

## Chapter - 4 "Audit Evidence"

- Topics Covered :
- (1) SA 500
  - (2) SA 503
  - (3) SA 505

### (4) SA 510 - Initial Audit Engagements - Opening Balances :

I. ABC Ltd.      FY 23-24      Mr. X (Auditor)

                          FY 22-23      Mr. Y (Auditor)

Closing Balance of 31.03.2023 [Audited by Mr. Y]



Opening Balances of 01.04.2023

→ Examine c/f

→ Study audit report of Mr. Y

→ Unless doubt arises, consider the op. Balances as correct.

II. ABC Ltd.      FY 23-24      Mr. X (Auditor)

                          FY 22-23      Unaudited

Closing Balance of 31.03.2023 [Unaudited]



Opening Balance of 01.04.2023

→ Examine c/f

→ ROMM - High.

- Perform Addl. procedures

Assets - Current assets -  $\left\{ \begin{array}{l} \text{Inventory} \\ \text{Trade Rec.} \end{array} \right.$

- Non current assets

Liabilities - Current liabilities

- Non current liabilities

(i) Meaning of Initial Audit Engagement: An audit engagement in which f.s. for the prior period are either:  
(a) Unaudited; or  
(b) audited by predecessor auditor.

(ii) Meaning of Opening Balances: Account balances that exist at the beginning of the period.  
These are based on the closing balances of prior period and reflect the effects of transactions and events of prior period and accounting policies applied in prior period.

(iii) Objectives of the auditor: Auditor's objective in relation to examination of opening balances of initial audit engagement is to obtain SAAE as to:  
(a) whether opening balances do not contain any material misstatements;  
and  
(b) whether accounting policies reflected in opening balances have been consistently applied; and changes, if any are appropriately accounted for and disclosed in the f.s. as per applicable FRF.

Imp

(iv) Audit procedures w.r.t. opening balances:

(a) Obtain SAAE w.r.t. op. balances to ensure that they are free from material misstatements. For this purpose:

(i) Ensure that closing balances of prior period have been correctly brought forward; Adjustment, if any, are disclosed as prior period item in

the current year statement of Profit and loss. (AS-5)

(ii) Determine that opening balances reflect application of appropriate accounting policies.

(iii) Perform any of the followings:

(a) Perusing the copies of latest audited f.s., along with audit report thereon, if any; or

(b) Evaluate whether audit procedures performed in current year provide relevant evidences w.r.t. op. balances; or

(c) Perform specific audit procedures to obtain evidences regarding opening balances.

(b) If auditor obtains audit evidences as to misstatements in opening balances that could affect current period f.s., perform additional procedures to determine the effect on current period f.s.

(c) If auditor concludes that misstatements exist in current period f.s., auditor shall communicate the misstatements with appropriate level of Mngt. and TCOG, with a request for necessary correction.

(v) Reporting w.r.t. Opening Balances:

(a) If auditor unable to obtain SAAE w.r.t. op. balances, he shall express a Qualified opinion or Disclaimer of opinion, as appropriate.

Qualified: If effects of op. balances on current period f.s. is material, but not pervasive.

Disclaimer: If effects of op. balances on current f.s. is material as well as pervasive.

(b) If auditor concludes that op. balances contains a misstatement that could affect the current period f.s. and effect of such misstatement is not properly accounted for or not adequately disclosed, he shall

express a **qualified opinion** or **adverse opinion**, as appropriate.

(Material effect, but not pervasive)

(Material as well as Pervasive effect)

	Effect - <b>Material</b> but not <b>Pervasive</b>	Effect - <b>Material + Pervasive</b>
Auditor <b>unable to Obtain SAAE</b> as to <u>Misstatements in F.S.</u>	<u>Qualified opinion</u>	<u>Disclaimer of opinion</u>
Auditor obtain <b>SAAE</b> w.r.t. <b>Misstatements</b> in F.S.	<u>Qualified opinion</u>	Adverse opinion

Qualified opinion: Except for the effects of significance of matter described in Basis of Qualified opinion, F.S. reflects a true and fair view.

Disclaimer of opinion: Because of significant restrictions and limitations, as described in Basis for disclaimer of opinion section, no opinion is being expressed.

Adverse opinion: Because of significance of matter as described in basis for adverse opinion, F.S. are not prepared, in all material respects as per applicable R.F.

(vi) Misc. Topics (remaining topics): - Reading from book -

## (5) SA 520 "Analytical Procedures" :

### (i) Meaning and Nature of AP :

AP may be defined as follow : " Evaluation of financial information through Analysis of plausible relationship among financial and non financial data   
 ↓ and, also includes   
 necessary investigation of identified fluctuations or relationships that differ from relevant information. "

Example: Predictive Model for substantial item: e.g. Room Rental Income - for a Hotel

$$= \text{No. of Rooms in a category} \times \text{Avg. tariff per day} \times \text{Occupancy Ratio} \times 365 \text{ days}$$

$$= 100 \text{ Rooms} \times ₹ 10,000 \times 90\% \times 365$$
$$= ₹ \underline{32,85,00,000}$$

Actual room rent as shown in P&L stn. = ₹ 30,00,00,000

Difference = ₹ 2,85,00,000 [ 8.67% ]

Tolerable range of Misstatement =  $\pm 1\%$ .

Auditor need to investigate the fluctuation (if exceeding tolerable range) through - (a) Inquiry of Mngt; and

(b) Other audit procedures (if mngt. unable to provide necessary explanation or explanation provided are inadequate).

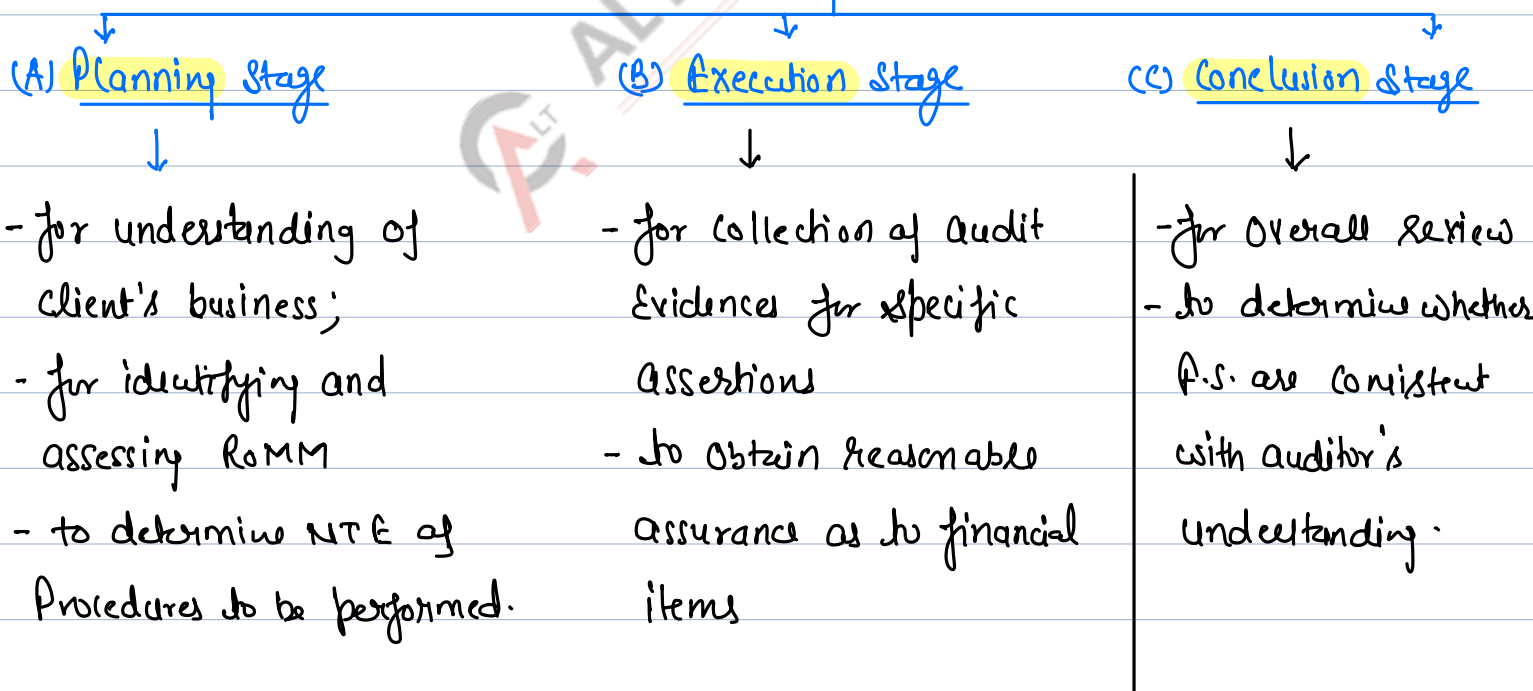
Analytical Procedures comprises of:

- (a) Consideration of Comparisons:
- with prior period information
  - with anticipated results, like budgeted data or auditor's expectation
  - with similar information of industry.

- (b) Consideration of Relationships:
- among financial items  
(e.g. Gross Margin %age; Operating Ratio)
  - among financial and non-financial items  
(e.g. Payroll cost to no. of employees)  
Input - Output Ratio

(ii) Timings of application of APs:

APs may be applied during different stages of audit.



Note: Use of AP during planning stage is dealt by SA 300 and 315.

Note: Application of AP as substantive procedures during execution and conclusion stage is dealt by SA-520.

(iii) Purpose of A.P.: Self study from book.

## Use of AP for Employee payroll: Predictive Model

Expected = No. of Employees × Avg. salary × 12 Months.  
Salary in a Grade scale in that Grade  
(Payroll)

	2023-24	2022-23	2021-22
Or <u>Employee Compensation.</u> (Comparison)	XX	XX	XX