

# **Standards on Auditing Audit Evidence – A Practical Approach (SA 500, SA 501, SA 505, SA 570)**

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# Is Compliance of Auditing Standards Mandatory while doing Company Audits?

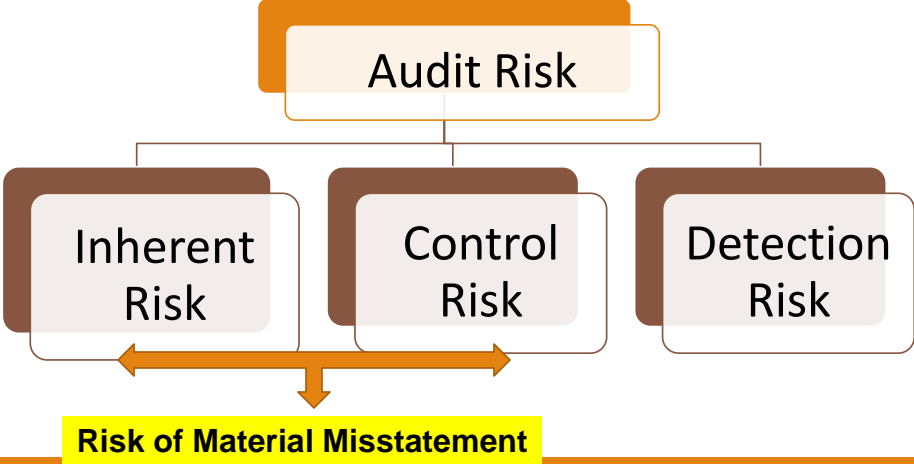
## Section 143(2) of the Companies Act, 2013

### Basic Requirements as to Financial Statements

The Auditor shall make the Report after taking into account, the following –

- the provisions of the Act,
- **the accounting and auditing Standards,**
- matters which are required to be included in the Audit Report under the provisions of the Act / Rules / Order u/s 143(11)
- best of his information and knowledge.

- Sec. 143(9) - Every Auditor shall **comply** with the Auditing Standards.
- Sec.143(10) - The Central Government may prescribe the **Standards of Auditing**, as recommended by the ICAI, in consultation with and after examination of the recommendations made by the National Financial Reporting Authority.



## An Audit of Financial Statements

The SAs contain items designed to **support the auditor** in obtaining reasonable assurance.

The SAs **require**, that the auditor exercise professional **judgment and maintain professional skepticism** and **shall**:

1. Identify and assess **risks of material misstatement**, whether due to fraud or error, based on an understanding of the entity and its environment, including the entity's internal control.
2. Obtain sufficient appropriate audit evidence about whether material misstatements exist, through designing and implementing appropriate responses to **assessed risks**
3. Form an opinion on the financial statements based on conclusions drawn from the audit evidence obtained.

# Standards on Auditing

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## 500-Audit Evidence

## Audit Evidence

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Audit evidence – 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.



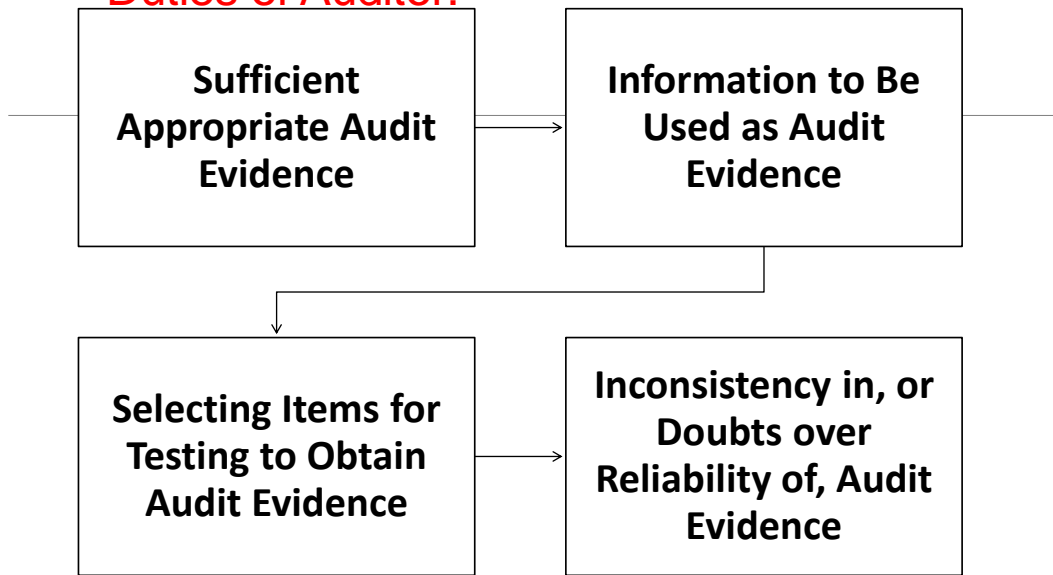
## Management's Expert

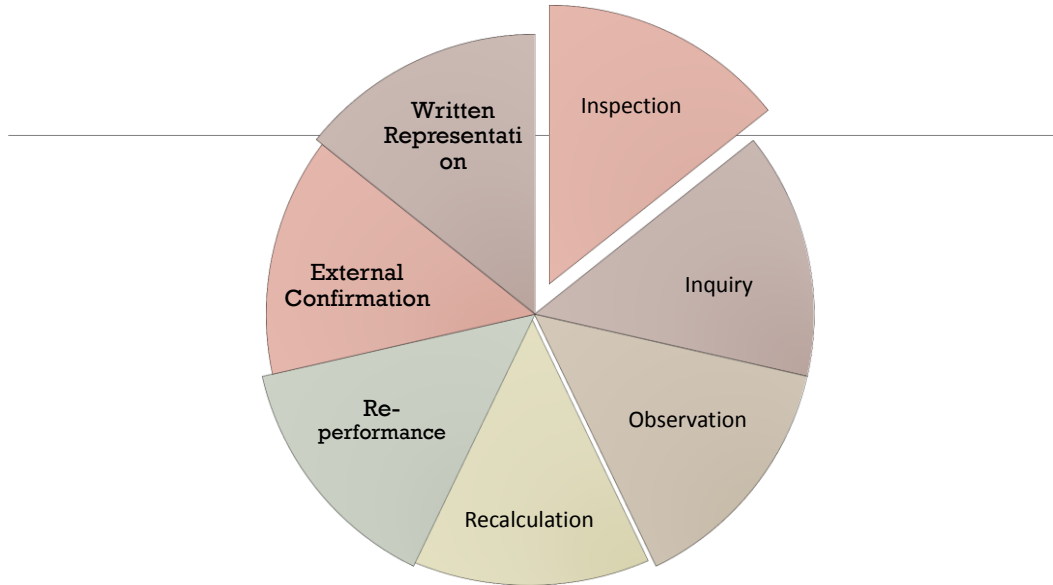
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An individual or organisation possessing expertise in a field other than accounting or auditing, whose work in that field is used by the entity to assist the entity in preparing the financial statements.

**Duties of Auditor:**



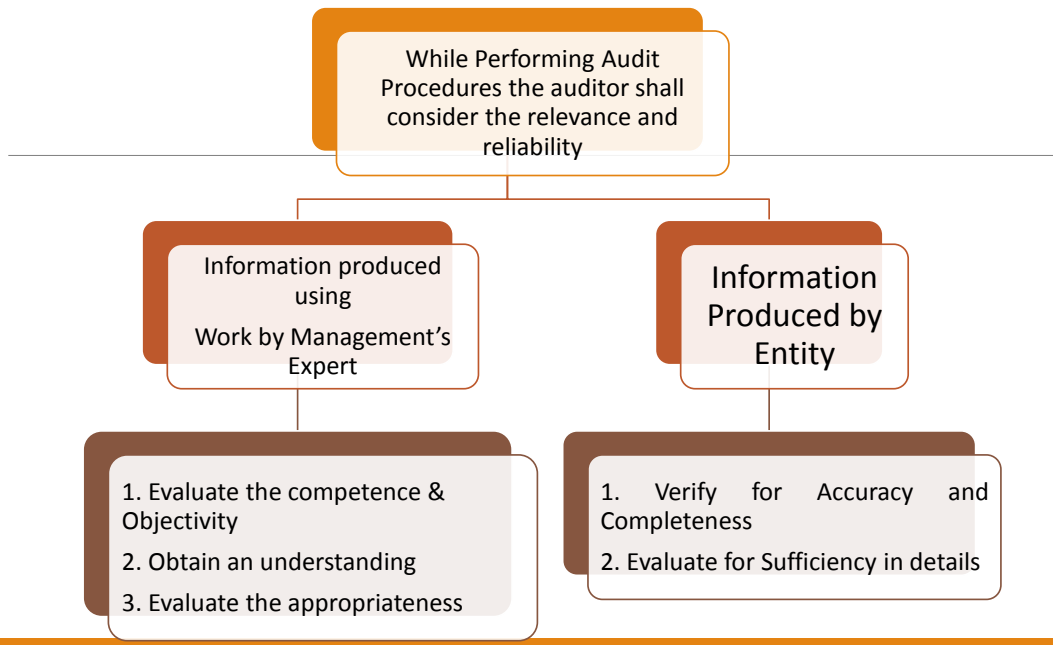


## Rules for Reliability of Audit Evidence

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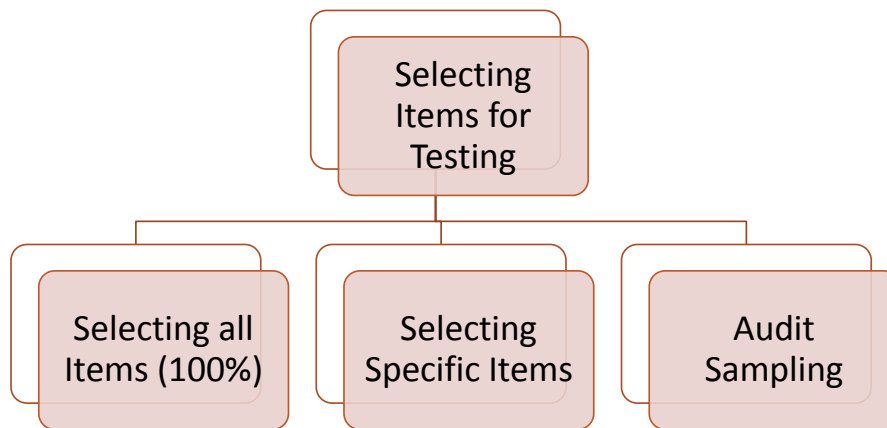


1. External evidences are more reliable than Internal Evidences.
2. Internal evidences are reliable, if internal controls are effective.
3. Audit Evidence is more reliable when it exists in documentary form, whether paper, electronic or other medium
4. Original documents are more reliable than photocopies
5. Evidences obtained directly by the auditor is more reliable



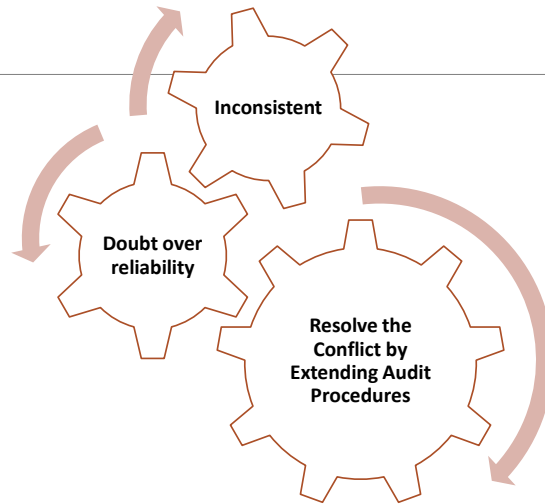
## Selecting Items for Testing

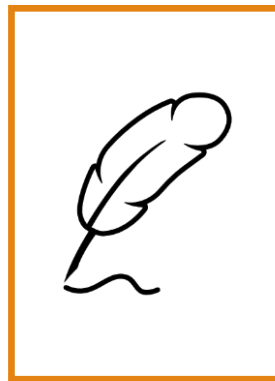
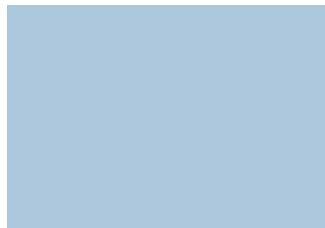
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# Audit Evidence

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# Documentation

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1. Compliance of SA 500
2. Audit Procedures Performed
3. Evaluation of SAAE
4. Conclusions reached



# SA 501 – Audit Evidence Specific Considerations

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## SA 501 - Specific Considerations for:

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1. Existence and condition of Inventory
2. Completeness of Litigation and claims
3. Presentation and disclosure of Segment Information – (Compliance FRF)

## Verification of Inventory

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1. Basic Responsibility with the Management
2. Periodic or Continuous method of verification
3. Auditor to apply principles enunciated in SA 500 & 501

# Physical Verification of Inventory

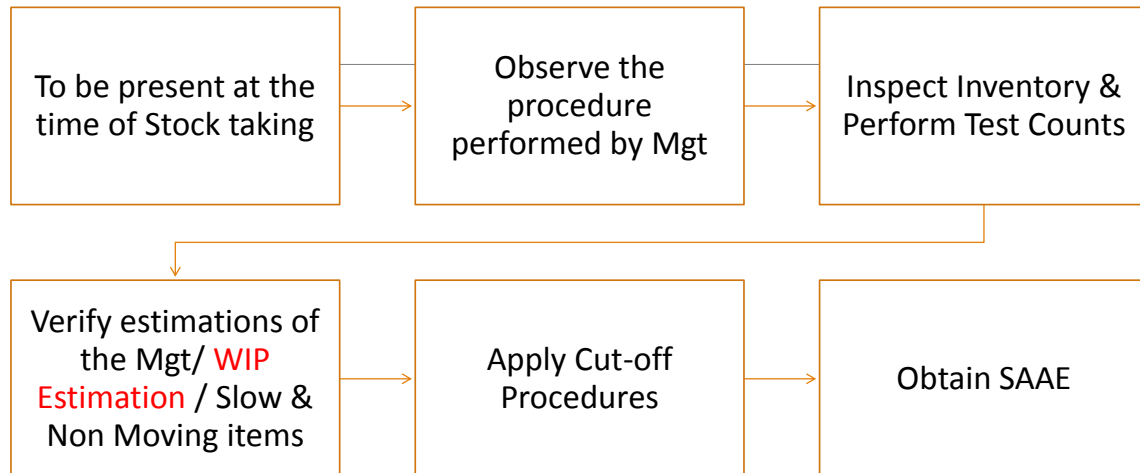
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## CARO 2016 - 3(ii) – Inventories

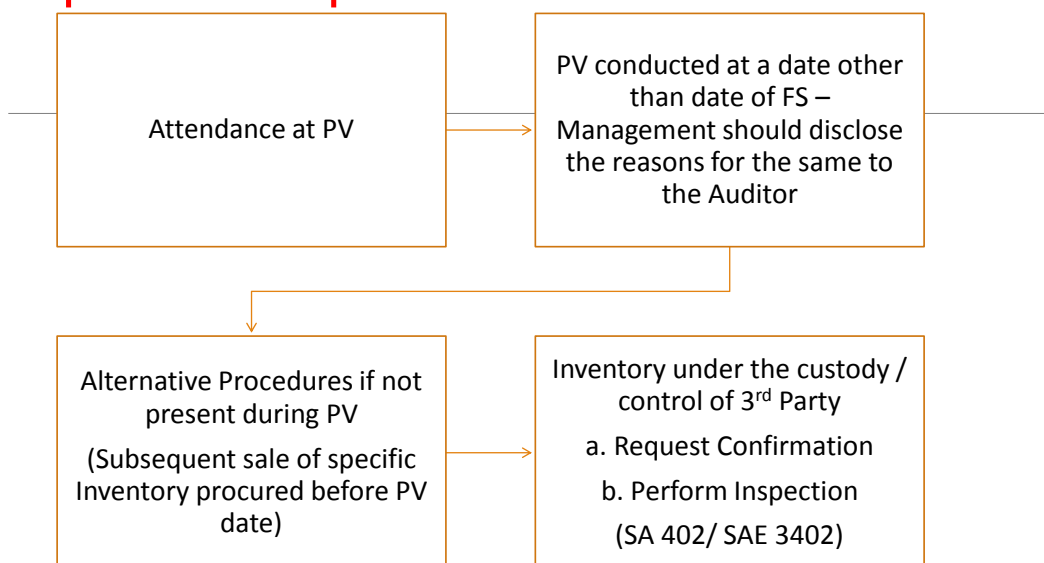
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Whether Physical Verification of Inventory has been conducted **at reasonable intervals** by the Management and **whether any material discrepancies** were noticed and if so, whether they have been properly dealt with in the books of accounts.

## Procedures to be followed by Auditor



## Specific Requirement of SA 501



## Attendance at Physical Inventory is impracticable [Para A.12 of SA 501]

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Auditors Attendance at physical inventory counting may be impracticable.

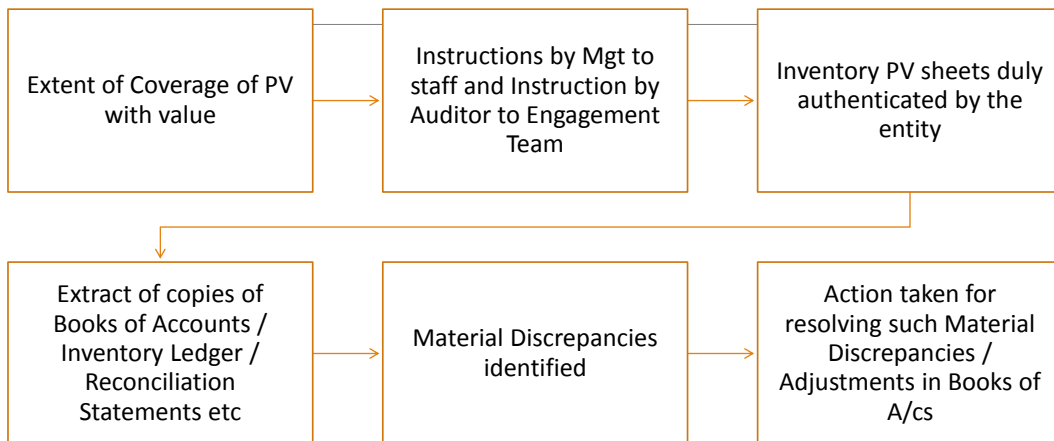
1. Factors such as nature and location of the inventory, [Example, where inventory is held in a location that may pose threats to the safety of the auditor.]
2. The matter of general inconvenience to the auditor

These are not sufficient to support a decision by the auditor that attendance is impracticable.

the matter of difficulty, time, or cost involved **is not in itself a valid basis for the auditor to omit an audit procedure.**



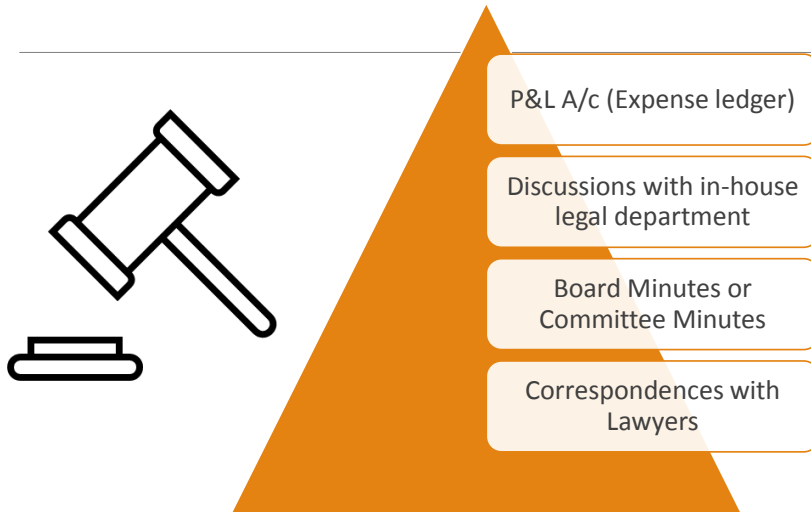
## Document the Following:

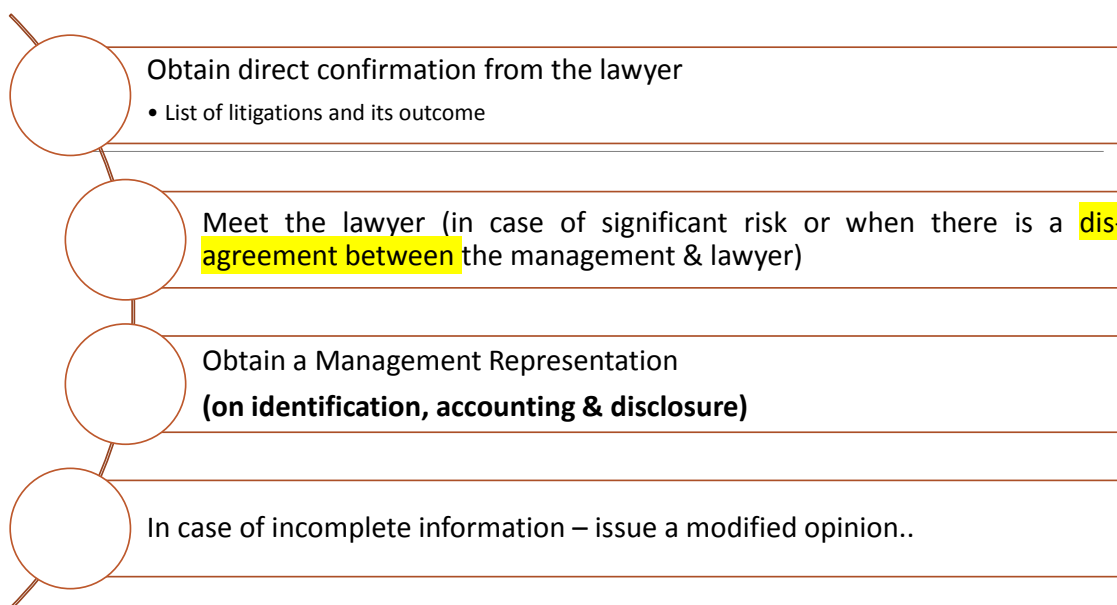


Other Prescribed matters (under Rule 11) to be reported u/s 143(3):

1. Disclosure of impact of **pending litigations** on its financial position,
2. Provision as required under any law or Accounting Standards, for **material foreseeable losses** on long-term contracts including Derivative Contracts,
3. **Delay** in transferring amounts to **Investor Education and Protection Fund**.

## Source of Information





## SA 505 - External Confirmation

### Definition - It is a process of

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Obtaining & evaluating audit evidence

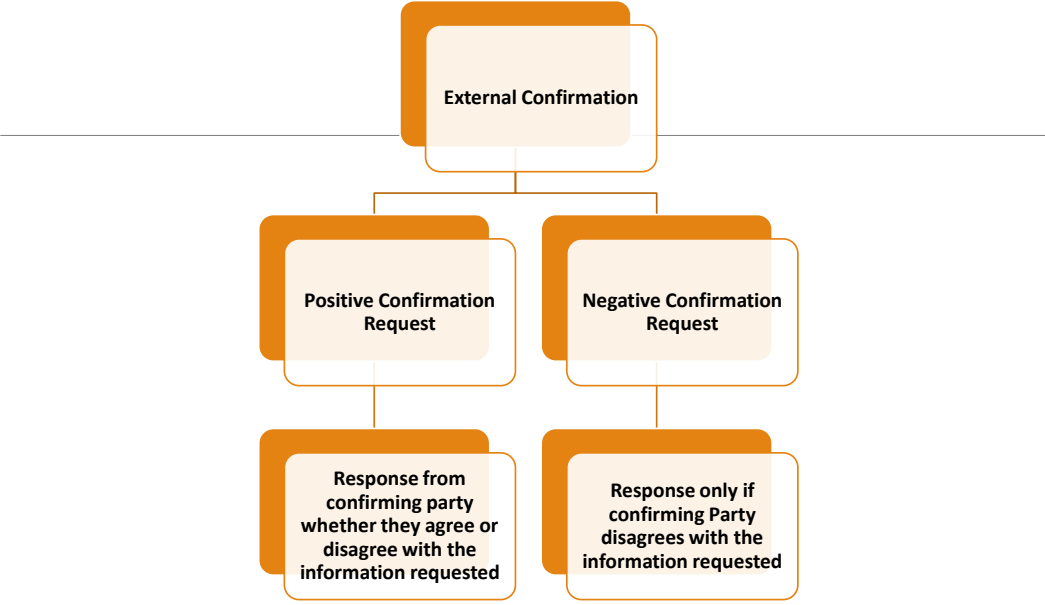
Through direct confirmation from the 3<sup>rd</sup> parties

In response to an inquiry

Affecting management's assertions.

Examples:

- Bank balances,
- debtors,
- creditors,
- stocks / other assets held by third parties,
- borrowings, etc



## Management Request to skip confirmation

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Consider whether is it reasonable

If Unreasonable

If not reasonable – Mgt Fraud

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# SA 570 - Going Concern (Revised)



## Going Concern – SA 570 (Revised)

Under the **Going Concern basis of Accounting**, The Financial Statements are prepared on the assumption that the entity is a going concern and will continue its operations for the **foreseeable future**. (atleast 12 months from the date of FS)

It is considered that the entity has neither the intention nor necessity of liquidation or closure of its business.

Also refer Sec.134(5) – Directors Responsibility Statement

## Objective of SA 570

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To obtain sufficient appropriate audit evidence regarding and conclude on the **appropriateness** of Management's use of the Going Concern basis of accounting in the preparation and presentation of the Financial Statements,

To conclude, based on the audit evidence obtained, whether a **material uncertainty exists** related to events or conditions that may cast significant doubt on the Entity's ability to continue as a Going Concern, and

To report in accordance with this SA.

## Material uncertainty

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“Material Uncertainty” means the **uncertainties related to events or conditions** which may cast **significant doubt on the entity’s ability to continue as a going concern that should be disclosed** in the financial statements.

It is also termed as “**significant uncertainty**” is used in similar circumstances.

## Indicators Affecting Going Concern Assumption

1. Fixed term borrowings approaching maturity without realistic prospectus to repay.
2. **Adverse key financial ratios – Excessive reliance on short term borrowings to finance long-term assets.**
3. Substantial operating loss
4. Inability to pay creditors on due dates
5. Loss of a major market
6. Shortages of key raw material
7. Huge Labour turnover / Labour unrest
8. Pending legal proceeding and claims from which are substantial
9. Non-compliance of Law / regulation
10. Changes in law or regulation by Government

## Extended reporting under the Section “Management’s responsibilities for the financial statements”

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This Section will include the following new aspects:

Management’s responsibilities for assessing the **entity’s ability to continue as a going concern** and whether the **use of the going concern basis of accounting is appropriate** as well as disclosing, matters relating to going concern.

## responsibilities for the audit of the financial statements

Describing the auditor's responsibilities regarding going concern aspect

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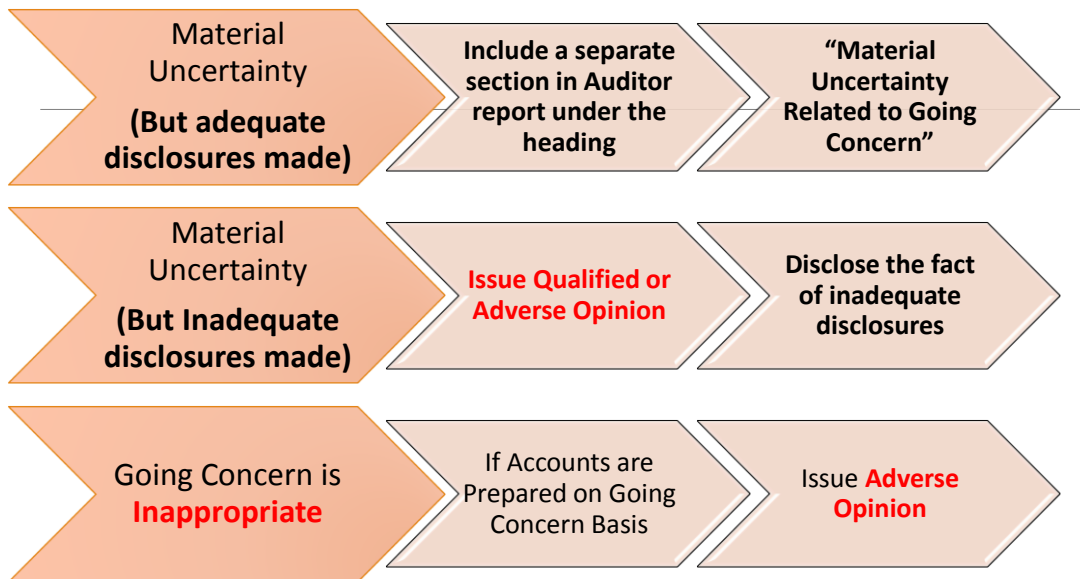
- ❑ Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern.
- ❑ If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion.
- ❑ Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.

## Reporting Change

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Instead of the earlier requirement to report material uncertainties within an **Emphasis of Matter paragraph**, reporting of a material uncertainty is now required to be made within a separate section of auditor's report titled as **"Material Uncertainty related to Going Concern"**.

## Auditor's Duty: Reporting on Going Concern





## Inclusion as KAM?

Disclosing matters relating to Going Concern as Key Audit Matter is possible only when the auditor:

1. Identify events and conditions that may cast significant doubt on an entity's ability to continue as a going concern and
2. Conclude that no material uncertainty exists and
3. Conclude that the disclosures related to those events or conditions are adequate

# Thank You!

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