OLD SM-EX)
- 7) While conducting the audit of Jay Kay Ltd, the auditor K of KLM and Associates, Chartered Accountants observes that there is a large number of Trade payables and receivables standing in the books of accounts as on 31st March. The auditor wanted to send confirmation requests to a few trade receivables, but the management refused the auditor to send confirmation requests. How would the auditor proceed? (N20-4M)

- 8) External confirmation procedures frequently are relevant when addressing assertions associated with account balances and their elements but need not be restricted to these items. Discuss. (M18-MTP2-5M)
- 9) 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. (JULY21-RTP)

SA 550 RELATED PARTIES

Q.No.24. What is Related Party under SA 550?

(L TO L)

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

However, 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.
- 2) **MEANING OF CONTROL AND SIGNIFICANT INFLUENCE:** Many financial reporting frameworks discuss the concepts of control and significant influence. They generally explain that:
- a) Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities; and
 - b) Significant influence (which may be gained by share ownership, statute or agreement) is the power to participate in the financial and operating policy decisions of an entity, but is not control over those policies.
 - c) The existence of the following relationships may indicate the presence of control or significant influence:
 - Direct or indirect equity holdings or other financial interests in the entity.
 - The entity's holdings of direct or indirect equity or other financial interests in other entities.
 - Being part of those charged with governance or key management (i.e., those members of management who have the authority and responsibility for planning, directing and controlling the activities of the entity).
 - Being a close family member of any person referred to in subparagraph (iii).
 - Having a significant business relationship with any person referred to in subparagraph (iii).
- 3) **MEANING OF RELATED PARTIES WITH DOMINANT INFLUENCE:** Related parties, by virtue of their ability to exert control or significant influence, may be in a position to exert dominant influence over the entity or its management. Consideration of such behaviour is relevant when identifying and assessing the risks of material misstatement due to fraud.

- 4) **MEANING OF SPECIAL-PURPOSE ENTITIES AS RELATED PARTIES:** In some circumstances, a special-purpose entity 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 the special- purpose entity's equity.

Q.No.25. Explain the Nature of Related Party Relationships and Transactions & How the auditor shall Understand the Entity's Related Party Relationships & Transactions?

1) NATURE OF RELATED PARTY RELATIONSHIPS AND TRANSACTIONS:

- a) 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.
- b) 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. For Example:
 - 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 summarizing 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 without consideration.

2) UNDERSTANDING THE ENTITY'S RELATED PARTY RELATIONSHIPS & TRANSACTIONS:

- a) The auditor shall inquire of management regarding:
 - The identity of the entity's related parties, including changes from the prior period
 - The nature of the relationships between the entity and these related parties; and
 - Whether the entity entered into any transactions with these related parties during the period and, if so, the type and purpose of the transactions.
- b) The auditor shall inquire of management and others within the entity, and perform other risk assessment procedures considered appropriate, to obtain an understanding of the controls, if any, that management has established to,
 - Identify, account for, and disclose related party relationships and transactions in accordance with the applicable financial reporting framework.
 - Authorize and approve significant transactions and arrangements with related parties; and
 - Authorize and approve significant transactions and arrangements outside the normal course of business.

CONCEPT QUESTION (CRD):

- 1) 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. (NEW SM-TQ) (N)
- 2) Which of the following auditing procedures most likely would assist an auditor in identifying related party transactions? (NON-ICAI SOURCES) (N)
 - a) Inspecting correspondence with lawyers for evidence of unreported contingent liabilities.
 - b) Vouching accounting records for recurring transactions recorded just after the balance sheet date.
 - c) Reviewing confirmations of loans receivable and payable for indications of guarantees.
 - d) Performing analytical procedures for indications of possible financial difficulties.

ADVANCED CONCEPT QUESTIONS: Faculty Shall Discuss 1 CQ Here

(NON-ICAI SOURCES) (N)

Q.No.26. Write about Considerations specific to smaller entities by the auditor under SA 550?

- 1) Control environment in smaller entities is likely to be different from larger entities. In particular those charged with governance may not include an outside member, and the role of governance may be undertaken directly by the owner-manager where no other owner exists.
- 2) Control activities in smaller entities are likely to be less formal and smaller entities may have no documented processes for dealing with related party relationships and transactions.
- 3) An owner-manager may mitigate some of the risks arising from related party transactions, or potentially increase those risks, through active involvement in all the main aspects of the transactions.
- 4) For such entities, the auditor may obtain an understanding of the related party relationships and transactions, and any controls that may exist over these, through inquiry of management combined with other procedures, such as observation of management's oversight and review activities, and inspection of available relevant documentation.

DIVISION 2: THEORY FOR SELF STUDY**Q.No.1. 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. Explain?**

- 1) 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.
- 2) 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.
- 3) He needs evidence to obtain information for arriving at his judgement.
- 4) 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.

Q.No.2. Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence. Substantiate

- 1) Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence. The auditor uses various audit procedures to obtain audit evidence such as inspection, observation, confirmation, recalculation, reperformance and analytical procedures, often in some combination, in addition to inquiry.
- 2) 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.
- 3) SA 330 requires the auditor to conclude whether sufficient appropriate audit evidence has been obtained to reduce audit risk to an acceptably low level, and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion, is a matter of professional judgment.
- 4) SA 200 contains discussion of such matters as the nature of audit procedures, the timeliness of financial reporting, and the balance between benefit and cost, which are relevant factors when the auditor exercises professional judgment regarding whether sufficient appropriate audit evidence has been obtained.

SOURCE OF AUDIT EVIDENCE:

- 1) Some audit evidence is obtained by performing audit procedures to test the accounting records.
- 2) **Example**
 - Through analysis and review,
 - Repperforming procedures followed in the financial reporting process,
 - Reconciling related types and applications of the same information.
- 3) Through the performance of such audit procedures, the auditor may determine that the accounting records are internally consistent and agree to the financial statements.
- 4) More assurance is ordinarily obtained from consistent audit evidence obtained from different sources or of a different nature than from items of audit evidence considered individually.
- 5) **Example:**
 - Corroborating information obtained from a source independent of the entity may increase the assurance the auditor obtains from audit evidence that is generated internally, such as evidence existing within the accounting records, minutes of meetings, or a management representation.
 - Information from sources independent of the entity that the auditor may use as audit evidence may include confirmations from third parties, analysts' reports, and comparable data about competitors.

Q.No.3. Explain the circumstances in which the external auditor shall plan to use less of the work of the Internal audit function and perform more of the work directly?

The external auditor shall make all significant judgments in the audit engagement and, to prevent undue use of the work of the internal audit function, shall plan to use less of the work of the function and perform more of the work directly if:

- 1) The more judgment is involved in:
 - a) Planning and performing relevant audit procedures; and
 - b) Evaluating the audit evidence gathered.
- 2) The higher the assessed risk of material misstatement at the assertion level, with special consideration given to risks identified as significant.
- 3) The less the internal audit function's organizational status and relevant policies and procedures adequately support the objectivity of the internal auditors; and

The lower the level of competence of the internal audit function.

Q.No.4. How can an auditor verify the existence of related party relationships and transactions?

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:

- 1) Entity income tax returns.
- 2) Information supplied by the entity to regulatory authorities.
- 3) Shareholder registers to identify the entity's principal shareholders.
- 4) Statements of conflicts of interest from management and those charged with governance.
- 5) Records of the entity's investments and those of its pension plans.
- 6) Contracts and agreements with key management or those charged with governance.

- 7) Significant contracts and agreements not in the entity's ordinary course of business.
- 8) Specific invoices and correspondence from the entity's professional advisors.
- 9) Life insurance policies acquired by the entity.
- 10) Significant contracts re-negotiated by the entity during the period.
- 11) Internal auditors' reports.
- 12) Documents associated with the entity's filings with a securities regulator e.g, prospectuses.

Q.No.5. What are the factors that auditor shall evaluate when using information produced by the entity about sufficiency and reliable for the auditor's purposes, including as necessary in the circumstances?

When using information produced by the entity, the auditor shall evaluate whether the information is sufficiently reliable for the auditor's purposes, including as necessary in the circumstances:

- 1) Obtaining audit evidence about the accuracy and completeness of the information and
- 2) Evaluating whether the information is sufficiently precise and detailed for the auditor's purposes.

DIVISION 3: TEST YOUR KNOWLEDGE (CRD)

- 1) 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 by the quality of such audit evidence. Obtaining more audit evidence, however, may not compensate for its poor quality. Explain also stating the factors affecting auditor's judgment as to sufficiency of audit evidence. (M18-RTP, N20-RTP)
- 2) Can a Principal auditor demand/request the working papers of branch/ component auditor?
- 3) Obtaining more evidences may not compensate for their poor quality. Explain the factors affecting the auditor's judgment of sufficiency and appropriateness of audit evidence. (M19-RTP)
- 4) The reliability of audit evidence is influenced by its source, nature, and circumstances under which it is obtained. Discuss.
- 5) The auditor of a limited company has given a dean report on the financial statement on the basis of Xerox copies of the books of accounts vouchers & other records which were taken away by the Income-tax Department in search under section 132 of the I.T. Act, 1961. Comment with respect to reliability of audit evidence obtained while performing the audit function. (N04-5M, N15-RTP)
- 6) 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. (N22 RTP)
- 7) CA K audited the books of accounts of E Ltd. for the financial year 2020-2021. The auditor used an audit procedure according to which all the documents & records maintained by the company were checked in detail to obtain audit evidence. Explain the audit procedure used by the auditor & its reliability? (N21-3M)
- 8) 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 various intercompany 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? (M22-4M)
- 9) 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, clearly state generalisations about the reliability of audit evidence. (COMPREHENSIVE) (M18-RTP)
- 10) Mr. A was appointed statutory auditor of P Ltd., but he was not able to gather the sufficient audit evidences. Discuss how he should proceed to gather more audit evidence. (COMPREHENSIVE) (M19-RTP)

DIVISION 3: TEST YOUR KNOWLEDGE (SELF STUDY)

- 1) Audit evidence is necessary to draw reasonable conclusions on which to base the auditor's opinion is obtained by performing various audit procedures. Explain the audit procedures. (NON-ICAI SOURCES)
- 2) What is meant by sufficiency of Audit Evidence? Explain the factors affecting the auditor's judgement as to the sufficiency of audit evidence. (OLD SM-TYK)
- 3) Audit evidence includes both information contained in the accounting records underlying the financial statements and other information. Discuss (M18-RTP)
- 4) General factors which may influence the auditor's judgment as to what is sufficient and appropriate audit evidence?
- 5) "As an ordinary rule the auditor should try to match internal and 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 evidence corroborates each other". You are required to distinguish between the two evidences in the given statements. (NON-ICAI SOURCES)
- 6) 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. Therefore, generalizations about the reliability of various kinds of audit evidence are subject to important exceptions. While recognizing that exceptions may exist, state the generalizations about the reliability of audit evidence that may be useful. (NON-ICAI SOURCES)
- 7) Evaluating responses to inquiries is an integral part of the inquiry process. Explain. (M18-RTP)
- 8) "Inquiry is used extensively throughout the audit in addition to other audit procedures". (N19-MTP1-4M)
- 9) 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. (N18-RTP), (N19-RTP)
- 10) The nature & timing of the audit procedures to be used may be affected by the fact that some of the accounting data & other information may be available only in electronic form or only at certain points or periods in time. Explain with the help of examples. (N20-RTP)

DIVISION 4: IDENTICAL QUESTIONS (SP)

1) Purpose of Audit Documentation Vs Benefits of Audit Documentation

Ans: Purpose of Audit Documentation includes the objectives of Audit documentation whereas benefits of audit documentation have been given by ICAI as purpose of audit documentation. So, we request to write both answers if the question relates to purpose of audit documentation.

2) Assembly period Vs Retention Period

Ans: Assembly period refers to after issuance of audit report, within 60 days shall assemble the audit file to keep it for future reference. This process is also known as working paper arrangement. (SQC - 1) whereas retention period means the auditor shall retain the working paper file for a minimum period of 7 years from the date of audit report or group audit report, whichever is later. (SQC - 1)

DIVISION 5: IMPORTANT TECHNICAL TERMS (SP)

- 1) **ASSERTION:** In the context of auditing, the term "assertion" refers to a claim or statement made by management regarding a specific financial statement element, account, or transaction. These assertions are crucial for auditors to evaluate and provide assurance on the accuracy and reliability of financial statements.

- 2) **QUALITY CONTROL REVIEW:** - refers to a systematic evaluation of an audit engagement conducted by an independent reviewer or team. The purpose of the review is to assess whether the audit work performed complies with applicable auditing standards, firm policies, and regulatory requirements. The objective is to ensure the overall quality and reliability of the audit process and the resulting financial statements.
- 3) **QUALITY CONTROL REVIEWER:** Refers to an individual or a team responsible for conducting an independent evaluation of an audit engagement. The primary role of a quality control reviewer is to assess the quality and effectiveness of the audit work performed by the engagement team.
- The quality control reviewer is typically a senior member of the auditing firm who was not directly involved in the audited engagement. They possess expertise and experience in auditing standards, firm policies, and regulatory requirements. Their objective is to provide an unbiased and objective assessment of the engagement's compliance with these standards and requirements.
- 4) **PEER REVIEW:** It is a process that involves the examination and assessment of the quality of audit and assurance services provided by its members in public practice. The ICAI, being the regulatory body for the accounting profession in India, has established the Peer Review Board (PRB) to oversee and administer this process.
- 5) **MANAGEMENT'S EXPERT:** An individual or organization possessing expertise in a field other than accounting or auditing, whose work in that field is used by the entity to assist the entity in preparing the financial statements.

DIVISION 6: CONCEPTS THAT ARE RESHUFFLED

S.NO.	TOPIC / CONCEPT	COVERAGE IN ICAI STUDY MATERIAL	COVERAGE IN MASTERMINDS MATERIAL
1)	Assertions related to test of details	Audit Evidence	Audit of Items of Financial Statements.”
2)	Means available to auditor for selecting items for testing	Audit Evidence	Audit Sampling
3)	Uses of audit trail/ Audit Logs	Audit Evidence	Automated Environment
4)	Assertions being addressed by auditor	Audit Evidence	Audit of items of financial statements
5)	Distinction between Internal Financial Control and Internal Control over financial reporting	Audit Evidence	Risk assessment & internal Controls
6)	Responsibilities of Internal Auditor	Audit Evidence	Beyond Exam Standards
7)	Objectives And Scope of Internal Audit Functions	Audit Evidence	Beyond Exam Standards

THE END

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