

Chapter - 4 " Audit Evidence

- Topic Covered:
- (1) SA-500 " Audit Evidence "
 - (2) SA-501 " Audit Evidence - Specific Consideration for Selected Items "
 - (3) SA-505 " External Confirmations "
 - (4) SA-510 " Initial Audit Engagements - Opening Balance "

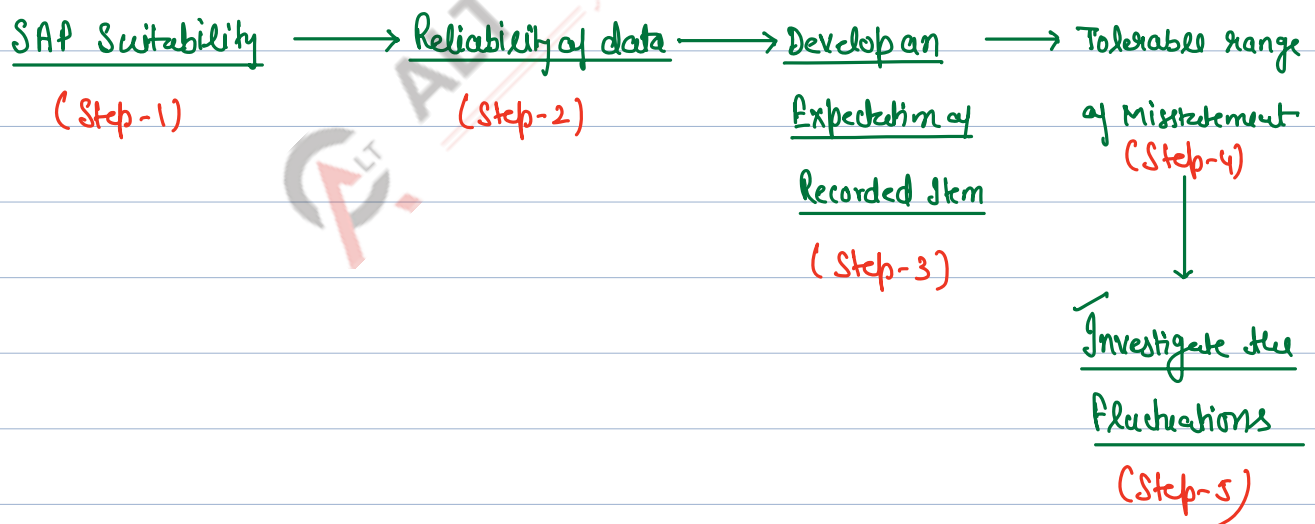
(5) SA-520 " Analytical Procedures "

(i) Meaning and Nature:

(ii) Need and Purpose:

(iii) Application of AP:

(iv) Steps while performing Substantive Analytical Procedures:



Step-1: To determine suitability of Substantive AP (SAP):

- Auditor is required to determine nature of audit procedures to be performed over the accounting data, to reduce the audit risk to an acceptable low level. (Tod / SAP / Combination of Tod and SAP).
- While determining use of analytical procedures, as SAP, auditor should consider certain factors like:

(a) Availability of relevant and reliable data.

(b) Degree of disaggregation (classification) of available data.

(c) Type of accounting information - SAPs are more useful for certain type of accounts than for others. e.g. for B/S items, subjected to management judgements, SAPs may not be effective.

(d) Source of information

(e) Predictability of information: SAPs are more suitable to large volume of transactions that tend to be predictable over time.

(f) Nature of Assertion: SAPs are more effective more some assertions (like completeness, valuation etc.) than for others (like existence, rights and obligations).

(g) Nature of RoMM.

Note: Different SAPs will provide different levels of assurance.

Step-2: Evaluate Reliability of data:

- Auditor should evaluate the reliability of data over which SAPs are to be performed.

- Reliability of data is effected by following factors:

(a) Source of information available.

(b) Comparability of information available.

(c) Nature and relevance of information.

(d) Internal Controls exercised over the preparation of information.

SC-NRI

Step-3: Develop an expectation of recorded amount or ratio and Evaluate whether the expectation is sufficiently precise to identify the material misstatement:

While developing the expectation and evaluating the expectation, auditor should consider the following:

- (a) Accuracy with which the expected results can be predicted;
- (b) Extent to which data can be disaggregated;
- (c) Availability of the information.

Step-4: Determine the tolerable range of differences that can be accepted without further investigation.

Tolerable range depends on professional judgement of auditor and based on desired levels of assurance.

Step-5: Investigating the difference beyond tolerable range:

If as a result of SAP, auditor identify any fluctuation or relationship that is inconsistent with the relevant information by a significant amount, auditor shall investigate the difference by:

- (a) Inquiring the management and Obtaining evidences relevant to management response; or
- (b) Performing other audit procedures as seems appropriate in the circumstances.

Note: Need to perform other audit procedures arises when:

(a) Mngt. is unable to provide explanation;

OR

(b) Explanation provided by Mngt. is inadequate.

Example: AP → for Payroll Salary - No. of Employees × Avg. Sal. p.M. × 12 Months.

$$= 750 \times 25650 \times 12 M$$

$$= 23,08,50,000$$

$$\text{Recorded Amount} = ₹ 30,10,70,650 - 6,50,00,000 = 23,60,70,650$$

$$\text{Difference} = ₹ 7,02,20,650$$

$$\text{Tolerable range} = \pm 5\%$$

Fluctuation

= 30.42%



Requires Investigation



Inquiry with Management — Response

↓ Pending Court Case.
as to revision of
Salary of last year.

(2017-2022)

↓ Decision — against

₹ 6.50 Crores — Prior Period

Ask - Court judgement
↓
Certified copy

Imp:

(V) Techniques while Using SAP:

(a) Trend Analysis: Most commonly used technique.

Involves comparison of data of current period with data of one or more prior periods.

(b) Ratio Analysis: To establish relationship among financial and non-financial items.

Also involves comparison of significant ratio of current period with that of prior periods or anticipated ratio or industry averages.

(c) Reasonable Tests: Such tests are applicable over income statement items, through which financial items are tested using non-financial data.

For Ex:- Sales discount and Commission against Volume of Sales (No. of items sold);

- Rental Income based on occupancy of premises.
- Raw Material consumption in production.

- Interest Expense against interest bearing obligations;
- %age of waste/scrap produced in a production process.

(d) Structural Modelling: A modelling tool that constructs a statistical model from financial and/or non-financial data of prior periods so as to predict the current period Balances

	I_1	I_2	I_3
19-20	X	Y	Z_1
20-21	X_1	Y	Z_2
21-22	X_2	Y	Z_4
22-23	X_3	Y	Z_8
23-24	X_4	Y	Z_{16}

(6) Audit Sampling (SA-530): - Recorded class of last batch. \leftarrow