

**10+ years of experience! Unbeatable Passion for Audit Subject!!! That's CA Pragnesh Kanabar Sir!**

# **Brahmastra Revision CA Final Audit- New Syllabus**

**Chapter 5 SAs by CA Pragnesh Kanabar**

**SA 500, 501, 505, 510, 530 & 550**

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# Revise your basics properly for 500 series SAs

## Possibilities while performing audit procedures

SAAE (sufficient and appropriate audit evidence) available

IF there is any inconsistency with books of accounts and other records

Then Perform additional audit procedures

Discuss the matter with mgmt. and where appropriate, TCWG

IF misstatement is identified

Then Communicate such misstatement for rectification

IF rectification is not done then

Evaluate the impact of such uncorrected misstatements on the FS as a whole and consider impact on audit opinion as per SA 705

SAAE not available

Inquire about the reasons

Valid Reasons

Perform Alternate Audit Procedures

IF SAAE still not available (it creates limitation on scope of audit due to circumstances)

Then consider impact on audit opinion as per SA 705

Invalid Reasons

Discuss the matter with TCWG

IF SAAE still not available (it creates limitation on scope of audit by mgmt. and TCWG)

Then either consider impact on audit opinion as per SA 705 or withdraw from the engagement, if legally permissible

## Audit opinion formation

Sufficient and Appropriate Audit Evidence (SAAE) has been obtained

IF there are uncorrected misstatements (incorrect accounting, presentation or disclosure in FS)

IF the accumulation of such uncorrected misstatement is material then

It could lead to Either Qualified opinion or Adverse opinion

Qualified opinion is given when the effect of accumulated uncorrected misstatement(s) is **Material but not pervasive**

Adverse opinion is given when the effect of accumulated uncorrected misstatement(s) is **Material & pervasive**

Sufficient and Appropriate Audit Evidence (SAAE) is not available i.e. Limitation on scope of audit

We need to evaluate what can be the possible effect of undetected misstatements?

IF the possible effect of such undetected misstatement is material then

It could lead to Either Qualified opinion or Disclaimer of an opinion

Qualified opinion is given when the possible effect of undetected misstatement(s) is **Material but not pervasive**

Disclaimer of an opinion is given when the possible effect of undetected misstatement(s) is **Material & pervasive**

## SA 500 - "Audit Evidence"

### Scope of the SA

This SA deals with the auditor's responsibility to design and perform audit procedures to obtain sufficient and appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion.

This SA is applicable to all the audit evidence obtained during the course of audit.

### Objective of the auditor

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 auditor's opinion.

### Information to be used as audit evidence

The auditor shall consider the relevance and reliability of the information to be used as audit evidence.

When information from management expert is used, the auditor shall evaluate the competence, objectivity of the expert, appropriateness of the expert's work. When using information produced by the entity, the auditor shall evaluate the reliability, completeness, accuracy of the information.

### Audit procedures to obtain audit evidence

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

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

### Inconsistency in or doubts over reliability of audit evidence

The auditors 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.

**SA 501 deals with auditor's responsibility to obtain**

Sufficient and Appropriate Audit Evidence (SAAE) for verifying

Existence and Condition of

Completeness of

Presentation and disclosure of

Inventory

Litigation and Claims

Segment information

**Main procedure:-** Attend the physical counting of inventory being done by the management

**Main procedure:-** Perform Procedures to identify litigation and claims involving the entity

**Main procedure:-** Verify the presentation and disclosure as per Applicable Financial Reporting Framework (AS 17 and IND AS 108)

Audit Procedures

Various Practical Possibilities (next page)

Audit Procedures

- I- Inquiries of entity's in-house legal counsel
- M- Minutes of meeting
- C- Communication between entity and its external legal counsel
- R- Reviewing legal expense accounts
- E- External confirmation from the entity's external legal counsel → Prepare a letter on entity's letterhead and send it to the legal counsel. Two possibilities
  - A) If mgmt and TCWG refuse then consider impact on opinion as per SA 705
  - B) If mgmt allows but lawyer does not respond then perform alternate audit procedures. IF SAAE still not available then consider impact on opinion as per SA 705
- W- Written representation from mgmt as per SA 580 regarding completeness of L&C and its accounting, presentation and disclosure as per AFRF

A) Obtaining an **understanding of the methods used by mgmt in determining segment information** → whether such methods provide fair presentation as per AFRF and test the application of such methods. For example:

- (i) Sales, transfers and charges between segments, and elimination of inter-segment 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.

B) Perform **analytical procedures** (ratios and comparisons) as per SA 520

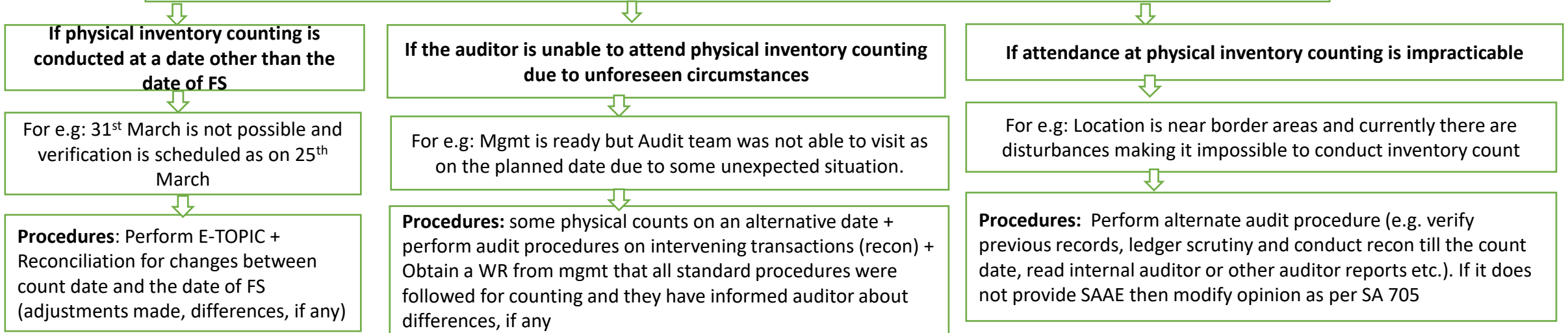
Planning attendance

Procedures to be performed

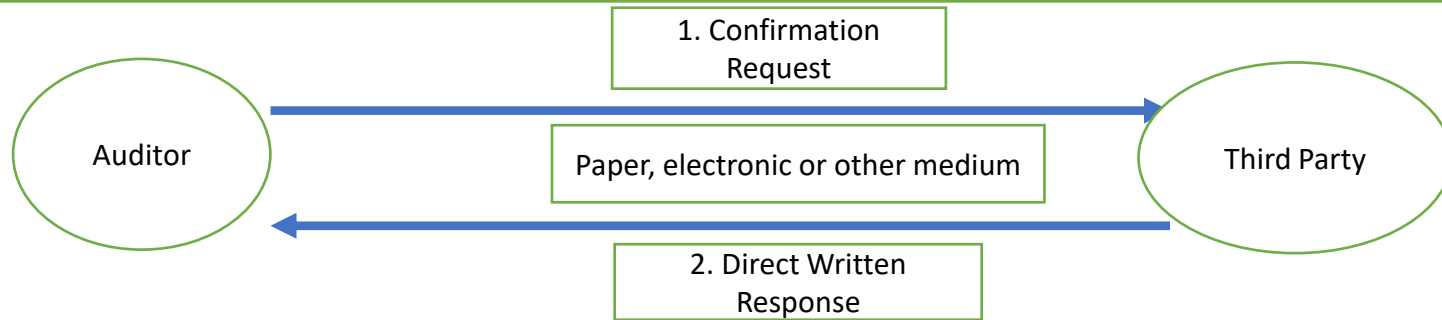
- W- Work in progress (determining completion)
- I- Internal control for maintenance of inventory
- N- Nature of Inventory
- L- Location at which inventory is held
- A- Adequate procedures established by the management? (arrangements made by them for inventory count)
- T- Timing of the count
- E- Expert's assistance required?
- R- Risk of Material Misstatement involved.

- E- Evaluating Management's instructions and procedures (e.g. controls implemented over movement of inventory, accurate identification of WIP, procedures used to estimate physical quantities etc.) for recording and controlling the results of the entity's physical inventory counting
- T- Test Counts (sample verification)
- O- Observation of management's count procedures
- P- Perform checks → Final inventory records vs Actual inventory count results
- I- Inspect the inventory (to test its condition)
- C- Confirmation with third parties (or inspection or both based upon the materiality of inventory held with third parties).

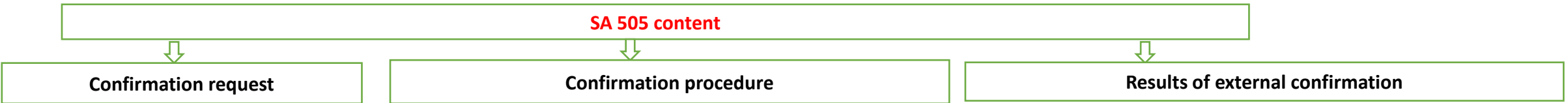
**SAAE for verifying Existence and Condition of Inventory (when inventory is material to the FS)... Various possibilities**



**SA 505 External Confirmation**



**SA 505 content**



SA 505 content

Confirmation request

**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.

**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.

It provides less persuasive (convincing) evidence than Positive confirmation request

Therefore it should be used less frequently and only if all of these conditions are satisfied:

**4 conditions (Code word: RAID):**

- 1) R- **Risk** of Material Misstatement is low
- 2) A- Too many similar items with lower **AMOUNTS**
- 3) I- Chances of **Ignorance** by third party are less i.e. 3<sup>rd</sup> party will not disregard such request.
- 4) D- Chances of **Disagreement** are less i.e. Low rate of Exception

Confirmation procedure

Determining the information to be confirmed or requested

Selecting the appropriate confirming party

Designing the confirmation requests

Sending the requests to the confirming party, including follow-up requests (additional request)

**Factors to be considered for designing a confirmation request:**

**Code: MAAL**

M- Management's authorization of the request (so that third parties reply faster)\*\*

A- Assertions being addressed (i.e. the nature of matter required)

A- Ability of third party to provide the requested information

L- Layout and presentation method

**\*\*What if Management refuses to authorize a confirmation request?**

Inquire whether there is a reasonable justification for such refusal? Re-assess RoMM and consider fraud risk

Valid Reasons

Perform Alternate Audit procedure

IF SAAE still not available

Then modify opinion as per SA 705

Invalid Reasons

Discuss the matter with TCWG

IF TCWG also refuses to allow the auditor to send the request

Results of external confirmation

**Following Categories of results possible (summarising previous chart)**

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.

D) A response indicating an exception.

**Reliability of the response:**

→ Factors that may create doubt over reliability of response:

A) Was received by the auditor indirectly

B) Appeared not to come from the originally intended confirming party.

→ When the auditor concludes that a response is unreliable, the auditor may need to revise the assessment of RoMM.

## SA 510 Initial Audit Engagement- Verification of opening balances.

### Initial Audit Engagement (IAE): An engagement in which either...

The financial statements for the prior period were not audited

OR

The financial statements for the prior period were audited by a predecessor (previous) auditor

### Objective of SA 510

To obtain sufficient and appropriate audit evidence (SAAE) about whether:

Opening balances contain misstatements that materially affect the current period's financial statements

Accounting policies reflected in the opening balances are:

- A) Appropriate as per AFRF
- B) Consistently applied
- C) Changes, if any, are properly accounted presented and disclosed as per AFRF

### Opening balances

Account balances that exist at the beginning of the period i.e. prior period closing balances

+

matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments of the prior period

Read the most recent financial statements, if any and predecessor auditor's report, if any

Whether prior period balances have been correctly brought forward

Any adjustment to opening balances disclosed as prior period items in the current year's P&L

Verify whether accounting policies are Appropriate as per AFRF, Consistently applied and changes, if any have been properly accounted, presented and disclosed

### Use of Predecessor Auditor's report

While performing Risk Assessment Procedure

If predecessor auditor has expressed modified opinion on prior period FS then it helps the auditor to understand RoMM in the current period FS

Matter has been resolved in CYFS

While forming audit conclusions

Modified opinion expressed by the predecessor auditor on prior period FS

Matter remains unresolved in CYFS

Matter remains relevant and material in CYFS

Modify opinion on CYFS



## SA 550 Related Party

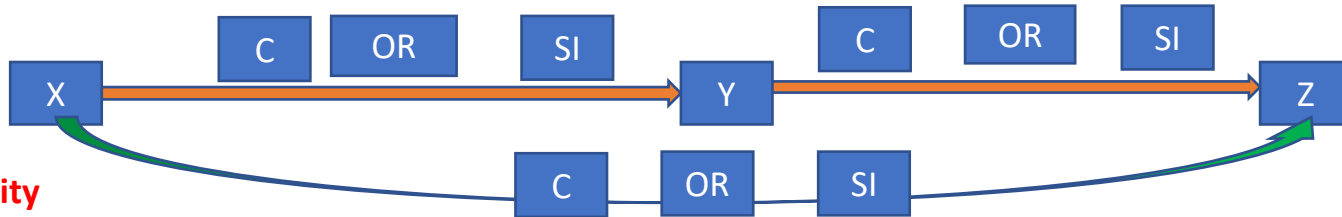
### Definition

As defined in the applicable financial reporting framework (AFRF) → AS 18/ IND AS 24

If AFRF is silent

Then following relationships will be considered as Related Parties

A) A person or other entity that has **control (C)** or **significant influence (SI)**, directly or indirectly through one or more intermediaries, over the **reporting entity (entity being audited)**



X → A Person or other entity

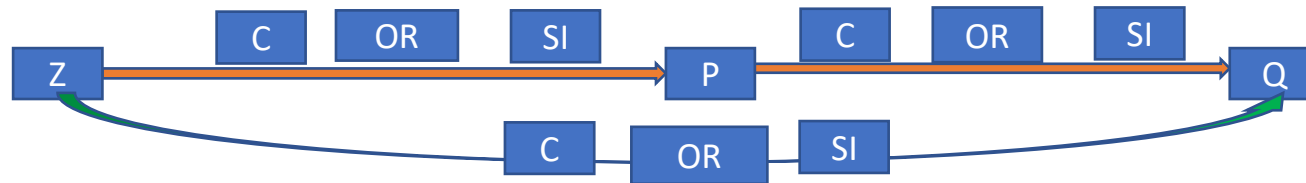
Y → Intermediary

Z → Reporting entity (entity being audited)

In the above diagram → X, Y and Z are related Parties

For definition of Control/Significant influence → Refer AS-18 (inter-ca), IND AS 24 (final ca)

B) Another entity over which **the reporting entity has control or significant influence**, directly or indirectly through one or more intermediaries



Q → A Person or other entity

P → Intermediary

Z → Reporting entity (entity being audited)

In the above diagram → Z, P and Q are related Parties

For definition of Control/Significant influence → Refer AS-18 (inter-ca), IND AS 24 (final ca)



C) Another entity that is under common control with the reporting entity through having:



- i. Common controlling ownership;
- ii. Owners who are close family member
- iii. Common key management.

**R** → A Person or other entity

**Z** → Reporting entity (entity being audited)

**Z and R being commonly controlled in any of the above mentioned ways.**

**Exception: Government controlled entities** → 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

### Risk Assessment Procedure

#### Understanding the entity's RPR and RPT:

##### Conduct Inquiry of the management regarding

- i) RPR → Identity of entity's related parties, changes from prior period, nature of entity's related party relationship
- ii) RPT → type and purpose of transactions

#### Evaluating internal controls over entity's RPR and RPT:

- i) How entity IAD → Identifies, Accounts for and Discloses RPR and RPT in FS
- ii) Who authorizes and approves significant arrangements with related parties
- iii) Who authorizes and approves significant transactions with related parties including transactions outside the normal course of business.

#### RoMM associated with RPR and RPT

- i) RoMM about RPR and RPT not being identified or disclosed
- ii) RoMM associated with RPT outside the normal course of business
- iii) RoMM associated with RPT not being at arms length price
- iv) RoMM about RPR and RPT not being disclosed in the FS as per AFRF.

### Further Audit Procedure (responding to the assessed RoMM)

**1) IDENTIFICATION** of previously unidentified or undisclosed Related Parties or Significant Related Party Transactions

**Examples** of records/documents which can show the existence of RPR and RPT

#### I4S2

- A) I → Income tax returns
- B) I → Internal auditors' reports.
- C) I → Records of the entity's investments
- D) I → Information supplied by the entity to regulatory authorities
- E) S → Significant contracts and agreements not in the entity's ordinary course of business.
- F) S → Shareholder registers etc..

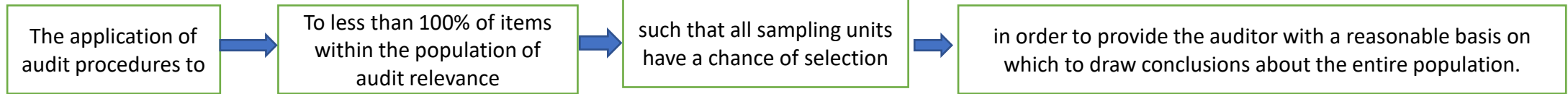
**2) Procedures for Significant transactions outside the NORMAL course of business: CAA**

- A) Inspect the supporting **CONTRACTS** → Rationale (logic) behind such transaction?, whether terms of the contract is as per mgmt.'s explanation?
- B) Whether such transactions have been IAD → **Identified, ACCOUNTED and disclosed in FS as per AFRF**
- C) Who **APPROVED** such transactions → appropriate?

**3) Whether RPT have been done at ARMS Length Price (fair value): OPEN UAE**

- A) Comparing the terms of the transaction to known market terms for broadly similar transactions on an **open** market.
- B) Comparing the terms of the related party transaction to those of an identical or similar transaction with one or more **unrelated parties**
- C) Evaluating the reasonableness of any significant **assumptions** on which the assertion is based
- D) Engaging an **external expert** to determine a market value and to confirm market terms and conditions for the transaction.

## SA 530- Audit Sampling Definition



## Tolerance Level

### Definition

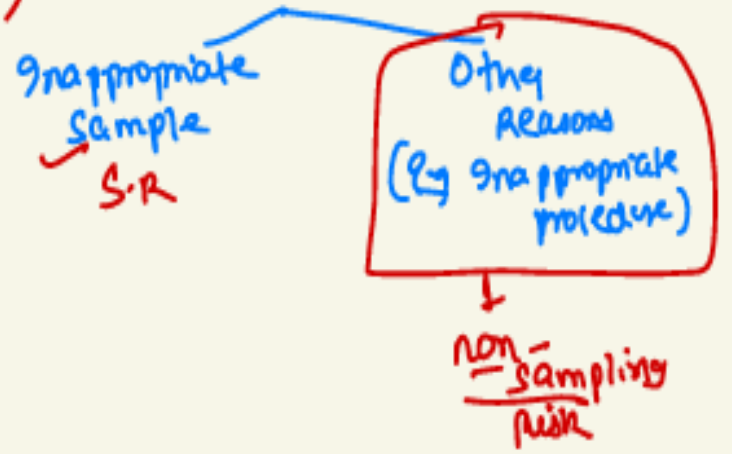
**A) Tolerable Misstatement** → A monetary amount set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that the monetary amount set by the auditor is not exceeded by the actual misstatement in the population

**(Maximum misstatement that auditor is ready to accept while performing test of details)**

**B) Tolerable rate of Deviation** → A rate of deviation from prescribed internal control procedures set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that the rate of deviation set by the auditor is not exceeded by the actual rate of deviation in the population.

**(maximum rate of deviation from controls that auditor is ready to accept while performing test of controls)**

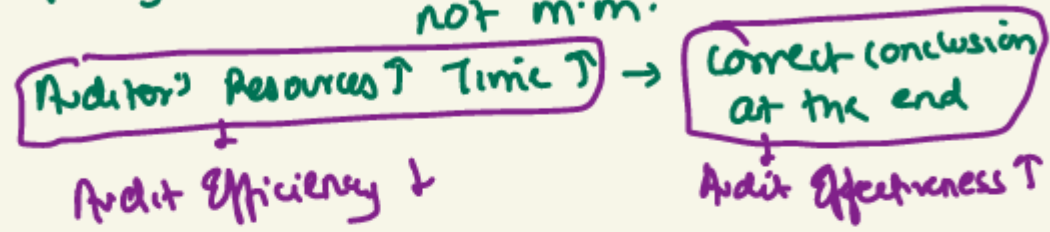
③ Sampling Risk → Risk of deriving erroneous conclusions due to (S.R.)



Audit procedure	Sampling result	Actual scenario (100% verification)	Remark
A) Test of controls	A1 Controls are ↑ effective	Controls are ↓ effective	Type 1 S.R.
	A2 Controls are ↓ effective	Controls are ↑ effective	Type 2 S.R.
B) Test of details	B1 Population is free from m.m	Population is m.m	Type 1 S.R.
	B2 Population is m.m	Population is free from m.m	Type 2 S.R.

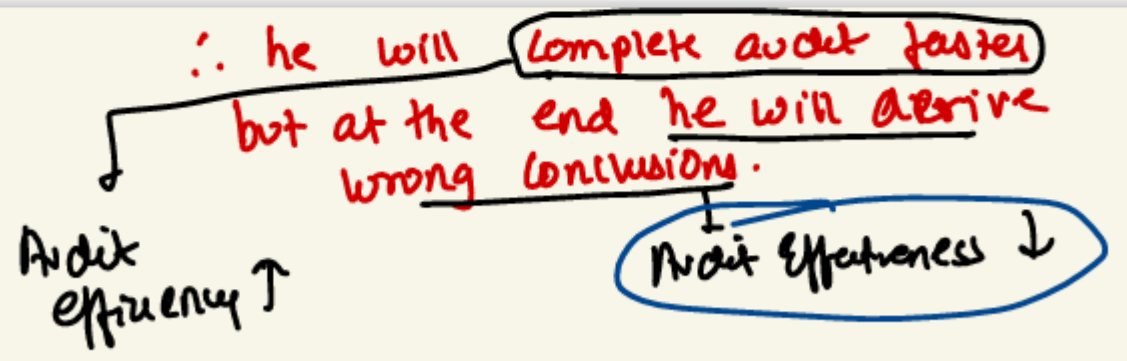
Analysing Type 2

Auditor will increase his sample size due to the initial findings & then he will realize that controls are effective/population is not m.m.



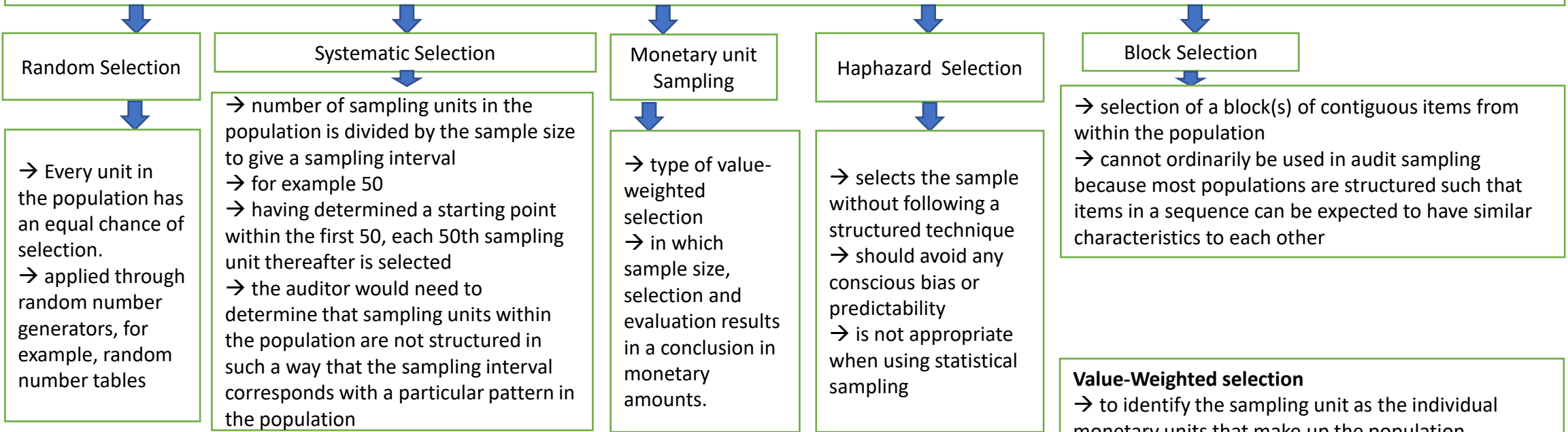
Analysing Type 1

Auditor will not take additional efforts due to his initial findings.



Auditor is more concerned with a) Type 2 S.R.

## Sampling Techniques



### Factors influencing sample size for TOC

- An increase in the extent to which the auditor's risk assessment takes into account relevant controls → Sample Size \_\_\_\_\_
- An increase in the tolerable rate of deviation → Sample Size \_\_\_\_\_
- An increase in the expected rate of deviation of the population to be tested → Sample Size \_\_\_\_\_
- An increase in the auditor's desired level of assurance → Sample Size \_\_\_\_\_
- Increase in number of sampling units in the population → \_\_\_\_\_

### Factors influencing Sample Size for TOD

- An increase in the auditor's assessment of the risk of material misstatement → Sample Size \_\_\_\_\_
- An increase in the use of other substantive procedures directed at the same assertion → Sample Size \_\_\_\_\_
- An increase in the auditor's desired level of assurance → Sample Size \_\_\_\_\_
- An increase in tolerable misstatement → Sample Size \_\_\_\_\_
- An increase in the amount of expected misstatement → Sample Size → \_\_\_\_\_

**Value-Weighted selection**  
 → to identify the sampling unit as the individual monetary units that make up the population  
 → Having selected specific monetary units from within the population, for example, the accounts receivable balance, the auditor may then examine the particular items, for example, individual balances, that contain those monetary units.

**Stratification** → Dividing population into discrete (separate) sub-population.  
 → Objective → allow sample size to reduce without increasing sampling risk.  
 → Stratification by monetary value or a particular characteristic  
 → results of audit procedures applied to a sample of items within a stratum can only be projected to the items that make up that stratum

**9** Sampling Result (Read only pt-9 & pt-10 from TB)

After performing procedure on sample selected

(D/m) Deviation/misstatements identified

D/m do not exist in the sample  
☺

Analyse the nature & cause of D/m identified

(related to a product, period, branch etc-? intentional/unintentional?)

D/m represent the population → "Non-Anomalous D/m"

D/m do not represent the population → "Anomaly"

Such misstatements can be projected to the entire population

Such misstatements cannot be projected to the entire population

Eg Sales of Product Y

Eg Sales of Product Y

Total transactions - 10000 units

Sample - 1000 units

2 invoices

① 20% discount

② 50 sample additional

no such error  
Cannot project it to entire

For some invoices → GST %

April - September

[Company had forgotten to update amended GST rates]

Projection of non-anomalous

∴ total sales in April-September of product Y  
GST %

population

Best estimate of misstatement in sales of product Y

= projection of non-anomalous misstatements (to Anomaly)

**The auditor shall evaluate:**

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

→ In analysing the deviations and misstatements identified, the auditor may observe that many have a **common feature** → the auditor may decide to identify all items in the population that possess the common feature.

→ In addition, such deviations or misstatements may be intentional, and may indicate the **possibility of fraud**.

**Projecting Misstatements:**

→ The auditor is required to project misstatements for the population to obtain a broad view of the scale of misstatement but this projection may not be sufficient to determine an amount to be recorded.

→ When a misstatement has been **established as an anomaly**, it may be excluded when projecting misstatements to the population. However, the effect of any such misstatement, if uncorrected, still needs to be considered in addition to the projection of the non-anomalous misstatements.

→ In the case of tests of details, **the projected misstatement plus anomalous misstatement, if any, is the auditor's best estimate of misstatement in the population.**

→ If the auditor concludes that audit sampling has not provided a reasonable basis for conclusions about the population that has been tested, the auditor may → Request mgmt to investigate misstatements that have been identified or modify the NTE of further audit procedures.