

PAPER 5

Auditing and Ethics Reviewer

Chapter-wise compilation
RTP, MTP and PYP questions

KEY HIGHLIGHTS



Easy to Hard
Difficulty Level



Importance levels
marked as A, B or C



Reference to
all questions



Quick recap of
important concepts



Exam
Insights



Last Day Revision
Questions Marked

APPLICABLE
FOR MAY'25,
SEPT'25 AND
JAN'26



VIVITSU
STRIVING TOWARDS KNOWLEDGE

This book belongs to future,

CA Finalist _____

“You become what you believe.”

-Oprah Winfrey



Visit Website



Join the Telegram
Community



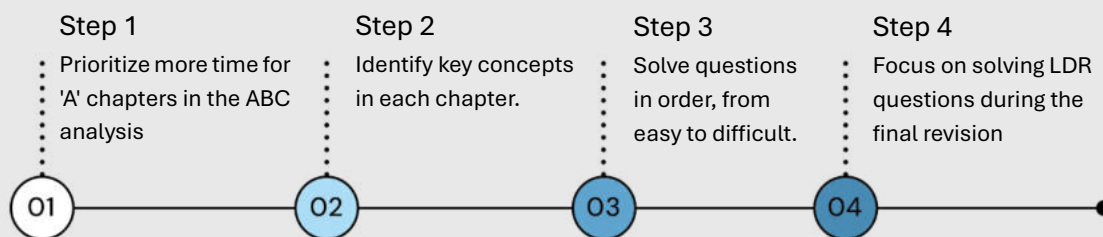
Chat with us
on WhatsApp



Follow us on
Instagram

YOU MUST BE WONDERING

How to Read this book?



Step 1: Prioritize your chapters

Chapters in the index are categorized as A, B, or C based on their importance. Focus more on 'A' chapters, as they carry the most weight, and give adequate attention to 'B' chapters. While all chapters must be covered, this approach helps manage time efficiently for better results.



Step 2: Identify key concept

Identify the key concepts for each chapter using the list provided at the start of the chapter. Ensure you understand them thoroughly. If you struggle with a question, revisit the concepts, review them, and strengthen your understanding before moving forward.



Step 3: Start easy

The questions are segregated concept & SA wise. Start with Question 1, as they progress from easy to difficult, helping you build confidence throughout the chapter. Pay close attention to the “EXAM INSIGHTS” to avoid common mistakes.



Step 4: Last Day Revision (LDR)

Focus on solving LDR questions during the final revision. In the 1.5 days before the exam, prioritize these questions as they cover the most critical concepts from each chapter. You'll find a quick summary of LDR question numbers listed right before each chapter for easy reference.

1. Last Day Revision Questions

Last Day Revision Questions mentioned right at the beginning of each chapter

Easy to find 1 day before the exam

CONCEPTS OF THIS CHAPTER

- Audit Risk and influencing Variables
- Risk Assessment Procedures
- Materiality in Audit Planning and Execution
- Understanding the Entity and its Environment
- Internal Control: Meaning, Objectives, Benefits, Limitations, Components
- Relevance of controls to Audits
- Understanding and Evaluating relevant Controls
- Risks needing Special Audit Focus
- Internal Control Evaluation: Benefits and Methods
- Testing Internal Controls
- Key features of Automated Environments
- IT System Risks
- Control types in Automated Settings
- Role of Data Analytics in Audit
- Internal Financial Controls as per laws
- Auditor's Response to Assessed Risks



LDR Questions

- Q 18
- Q 21
- Q 30
- Q 38
- Q 52
- Q 54
- Q 80

2. Master Every Concept!

A quick concept list shows what's covered, helping you pinpoint areas if you stumble on related questions

Table of Contents

Sr.	Particulars	Page No.	IMP
1	Nature, Objective and Scope of Audit	1.1 - 1.10	C
2	Audit Strategy, Audit Planning and Audit Programme	2.1 - 2.10	B
3	Risk Assessment and Internal Control	3.1 - 3.40	B
4	Audit Evidence	4.1 - 4.1	A
4.1	SA 500- Audit Evidence	4.1 - 4.1	
4.2	SA 501- Audit Evidence- Perceptions	4.2 - 4.2	
4.3	SA 502- Audit Evidence- Sufficiency	4.3 - 4.3	
4.4	SA 503- Audit Evidence- Reliability	4.4 - 4.4	
4.5	SA 504- Audit Evidence- Competence and Competency	4.5 - 4.5	
4.6	SA 505- Audit Evidence- External Confirmations	4.6 - 4.6	
4.7	SA 506- Audit Evidence- External Confirmations	4.7 - 4.7	
4.8	SA 520 Analytical Procedures	4.8.1 - 4.8	
5	Audit of Items of Financial Statements	5.1 - 5.40	
6	Audit Documentation	6.1 - 6.6	A
7	Completion and Review		C
7.1	SA 560- Subsequent Events	7.1.1 - 7.1	B
7.2	SA 570- Going Concerns	7.2.1 - 7.2	
7.3	SA 450- Evaluation of Misstatements Identified during Audit	7.3.1 - 7.3	
7.4	SA 580- Written Representations	7.4.1 - 7.4	
7.5	SA 260- Communication with Those Charged with Governance	7.5.1	
7.6	SA 265- Communicating Deficiencies in Internal Control to Those Charged with Governance and Management	7.6.1 - 7.6	
8	Audit Report		
8.1	SA 700- Forming an Opinion and Reporting on Financial Statements	8.1.1 - 8.1	
8.2	SA 705- Modifications to the Opinion in the Independent Auditor's Report	8.2.1 - 8.2	B
8.3	SA 706- Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report	8.3.1 - 8.3	
8.4	SA 701- Communicating Key Audit Matters in the Independent Auditor's Report	8.4.1 - 8.4.2	
8.5	SA 710- Comparative Information—Corresponding Figures and Comparative Financial Statements	8.5.1 - 8.5.3	
8.6	Audit of Branch Office Accounts 128(1)	8.6.1 - 8.6.2	

Prioritize using ABC Analysis

Each chapter is categorized as A , B or C

A : Very Important, Read on priority

B : Moderately Important

C : Less Critical but still essential

CHAPTER 4: AUDIT EVIDENCE

Concept Summary

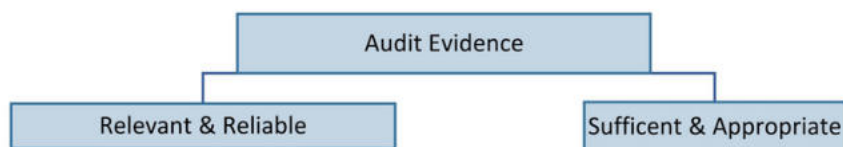
Sharpen your memory with lightning-fast concepts recap before you hit the questions. Also perfect for the final 1.5-day revision!

Chapter 4.3: SA 105- External Confirmations	4.3.1 - 4.3.14	Q22, Q24, Q25
Chapter 4.4: SA 110- Initial Audit Engagements - Opening Balances	4.2.1 - 4.2.4	Q2
Chapter 4.7: SA 110- Related Parties	4.1 - 4.3.14	Q19, Q26
Chapter 4.8: SA 315- Analytical Procedures	4.4.1 - 4.4.7	Q7
	4.3.1 - 4.3.14	Q8
	4.4 - 4.6.2	Q9
	4.1 - 4.1.1	Q1

QUICK REVIEW OF IMPORTANT CONCEPTS

Scope

Design and perform audit procedures in such a way as to enable the auditor to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion.



Methods to obtain Audit Evidence

- | | | |
|-------------------------|-----------------|-------------------------|
| • Inspection | • Recalculation | • Observation |
| • Reperformance | • Inquiry | • Analytical procedures |
| • External Confirmation | | |

Using the Work of management's expert

- Understand the competence, capabilities and objectives of that expert;
- Obtain an understanding of the work of that expert; and
- Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion.

Audit procedures to obtain audit evidence

- Risk Assessment procedures
- Further audit procedures comprising of: Test of controls and Substantive procedures.

Assertions evaluated

Transaction Occurrence during the year	Account balances at period end	Presentation & Disclosures
Occurrence	Existence	Occurrence
Completeness	Rights & Obligations	Completeness
Accuracy	Completeness	Classification
Cut Off	Valuation & Disclosure	Accuracy & Valuation
Classification		



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.

Examples of procedures in which CA Mukul shall not use internal auditor to provide direct assistance to him are:-

- (a) Procedures which involve making significant judgments in the audit;
- (b) Procedures relating 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) Procedures relating 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) Procedures relating 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.

Multiple Choice Questions (MCQ)

1. Which of the following is not one of functions of internal auditor of an organization? (SM)

- (a) Performing assurance activities
- (b) Performing consulting activities to improve governance of organization
- (c) Performing risk management activities
- (d) Expressing independent opinion on financial statements of organization

Ans: (d)



All chapters include MCQs

Complete each chapter with a collection of MCQs
Your one-stop spot to learn, test and master key concepts!

1. Reference's to Attempts in all Questions

Each question includes references and duplicates are removed — with all prior attempts noted.

(MTP 2 Marks Oct'23, RTP May'18, SM)

2. Exam Insights

Use exam insights to learn common mistakes and avoid them.
Stay ahead of others

EXAM INSIGHTS: Examples of audit procedure: Many examinees did not understand the requirement of the question and their answer was not relevant to the topic. Some examinees just explained about observation and inspection which was not required.

3. Questions arrange in easy to difficult way

Building your confidence step-by-step. Question 1 in any chapter is the easiest slowly progressing to more difficult questions

ABC Analysis

Each chapter is categorized as A , B or C

A : Very Important, Read on priority

B : Moderately Important

C : Less Critical but still essential

- Risk Assessment Procedures
- Materiality in Audit Planning and Execution
- Understanding the Entity and Its Environment
- Internal Control: Meaning, Objectives, Benefits, Limitations, Components
- Relevance of controls to Audits
- Understanding and Evaluating relevant Controls
- Risks needing Special Audit Focus
- Internal Control Evaluation: Benefits and Methods
- Testing Internal Controls
- Key features of Automated Environments
- IT System Risks
- Control types in Automated Settings
- Role of Data Analytics in Audit
- Internal Financial Controls as per laws
- Auditor's Response to Assessed Risks



LDR Questions

- Q 18
- Q 21
- Q 30
- Q 38
- Q 52
- Q 54
- Q 80

VIVITSU

STUDYING TOMORROW'S BUSINESS ETHICS

QUICK REVIEW OF IMPORTANT CONCEPTS

Audit Risk

$$\text{Audit Risk} = \text{Risk of Material Misstatement} \times \text{Detection Risk}$$

$$\text{Risk of material Misstatement} = \text{Inherent risk} \times \text{Control risk}$$

$$\text{Detection Risk} = \text{Sampling Risk} \times \text{Non-Sampling Risk}$$

Risk Assessment Procedures

- Inquiries of management and of others within the entity who in the auditor's judgment may have information that is likely to assist in identifying risks of material misstatement due to fraud or error.
- Analytical procedures.
- Observation and inspection.

Risks That Require Special Audit Consideration

- Determine if the risk involves potential fraud.
- Assess if the risk arises from recent significant changes in the economic, accounting, or regulatory environment.
- Evaluate the complexity of the transactions.
- Consider if significant related-party transactions are involved.
- Assess the degree of subjectivity in financial measurements, especially with high uncertainty.
- Identify significant transactions outside normal business operations or those appearing unusual.

Auditor's responses to assessed risks

- Tests of Controls
- Substantive Procedures
 - Tests of Details
 - Tests of transactions i.e. Vouching
 - Tests of balances i.e. Verification

Table of Contents

Sr.	Particulars	PAGE NO.	IMP
1	Nature, Objective and Scope of Audit	1.1 – 1.16	C
2	Audit Strategy, Audit Planning and Audit Programme	2.1 – 2.19	B
3	Risk Assessment and Internal Control	3.1 – 3.41	B
4	Audit Evidence		A
4.1	SA 500- Audit Evidence	4.1-1 – 4.1-14	
4.2	SA 610- Using the Work of Internal Auditors	4.2-1 – 4.2-4	
4.3	SA 530 Audit Sampling	4.3-1 – 4.3-14	
4.4	SA 501- Audit Evidence-Specific Considerations for Selected Items	4.4-1 – 4.4-7	
4.5	SA 505- External Confirmations	4.5-1 – 4.5-5	
4.6	SA 510- Initial Audit Engagements – Opening Balances	4.6-1 – 4.6-2	
4.7	SA 550- Related Parties	4.7-1 – 4.7-3	
4.8	SA 520 Analytical Procedures	4.8-1 – 4.8-10	
5	Audit of Items of Financial Statements	5.1 – 5.45	A
6	Audit Documentation	6.1 – 6.9	C
7	Completion and Review		B
7.1	SA 560- Subsequent Events	7.1-1 – 7.1-5	
7.2	SA 570- Going Concern	7.2-1 – 7.2-7	
7.3	SA 450- Evaluation of Misstatements Identified during Audit	7.3-1 – 7.3-2	
7.4	SA 580- Written Representations	7.4-1 – 7.4-5	
7.5	SA 260- Communication with Those Charged with Governance	7.5-1	
7.6	SA 265- Communicating Deficiencies in Internal Control to Those Charged with Governance and Management	7.6-1 – 7.6-3	
8	Audit Report		B
8.1	SA 700- Forming an Opinion and Reporting on Financial Statements	8.1-1 – 8.1-8	
8.2	SA 705- Modifications to the Opinion in the Independent Auditor's Report	8.2-1 – 8.2-5	
8.3	SA 706- Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report	8.3-1 – 8.3-3	
8.4	SA 701- Communicating Key Audit Matters in the Independent Auditor's Report	8.4-1 – 8.4-2	
8.5	SA 710- Comparative Information—Corresponding Figures and Comparative Financial Statements	8.5-1 – 8.5-3	
8.6	Audit of Branch Office Accounts 128(1)	8.6-1 – 8.6-2	

8.7	Joint Audit	8.7 -1 – 8.7-3	
8.8	Reporting Requirements under Companies Act	8.8-1 – 8.8-6	
8.9	CARO	8.9-1 – 8.9-12	
9	Special Features of Audit of Different Type of Entities	9.1 – 9.33	B
10	Audit of Banks	10.1 – 10.22	C
11	Ethics and Terms of Audit Engagements		B
11.1	Ethics	11.1-1 – 11.1-9	
11.2	SA 210- Agreeing the Terms of Audit Engagements	11.2-1 – 11.2-6	
11.3	SQC 1- Quality Control for Firms which Perform Audits and Reviews of Historical Financial Information and Other Assurance and Related Service Engagements	11.3-1 – 11.3-5	
11.4	SA 220- Quality Control for an Audit of Financial Statements	11.4-1 – 11.4-3	
12	Case Scenarios	12.1 – 12.73	A

ABC Analysis



Very Important,
Read on priority



Moderately
Important



Less critical but still
essential

Ensure you thoroughly read all chapters without skipping any. The ABC analysis is designed to help you prioritize based on past trends, but it should not replace comprehensive preparation.

ABBREVIATIONS : -

TCWG= Those Charged with Governance

FRF= Financial Reporting Framework

EOM= Emphasis of Matter Paragraph

SAAE= Sufficient Appropriate Audit Evidence

FS= Financial Statements

RPT= Related Party Transactions

OMP= Other Matters Paragraph

KAM= Key Audit Matters

CHAPTER 3: RISK ASSESSMENT & INTERNAL CONTROL

CONCEPTS OF THIS CHAPTER

- Audit Risk and influencing Variables
- Risk Assessment Procedures
- Materiality in Audit Planning and Execution
- Understanding the Entity and its Environment
- Internal Control: Meaning, Objectives, Benefits, Limitations, Components
- Relevance of controls to Audits
- Understanding and Evaluating relevant Controls
- Risks needing Special Audit Focus
- Internal Control Evaluation: Benefits and Methods
- Testing Internal Controls
- Key features of Automated Environments
- IT System Risks
- Control types in Automated Settings
- Role of Data Analytics in Audit
- Internal Financial Controls as per laws
- Auditor's Response to Assessed Risks



LDR Questions

- Q 18
- Q 21
- Q 30
- Q 38
- Q 52
- Q 54
- Q 80

QUICK REVIEW OF IMPORTANT CONCEPTS

Audit Risk

$$\text{Audit Risk} = \text{Risk of Material Misstatement} \times \text{Detection Risk}$$

Risk of material Misstatement = Inherent risk
X Control risk.

Detection Risk= Sampling Risk X
Non- Sampling Risk

Risk Assessment Procedures

- Inquiries of management and of others within the entity who in the auditor's judgment may have information that is likely to assist in identifying risks of material misstatement due to fraud or error.
- Analytical procedures.
- Observation and inspection.

Risks That Require Special Audit Consideration

- Determine if the risk involves potential fraud.
- Assess if the risk arises from recent significant changes in the economic, accounting, or regulatory environment.
- Evaluate the complexity of the transactions.
- Consider if significant related-party transactions are involved.
- Assess the degree of subjectivity in financial measurements, especially with high uncertainty.
- Identify significant transactions outside normal business operations or those appearing unusual.

Auditor's responses to assessed risks

- Tests of Controls
- Substantive Procedures
 - Tests of Details
 - Tests of transactions i.e. Vouching
 - Tests of balances i.e. Verification



– Substantive analytical procedures

Materiality

Performance Materiality

In order to perform audit of financial statements, auditor needs to set a level of materiality after selecting appropriate benchmark.

However during the course of audit, auditor intends to lower the risk of not detecting a material misstatement and hence he may verify certain transactions or financial items which may be below the set level of materiality however such transactions appear to be important.

Such level (which is below the materiality level) at which auditor performs his procedures is known as performance materiality level.

Revision of Materiality

- (a) Materiality for the financial statements as a whole or for particular class of transactions may need to be revised as a result of a change in circumstances that occurred during the audit (for example, a decision to dispose of a major part of the entity's business), new information, or a change in the auditor's understanding of the entity and its operations as a result of performing further audit procedures.
- (b) If the auditor concludes a lower materiality for the same, then he should consider the fact that whether it is necessary to revise performance materiality and whether the nature, timing and extent of the further audit procedures remain appropriate.

Use of benchmark in determining Materiality

A percentage is applied to a chosen benchmark as a starting point in determining materiality for the F.S. as a whole.

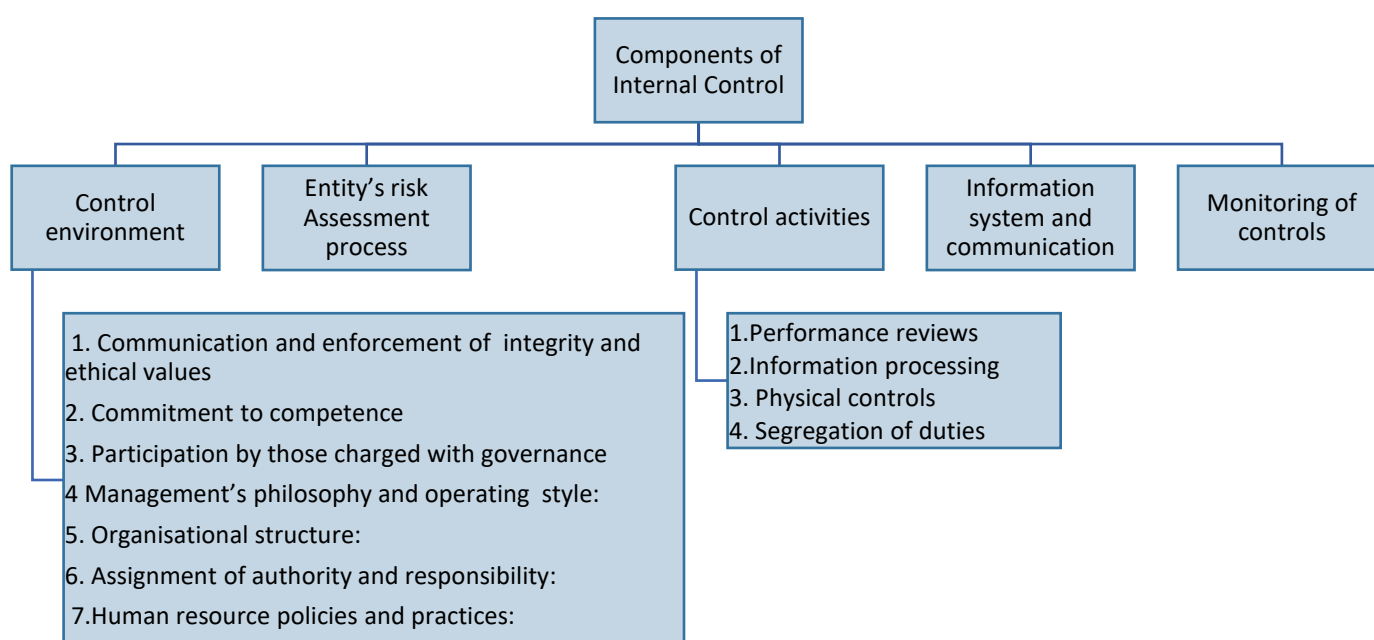
Factors affecting identification of appropriate benchmark

1. The elements of the financial statements;
2. Items on which the attention of the users of the particular entity's financial statements tends to be focused;
3. The nature of the entity, where the entity is at in its life cycle, and the industry and economic environment in which the entity operates;
4. The entity's ownership structure and the way it is financed; and
5. The relative volatility of the benchmark.

Internal Control

Internal control is designed, implemented and maintained to address identified business risks that threaten the achievement of any of the entity's objectives that concern:

- The reliability of the entity's financial reporting
- The effectiveness and efficiency of its operations
- Its compliance with applicable laws and regulations; and
- Safeguarding of assets.



Methods of evaluation of Internal control



- | | | | |
|---------------------|------------------|---------------|---------------|
| 1. Narrative Record | 2. Questionnaire | 3. Check List | 4. Flow chart |
|---------------------|------------------|---------------|---------------|

Internal Financial Controls

- | | |
|---|--|
| <ul style="list-style-type: none"> Reliability of financial reporting Compliance with applicable laws and regulations Prevention and detection of frauds | <ul style="list-style-type: none"> Effectiveness and efficiency of operations Safeguarding of assets |
|---|--|

Understanding of Entity & its Environment

1. Relevant Industry, Regulatory & other External Factors including Financial Reporting Framework.
2. Nature of Entity
3. Selection & Application of Accounting Policies & reasons for changes thereto
4. Entity objectives, strategies and business risks
5. Measurement & review of Financial Performance
6. Internal control relevant to audit

Automated Environment

Understanding and documenting automated environment

- | | | |
|--|---|--|
| <ul style="list-style-type: none"> Information systems being used Architecture In-house vs Packaged | <ul style="list-style-type: none"> Their purpose Version Outsourced activities | <ul style="list-style-type: none"> Location of IT systems - local vs global Interfaces within systems Key persons |
|--|---|--|

Risks arising from use of IT Systems

- | | |
|---|--|
| <ul style="list-style-type: none"> Inaccurate processing of data, processing inaccurate data, or both Lack of adequate segregation of duties. Direct data changes (backend changes). Failure to make necessary changes to systems or programs | <ul style="list-style-type: none"> Unauthorized access to data. Excessive access / Privileged access (super users). Unauthorized changes to systems or programs. Loss of data. |
|---|--|

Types of Controls

- General IT controls
 - Controls over Data centre and network operations
 - Program Change
 - Application system acquisition, development, and maintenance
 - Access Security
- Application controls
- IT-dependent controls

Data Analytics For Audit

- Check completeness of data and population that is used in either test of controls or substantive audit tests.
- Selection of audit samples – random sampling, systematic sampling.
- Re-computation of balances – reconstruction of trial balance from transaction data.
- Reperformance of mathematical calculations – depreciation, bank interest calculation.
- Analysis of journal entries
- Fraud investigation.
- Evaluating impact of control deficiencies

Audit Risk & Risk Assessment Procedures

True & False- Examine with reasons (in short) whether the following statement is correct or incorrect

Question 1

If the auditor assesses a risk of material misstatement regarding litigation or claims that have been identified, the auditor need not seek direct communication with the entity's external legal counsel. (RTP Nov '21)

Answer 1

Incorrect: If the auditor assesses a risk of material misstatement regarding litigation or claims that have been identified, or when audit procedures performed indicate that other material litigation or claims may exist, the auditor shall, in addition to the procedures required by other SAs, seek direct communication with the entity's external legal counsel.



Question 2

According to SA 315, the objective of the auditor is to identify and assess the risk of material misstatement, whether due to fraud or error, only at assertion level. (RTP May '23)

Answer 2

Incorrect: According to SA 315, the objective of the auditor is to identify and assess the risk of material misstatement, whether due to fraud or error, at the financial statement and assertion levels, through understanding the entity and its environment, including the entity's internal control.

Question 3

Pervasive is a term used, in the context of misstatements, to describe the effects on the financial statements of misstatements or the possible effects on the financial statements of misstatements, if any, that are detected by obtaining sufficient appropriate audit evidence. (PYP 2 Marks May'22)

Answer 3

Incorrect: Pervasive is a term used, in the context of misstatements, to describe the effects on the financial statements of misstatements or the possible effects on the financial statements of misstatements, if any, that are undetected due to an inability to obtain sufficient appropriate audit evidence.

Exam insights: Meaning of Pervasive: Most of the examinees did not have knowledge of the concept of pervasive.

Question 4

For an auditor, the Risk assessment procedure provides sufficient appropriate audit evidence to base the audit opinion. (PYP 2 Marks Nov '19, MTP 2 Marks Apr'23)

Answer 4

Incorrect: The auditor shall perform risk assessment procedures to provide a basis for the identification and assessment of risks of material misstatement at the financial statement and assertion levels. Risk assessment procedures by themselves, however, do not provide sufficient appropriate audit evidence on which to base the audit opinion.

Question 5

There is an inverse relationship between detection risks and the combined level of inherent and control risks. (MTP 2 Marks April 22, RTP Nov '22 & Nov '23)

Answer 5

Correct: There is an inverse relationship between detection risks and the combined level of inherent and control risks. For example, when inherent and control risks are high, acceptable detection risks need to be low to reduce audit risk to an acceptably low level. On the other hand, when inherent and control risks are low, an auditor can accept a higher detection risk and still reduce audit risks to an acceptably low level.

Question 6

Misstatements in the financial statements can arise from either fraud or error. (MTP 2 Marks Sep'22, Aug '18, Oct'18 & March '18, PYP 2 Marks July '21)

Answer 6

Correct: Misstatements in the financial statements can arise from either fraud or error. The distinguishing factor between fraud and error is whether the underlying action that results in the misstatement of the financial statements is intentional or unintentional. Hence misstatement can arise from error or fraud.

Alternative solution: Misstatement refers to a difference between the amount, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation or disclosure that is required for the item to be in accordance with the applicable financial reporting framework. Hence misstatement can arise from error or fraud.



Question 7

Control risk is the susceptibility of an account balance or class of transactions to misstatement that could be material either individually or, when aggregated with misstatements in other balances or classes, assuming that there were no related internal controls. (MTP 2 Marks Oct'23, RTP May'18, SM)

Answer 7

Incorrect: Inherent risk is the susceptibility of an account balance or class of transactions to misstatement that could be material either individually or, when aggregated with misstatements in other balances or classes, assuming that there were no related internal controls. Control risk, on the other hand is the risk that a misstatement that could occur in an assertion about a class of transaction, account balance or disclosure and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity's internal control.

Questions & Answers

Question 8

While conducting the audit of Smart TV Ltd, engagement team of HTR& Co, has considered materiality and audit risk throughout the audit. Discuss explaining the meaning of audit risk. (RTP May '22)

Answer 8

Audit risk is the risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated. Audit risk is a function of the risks of material misstatement and detection risk. Materiality and audit risk are considered throughout the audit, in particular, when:

- Identifying and assessing the risks of material misstatement;
- Determining the nature, timing and extent of further audit procedures; and
- Evaluating the effect of uncorrected misstatements, if any, on the financial statements and in forming the opinion in the auditor's report.

Question 9

CA L is in the process of finalizing his Risk Assessment Procedures of Effluent Limited which include observation and inspection that may support inquiries of management and others. Discuss few examples of audit procedures which include observation or inspection of the entity's operations. (PYP 3 Marks, July'21)

Answer 9

Observation and inspection may support inquiries of management and others, and may also provide information about the entity and its environment.

Examples of audit procedures which include observation or inspection of the entity's operations are:

- Documents (such as business plans and strategies), records, and internal control manuals.
- Reports prepared by management (such as quarterly management reports and interim financial statements) and those charged with governance (such as minutes of board of director's meetings)
- The entity's premises and plant facilities.

EXAM INSIGHTS: Examples of audit procedure: Many examinees did not understand the requirement of the question and their answer was not relevant to the topic. Some examinees just explained about observation and inspection which was not required.

Question 10

Satraga Foods Private Limited is engaged in manufacturing of pickles. The auditors of the company have planned audit procedures in respect of recognition of revenues of the company. Despite that, there is a possibility that misstatements in revenue recognition are not identified by planned audit procedures. Identify and explain that particular risk in detail. (RTP May'24, SM)

Answer 10

There is a possibility that planned audit procedures may not achieve desired result and fail to detect



misstatements in revenue recognition. Such a risk is referred to as “detection risk”.

SA 200 defines detection risk as the risk that the procedures performed by the auditor to reduce audit risk to an acceptably low level will not detect a misstatement that exists and that could be material, either individually or when aggregated with other misstatements.

For example, auditor of a company uses certain audit procedures for the purpose of obtaining audit evidence and reducing audit risk, but still there will remain a risk that audit procedures used by the auditor may not be able to detect a misstatement which by nature is material, then that risk is known as detection Risk.

Detection risk comprises sampling and non-sampling risk.

- (a) **Sampling risk** is the risk that the auditor’s conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure. It simply means that the sample was not representative of the population from which it was chosen.
- (b) **Non-sampling risk** is the risk that the auditor reaches an erroneous conclusion for any reason not related to sampling risk. Like an auditor may reach an erroneous conclusion due to application to some inappropriate audit procedure.

Question 11

You are appointed as an auditor of Wiwitsu Ltd. Your audit assistant wants to understand the meaning of Audit Risk. Explain him the meaning of Audit Risk with example. Also guide him as to what is not included in Audit Risk. (PYP 4 Marks May ‘23)

Answer 11

Audit risk means the risk that the auditor gives an inappropriate audit opinion when the financial statements are materially misstated. Audit risk is a function of the risks of material misstatement and detection risk. Thus, it is the risk that the auditor may fail to express an appropriate opinion in an audit assignment.

Example

Wiwitsu Limited purchased a Plant and Machinery for ` 2 Crores in the financial year 2021-2022. The accountant of Wiwitsu limited debited ` 2 crores in the repair and maintenance account in the statement of Profit and loss instead of taking it to the balance sheet as PPE and claim depreciation on it. While auditing the accounts of this company the auditor may not notice this and consequently may not report anything regarding the plant and machinery. Therefore, opinion given by the auditor would be inappropriate resulting in audit risk.

What is not included in Audit Risk?

- (i) Audit risk does not include the risk that the auditor might express an opinion that the financial statements are materially misstated when they are not. This risk is ordinarily insignificant.
- (ii) Further, audit risk is a technical term related to the process of auditing. It does not refer to the auditor’s business risks such as loss from litigation, adverse publicity, or other events arising in connection with the audit of financial statements.

Exam Insights: Audit Risk: Many examinees correctly wrote the meaning of audit risk but did not give the example of audit risk which was required to be given. Also, some examinees were not aware of as to what is not included in the audit risk.

Question 12

Risk of material misstatement refers to the risk that the financial statements are materially misstated prior to audit. Discuss the levels at which this risk exists. (RTP Nov ‘23 & Nov ‘20)

Answer 12

The risks of material misstatement may exist at two levels:

- (i) The overall financial statement level - Risks of material misstatement at the overall financial statement level refer to risks of material misstatement that relate pervasively to the financial statements as a whole and potentially affect many assertions.
- (ii) The assertion level for classes of transactions, account balances, and disclosures - Risks of material misstatement at the assertion level are assessed in order to determine the nature, timing, and extent of further audit procedures necessary to obtain sufficient appropriate audit evidence. This evidence enables



the auditor to express an opinion on the financial statements at an acceptably low level of audit risk.

Question 13

For the purpose of Identifying and assessing the risks of material misstatement, the auditor shall identify risks throughout the process of obtaining an understanding of the entity and its environment. Explain in detail along with other relevant points. (RTP Nov'20)

OR

Discuss the steps to be taken by the auditor for the purpose of Identifying and assessing the risks of material misstatement as per SA 315. (MTP 4 Marks Sep'22)

or

The objective of an auditor in accordance with SA 315 is to identify and assess risks of material misstatement at financial statement level and assertion level. Which specific activities an auditor is required to perform for the purpose of identifying and assessing risks of material misstatement? (MTP 4 Marks Mar'24)

Answer 13

For Identifying and assessing the risks of material misstatement, the auditor shall:

- (A) Identify risks throughout the process of obtaining an understanding of the entity and its environment, including relevant controls that relate to the risks, and by considering the classes of transactions, account balances, and disclosures in the financial statements;
- (B) Assess the identified risks, and evaluate whether they relate more pervasively to the financial statements as a whole and potentially affect many assertions;
- (C) Relate the identified risks to what can go wrong at the assertion level, taking account of relevant controls that the auditor intends to test; and
- (D) Consider the likelihood of misstatement, including the possibility of multiple misstatements, and whether the potential misstatement is of a magnitude that could result in a material misstatement.

Question 14

Risks of material misstatement may be greater for significant non-routine transactions arising from matters such as complex calculations. Also, risks of material misstatement may be greater for significant judgmental matters that require the development of accounting estimates, arising from matters such as accounting principles for accounting estimates may be subject to differing interpretation etc. Explain in detail. (MTP 3 Marks Oct'23, RTP Nov '21)

OR

Examine with reasons whether the following statements are correct or incorrect. Risks of material misstatement may be greater for significant judgmental matters that require the development of accounting estimates. (PYP 2 Marks, Nov'20)

Answer 14

Risks of Material Misstatement– Greater for Significant Non-Routine Transactions

Risks of material misstatement may be greater for significant non-routine transactions arising from matters such as the following:

- ◆ Greater management intervention to specify the accounting treatment.
- ◆ Greater manual intervention for data collection and processing.
- ◆ Complex calculations or accounting principles.
- ◆ The nature of non-routine transactions, which may make it difficult for the entity to implement effective controls over the risks.

Risks of material misstatement– Greater for Significant Judgmental Matters

Risks of material misstatement may be greater for significant judgmental matters that require the development of accounting estimates, arising from matters such as the following:

- ◆ Accounting principles for accounting estimates or revenue recognition may be subject to differing interpretation.
- ◆ Required judgment may be subjective or complex, or require assumptions about the effects of future events, for example, judgment about fair value.

CHAPTER 4: AUDIT EVIDENCE



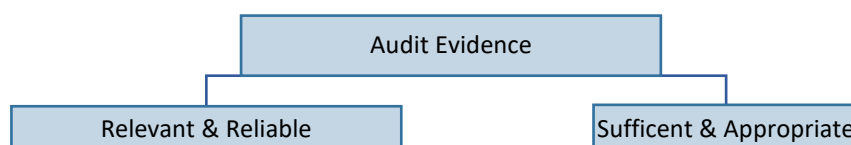
Chapters	Page Number	LDR Questions
Chapter 4.1: SA 500- Audit Evidence	4.1-1 – 4.1-14	Q22, Q24, Q25
Chapter 4.2: SA 610- Using the Work of Internal Auditors	4.2-1 – 4.2-4	Q2
Chapter 4.3: SA 530- Audit Sampling	4.3-1 – 4.3-14	Q19, Q26
Chapter 4.4: SA 501- Audit Evidence-Specific Considerations for Selected Items	4.4-1 – 4.4-7	Q7
Chapter 4.5: SA 505- External Confirmations	4.5 -1 – 4.5-5	Q8
Chapter 4.6: SA 510- Initial Audit Engagements – Opening Balances	4.6-1 – 4.6-2	Q3
Chapter 4.7: SA 550- Related Parties	4.7-1 – 4.7-3	Q2
Chapter 4.8: SA 520: Analytical Procedures	4.8-1 – 4.8-10	Q19, Q21

Chapter 4.1: SA 500- Audit Evidence

QUICK REVIEW OF IMPORTANT CONCEPTS

Scope

Design and perform audit procedures in such a way as to enable the auditor to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion.



Methods to obtain Audit Evidence

- Inspection
- Recalculation
- Observation
- Reperformance
- Inquiry
- Analytical procedures
- External Confirmation

Using the Work of management's expert

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

Audit procedures to obtain audit evidence

- Risk Assessment procedures
- Further audit procedures comprising of: Test of controls and Substantive procedures.

Assertions evaluated

Transaction Occurrence during the year	Account balances at period end	Presentation & Disclosures
Occurrence	Existence	Occurrence
Completeness	Rights & Obligations	Completeness
Accuracy	Completeness	Classification
Cut-Off	Valuation & Disclosure	Accuracy & Valuation
Classification		



True & False- Examine with reasons (in short) whether the following statement is correct or incorrect

Question 1

Inquiry alone ordinarily does not provide sufficient audit evidence. (MTP 2 Marks Nov '21 & March '22)

Answer 1

Correct: Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence. Audit procedures to obtain audit evidence can include inspection, observation, confirmation, recalculation, re-performance and analytical procedures, often in some combination, in addition to inquiry. Although inquiry may provide important audit evidence, and may even produce evidence of a misstatement, inquiry alone ordinarily does not provide sufficient audit evidence of the absence of a material misstatement at the assertion level, nor of the operating effectiveness of controls.

Question 2

While auditing the books of accounts of XYZ Ltd., the auditor of the company was involved in examining records and documents in paper form, electronic form etc. and was also conducting physical examination of assets. In the present case, audit procedure used by the auditor is known as "Observation". (MTP 2 Marks Sep '23 & Oct '23)

Answer 2

Incorrect: The audit procedure used by the auditor of XYZ Ltd. is known as "Inspection". Whereas Observation consists of looking at a process or procedure being performed by others.

Question 3

Negative assertions, encountered in the financial statements, may be expressed or implied. (MTP 2 Marks Oct '23, RTP Nov '22)

Answer 3

Correct: Negative assertions are also encountered in the financial statements and the same may be expressed or implied. For example, if it is stated that there is no contingent liability, it would be an expressed negative assertion. On the other hand, if in the balance sheet there is no item as "building", it would be an implied negative assertion that the entity did not own any building on the balance sheet date.

Question 4

While auditing the books of accounts of XYZ 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". (RTP May '23, PYP 2 Marks Dec '21)

Answer 4

Incorrect: The audit procedure used by the auditor of XYZ Ltd. is known as "observation". Whereas inspection involves examining records or documents, whether internal or external, in paper form, electronic form, or other media, or a physical examination of an asset.

EXAM INSIGHTS: Presence of auditor in inventory counting process: Many examinees could not recognize audit procedure as "Observation". Also, most of the examinees did not write about "inspection" to make comparison between the two, which was required to be given.

Question 5

Appropriateness is the measure of the quantity of audit evidence. (PYP 2 Marks May '23)

Answer 5

Incorrect: Appropriateness is the measure of the quality of audit evidence, that is, its relevance and its reliability in providing support for the conclusions on which the auditor's opinion is based. Sufficiency is the measure of quantity of audit evidence.



Question 6

Sales invoice is an example of external evidence. (PYP 2 Marks Nov'23)

Answer 6

Incorrect: Evidence which originates within the organisation being audited is called as internal evidence. The evidence that originates outside the client's organization is known as external evidence.

In view of above, sales invoice is an example of internal evidence because it originates within the organisation.

Question 7

Sufficiency is the measure of the quantity of audit evidence. (PYP 2 Marks Jan'21, SM)

Answer 7

Correct: Sufficiency is the measure of the quantity of audit evidence. The quantity of audit evidence is affected by the auditors assessment of the risks of misstatement. (Higher the assessed risks the more audit evidence is likely to be required.)

Question 8

Assertions refer to the representations by the auditor to consider the different types of the potential misstatements that may occur. (MTP 2 Marks Oct 20 & March '23, RTP May '23, PYP 2 Marks July '21, SM)

Answer 8

Incorrect: Assertions refer to representations by management that are embodied in the financial statements as used by the auditor to consider the different types of the potential misstatements that may occur.

EXAM INSIGHTS: Assertions refer to the representations by the auditor: In general most of the examinees wrote the definition of assertions correctly. However, some examinees wrote about the names of various assertions which was not required of the question.

Questions & Answers

Question 9

Discuss the following:

Name the assertions for the following audit procedures:

- (i) Year end inventory verification.
- (ii) Depreciation has been properly charged on all assets.
- (iii) The title deeds of the lands disclosed in the Balance Sheet are held in the name of the company.
- (iv) All liabilities are properly recorded in the financial statements.
- (v) Related party transactions are shown properly. (MTP 5 Marks April '21 PYP 5 Marks, May '18)

Answer 9

- (i) Year end inventory verification: Existence Assertion.
- (ii) Depreciation has been properly charged on all assets: Valuation Assertion.
- (iii) Title deeds of the lands disclosed in the Balance Sheet are held in the name of the Company: Rights & Obligations Assertion.
- (iv) All liabilities are properly recorded in the financial statements: Completeness.
- (v) Related party transactions are shown properly: Presentation & Disclosure.

Question 10

The objective of auditing is to design and perform audit procedures in such a way as to enable the auditor to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion. This can be obtained by performing which procedures? Name the types of audit procedures the auditor can perform to obtain audit evidence? (PYP 4 Marks Nov 22)



Answer 10

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

- (I) Risk assessment procedures; and
- (II) Further audit procedures, which comprise:
 - i. Test of controls, when required by the SAs or when the auditor has chosen to do so; and
 - ii. Substantive procedures, including tests of details and substantive analytical procedures.

Audit procedures to obtain audit evidence can include

- (a) Inspection
- (b) Observation
- (c) External Confirmation
- (d) Recalculation
- (e) Repperformance
- (f) Analytical Procedures
- (g) Inquiry

Question 11

Management is often in the best position to perpetrate fraud. As an auditor you are suspecting existence or suspicion of fraud from management. Give any three examples of "others within the entity" to whom direct inquiries can be made. (PYP 3 Marks May '23)

Answer 11

Examples of others within the entity to whom the auditor may direct inquiries about the existence or suspicion of fraud include:

1. Operating personnel not directly involved in the financial reporting process.
2. Employees with different levels of authority.
3. Employees involved in initiating, processing or recording complex or unusual transactions and those who supervise or monitor such employees.
4. In-house legal counsel.
5. Chief ethics officer or equivalent person.
6. The person or persons charged with dealing with allegations of fraud.

EXAM INSIGHTS: Direct Inquiries from others within the entity about the existence or suspicion of fraud: Examinees understood the question in wrong manner and wrote inquiries to be made with management, those charged with governance, debtors, creditors and mentioned general points instead of giving specific examples.

Question 12

Maintaining accounts using accounting software having a feature of recording audit trail can be useful for an auditor. Discuss some of the advantages for such a feature in accounting software for auditors. (SM)

Answer 12

An audit trail is a documented flow of a transaction. It is used to investigate how a source document was translated into an account entry and from there it was inserted into financial statement of an entity. It is used as audit evidence to establish authentication and integrity of a transaction. Audit trails help in maintaining record of system and user activity. Like, in case of banks, there is an audit trail keeping track of log-on activity detailing record of log-on attempts and device used.

It is a step-by-step record by which accounting, trade details, or other financial data can be traced to their source. Audit trails are used to verify and track many types of transactions including accounting and financial transactions. Audit trails (or audit logs) act as record-keepers that document evidence of certain events, procedures or operations, because their purpose is to reduce fraud, material errors, and unauthorized use. Audit trails help to enhance internal controls and data security. Audit trails can help in fixing responsibility, rebuilding events and in thorough analysis of problem areas. For example, audit trails can track activities of users thus fixing responsibility for users. These can also be used to rebuild events upon occurring of some problem. Audit trail analysis can specify reason of the problem. It can also help in ensuring operation of system as intended. In this way, audit trails can



help entities in their regular system operations.

Systems which have a feature of audit trail inspires confidence in auditors. It helps auditors in verifying whether controls devised by the management were operating effectively or not. It aids in verification whether a transaction was indeed performed by a person authorised to do it. Since audit trails also enhance data security, these can be used by auditor while performing audit procedures thus increasing reliability of audit evidence obtained.

Question 13

The reliability of information to be used as audit evidence, and therefore of the audit evidence itself, is influenced by its source, its nature and the circumstances under which it is obtained. Explain and elucidate the guiding principles which are useful in assessing the reliability of audit evidence. (MTP 3 Marks March 22, RTP May '18)

OR

The reliability of audit evidence depends on its source, nature, and the circumstances under which it is obtained, including the controls over its preparation and maintenance. Although exceptions may exist, few generalisations can be made about reliability of audit evidence. Considering above discuss such generalisations that can be made about the reliability of audit evidence. (MTP 5 Marks Nov'24)

Answer 13

Reliability of Audit Evidence: As per SA 500 on "Audit Evidence", 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, generalisations about the reliability of various kinds of audit evidence are subject to important exceptions.

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

- (i) The reliability of audit evidence is increased when it is obtained from independent sources outside the entity.
- (ii) 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.
- (iii) 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).
- (iv) 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).
- (v) Audit evidence provided by original documents is more reliable than audit evidence provided by photocopies or facsimiles, or documents that have been filmed, digitized or otherwise transformed into electronic form, the reliability of which may depend on the controls over their preparation and maintenance.

Question 14

While conducting the audit of Pummy Limited, the statutory auditors collected written representations from the Management. The audit was finalized in addition to other audit procedures but, without making any inquiries, as the statutory auditors were short of time. In the light of this information, state the importance of inquiry as one of the methods of collecting Audit Evidence. (RTP May '22)

Answer 14

Inquiry: As per SA 500 Audit Evidence: -

- (i) Inquiry consists of seeking information of knowledgeable persons, financial and non- financial, within the entity or outside the entity. Inquiry is used extensively throughout the audit in addition to other audit procedures. Inquiries may range from formal written inquiries to informal oral inquiries. Evaluating responses to inquiries is an integral part of the inquiry process.
- (ii) Responses to inquiries may provide the auditor with information not previously possessed or with corroborative audit evidence. Alternatively, responses might provide information that differs



significantly from other information that the auditor has obtained, for example, information regarding the possibility of management override of controls. In some cases, responses to inquiries provide a basis for the auditor to modify or perform additional audit procedures.

- (iii) Although corroboration of evidence obtained through inquiry is often of particular importance, in the case of inquiries about management intent, the information available to support management's intent may be limited. In these cases, understanding management's past history of carrying out its stated intentions, management's stated reasons for choosing a particular course of action, and management's ability to pursue a specific course of action may provide relevant information to corroborate the evidence obtained through inquiry.
- (iv) 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

Question 15

Auditing is a logical process. An auditor is called upon to assess the actualities of the situation, review the statements of account and give an expert opinion about the truth and fairness of such accounts. This he cannot do unless he has examined the financial statements objectively. He needs evidence to obtain information for arriving at his judgment. Discuss explaining clearly the meaning of audit evidence in detail. (MTP 4 Marks Oct'23, RTP Nov '19, RTP Nov'22)

Answer 15

Auditing is a logical process. An auditor is called upon to assess the actualities of the situation, review the statements of account and give an expert opinion about the truth and fairness of such accounts. This he cannot do unless he has examined the financial statements objectively.

Objective examination connotes critical examination and scrutiny of the accounting statements of the undertaking with a view to assessing how far the statements present the actual state of affairs in the correct context and whether they give a true and fair view about the financial results and state of affairs. An opinion founded on a rather reckless and negligent examination and evaluation may expose the auditor to legal action with consequential loss of professional standing and prestige.

He needs evidence to obtain information for arriving at his judgment.

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.

Explaining this further, audit evidence includes:-

- (1) Information contained in the accounting records: Accounting records include the records of initial accounting entries and supporting records, such as checks and records of electronic fund transfers; invoices; contracts; the general and subsidiary ledgers, journal entries and other adjustments to the financial statements that are not reflected in journal entries; and records such as work sheets and spreadsheets supporting cost allocations, computations, reconciliations and disclosures.
- (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. A combination of tests of accounting records and other information is generally used by the auditor to support his opinion on the financial statements.

Question 16

The auditor carries out his work by obtaining audit evidence through performance of audit procedures. However, there are practical and legal limitations on ability of auditor to obtain audit evidence. Give one example each for such practical and legal limitations. (MTP 3 Marks Mar'24)

Answer 16

Example of practical limitation on ability of auditor to obtain audit evidence

An auditor does not test all transactions and balances. He forms his opinion only by testing samples. It is an example of practical limitation on auditor's ability to obtain audit evidence.



Example of legal limitation on ability of auditor to obtain audit evidence

Management may not provide complete information as requested by auditor. There is no way by which auditor can force management to provide complete information as may be requested by auditor. In case he is not provided with required information, he can only report. It is an example of legal limitation on auditor's ability to obtain audit evidence.

Question 17

Manya Textiles is manufacturer of bed sheets, curtain cloths, other handloom items etc. having its plant at Panipat. Auditors SJ & Co. is having doubts over the reliability of information given to him as audit evidence. Also, auditors observed inconsistent information while conducting audit. Guide the auditor as to how they should proceed in the given situation. (RTP Nov'22)

Answer 17

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,
- 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.

Question 18

In the course of audit of WIVITSU Limited for the financial year ended 31st March, 2020 you have observed as an auditor that the company has provided a sum of ` 20 Lakhs in the books of account as Gratuity payable to employees based on certificate obtained from an actuary. Give your comments with reference to the Standard on Auditing. (MTP 3 Marks Nov '21)

Answer 18

Certificate from a Management's Expert: In the given case, WIVITSU Limited has provided a sum of 20 lakh in the books of accounts as gratuity payable on the basis of certificate obtained from an actuary. The liability towards gratuity payable to the employees at the time of cessation of service should be ascertained and provided for in the accounts when the employees are in service, it is an ascertained present liability accruing over the period of service but payable upon cessation of service.

The auditor should check the quantification of the gratuity liability. He should ascertain whether the same had been actuarially determined. The auditor should treat the actuary as managements' expert and conduct procedures relevant to checking the opinion of an expert in accordance with SA 500.

As per SA 500, "Audit Evidence", when information to be used as audit evidence has been prepared using the work of a management's expert, the auditor shall, to the extent necessary, having regard to the significance of that expert's work for the auditor's purposes:

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

Question 19

CA Kanika audited books of accounts of Engineering Ltd. for the financial year 2022-2023. 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. Comment on reliability of audit evidence obtained by performing such an audit procedure in some situations. (RTP May'24 PYP 3 Marks, Dec'21)

Answer 19

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. In view of above, it can be concluded that CA Kanika used Inspection as an audit procedure.

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.



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.

Examples of procedures in which CA Mukul shall not use internal auditor to provide direct assistance to him are: -

- (a) Procedures which involve making significant judgments in the audit;
- (b) Procedures relating 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) Procedures relating 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) Procedures relating 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.

Multiple Choice Questions (MCQ)

1. Which of the following is not one of functions of internal auditor of an organization? (SM)

- (a) Performing assurance activities
- (b) Performing consulting activities to improve governance of organization
- (c) Performing risk management activities
- (d) Expressing independent opinion on financial statements of organization

Ans: (d)

2. CA M is internal auditor of Crayon Products Limited. Which of the following is not TRUE about scope of internal audit? (MTP 1 Marks Oct'22)

- (a) Internal audit is an independent assurance activity.
- (b) Internal audit helps in improving internal control of the company.
- (c) Internal audit cannot review non-financial activities of company.
- (d) Internal audit can review compliance of company with various laws and regulations.

Ans: (c)



Chapter 4.3: SA 530- Audit Sampling

QUICK REVIEW OF IMPORTANT CONCEPTS

Meaning of Sampling Risk

Risk that auditor's conclusion based on a sample is different from the conclusion if the entire population were subjected to same audit procedure.

Characteristics of Population

- Appropriateness
- Completeness
- Reliable

Approaches to Sampling

- Statistical Sampling
- Non- Statistical Sampling

Methods of selection of sample size:

- (1) Random Sampling:
 - Simple Random Sampling
 - Stratified Sampling
- (2) Interval Sampling or Systematic Sampling
- (3) Monetary Unit Sampling
- (4) Haphazard Sampling
- (5) Block Sampling

Sampling Process

- Sample Design
- Sample Size
- Sample Selection
- Audit Procedures
- Nature and Cause of Deviation
- Projecting
- Evaluating Results of Audit

Requirements relating to Sample design, Sample size and Selection of items for testing

- **Sample Design:** The auditor considers the purpose of the audit procedure and the population characteristics when designing the sample.
- **Sample Size:** The auditor determines a sample size that reduces sampling risk to an acceptably low level.
- **Item Selection:** The auditor selects sample items to ensure each unit in the population has a chance of being chosen

Nature and Cause of Deviations and Misstatements

- Investigate the nature and cause of deviations to assess their potential impact on audit procedures and other audit areas.
- If a misstatement or deviation is considered an anomaly, the auditor must obtain a high degree of certainty that it is not representative of the population by performing additional audit procedures.

Evaluating Results of Audit Sampling

- The results of the sample; and
- Whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested.

True & False- Examine with reasons (in short) whether the following statement is correct or incorrect

Question 1

Systematic sampling means dividing heterogeneous population into homogeneous sub population, where samples are drawn from each sub population. (MTP 2 Marks Oct'22)

Answer 1

Incorrect: Stratification means dividing heterogeneous population into homogeneous sub population, where samples are drawn from each sub population. Systematic sampling is a selection method in which the number of sampling units in the population is divided by the sample size to give a sampling interval, for example 50, and having determined a starting point within the first 50, each 50th sampling unit thereafter is selected.

Question 2

The higher the auditor's assessment of the risk of material misstatement, the smaller the sample size needs to be. (MTP 2 Marks Oct'22)



Answer 2

Incorrect: The higher the auditor's assessment of the risk of material misstatement, the larger the sample size needs to be. The auditor's assessment of the risk of material misstatement is affected by inherent risk and control risk. Therefore, in order to reduce audit risk to an acceptably low level, the auditor needs a low detection risk and will rely more on substantive procedures. The more audit evidence that is obtained from tests of details (that is, the lower the detection risk), the larger the sample size will need to be.

Question 3

The level of sampling risk that the auditor is willing to accept will not affect the sample size. (MTP 2 Marks April 22, RTP Nov '22)

Answer 3

Incorrect: As per SA 530, "Audit Sampling" the level of sampling risk that the auditor is willing to accept affects the sample size required. The lower the risk the auditor is willing to accept, the greater the sample size will need to be.

Question 4

Low acceptable sampling risk requires larger sample size. (MTP 2 Marks March '23, SM)

Answer 4

Correct: Sampling risk arises from possibility that the auditor's conclusion based upon sample may be different from conclusion that would have been reached if same audit procedures were applied on the entire population. If acceptable sampling risk is low, large sample size is needed.

Question 5

Block sampling does not involve judgement, does not even use the random number tables and has no structured approach. (PYP 2 Marks Nov'23)

Answer 5

Incorrect: Haphazard sampling has no structured approach, does not involve judgment and does not even use the random number tables.

On the other hand, Block sampling involves selection of a block(s) of contiguous items from within population. Such selection has a risk of bias and of establishing a pattern of selection. Therefore, block sampling involves use of judgment.

Question 6

In case of stratified sampling, the conclusions are drawn on the stratum. (MTP 2 Marks Sep'22, PYP 2 Marks July'21, SM)

Answer 6

Correct: In case of stratified sampling, the conclusions are drawn on the stratum. The combination of all the conclusions on stratum together will be used to determine the possible effect of misstatement or deviation. Hence the samples are used to derive conclusion only on the respective stratum from where they are drawn and not the whole population

Question 7

Statistical sampling being more scientific and without personal bias will always be appropriate to use under all circumstances. (MTP 2 Marks April '23 & Oct '23, PYP 2 Marks Dec '21)

Answer 7

Incorrect: Statistical sampling is widely accepted way of sampling as it is more scientific, without personal bias and the result of sample can be evaluated and projected in more reliable way.

Under some audit circumstances, statistical sampling methods may not be appropriate. The auditor should not attempt to use statistical sampling when another approach is either necessary or will provide satisfactory information in less time or with less effort. For instance, when exact accuracy is required or in case of legal requirements etc.



Chapter 4.4: SA 501- Audit Evidence-Specific Considerations for Selected Items

QUICK REVIEW OF IMPORTANT CONCEPTS

Evidence About Existence Condition Of Inventory

- Inspecting the inventory
- Observing compliance with management's instructions for recording and controlling results of physical inventory count
- Obtaining audit evidence as to the reliability of management's count procedures
- Performing audit procedures over the entity's final inventory records

Special Procedures

1. Inventory counting conducted at date other than Balancesheet date - Perform audit procedures to obtain audit evidence / about whether changes in inventory between the count date and the date of the F.S. are properly recorded.
2. Auditor unable to attend Inventory Count - Make or observe some physical counts on an alternative date and perform audit procedures on intervening transactions.
3. Attendance at inventory count is impracticable - Perform alternative audit procedures to obtain evidence regarding existence and condition of inventory. If it is not possible to do so, modify the opinion in the auditor's report in accordance with SA 705.
4. Inventory under custody and control of Third Party - Request confirmation from third party and perform other audit procedures.

Litigation & Claims

Audit Procedures

- Inquiry of management
 - Reviewing minutes of meetings
 - Reviewing legal expense accounts
- If management refuses to permit auditor to communicate with legal counsel / external legal counsel refuses / auditor unable to collect SAAE by performing alternate procedures modify opinion in accordance with SA 705.

Segment Reporting

The auditor shall obtain sufficient and appropriate audit evidence regarding presentation and disclosure of segment information in accordance with applicable Financial Reporting Framework by:

- (a) Obtaining understanding of such methods used by management in determining segment information in accordance with applicable Financial Reporting Framework.
- (b) Performing analytical procedures or other audit procedures appropriate in the circumstance.

Inventories

True & False- Examine with reasons (in short) whether the following statement is correct or incorrect

Question 1

When inventory under the custody and control of a third party is material to the financial statements, the auditor cannot obtain sufficient appropriate audit evidence regarding the existence and condition of that inventory by taking written representation from management. (MTP 2 Marks Sep '23, RTP May '23, SM)

Answer 1

Correct: When inventory under the custody and control of a third party is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of that inventory by performing one or both of the following:

- (a) Request confirmation from the third party as to the quantities and condition of inventory held on behalf of the entity.
- (b) Perform inspection or other audit procedures appropriate in the circumstances.



Questions & Answers

Question 2

In an initial audit engagement, in the case of inventories, the current period's audit procedures on the closing inventory balance provide little audit evidence regarding inventory on hand at the beginning of the period. Therefore, in such a case, additional audit procedures become necessary so that auditor may obtain sufficient appropriate audit evidence. Discuss those additional audit procedures. (MTP 3 Marks Apr'24)

Answer 2

In an initial audit engagement, in the case of inventories, the current period's audit procedures on the closing inventory balance provide little audit evidence regarding inventory on hand at the beginning of the period. Therefore, additional audit procedures may be necessary, and one or more of the following may provide sufficient appropriate audit evidence:

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

Question 3

Narrate the audit procedures to be performed by an auditor in order to ascertain that the Raw materials and consumables are valued appropriately and as per generally accepted accounting policies and practices. (PYP 4 Marks Nov'23)

Answer 3

Audit procedures performed by an auditor in order to ascertain that raw material and consumables are valued appropriately in accordance with generally accepted accounting policies and practices are as under:

1. Ascertain what elements of cost are included e.g. carriage inward, non-refundable duties etc.
2. If standard costs are used, enquire into basis of standards; how these are compared with actual costs and how variances are analyzed and accounted for/ treated in accounting records.
3. Test check cost prices used with purchase invoices received in the month(s) prior to counting.
4. Follow up valuation of all damaged or obsolete inventories noted during observance of physical counting with a view to establishing a realistic net realizable value.

Exam insights: Audit Procedures relating to Valuation of Raw materials/consumables: Examinees failed to explain the audit procedure relating to Valuation of raw materials/consumables and mentioned various other types of assertions like completeness, cut-off procedures and external confirmations.

Question 4

While conducting audit of Vee Ltd, CA Aman, auditor of the company, found that some goods are lying with third party for a long period. Advise Aman how will he verify them. (MTP 4 Marks Oct '21)

Answer 4

Goods Lying with Third Party: The auditor should check that the materiality of the item under this caption included in inventories.

- (i) He should obtain confirmation of the amount of goods lying with them. The confirmation may be directly obtained by auditor or be produced by client depending upon the situation.
- (ii) He should inquire into the necessity of sub contractor retaining the inventory. He should ensure the process that they do are related to the business requirement and there is no ground for suspicion on this score.
- (iii) The goods lying with them for the very long period would merit auditors' special attention for making provision.
- (iv) The records, voucher/slips for the regulating the movement of inventory into and out of entity for sub-contracting work be reviewed by vouching for few transaction for ensuring existence and working of internal control system for them.
- (v) The excise gate pass, entry in such records, information in returns, be also cross-verified.
- (vi) The valuation of inventories should be correctly made for including material cost on appropriate inventory valuation formulae and also for inclusion of proportionate processing charges for the work in