CHAPTER 5

AUDIT EVIDENCE



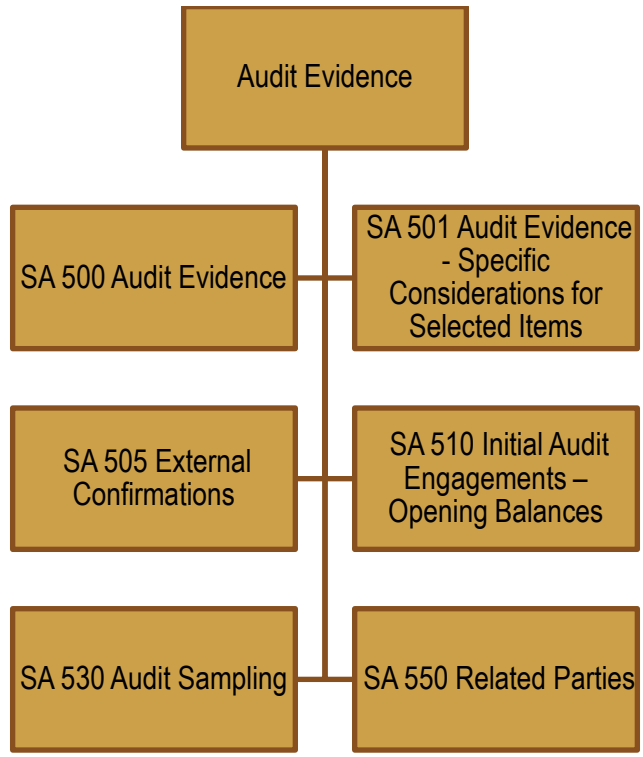
LEARNING OUTCOMES

After studying this chapter, you will be able to:

- Refreshen up your knowledge about procedures relating to Audit Evidence.
- Glance through relevant SAs-SA 500, SA 501, SA 505, SA 510, SA 530 and SA 550 pictorially.
- Gain application-based knowledge of above SAs.
- Understand the concepts through use of analytical examples and case studies.
- Gain knowledge about varied practical situations for an auditor while performing such procedures.

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CHAPTER OVERVIEW



CA. Kartik is intrinsically efficient and has an inherent dislike for wasting time on frivolous things. He wants to do everything perfect- spick and span- and in a cost- effective manner. Adopting the same approach, in the course of his professional work as an auditor, he is very particular in completing work quickly in a time bound manner.

During one such audit of a company's accounts, he chose to select some specific items for performing "tests of details" according to his judgment. Like, he decided to verify sales transactions above the threshold amount of ₹ 25 lacs. Fresh additions to "Property, Plant and Equipment" above the threshold of the same amount were selected by him for detailed verification.

He also grew suspicious about certain sales transactions aggregating to ₹ 50 lacs. Such transactions were at fag end of the year, and goods moved out from the company's premises were purportedly sent through non-motorised conveyance without accompanying e-way bills to a single customer over a span of few days. It was agreed to send an external confirmation request to this customer only. Besides, it was decided to go through all related party transactions in a detailed manner without exception to dig out any material misstatement.

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Litigation claims involving the company were considered a misstatement prone area and came for detailed examination on his radar. Such a testing approach, he thought, would be efficient and cost-effective for obtaining audit evidence.

Can above approach followed by auditor be construed as "audit sampling"? What does it signify and to what kind of risk such an approach is subject to? Such a testing approach to obtain audit evidence relates to "selective examination of specific items" from class of transactions and account balances. While "selective examination of specific items" as a testing means to obtain audit evidence could be an efficient way of obtaining audit evidence, it does not constitute audit sampling.

The results of audit procedures to items selected in this way cannot be projected to the entire population. "Selective examination of specific items" does not provide audit evidence concerning the remainder of the population. Such an approach is subject to non-sampling risk. It is the risk of an auditor reaching an erroneous conclusion due to inappropriate audit procedures, misinterpretation of audit evidence and failure to recognise a misstatement or deviation.

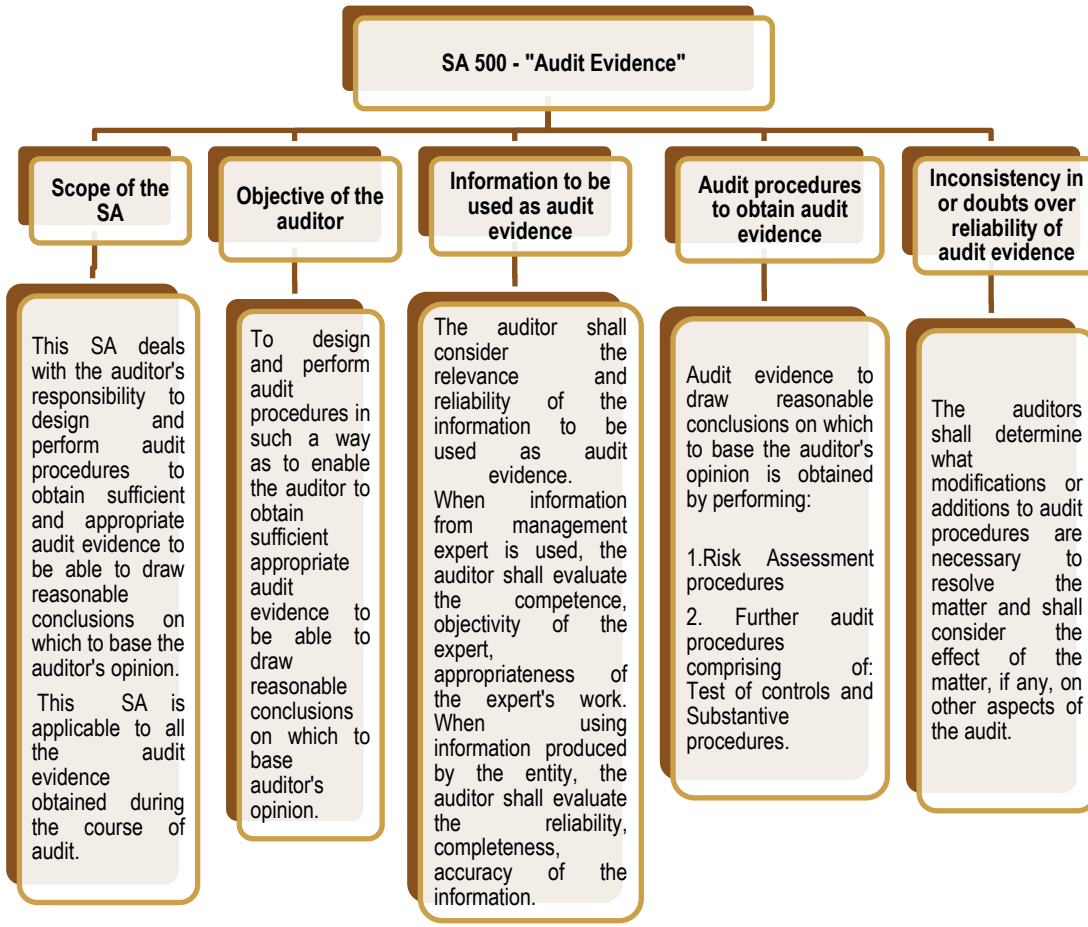
Whereas "audit sampling" refers to the application of audit procedures to less than 100% of items within a population relevant under the audit, such that all the items in the population have an equal chance of selection. Being subject to sampling risk, testing on the basis of samples may also lead to erroneous conclusions. It can be due to 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. Such a risk is always there in audit sampling!

1. SA 500 AUDIT EVIDENCE

SA 500 deals with the auditor's responsibility to design and perform audit procedures to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion. It also explains what constitutes audit evidence in an audit of financial statements.

Audit evidence is 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.

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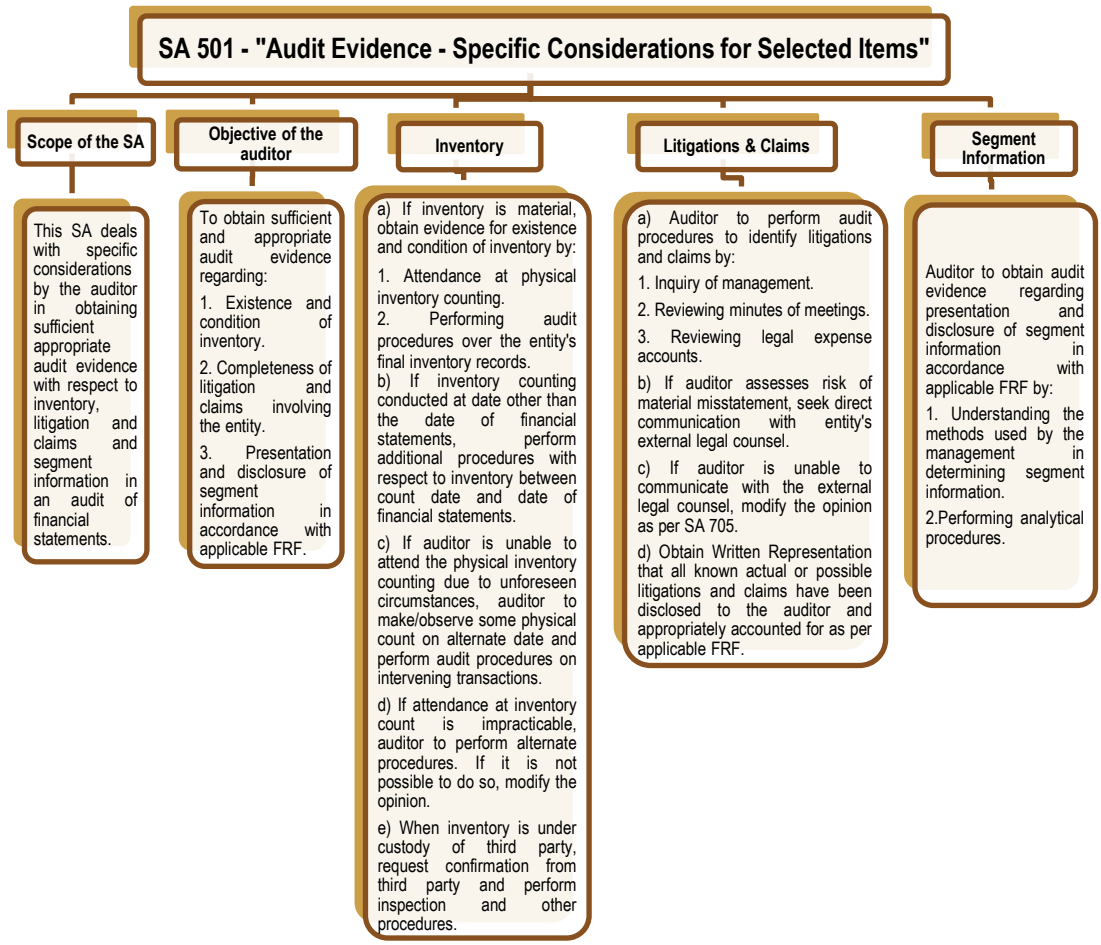
TEST YOUR UNDERSTANDING 1

The auditor of BBNS Ltd. accepted the gratuity liability valuation based on the certificate issued by a qualified actuary. However, the auditor noticed that the retirement age adopted is 65 years as against the existing retirement age of 60 years. The company is considering a proposal to increase the retirement age to 65 years. Comment.

2. SA 501 AUDIT EVIDENCE - SPECIFIC CONSIDERATIONS FOR SELECTED ITEMS

SA 501 deals with specific considerations by the auditor in obtaining sufficient appropriate audit evidence with respect to certain aspects of **inventory, litigations and claims involving the entity, and segment information** in an audit of financial statements.

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TEST YOUR UNDERSTANDING 2

CA Prabhjot has planned to observe the physical count of inventories at the plant of a company located in the remote area in the state of Uttarakhand, as part of a statutory audit exercise, few days before completion of the financial year 2025-26. He already informed his intention to management that he is planning to visit the plant site on 29th March 2026. He plans to inspect inventories, observe the counting process and perform test counts among other matters.

The management has made all the necessary arrangements to facilitate the above exercise. However, an agitation in Himalayan hills started on 28th March 2026 for the announcement of a strict law regarding the conversion of agricultural land for commercial use. Many civil society groups are participating in the agitation. NH-7 leading to the plant site is blocked by protestors. The plant is not accessible through any other mode. The blockade is lifted one month after the state government announced the formation of a committee to look into protestors' demands.

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Does the above case highlight a situation of "impracticability of attendance" at inventory counting in terms of requirements of SA 501?

How should the auditor proceed in the above situation?

TEST YOUR UNDERSTANDING 3

On reviewing legal expenses account of Zed Ltd., CA. Sunitha, auditor of company, finds that legal fees amounting to ₹ 10 lac was paid to B. George, a reputed lawyer, during the year 2025-26. On inquiry with management regarding the purpose of such expenditure, evasive reply was received from management stating that a lot of work is performed by the said lawyer on behalf of the company. However, no specific details were provided.

She finds it proper to correspond directly with the lawyer. She obtains the address and mail id of the lawyer from his professional services bill. She shoots off an inquiry letter asking for the nature and status of litigation claims against the company on her letterhead.

Is her approach proper? Irrespective of the merits of the approach followed by her, what is she trying to achieve by corresponding with the lawyer of the company?

TEST YOUR UNDERSTANDING 4

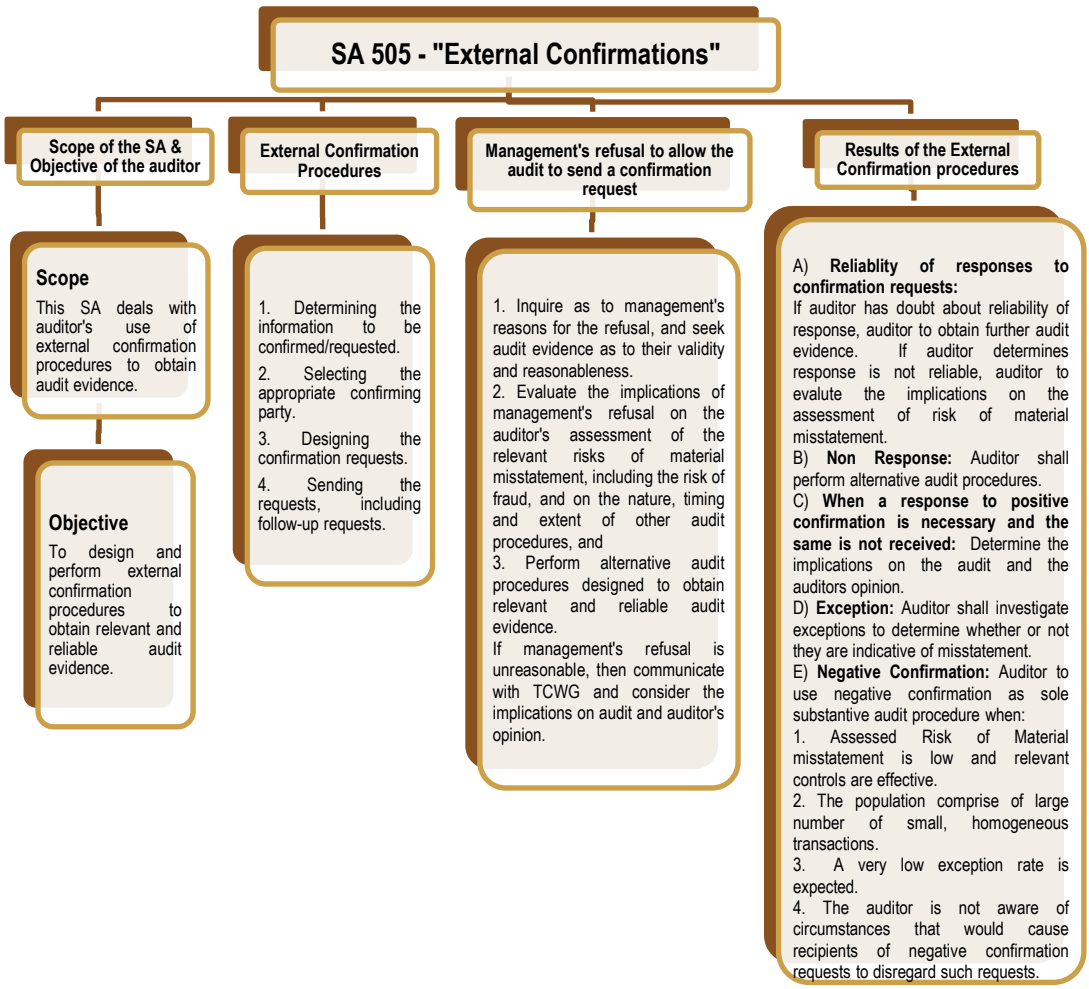
During the audit of TS Ltd., CA Tanmaya finds that substantial inventories of the company consisting of mast lighting poles remain with "Super Industries" for certain finishing works. While planning audit procedures, he had planned about seeking confirmation from "Super Industries" regarding existence and condition of such mast lighting poles belonging to TS Ltd. lying with them as on 31st March, 2026.

However, the premises of "Super Industries" were raided by DGGI officials (Director General of GST Intelligence) in connection with the busting of a fake billing scam. The proprietor of the firm was arrested in November 2025 and came out on bail in the month of March 2026. The details of the proprietor and his firm were flashed prominently in local newspapers of the city where company is located. CA. Tanmaya also belongs to the same place. Discuss how he should proceed in the above matter as auditor of TS Ltd.

3. SA 505 EXTERNAL CONFIRMATIONS

SA 505 deals with the auditor's use of external confirmation procedures to obtain audit evidence in accordance with the requirements of SA 500. It is intended to assist the auditor in designing and performing external confirmations procedures to obtain relevant and reliable audit evidence.

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TEST YOUR UNDERSTANDING 5

As auditor of Groom Limited, you have sent positive confirmation requests to 30 creditors of the company in March 2026. All the creditors in the informal sector are small concerns. You selected to send positive confirmation requests to all the above parties at their business addresses stated on respective bills after discussing the matter with the CFO of the company. The CFO is cooperative and does not raise any hassles in the matter.

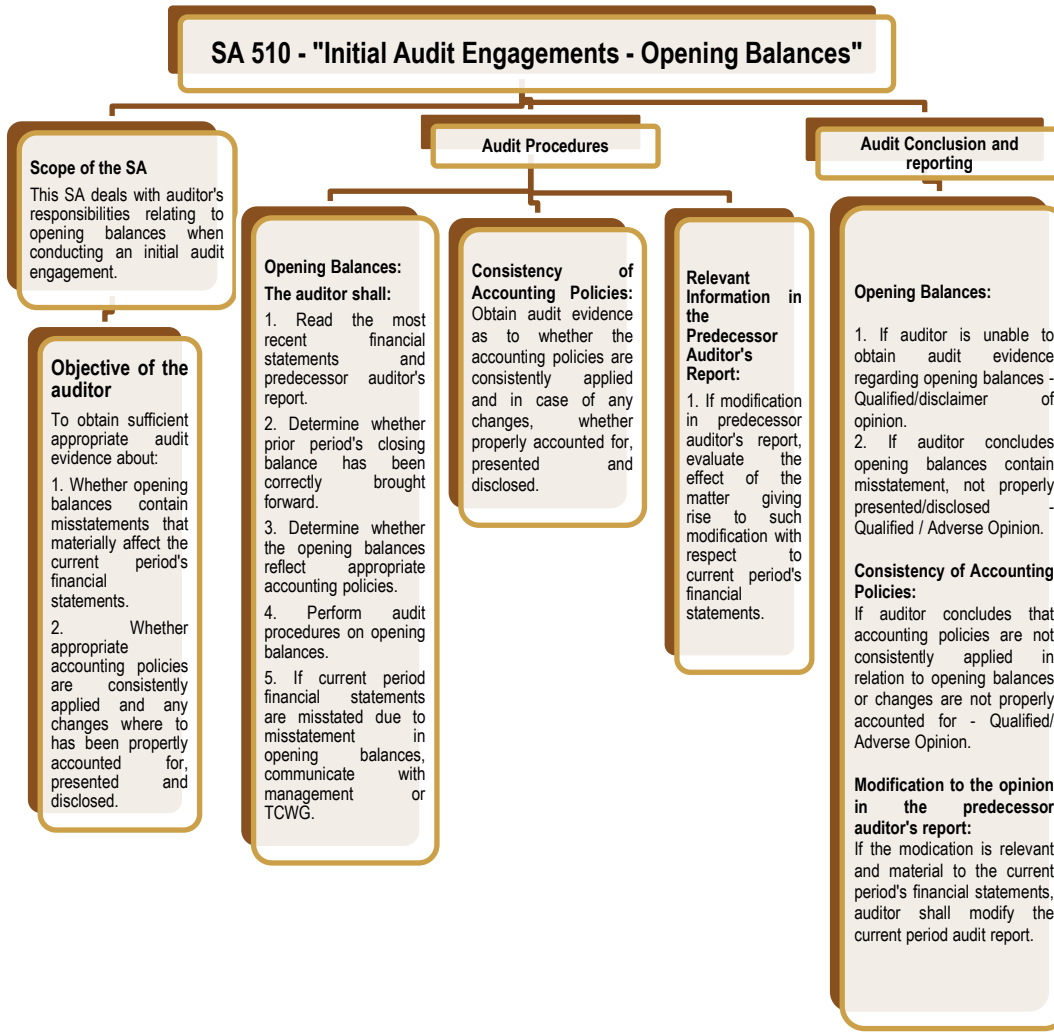
Responses to confirmation requests are received within a week's time. Your article assistant informs you that out of 30 creditors, GST registrations of 25 creditors have been cancelled during financial year 2025-26 itself by collating information from GST portal. He further informs you that there are no fresh registrations pertaining to PANs of these parties.

How would you proceed to deal with the situation as an auditor of the company?

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4. SA 510 INITIAL AUDIT ENGAGEMENTS-OPENING BALANCES

SA 510 deals with the auditor's responsibilities relating to opening balances when conducting an initial audit engagement. An initial audit engagement is an engagement in which either the financial statements for prior period were not audited or were audited by a predecessor auditor.



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TEST YOUR UNDERSTANDING 6

CA M. Hussain is appointed as auditor of a firm for the year 2025-26 on 31st July, 2025. The accounts of the firm were unaudited in the year 2024-25. The firm had material inventories reflected in its financial statements even as on close of 31st March, 2025.

He is performing audit procedures, including attending physical inventory count as on 31st March 2026. However, there is a lingering doubt in his mind regarding opening inventories reflected in financial statements.

Does there exist any responsibility on his part in such a situation?

5. SA 530 AUDIT SAMPLING

SA 530 deals with the auditor's use of statistical and non-statistical sampling when designing and selecting the audit sample, performing tests of controls and tests of details and evaluating the results from the sample.

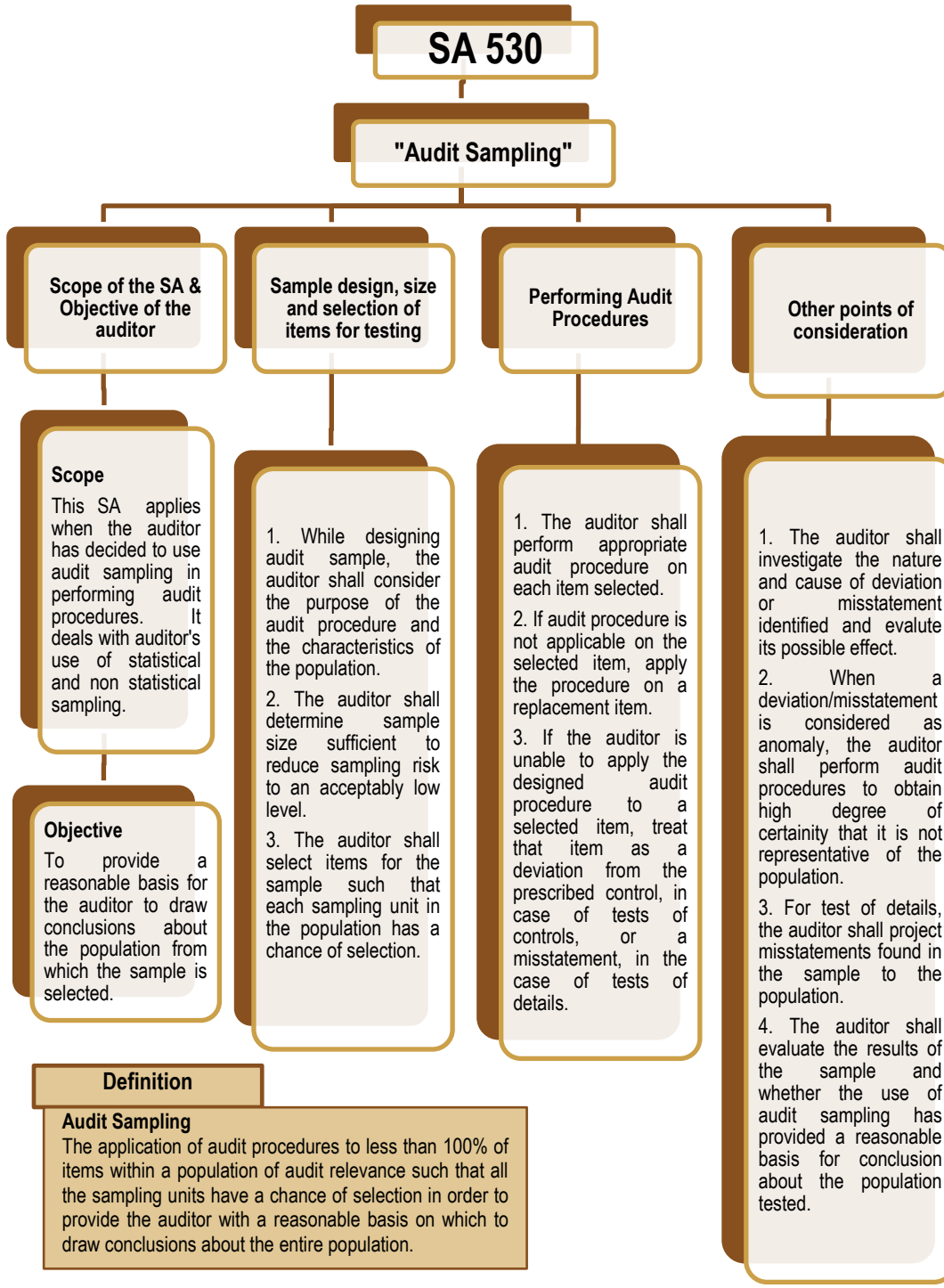
TEST YOUR UNDERSTANDING 7

CA Ritesh has drawn some samples during the audit of a manufacturing company for testing controls as well as for tests of details. On the basis of the samples selected, he reaches an erroneous conclusion that access controls on applications are less effective.

Further, on the basis of samples selected, he concludes erroneously that work-in progress inventories amounting to ₹ 5 crore in financial statements are materially misstated.

Outlining the above risk involved, discuss how it is going to affect his audit of the company.

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6. SA 550 RELATED PARTIES

SA 550- " Related Parties"

Scope of the SA

This SA deals with the auditor's responsibilities regarding related party relationships and transactions. It expands on how SA 315, SA 330, SA 240 are to be applied in relation to related party relationships and transactions.

Objectives of the auditor

I. To obtain an understanding of the related party transactions to:
1. recognize fraud risk factors arising from such transactions.
2. conclude whether financial statements in so far as they are affected by such transactions:
a) achieve a true and fair presentation.
b) are not misleading.

II. To obtain audit evidence as to whether the related party transactions are properly identified, accounted for, and disclosed in the financial statements.

Requirements of the SA

1. Risk Assessment procedures and related activities.
2. Understanding the Entity's related party relationships and transactions.
3. Maintaining alertness for related party information when reviewing records or documents.
4. Sharing related party information with the Engagement team.
5. Identification and assessment of the risk of material misstatement associated with related party transactions and relationships.
6. Responses to the Risks of Material Misstatement associated with related party relationships and transactions.

Identification of previously unidentified or undisclosed related party transactions.

1. Auditor shall determine whether the underlying circumstances confirm the existence of such transactions.
2. Communicate within the team.
3. Request management to identify all transactions with newly identified related parties.
4. Perform more substantive procedures.
5. Reconsider risks with respect to other related parties.
6. If non disclosure by the management appears intentional, evaluate the implications for the audit.

Identified significant related party transactions outside the entity's normal course of business

1. Inspect the underlying contracts and evaluate:
a) the business rationale of the transactions.
b) whether the terms of transactions are consistent with management's explanations.
c) whether such transactions have been properly accounted for.
2. Obtain audit evidence that the transactions have been appropriately authorised and approved.

Other important points

The auditor shall obatin Written Representation that:
a) all the related parties and related party transactions have been disclosed to the auditor and
b) all such transactions have been properly accounted for and disclosed.

Communication with TCWG
The auditor shall communicate with TCWG significant matters arising during the audit in connection with the entity's related parties.

Documentation:
The auditor shall include in audit documentation names of the related parties and the nature of the related party transactions.

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SA 550 deals with the auditor's responsibilities regarding related party relationships and transactions when performing an audit of financial statements. Specifically, it applies in relation to risks of material misstatement associated with related party relationships and transactions.

TEST YOUR UNDERSTANDING 8

"Living Well Private Limited" is engaged in the manufacturing and export of floor coverings. Such products are labour-intensive and do not require much capital investment in machinery. The company has no plans to diversify in other product lines. Its directors are also holding significant interest in another company "My Living Private Limited" engaged in manufacturing of blankets using capital intensive machinery.

During the audit of "My Living Private Limited", it was noticed that the company has sold machinery of ₹ 1 crore to "Living Well Private Limited" during the year. The transaction has been done at normal market rates applicable to such used machinery.

How do you view the above transaction as auditor of "My Living Private Limited"?

Case Study 1

Honest Speciality Chemicals Private Limited is a company with a turnover of ₹ 1,000 crore having plants in Khopoli, Mahad, and Ankleshwar for manufacturing various products for fertilizer units, cosmetics and paint industry, etc. The company has built up a good reputation, and apart from the domestic market, it exports to the European market and the Middle East. The company is a closely held company owned by three friends and their family members. The types of materials handled and produced are hazardous.

Following further latest information relating to the company is as under: -

- The company needs to import key raw materials and is exposed to high risk of price fluctuations and currency risks.
- The company carries high inventory due to the long import cycle and seasonal sales pattern.
- The working capital is almost 60% blocked in inventory and rest in receivables.
- The company has huge investments in plant and machinery financed through term loans from financial institutions.
- Since the company has large imports, it buys import licenses from the open market.

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- The company has received notices from the custom department for using fake licenses for importing materials without paying duty. The company has filed an appeal against the said notice and the same is pending with the Appellate Tribunal. The amount involved is material and, along with interest and penalty, could be more than 10% of turnover.
- The company has liquid chemicals stored in huge tanks.
- The powdered form of chemicals is stored in standard-sized drums.
- Few items of stock like coal, sulphur are lying in the open area.
- The company has huge domestic sales on a consignment basis, and vast quantities of finished inventories are lying with the consignees across India.
- The company has received an order from NGT to pay a fine of INR 1.5 crores for the emission of toxic chemicals into the air and water. The company has filed an appeal against the said order.
- The type of plant is such that it has to be a continuous process, and at any time, huge quantities of materials are in process.
- Raw Materials are stored in huge tanks located 2 kilometers from the plant, and to transport the chemicals (liquid), there is a network of pipes connecting them, and at any point in time, there are huge quantities of materials lying in the pipeline.
- The company has prepared its inventory details by involving a management expert.
- During the year, the previous auditor resigned, and a new auditor got appointed.

Theoretical Questions

Based on the case study, please advise the auditor on the important aspects of carrying out the audit procedures to obtain sufficient appropriate audit evidence in respect of the following: -

1. *Which audit procedures are required for verifying the existence and condition of company's inventories with specific reference to its nature of operations?*

2. *The company has prepared inventory details by involving a management's expert. Elaborating upon its rationale, discuss responsibilities of auditor in regard to information prepared by company involving such an expert.*

3. *What additional procedures does the auditor need to carry out in respect of stocks lying with consignees all over the country?*

4. *What procedures should the auditor need to undertake for litigation matters?*

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Multiple Choice Questions

1. *The objectivity of the management's expert is likely to be lesser if:*

(a) The expert is competent

(b) The expert is capable

(c) The expert has relevant experience

(d) The expert is employed by the entity

2. *Which of the following matter is irrelevant for auditor in planning attendance at physical inventory counts?*

(a) Nature of inventory

(b) The timing of physical inventory counting

(c) The nature of the internal control related to inventory

(d) Whether 100% of inventory is covered in the count

3. *External confirmations for receivables are not reliable if:*

(a) The response directly received by the auditor

(b) The confirmation has come from the address of the confirming party

(c) The confirmation is signed by the plant manager

(d) The confirmation is positive confirmation

4. *The new auditor planned certain procedures with respect to opening balances. Which of the following procedures is not in accordance with SA 510?*

(a) Reading the most recent financial statements and audit report

(b) Where the prior period report is modified, the impact on the current period

(c) Correctly bringing forward of prior period closing balances

(d) Ascertaining whether predecessor auditor had attended physical inventory count

Answers to Theoretical Questions

1. The auditor needs to obtain sufficient appropriate audit evidence regarding existence and condition of inventory.

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For the above, the auditor needs to do all the following: -

(a) Attendance at physical inventory counting to:

(i) Evaluate management's instructions and procedures for recording and controlling the results of the entity's physical inventory counting like:

- The existence of appropriate control activities: collection of used physical inventory count records, accounting for unused physical inventory count records, count and recount procedures.
- The accurate identification of the stage of completion of work-in-progress, of slow moving, obsolete, or damaged items and of inventory lying in tanks, in pipes and in open areas.
- The procedures used to estimate physical quantities, for liquid chemicals lying in process, tanks, pipelines, in open areas like coal pile, sulphur pile, etc.
- Control over the movement of inventory between areas and the shipping and receipt of inventory before and after the cutoff date.

(b) Observe the performance of Management's count procedure by observing the control over the movement of inventory before, during and after the count to determine adequacy and effectiveness of count procedure.

(c) Inspect the inventory to assist in identifying obsolete, damaged or ageing of inventory.

(d) Perform the test counts to obtain the sufficient appropriate audit evidence

(i) By tracing items selected from the physical inventory to management's count records,

(ii) By obtaining copies of Management's completed physical inventory count records

(e) Cross matching the final inventory records with the actual inventory count results.

2. The company deals with speciality chemicals which are in liquid condition, powdered condition, lying in huge tanks or in plants under process, lying in pipelines or lying in open areas like coal and sulphur. The unit of measurement for each of the above categories may be different and could involve technical and mathematical principles involving technical and

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scientific expertise. Keeping these matters in view, inventory details have been prepared by involving management's expert.

When information to be used as audit evidence has been prepared using the work of a management's expert, the auditor shall, having regard to the significance of that expert's work for the auditor's purposes:

(a) Evaluate the competence, capabilities and objectivity of that expert

(b) Obtain an understanding of the work of that expert and

(c) Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion.

3. Apart from obtaining the confirmation from the third party as to the quantities and condition of the inventory held on behalf of the entity, the auditor may perform the following other audit procedures:

- Attending, or arranging for another auditor to attend, the third party's physical counting of inventory,
- Obtaining another auditor's report or a service auditor's report on the adequacy of the third party's internal control for ensuring that inventory is properly counted and adequately safeguarded.
- Inspecting documentation regarding inventory held by third parties

4. The auditor shall design and perform audit procedures in order to identify litigation and claims involving the entity by:-

- Inquiry of management and, where applicable, others within the entity including in-house legal counsel.
- Reviewing minutes of meetings of those charged with governance and correspondence between the entity and its external legal counsel.
- Reviewing legal expense account.

The legal claims involving customs and fines of NGT are material. In such circumstances if auditor assesses risk of material misstatements regarding litigation, he can seek letter of specific inquiry from the external legal counsel including: -

- A list of litigation and claims

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- Where applicable, management's assessment of the outcome of each of the identified litigation and claims and its estimate of the financial implications, including cost involved and
- A request that the entity's external legal counsel confirm the reasonableness of management's assessments and provide the auditor with further information if the list is considered incomplete or incorrect.
- The auditor may seek a meeting with the external legal counsel if the matter is having significant risk, it is complex or there is disagreement between management assertion and legal counsel's views.
- Obtaining written representation from the management and where appropriate those charged with governance that all the known actual or possible litigation and claims whose effects should be considered when preparing the financial statement have been disclosed to the auditor and appropriately accounted for and disclosed in accordance with the applicable financial reporting framework.

MCQ answers

1. (d) **2.** (d) **3.** (c) **4.** (d)

Case Study 2

"Trustworthy Real Estate Private Limited" with Mr. Bharose Lal as MD along with his wife, Maya, owned the company.

The company had floated one SPV *"Real Trust Developers Private Limited"* in which a foreign entity became a Joint Venture partner with a 50% stake.

The venture was formed with its Head Office in Mumbai to invest in SRA projects (Slum Rehabilitation Authority) and develop them into commercial units for sale.

Mr. Bharose Lal was going through a rough patch in his life. He was in financial difficulty and had mounting dues and huge outstanding exposure to banks and suppliers in his companies. He approached one of his rich friends Mrs. Maya. Mrs. Maya had an expensive lifestyle and was always short of funds to maintain her lifestyle. Mr. Bharose Lal sensed a golden opportunity in the new venture because the foreign partner had no knowledge of Indian regulations and how the SRA projects worked and was solely dependent on the local partner to get all the permissions, scouting for the projects, getting consents from the slum dwellers for the project, giving contracts for the construction of projects and such matters.

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M/S ABC and Company, Chartered Accountants were appointed as the auditor of the joint venture, and the engagement team was headed by CA Sceptic, who had, in his stint with the firm, was instrumental in unearthing two major frauds and had the ability to sniff out any such scenarios.

Mr. Bharose Lal has a dominant personality and a powerful influence on functioning, and everybody looks to him for guidance. The governance structure was very poor in the organization, and Mr. Bharose Lal used to dictate the decisions. Even though as part of the Joint Venture, there was a detailed governance structure and policies and procedures in place for the decision-making process at the joint venture. However, the representative on the board of the Joint Venture of the foreign partner who had shifted to India to supervise the SRA project had grown friendly with Mr. Bharose Lal, and Mr. Bharose Lal had even gone out of the way to help him get good accommodation and second- hand Mercedes. Often, they both go to a club in the evening for a drink.

The dealings in the SRA project are not very transparent and above board but are very opaque. Given the above situation, CA Sceptic wants to discuss with the audit team areas and situations where the risk of material misstatement is possible and there are chances of having an undisclosed related party relationship to misappropriate the funds.

Theoretical Questions

1. *Please guide the engagement team on the further course of action as per SA 550.*
2. *What are fraud risk factors in given case?*
3. *Given the situation that each partner in the joint venture has to bring into the entity a contribution of 5 crores each and given the situation that Mr. Bharose Lal had appointed one agency, the name Useless & Sons Private Limited, to get consent from the slum dwellers, for which the agency was paid 20 crores as Kitty to get the job done.*

   CA Sceptic inclines that there is some connection between the 20 crores paid and, simultaneously, within a short span, the infusion of INR 5 crores as equity contribution by Mr. Bharose Lal.

   Please guide CA Sceptic in establishing this link based on the guidance available in SA 550 and SA 240.

   What additional audit procedures does his team need to undertake for the conclusion?
4. *If, based on additional audit procedures undertaken by CA Sceptic, it is established that there is a likelihood of misappropriation of funds and the financial statements as a whole may be materially misstated, how CA Sceptic needs to plan the future course of action?*

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Multiple Choice Questions

1. *Which of the following best describes the method that Mr. Bharose Lal can indulge to commit fraud?*

   (a) *Concealing and not disclosing facts that could affect the amounts recorded in financial statements.*

   (b) *Engaging in complex transactions that are structured to misrepresent the financial position or financial performance of the entity.*

   (c) *Causing an entity to pay for goods or services not received.*

   (d) *Using undisclosed business partners to misappropriate funds in the garb of making a business transaction and thus siphoning off the funds.*

2. *In the given case scenario, the main factor giving rise to risk of material misstatement is:*

   (a) *The expensive lifestyle of owners.*

   (b) *Appointment of an auditor having experience in unearthing of frauds*

   (c) *The deteriorating financial condition of the owner's business.*

   (d) *The vulnerability and dependence of the foreign partner on the local partner.*

3. *In the given case scenario, which is the most important red flag for auditor:*

   (a) *Expensive lifestyle*

   (b) *Undisclosed related party relationships to siphon off the funds.*

   (c) *Financial crunch*

   (d) *The dominant influence of the owners*

4. *Which of the following is not a fraud risk factor?*

   (a) *Dominant influence of the owners*

   (b) *Expensive lifestyle*

   (c) *Fraud risk due to the nature of the industry*

   (d) *Floating of a new SPV itself*

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Answers to Theoretical Questions

1. The engagement team shall include specific consideration of the susceptibility of the financial statements to material misstatement due to fraud or error that could result from the entity's related party relationships and transactions.

- The nature and extent of the entity's relationships and transactions with related parties as identified independently by the Auditor by verification of MBP-1 data and data available on MCA website relating to directors and companies, etc.
- An emphasis on the importance of maintaining Professional Skepticism throughout the audit regarding the potential for material misstatement associated with related party relationships and transactions.
- The circumstances or conditions of the entity that may indicate the existence of related party relationships or transactions that management has not identified or disclosed to the auditor (e.g., a complex organisational structure, use of special purpose entities off-balance sheet transactions, or an inadequate information system).
- The records or documents that may indicate the existence of related party relationships or transactions.
- The importance of management and those charged with governance attached to the identification, appropriate accounting for, and disclosure of related party relationships and transactions (if the applicable financial reporting framework establishes related party requirement), and the related risk of Management override of relevant controls.
- In addition, the discussion in the context of fraud may include specific consideration of how related parties may be involved in fraud. For example:

  (a) How special-purpose entities controlled by management might be used to facilitate earnings management

  (b) How transactions between the entity and a known business partner of a key member of management could be arranged to facilitate misappropriation of the entity's assets.

    - An exchange of ideas among engagement team members about how and where they believe the entity's financial statements may be susceptible to material misstatement due to fraud, how management could perpetrate and conceal fraudulent financial reporting, and how assets of the entity could be misappropriated.

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- A consideration of circumstances that might be indicative of earnings management and the practices that might be followed by management to manage earnings that could lead to fraudulent financial reporting.
- A consideration of the known external and internal factors affecting the entity that may create an incentive or pressure for management or others to commit fraud, provide the opportunity for fraud to be perpetrated, and indicate a culture or environment that enables management or others to rationalize committing fraud.
- A consideration of management's involvement in overseeing employees with access to cash or other assets susceptible to misappropriation.
- A consideration of any unusual or unexplained changes in behaviour or lifestyle of management or employees which have come to the attention of the engagement team.
- An emphasis on the importance of maintaining a proper state of mind throughout the audit regarding the potential for material misstatement due to fraud.
- A consideration of the types of circumstances that, if encountered, might indicate the possibility of fraud.
- A consideration of how an element of unpredictability will be incorporated into the nature, timing and extent of the audit procedures to be performed.
- A consideration of the audit procedures that might be selected to respond to the susceptibility of the entity's financial statement to material misstatement due to fraud and whether certain types of audit procedures are more effective than others.
- A consideration of any allegations of fraud that have come to the auditor's attention.
- A consideration of the risk of management override of controls.

2. The fraud risk factors are the events or conditions that indicate an incentive or pressure to commit fraud or provide an opportunity to commit fraud.

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The fraud risk factors are classified based on the three conditions that are generally present when fraud exists:

(i) An incentive or pressure to commit fraud

(ii) A perceived opportunity to commit fraud

(iii) An ability to rationalize fraudulent actions.

In the given case scenario following fraud risk factors can be segregated in the 2 conditions of incentive or pressure to commit fraud in a perceived opportunity to commit fraud.

1) An incentive or pressure to commit fraud:

- Financial difficulty with huge outstanding dues towards vendors and Financial Institutions.
- Expensive lifestyle.
- Requirement to fund ₹ 5 crore as equity contribution in the SPV.

2) A perceived opportunity to commit fraud:

- Dependency of the foreign partner and no knowledge of the foreign partner of local laws and the SRA business model in India
- The risk is due to the way the real estate industry functions and particularly risk due to the SRA business model.
- Dominant personality of MD, which can lead to management override of controls for undisclosed business relationships with M/s. Useless and Sons (P) Ltd.

3. If the auditor identifies arrangements or information that suggests the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditors, the auditor shall determine whether the underlying circumstances confirm the existence of those relationships or transactions.

In such situations, the auditor shall:

- Promptly communicate the relevant information to the other members of the engagement team in order to assist them in determining whether this information affects the results of, and conclusions drawn from risk assessment procedures already performed, including whether the risk of material misstatement needs to be reassessed.

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- Where the applicable financial reporting framework establishes related party requirements:

  (i) Request management to identify all transactions with the newly identified related parties for the auditor's further evaluation; and

  (ii) Inquire as to why the entity's controls over related party relationships and transactions failed to enable the identification or disclosure of the related party relationships or transactions;

  - Perform appropriate substantive audit procedures relating to such newly identified related parties or significant related party transactions.
  - Reconsider the risk that other related parties or significant related party transactions may exist that management has not previously identified or disclose to the auditor, and perform additional audit procedures as necessary; and
  - If the non-disclosure by management appears intentional (and therefore indicative of a risk of material misstatement due to fraud), evaluate the implications for the audit. In such cases, the requirements and guidance in SA-240 regarding the auditor's responsibilities relating to fraud in an audit of financial statements are relevant where management appears to have intentionally failed to disclose related parties or significant related party transactions to the auditor. The auditor may also consider whether it is necessary to re-evaluate the reliability of management's responses to the auditor's inquiries and management's representations to the auditor.
  - The Auditor needs to carry out verification and inspection of the ownership structure and the review of the financial statements of M/s. Useless and Sons (P) Ltd through the MCA website and establish the nexus between the two.
  - The Auditor needs to carry out an inspection of the data filed by Mr. Bharose Lal for his group companies to establish any past transactions/relationships between the two entities.
  - The Auditor needs to ask for all the documents for the utilization of INR 20 crore and can investigate by visiting the parties involved and asking for confirmation directly.

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4. The Auditor needs to reassess the reliability of evidence previously obtained as there are doubts about the completeness and truthfulness of representations made and about the genuineness of accounting records and documentation.

(a) Determine the professional and legal responsibilities applicable in the circumstances, including whether there is the requirement for the auditor to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities;

(b) Consider whether it is appropriate to withdraw from the engagement, where withdrawal from the engagement is legally permitted; and

(c) If the auditor withdraws:

(i) Discuss with the appropriate level of management and those charged with governance the auditor's withdrawal from the engagement and the reasons for the withdrawal; and

(ii) Determine whether there is a professional or legal requirement to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities, the auditor's withdrawal from the engagement and the reasons for the withdrawal.

MCQ answers

1. (d) **2.** (d) **3.** (b) **4.** (d)

Integrated Case Scenario

Black & White Ltd. is into the business of manufacturing readymade garments in Amritsar. It procures all the raw material required for its production from Punjab, Himachal Pradesh & J&K. Its sales market, however, covers almost all the northern parts of the country. CA Anu is the engagement partner of Maheshwari & Co appointed as the statutory auditor of the company. She calls for a meeting of the engagement team to delegate work and responsibilities. During the audit, the engagement team comes across the following facts:-

- Woolen Private Limited is one of the vendors of the company from which the company has been purchasing wool for many years on a current account basis, but no single purchase has been made in the last nine months, and the outstanding balance stands as it is in the books of accounts. CA Anu wants to confirm the balance and requests the CFO of the company for sending a balance confirmation request to Woolen Private Ltd., to which he refuses and is not willing.

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- The Fashion Jingo Ltd. is one of the customers of the company and hasn't replied to CA Anu's positive balance confirmation request sent.
- Mr. X, one of the fashion designers, had sold his designs to the company but owing to a dispute, the contract got cancelled, and now both the parties are under litigation in the local court of law. The engagement team is guided as to the procedures to be designed and performed to identify this matter.
- CA Anu simultaneously seeks direct communication with the company's external legal counsel sensing the risk of material misstatement. However, it ends up in vain as the external legal counsel, Mr. Chadha, refuses to comment. She is unable to obtain sufficient appropriate audit evidence in this regard through alternative audit procedures either.

The team documents all the relevant information w.r.t. the above facts, and CA Anu issues the audit report accordingly.

Multiple Choice Questions

1. *Fashion Jingo Ltd. has not responded to CA Anu's request. What would be proper course of action for her in such a situation?*

   (a) Perform alternative audit procedures

   (b) Consider it as a negative confirmation

   (c) Give a Qualified opinion

   (d) Should visit the customer company premises herself and confirm the balance on the spot.

2. *With respect to Advocate Chadha's cold shoulder to CA Anu's request, what she should do?*

   (a) Modify her audit opinion

   (b) Give an unqualified opinion

   (c) Give a disclaimer of opinion

   (d) Withdraw from this engagement

3. *What should be CA Anu's first and foremost response in the case of request made relating to balance confirmation from Woolen Pvt. Ltd.?*

   (a) Perform alternate audit procedures.

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(b) *Withdraw from the engagement.*

(c) *Communicate with Those charged with Governance telling the effects on his audit opinion.*

(d) *Inquire as to the reasons behind the management's response and seek audit evidence as to its validity and reasonableness.*

4. *Which of the following procedures will not be performed by the engagement team as audit procedures while dealing with the case of Mr. X?*

(a) *Inquiry of Management.*

(b) *Inquiry of Mr. X*

(c) *Reviewing Minutes of Meetings*

(d) *Reviewing Legal expenses account*

Answer to MCQs of Integrated Case Scenario

1. (a) **2.** (a) **3.** (d) **4.** (b)

Key Takeaways

- SA 500 deals with the auditor's responsibility to design and perform audit procedures to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion.
- The quality of all audit evidence is affected by the relevance and reliability of the information upon which it is based.
- Relevance deals with the logical connection with, or bearing upon, the purpose of the audit procedure and, where appropriate, the assertion under consideration. The relevance of information to be used as audit evidence may be affected by the direction of testing.
- 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. Even when information to be used as audit evidence is obtained from sources external to the entity, circumstances may exist that could affect its reliability.
- 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, evaluate competence, capability

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and objectivity of such an expert besides obtaining understanding of his work. Further, appropriateness of management's expert work as audit evidence for relevant assertion has also to be evaluated.

- SA 501 deals with specific considerations by the auditor in obtaining sufficient appropriate audit evidence with respect to certain aspects of inventory, litigation and claims involving the entity, and segment information in an audit of financial statements.
- When inventory is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by attendance at physical inventory counting, unless impracticable.
- The auditor shall design and perform audit procedures in order to identify litigation and claims involving the entity which may give rise to a risk of material misstatement. Litigation and claims involving the entity may have a material effect on the financial statements and thus may be required to be disclosed or accounted for in the financial statements.
- Segment information refers to information about different types of products and services of an enterprise and its operations in different geographical areas. In accordance with SA 501, the auditor shall obtain sufficient appropriate audit evidence regarding the presentation and disclosure of segment information in accordance with the applicable financial reporting framework.
- SA 505 deals with the auditor's use of external confirmation procedures to obtain audit evidence in accordance with the requirements of SA 500. It is intended to assist the auditor in designing and performing external confirmations procedures to obtain relevant and reliable audit evidence.
- SA 510 deals with the auditor's responsibilities relating to opening balances when conducting an initial audit engagement. An initial audit engagement is an engagement in which either the financial statements for prior period were not audited or were audited by a predecessor auditor.
- SA 530 deals with the auditor's use of statistical and non-statistical sampling when designing and selecting the audit sample, performing tests of controls and tests of details and evaluating the results from the sample.
- The objective of the auditor when using audit sampling is to provide a reasonable basis for the auditor to draw conclusions about the population from which the sample is selected.
- 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.

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- Whatever may be the approach, statistical sampling or non-statistical sampling, the sample must be representative. This means that it must be closely similar to the whole population although not necessarily exactly the same. The sample must be large enough to provide statistically meaningful results.
- SA 550 deals with the auditor's responsibilities regarding related party relationships and transactions when performing an audit of financial statements.

Note:

Content of SA 500 "Audit Evidence"; SA 501 "Audit Evidence - Specific Considerations for Selected Items"; SA 505 "External Confirmations"; SA 510 "Initial Audit Engagements – Opening Balances"; SA 530 "Audit Sampling" & SA 550 "Related Parties" is covered in depth at Intermediate level. Thus, application part of the above SAs may be discussed in the form of Case Study at Final level.

Student may note that SA 500, SA 501, SA 505, SA 510, SA 530 & SA 550 are covered in chapter 4: Audit Evidence at Intermediate level, available at: https://resource.cdn.icai.org/93335bos-aps5884-ch4.pdf

For a concise revision of the key concepts covered in this chapter, students may refer to the Saransh Booklet for Paper 3: Advanced Auditing, Assurance and Professional Ethics, which serves as a useful last-mile revision resource for examination preparation. Saransh Booklet can be accessed at https://boslive.icai.org/AAAPE_SARANSH.pdf

TEST YOUR KNOWLEDGE

Theoretical Questions

1. *Coccyx Ltd. supplies navy uniforms across the country. The company has 3 warehouses at different locations throughout India and 5 warehouses at the borders. The major stocks are generally supplied from the borders. Coccyx Ltd. appointed M/s OPAQE & Co. to conduct its audit for the financial year 2025-26. Mr. P, partner of M/s OPAQE & Co., attended all the physical inventory counting conducted throughout India but could not attend the same at borders due to some unavoidable reason.*

   You are required to advise M/s OPAQE & Co.,

   (I) How sufficient appropriate audit evidence regarding the existence and condition of inventory may be obtained?

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(II) How is an auditor supposed to deal when attendance at physical inventory counting is impracticable?

2. *GHK Associates, Chartered Accountants, conducting the audit of PBS Ltd., a listed company for the year ended 31-03-2026 is concerned with the presentation and disclosure of segment information included in Company's Annual Report. GHK Associates want to ensure that methods adopted by management for determining segment information have resulted in disclosure in accordance with the applicable financial reporting framework. Guide GHK Associates with 'Examples of Matters' that may be relevant when obtaining an understanding of the methods used by the management with reference to the relevant Standards on Auditing.*

3. *Chintamani Ltd appoints Chintan & Mani as statutory auditors for the financial year 2025-26. Chintan & Mani seem to have different opinions on the Audit approach to be adopted for audit of Chintamani Ltd. Mani is of the opinion that 100% checking is not required and they can rely on Audit Sampling techniques in order to provide them a reasonable basis on which they can draw conclusions about the entire population.*

   Chintan is concerned that whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested.

   You are required to guide Chintan about his role if audit sampling has not provided a reasonable basis for conclusions about the population that has been tested in accordance with SA 530.

4. *During the audit of Star Ltd., a company engaged in the production of paper, the auditor received certain confirmation for the balances of trade payables outstanding in the balance sheet through external confirmation by "Negative Confirmation Request". In the list of trade payables, there are number of small balances except one which is an old outstanding of ₹ 20 lakhs for which no confirmation was received. Comment with respect to Standards of Auditing relating to the confirmation process and how to deal with the non-receipt of confirmation.*

5. *Mr. Atharv, while conducting the audit of Black Mountain Mining Ltd., which is involved in phosphate mining, decided to engage an auditor's expert to assess environmental liabilities and site clean-up costs. Black Mountain Mining Ltd. re-appointed Mr. Aman as an independent expert for this task. For the past five years, the management has consistently re-appointed Mr. Aman. He calculated the environmental liabilities for both completed mining*

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sites and sites scheduled for closure in the near future, including provisions for clean-up costs. Management accepted his assessment.

Mr. Atharv, after performing the inquiries with management, was of the opinion that the objectivity of the independent expert cannot be questioned just because he was appointed by management as their expert. Hence, there is no need to raise a question on the objectivity of Mr. Aman or on his work performed for the company. However, the audit partner was of the opinion that the audit team needs to evaluate the objectivity of an expert engaged by the entity, irrespective of the fact that he was appointed as an independent expert.

Guide the audit partner and Mr. Atharv with respect to requirements pertaining to evaluating the objectivity of the management expert.

6. *While conducting the statutory audit of Tasty Foods Limited, CA. Careful has planned attendance at physical inventory count of the company from 29th March to 31st March 2026. The company is engaged in the business of extracting rice from paddy grains and caters to domestic as well as international market particularly in Gulf region. It has its plant spread in an area of about 20 acres located in National Capital Region (NCR). Paddies contained in jute bags of nearly standard sizes is purchased from dealers/agents. It is stored in heaps on pallets (kind of wooden structures) in an open area covered by protective sheets and in steel silos (silos are huge steel containers with measuring strain gauges) in company's premises.*

The company mainly produces three rice brands viz. "Raja" and "Shehzada" (both for the domestic market) and "Badshah" (for the international market). The process of obtaining rice from paddy consists of various steps like cleaning of paddy, removing outer husk layer from paddy grains to obtain brown rice, whitening, polishing, grading and sorting, packaging which is accomplished by means of various types of machineries installed in plant.

The company's management has prepared a set of instructions and procedures to be followed for recording and controlling results of company's physical inventory counting which are listed as under: -

- *The physical inventory count process is to be supervised by a responsible officer of company responsible for storage functions.*
- *There should be no disturbance to the routine process of receiving goods and despatch during the counting time period.*
- *Counting process is to be undertaken by constituting different teams of 3 members each for counting/verifying raw material, work in progress and finished goods.*

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- *Paddy in steel silos is to be estimated using their capacity.*
- *Quantity of work in progress is to be estimated considering plant capacity as whole.*
- *The responsible officer should ensure that stocks have been counted/verified in all areas.*

Before proceeding to attend physical inventory count process of company, evaluate management's instructions and procedures sent to CA Careful as stated above. You may suggest modification, addition or removal of such instructions to ensure effective count process.

7. During the audit of the financial statements of Looks Limited for the year ended March 31, 2026, CA Suyash, the statutory auditor requested external confirmation for certain trade receivables and trade payables as part of audit procedures in accordance with SA 505:

(i) CA Suyash sent a confirmation request to a debtor for balance of ₹ 15,50,000 which was outstanding for more than 6 months, insisting him to respond directly to the auditor, confirming whether they agree or disagree with the balance stated.

(ii) He also sent a confirmation request to a creditor with an outstanding balance of ₹ 13,25,000 requesting a response only if there was a disagreement with the stated amount.

CA Suyash received responses from the aforementioned debtor and creditor in following manner:

- ***The debtor confirmed that, as per their records, they owed ₹ 14,90,000 to Looks Limited instead of ₹ 15,50,000 as per the company's books.***
- ***The creditor did not respond to the confirmation request.***

Identify and explain the type of confirmation request sent by the auditor to the debtor and creditor. Also, discuss the course of action the auditor should take for the discrepancy in the confirmation received from the debtor and non-receipt of confirmation from the creditor.

8. PQR Ltd. is engaged in the business of construction and real estate having various projects across the states. M/s ST & Co., Chartered Accountants have been appointed as statutory auditors. CA T, an engagement partner, who leads engagement team, during preliminary verification, identified a few agreements entered by PQR Ltd. for the

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provision of services to some parties under terms and conditions that are outside PQR Ltd.'s normal course of business, suggestive of the indications about existence of related party transactions that management has not previously disclosed to the auditor. Highlight the aspects that M/s ST & Co., shall consider on identification of previously undisclosed related party transactions with reference to the relevant standard on auditing.

9. *ABC Limited is in the business of manufacturing of iron ore and steel bars since last decade. The company is having its registered office in Mumbai and factory in Bhiwandi. M/s. R and Associates are appointed as the statutory auditors of the company for the financial year 2025-26. While going through the trial balance of the company, they observed that the company has 50 customers and 40 vendors. They requested the company to authorise them to send the external confirmation to few of its customers and vendors. The company immediately provided them an authority letter to send the external confirmation to their customers and vendors. The auditor sent positive confirmation request to top 3 customers and top 3 vendors. After two days of sending positive confirmation request, the management of the company handed over to them the duly signed response received from the respective customers and vendors to whom they had sent the confirmation request. How would M/s. R and Associates proceed to deal with the situation as the auditor of the company?*

10. *The statutory audit of Nizovus Pharmaceuticals Ltd., for the financial year 2025-26, is underway. During the review of "Professional and Legal Fees" ledger, the engagement team noted a significant payment to a high-profile law firm specializing in Intellectual Property (IP) disputes. The management, during initial inquiries, stated that the payment was for 'general advisory services and that no active litigation exists that requires disclosure under the applicable financial reporting framework. However, the minutes of the Board Meeting from February 2026 hint at a potential significant patent infringement claim from a global competitor.*

    The engagement partner, CA Rukma, insisted on sending a letter of direct inquiry to the external legal counsel to assess the probability of an outflow of resources. The management has refused to permit this communication, citing 'confidentiality clauses' in their contract with the law firm. They have offered to provide a comprehensive written representation confirming that no material litigations are pending. CA Rukma is concerned about the management's stand and non-availability of direct confirmation from the lawyers.

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Is management's written representation sufficient in place of legal confirmation? Advise CA Rukma, about the additional audit procedures and reporting implications, if legal confirmation is denied.

11. *Evershine Refineries Ltd. has recognized a substantial provision towards decommissioning and environmental restoration obligations relating to its offshore drilling operations. The measurement of this provision requires complex assumptions involving long-term discounting, engineering life-cycle estimates, and evolving environmental compliance costs. For the current financial year, the Company has relied on a technical assessment prepared by its internal Chief Technical Officer (CTO), who is a qualified environmental engineer and has been associated with the organization for over two decades. Based on internally developed operational efficiency measures, the CTO's report recommends a 15% reduction in the existing provision.*

    During the audit, the engagement partner, CA Meera, has identified the provision as a significant matter due to the significant estimation uncertainty and its material effect on the profitability of the Company. Although the CTO possesses relevant technical competence, CA Meera has noted that the CTO's performance incentives are linked to the Company's profitability targets. Further, the audit team does not possess specialized engineering expertise to independently validate the technical assumptions underlying the revised provision estimate, and no comparable external market benchmarks are available for similar offshore decommissioning projects.

    Analyse the case and guide CA Meera whether to rely on CTO'S recommendations with reference to the relevant Standard on Auditing.

12. *The Engagement Partner of the audit team of High Inventory Limited assessed that the inventory is material with respect to the audit of the financial statement for the current period. Upon inquiring with the management, the Engagement Partner identified that the management will be performing an annual physical inventory count at all the warehouses where the entity stores and maintains its inventory. Moreover, management confirmed in its written representation that they will be performing a 100% physical count of inventory for the current period.*

    As a result, the Engagement Partner decided not to perform any physical count of inventory as it will be a duplication of the work. Moreover, he decided that the written representation from management stating "the inventory exists and is in appropriate

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physical condition" will be sufficient and appropriate with respect to audit evidence to conclude that the inventory balance in the financial statement is free from any material misstatement.

In the light of SA 501, evaluate whether the decision taken by the Engagement Partner is appropriate or not.

13. *CA Zora has recently accepted engagement of the statutory audit of Segment Ltd. for the financial year 2025-26. While reviewing the trial balance and financial records, Zora identifies that the Opening Balances as on 1st April 2025 are carried forward from the previous year and were audited by another auditor, CA Rohan. Zora wants to be satisfied regarding the sufficiency and appropriateness of 'Opening Balances' to ensure that they are free from misstatements.*

    (i) Briefly mention the audit procedures Zora should perform to obtain sufficient and appropriate audit evidence regarding the Opening Balances, considering it is an initial audit engagement?

    (ii) Also suggest the approach to be followed by Zora if he is either unable to obtain adequate evidence about the Opening Balances or finds material misstatements therein.

14. *CA Pawan has been appointed as the statutory auditor of Vij Pvt. Ltd. for the financial year 2025-26. During the course of the audit, he obtained sufficient and appropriate audit evidence for items shown in the Statement of Profit and Loss. However, while auditing the Balance Sheet items, he left obtaining appropriate audit evidence, say, external confirmations, for outstanding accounts receivable amounting to ₹135 lakhs.*

    He continued as it is from last year, on the affirmation of management that there are no receipts and further credits during the year. CA Pawan, therefore, excluded from the audit programme, the audit of accounts receivable on the understanding that it pertains to the preceding year which was already audited by the predecessor auditor.

    What measures need to be taken by the auditor CA Pawan? Also, suggest the correct audit procedure in this regard.

15. *CA Chirag is the statutory auditor of Electric Corporation Limited, a Government Company for the year ended on 31st March 2026. The turnover of the Company for the period was ₹10,000 crores from sales of electricity. During the audit, Chirag found that the Company had procured spares for Transmitters for ₹ 700 crores from abroad through a Corporation by name PCDC India Limited which is also owned and controlled*

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by Government of India. The Financial Statements of the Electric Corporation Limited, prepared in compliance with Ind AS for the year ended on 31st March, 2026 did not contain any additional disclosure regarding the procurement of spares as referred to above. Chirag had query as to whether any disclosure regarding Related Party Transaction would be required, the Management of the Corporation replied that no such disclosure would be necessary for transactions between State Controlled Enterprises.

Analyse this issue faced during finalising the Audit Report.

Answers to Test Your Understanding

1. **Evaluating the Work of Management's Expert:** 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:

   (a) Evaluate the competence, capabilities and objectivity of that expert;

   (b) Obtain an understanding of the work of that expert; and

   (c) Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion.

   The auditor may obtain information regarding the competence, capabilities and objectivity of a management's expert from a variety of sources, such as personal experience with previous work of that expert; discussions with that expert; discussions with others who are familiar with that expert's work; knowledge of that expert's qualifications; published papers or books written by that expert.

   Aspects of the management's expert's field relevant to the auditor's understanding may include what assumptions and methods are used by the management's expert, and whether they are generally accepted within that expert's field and appropriate for financial reporting purposes.

   The auditor may also consider the following while evaluating the appropriateness of the management's expert's work as audit evidence for the relevant assertion:

   (i) The relevance and reasonableness of that expert's findings or conclusions, their consistency with other audit evidence, and whether they have been appropriately reflected in the financial statements.

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(ii) If that expert's work involves use of significant assumptions and methods, the relevance and reasonableness of those assumptions and methods; and

(iii) If that expert's work involves significant use of source data, the relevance, completeness, and accuracy of that source data.

In the instant case, BBNS Ltd. accepted the gratuity liability valuation based on the certificate issued by an expert i.e., a qualified actuary who is management's expert. Here the basis for computation and valuation is taken as age 65 years by the actuary, which is not correct as company is considering proposal to increase the retirement age from existing age to 65 years. Therefore, assumptions and methods used by the management's expert are not appropriate for financial reporting purposes. Hence, the auditor may qualify the report accordingly.

2. The given situation does not highlight the impracticability of attendance at inventory counting. It only shows that the auditor is unable to attend physical inventory counting due to unforeseen circumstances arising out of agitation by protestors. It has led to the inaccessibility of the plant site for a month. The blockade is lifted after a month.

SA 501 states that if the auditor is unable to attend physical inventory counting due to unforeseen circumstances, the auditor shall make or observe some physical counts on an alternative date and perform audit procedures on intervening transactions. Therefore, the auditor should attend the physical inventory count after the blockade is lifted and perform audit procedures on intervening transactions.

3. SA 501 states that when audit procedures performed indicate that material litigation or claims may exist, the auditor shall seek direct communication with the entity's external legal counsel. The auditor shall do so through a letter of inquiry prepared by management and sent by the auditor, requesting the entity's external legal counsel to communicate directly with the auditor.

Therefore, her approach in communicating with an external lawyer is not correct. She needs to make management aware of her intention to communicate directly with the lawyer. The letter of inquiry has to be prepared by management and sent by her.

Her purpose in corresponding with the lawyer of the company is to identify litigation and claims involving the entity which may give rise to a risk of material misstatement. It is due to the reason that litigation and claims involving the entity may have a material effect on the financial statements and thus may be required to be disclosed or accounted for in the financial statements.

4. SA 501 states that 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

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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.

It further states that where information is obtained that raises doubt about the integrity and objectivity of the third party, the auditor may consider it appropriate to perform other audit procedures instead of, or in addition to, confirmation with the third party.

Examples of other audit procedures include:

- Attending, or arranging for another auditor to attend, the third party's physical counting of inventory, if practicable.
- Obtaining another auditor's report, or a service auditor's report, on the adequacy of the third party's internal control for ensuring that inventory is properly counted and adequately safeguarded.
- Inspecting documentation regarding inventory held by third parties

In the given case, the integrity of the third party appears to be doubtful in view of DGGI raids and his possible involvement in a fake billing scam. He has already been behind bars.

Keeping in view the above, besides obtaining confirmation from such party, he may attend a third party's physical counting or ask some other auditor to attend physical counting as on reporting date, depending upon practical considerations. He can also inspect the record of goods sent and received back from such party by tracing it to challans, e-ways bills etc. and correlate the above information.

5. SA 505 states that if the auditor determines that a response to a confirmation request is not reliable, the auditor shall evaluate the implications on the assessment of the relevant risks of material misstatement, including the risk of fraud, and on the related nature, timing and extent of other audit procedures.

In the instant case, GST registrations of 25 concerns have been cancelled in the year 2025-26. It indicates that businesses on those addresses were closed. Further, there are no fresh registrations pertaining to the PANs of these parties. However, the auditor sent external confirmation requests in March 2026, which were duly responded. It raises questions on the reliability of responses received.

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SA 500 indicates that even when audit evidence is obtained from sources external to the entity, circumstances may exist that affect its reliability. All responses carry some risk of interception, alteration or fraud. Such risk exists regardless of whether a response is obtained in paper form or by electronic or other medium. Factors that may indicate doubts about the reliability of a response include:

- Was received by the auditor indirectly or
- Appeared not to come from the originally intended confirming party.

Considering the fact that the response was received by the auditor indirectly, it raises questions on the reliability of responses received and indicates a fraud risk factor that requires evaluation.

In view of above, if the auditor has doubts regarding the reliability of these responses, it becomes necessary to obtain additional audit evidence to address those concerns. The auditor should also reassess the risk of material misstatement, including the possibility of fraud, and accordingly design further audit procedures.

6. SA 510 states that in conducting an initial audit engagement, one of the objectives of the auditor with respect to opening balances is to obtain sufficient appropriate audit evidence about whether opening balances contain misstatements that materially affect the current period's financial statements. The auditor has to evaluate whether audit procedures performed in the current period provide evidence relevant to the opening balances or specific audit procedures are required to be performed to obtain evidence regarding the opening balances.

In the case of inventories, however, 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.

7. The described risk is sampling risk. It is a 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.

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In the given case, the auditor has arrived at erroneous conclusions on the basis of the samples selected. In the case of a test of controls, he has concluded that access controls are less effective than they actually are. In the case of a test of details, he has concluded erroneously that a material misstatement exists when in fact, it does not. This type of erroneous conclusion affects audit efficiency as it would usually lead to additional work to establish that initial conclusions were incorrect.

8. In respect of significantly related party transactions outside the normal course of business of an entity, it is the responsibility of the auditor, in accordance with SA 550, to evaluate the business rationale or lack thereof of transactions that may have been entered to indulge in fraudulent financial reporting or conceal misappropriation of assets.

The auditor has to seek to understand the business rationale of such a transaction from a related party's perspective. It would help him understand the economic reality of such a transaction and why it was carried out.

In the given situation, there is no primary rationale for such a transaction. Living Well Private Limited does not manufacture blankets, and the purchase of part of old machinery pertaining to blanket manufacturing has no rationale for it primarily. A business rationale from the related party's perspective that appears inconsistent with the nature of its business may represent a fraud risk factor.

Hints /Answers to Theoretical Questions

1. **(I)** **Special Consideration with Regard to Inventory:** As per SA 501 "Audit Evidence-Specific Considerations for Selected Items", when inventory is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by:

(1) Attendance at physical inventory counting, unless impracticable, to:

(i) Evaluate management's instructions and procedures for recording and controlling the results of the entity's physical inventory counting;

(ii) Observe the performance of management's count procedures;

(iii) Inspect the inventory; and

(iv) Perform test counts; and

(2) Performing audit procedures over the entity's final inventory records to determine whether they accurately reflect actual inventory count results.

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(II) **Attendance at Physical Inventory Counting Not Practicable:** In some cases, attendance at physical inventory counting may be impracticable. This may be due to factors such as the nature and location of the inventory, for example, where inventory is held in a location that may pose threats to the safety of the auditor. The matter of general inconvenience to the auditor, however, is not sufficient to support a decision by the auditor that attendance is impracticable. Further, as explained in SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", the matter of difficulty, time, or cost involved is not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative or to be satisfied with audit evidence that is less than persuasive.

Further, where attendance is impracticable, alternative audit procedures, for example, inspection of documentation of the subsequent sale of specific inventory items acquired or purchased prior to the physical inventory counting, may provide sufficient appropriate audit evidence about the existence and condition of inventory.

In some cases, though, it may not be possible to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by performing alternative audit procedures. In such cases, SA 705 on Modifications to the Opinion in the Independent Auditor's Report, requires the auditor to modify the opinion in the auditor's report as a result of the scope limitation.

2. The auditors, GHK Associates wanted to ensure and obtain sufficient appropriate audit evidence regarding the presentation and disclosure of segment information in accordance with the applicable financial reporting framework by obtaining an understanding of the methods used by management in determining segment information. SA 501 guides in this regard. As per SA 501- "Audit Evidence—Specific Considerations for Selected Items", example of matters that may be relevant when obtaining an understanding of the methods used by management in determining segment information and whether such methods are likely to result in disclosure in accordance with the applicable financial reporting framework include:

(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.

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(iv) Consistency with prior periods, and the adequacy of the disclosures with respect to inconsistencies.

3. As per SA 530, "Audit Sampling", the auditor shall evaluate:

(a) The results of the sample; and

(b) Whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested.

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:

(I) Request management to investigate misstatements that have been identified and the potential for further misstatements and to make any necessary adjustments; or

(II) Tailor the nature, timing and extent of those further audit procedures to best achieve the required assurance. For example, in the case of tests of controls, the auditor might extend the sample size, test an alternative control or modify related substantive procedures.

4. **External Confirmation:** As per SA 505, "External Confirmations", negative confirmation is a request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request. Negative confirmations provide less persuasive audit evidence than positive confirmations.

The failure to receive a response to a negative confirmation request does not explicitly indicate receipt by the intended confirming party of the confirmation request or verification of the accuracy of the information contained in the request.

Accordingly, a failure of a confirming party to respond to a negative confirmation request provides significantly less persuasive audit evidence than does a response to a positive confirmation request.

Confirming parties also may be more likely to respond indicating their disagreement with a confirmation request when the information in the request is not in their favour, and less likely to respond otherwise.

In the instant case, while performing audit of Star Limited, the auditor sent the negative confirmation requesting the trade payables having outstanding balances in the balance sheet. One of the old outstanding of ₹ 20 lakh has not sent the confirmation on the credit balance. In case of non-response, the auditor may examine subsequent cash disbursements or correspondence from third parties, and other records, such as goods received notes. Further non-response for negative confirmation request does not mean that there is some

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misstatement as negative confirmation request itself is to respond to the auditor only if the confirming party disagrees with the information provided in the request.

5. 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, have regard to the significance of that expert's work for the auditor's purposes evaluate the competence, capabilities and objectivity of that expert.

A broad range of circumstances may threaten objectivity, for example, self-interest threats, advocacy threats, familiarity threats, self-review threats and intimidation threats. Safeguards may reduce such threats and may be created either by external structures (for example, the management's expert's profession, legislation or regulation), or by the management's expert's work environment (for example, quality control policies and procedures). Although safeguards cannot eliminate all threats to a management expert's objectivity, threats such as intimidation threats may be of less significance to an expert engaged by the entity than to an expert employed by the entity, and the effectiveness of safeguards such as quality control policies and procedures may be greater. Because the threat to objectivity created by being an employee of the entity will always be present, an expert employed by the entity cannot ordinarily be regarded as being more likely to be objective than other employees of the entity.

When evaluating the objectivity of an expert engaged by the entity, it may be relevant to discuss with management and that expert any interests and relationships that may create threats to the expert's objectivity and any applicable safeguards, including any professional requirements that apply to the expert; and to evaluate whether the safeguards are adequate. Interests and relationships creating threats may include:

- Financial interests.
- Business and personal relationships.
- Provision of other services.

In the current case, Black Mountain Mining Ltd. re-appointed Mr. Aman for this engagement as an independent expert. The audit team was of the view that the objectivity of the independent expert cannot be questioned just because he was appointed by management as their expert. However, the audit partner had a contrary view.

Hence, the audit team should evaluate the objectivity of an expert engaged by the entity as the threat to objectivity, created by being an employee of the entity, will always be present. An expert appointed by the entity cannot ordinarily be regarded as being more likely

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to be objective than other employees of the entity. As a result, audit partner Atharv is correct in his view.

6. The set of instructions and procedures given in the case scenario are incomplete and not properly followed, which are discussed as under:

- The physical inventory count process should be supervised by a responsible officer of the company, preferably from finance department. The supervision of the count process should not be done by person responsible for storage function. However, storage in-charge of each area should be present during inventory count process for co-ordination and facilitation.
- During inventory count process, inward and outward movement of goods should not be allowed as allowing such movement may distort the results or make it difficult to arrive at proper results.
- The instruction relating to the constitution of teams for counting process does not specify that counting shall be undertaken by members drawn from departments not connected with storage function. For example, these members may be from the finance department. Further, within each team, duties should be fixed separately for counting and recording on serially numbered count sheets. It is nowhere stated that once counting in an area is complete, certain distinctive marks or tags are required to be put.
- Count sheets should contain description of products in accordance with inventory records of company.
- The management's instructions are silent about how team members would proceed with their work. Team members should be provided with lay out plans for different sections/ storage areas so that all areas are covered.
- The management's instructions are silent on how paddy lying in open is to be counted and verified. Paddy in jute bags lying in open in heaps should be verified by counting number of bags in one heap. As each bag is of nearly standard size, the quantity of paddy can be determined by counting number of bags in a heap and correlating it with the weight of standard bag.
- Paddy in steel silos should be determined using measuring strain gauges on silos. Determining quantity in silos based on silo capacity may lead to wrong results as paddy may have been used from such silos.

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- Quantities of work in progress should be estimated at each stage of production and not for the plant as a whole. Estimating WIP inventories for plant as a whole would give inaccurate picture of work in progress inventories.
- Finished goods inventories need to be counted category wise. Rice bags should be verified by checking the name of brand.
- There is no instruction regarding damaged or obsolete stock items particularly in the case of finished goods i.e. rice. Damaged/obsolete inventories should be counted and shifted to a separate area for assessment of their condition and to prevent mix-up with other standard inventories.
- Count sheets need to be signed by each team member.

The responsible officer should ensure that stocks have been counted/verified in all areas and distinctive marks are put to confirm completion of counting.

7. ***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.***

Exception – A response that indicates a difference between information requested to be confirmed, or contained in the entity's records, and information provided by the confirming party. The exception needs to be assessed to the entire population after analyzing the reason for difference.

In the given situation, the auditor has sent the positive confirmation request for the amount of ₹ 15,50,000 to a debtor which was outstanding for more than 6 months, however, due to difference between information requested to be confirmed, or contained in the entity's records (i.e. ₹ 15,50,000), and information provided by the confirming party (i.e. ₹ 14,90,000) is forming situation of exception confirmation.

The auditor's evaluation, when taken into account with other audit procedures the auditor may have performed, may assist the auditor in concluding whether sufficient appropriate audit evidence has been obtained or whether performing further audit procedures is necessary, as required by SA 330 in case a response is indicating an exception.

The company should be asked to investigate and reconcile the discrepancy indicated by the confirming party.

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Negative confirmation request – A request that the confirming party respond directly to the auditor only if the confirming party disagrees. In the given case, the auditor has sent the negative confirmation request for ₹13,25,000 to a creditor. Non- response by the creditor implies that creditor agrees with the amount. Thus, an auditor is not required to take any action in this case.

8. *As per SA 550, "Related Parties," M/s ST & Co. should take the following steps upon identifying previously undisclosed related party transactions:*

   - *Verify whether the circumstances substantiate the existence of such transactions.*
   - *Ensure timely communication of the relevant information to all members of the engagement team.*
   - *Confirm that appropriate substantive audit procedures have been conducted.*
   - *Inquire why the entity's controls failed to identify or disclose the related party relationships or transactions.*
   - *Carry out substantive audit procedures specifically for these newly identified related parties or significant related party transactions.*
   - *Reassess risks associated with other related parties.*
   - *Request management to identify all transactions involving the newly identified related parties.*
   - *If it appears that management intentionally did not disclose such transactions, evaluate the implications for the audit.*

9. *Reliability of External Confirmation: SA 505, "External Confirmations", states that if the auditor determines that a response to a confirmation request is not reliable, the auditor shall evaluate the implications on the assessment of the relevant risks of material misstatement, including the risk of fraud, and on the related nature, timing and extent of other audit procedures.*

   SA 500, "Audit Evidence", indicates that even when audit evidence is obtained from sources external to the entity, circumstances may exist that affect its reliability. All responses carry some risk of interception, alteration or fraud. Such risk exists regardless of whether a response is obtained in paper form, or by electronic or other medium.

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Factors that may indicate doubts about the reliability of a response include that it:

- *was received by the auditor indirectly; or*
- *appeared not to come from the originally intended confirming party.*

In the instant case, ABC Limited has 50 customers and 40 vendors in the year 2025-26. M/s R and Associates sent positive confirmation letter to top 3 customers and top 3 vendors. However, after 2 days of sending request, management of the company handed over duly signed response received from respective customers and vendors to auditor. Considering the fact that the response was received by the auditor indirectly, it raises questions on the reliability of responses received and indicates a fraud risk factor that requires evaluation.

In view of above, if the auditor has doubts regarding the reliability of these responses, it becomes necessary to obtain additional audit evidence to address those concerns. The auditor should also reassess the risk of material misstatement, including the possibility of fraud, and accordingly design further audit procedures.

10. *SA 580 "Written Representations" deals with the auditor's responsibility to obtain written representations from management and, where appropriate, those charged with governance. Although written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal. Furthermore, the fact that management has provided reliable written representations does not affect the nature or extent of other audit evidence that the auditor obtains about the fulfilment of management's responsibilities or about specific assertions.*

Further, SA 501 "Audit Evidence - Specific Considerations for Selected Items", states that when audit procedures performed indicate that material litigation or claims may exist, the auditor shall seek direct communication with the entity's external legal counsel. The auditor shall do so through a letter of inquiry prepared by management and sent by the auditor, requesting the entity's external legal counsel to communicate directly with the auditor.

In the given situation, significant payment to an IP litigation law firm, references in Board minutes to a possible patent infringement claim, and management's refusal to allow direct communication with legal counsel indicate a significant audit risk. As the matter may involve a contingent liability requiring disclosure or provision, she should not rely solely on management representation in this matter. The refusal to permit direct communication with external legal counsel is a significant audit concern and

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may indicate a scope limitation and risk of material misstatement relating to contingent liabilities and litigation disclosures.

Accordingly, CA Rukma shall design and perform additional audit procedures in order to identify litigation and claims involving the entity by:

- *Inquiry of management and, where applicable, others within the entity including in-house legal counsel.*
- *Reviewing minutes of meetings of those charged with governance and correspondence between the entity and its external legal counsel.*
- *Reviewing legal expense account.*

CA Rukma should express the modified opinion in accordance with SA 705 "Modifications to the Opinion in the Independent Auditor's Report", if she could not communicate with external legal counsel and unable to obtain sufficient appropriate audit evidence by performing additional audit procedures.

11. *In the case of Evershine Refineries Ltd., the Company reduced its decommissioning and environmental restoration provision by 15% based on a technical assessment prepared by its internal CTO, who is a management expert. Since the provision involves significant estimation uncertainty and materially impacts profitability, and the CTO's incentives are linked to profitability targets, there is a risk of management bias affecting objectivity. Accordingly, as the assessment is prepared by management's expert, the provisions of SA 500 relating to evaluation of information prepared by management's expert are applicable.*

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:

(i) Evaluate the competence, capabilities and objectivity of that expert;

(ii) Obtain an understanding of the work of that expert; and

(iii) Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion.

The auditor may obtain information regarding the competence, capabilities and objectivity of a management's expert from a variety of sources, such as personal

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experience with previous work of that expert; discussions with that expert; discussions with others who are familiar with that expert's work; knowledge of that expert's qualifications; published papers or books written by that expert.

Aspects of the management's expert's field relevant to the auditor's understanding may include what assumptions and methods are used by the management's expert, and whether they are generally accepted within that expert's field and appropriate for financial reporting purposes.

The auditor may also consider the following while evaluating the appropriateness of the management's expert's work as audit evidence for the relevant assertion:

(i) The relevance and reasonableness of that expert's findings or conclusions, their consistency with other audit evidence, and whether they have been appropriately reflected in the financial statements.

(ii) If that expert's work involves use of significant assumptions and methods, the relevance and reasonableness of those assumptions and methods; and

(iii) If that expert's work involves significant use of source data, the relevance, completeness, and accuracy of that source data.

In view of above, despite the CTO's technical competence, CA Meera cannot rely solely on the CTO's assessment due to the possible threat to objectivity and significant estimation uncertainty involved. She should evaluate the assumptions, methods, and supporting data in accordance with SA 500 and obtain sufficient appropriate audit evidence before concluding on the reasonableness of the provision.

12. *As per SA 501, "Audit Evidence - Specific Considerations for Selected Items", when inventory is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by:*

i. Attendance at physical inventory counting, unless impracticable, to

1. Evaluate management's instructions and procedures for recording and controlling the results of the entity's physical inventory counting.

2. Observe the performance of management's count procedures.

3. Inspect the inventory; and

4. Perform test counts; and

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ii Performing audit procedures over the entity's final inventory records to determine whether they accurately reflect actual inventory count results.

Attendance at physical inventory counting involves:

i. Inspecting the inventory to ascertain its existence and evaluate its condition and perform test counts.

ii. Observing compliance with management's instructions and the performance of procedures for recording and controlling the results of the physical inventory count; and

iii. Obtaining audit evidence as to the reliability of management's count procedures.

Hence in the given case, the approach of Engagement Partner is not appropriate as when inventory is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of inventory. This should be done by performing various audit procedures which also includes attending physical count, observing the count, inspecting the inventory and reperforming physical counts.

13. (i) Audit Procedures to be followed in case of initial audit engagement: As per SA 510, "Initial Audit Engagements – Opening Balances", the auditor shall obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements by:

- *Determining whether the prior period's closing balances have been correctly brought forward to the current period or, when appropriate, any adjustments have been disclosed as prior period items in the current year's Statement of Profit and Loss;*
- *Determining whether the opening balances reflect the application of appropriate accounting policies; and*
- *Performing one or more of the following:*
  - *Where the prior year financial statements were audited, perusing the copies of the audited financial statements including the other relevant documents relating to the prior period financial statements;*
  - *Evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances; or*

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- *Performing specific audit procedures to obtain evidence regarding the opening balances.*

(ii) Approach to be followed if he is either unable to obtain adequate evidence about the Opening Balances or finds material misstatements therein: If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor shall express a qualified opinion or a disclaimer of opinion, as appropriate. Further, If the auditor concludes that the opening balances contain a misstatement that materially affects the current period's financial statements, and the effect of the misstatement is not properly accounted for or not adequately presented or disclosed, the auditor shall express a qualified opinion or an adverse opinion.

14. As per SA 510, "Initial Audit Engagements – Opening Balances", while conducting an initial audit engagement, the objective of the auditor with respect to opening balances is to obtain sufficient appropriate audit evidence about whether -

(i) Opening balances contain misstatements that materially affect the current period's financial statements; and

(ii) Appropriate accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, or changes thereto are properly accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.

When the financial statements for the preceding period were audited by another auditor, the current auditor may be able to obtain sufficient appropriate audit evidence regarding opening balances by perusing the copies of the audited financial statements.

Ordinarily, the current auditor can place reliance on the closing balances contained in the financial statements for the preceding period, except when during the performance of audit procedures for the current period the possibility of misstatements in opening balances is indicated.

For current assets and liabilities, some audit evidence about opening balances may be obtained as part of the current period's audit procedures, say, the collection of opening accounts receivable, (like external confirmations) during the current period will provide some audit evidence of their existence, rights and obligations, completeness and valuation at the beginning of the period.

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In addition, according to SA 505, "External confirmations" the auditor can use external confirmation procedures to obtain audit evidence.

Further, according to SA 580, "Written Representations", the auditor may consider it necessary to request management to provide written representations about specific assertions in the financial statements; in particular, to support an understanding that the auditor has obtained from other audit evidence of management's judgment or intent in relation to, or the completeness of, a specific assertion. Although such written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own for that assertion.

In the given case, the management of Vij Pvt. Ltd. has restrained CA Pawan, its auditor, from obtaining appropriate audit evidence for balances of accounts receivable outstanding as it is from the preceding year. CA Pawan, on believing that the preceding year balances have already been audited and on the statement of the management that there are no receipts and credits during the current year, therefore excluded the verification of Accounts Receivable from his audit programme.

Thus, CA Pawan should have requested the management to provide written representation for their views and expressions and he should also not exclude the audit procedure of closing balances of Accounts Receivable from his audit programme.

15. *As per Ind AS 24, "Related Party Disclosures", a reporting entity is exempt from the disclosure requirements in relation to related party transactions and outstanding balances, including commitments, with (i) a government that has control or joint control of, or significant influence over, the reporting entity; and (ii) another entity that is a related party because the same government has control or joint control of, or significant influence over, both the reporting entity and the other entity.*

If a reporting entity applies the above exemption, it shall disclose the following about the transactions and related outstanding balances referred to:

(1) the name of the government and the nature of its relationship with the reporting entity (i.e. control, joint control or significant influence);

(2) the following information in sufficient detail to enable users of the entity's financial statements to understand the effect of related party transactions on its financial statements:

(i) the nature and amount of each individually significant transaction; and

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(ii) for other transactions that are collectively, but not individually, significant, a qualitative or quantitative indication of their extent.

Further, as per SA 550, "Related Parties", in forming an opinion on the financial statements in accordance with SA 700, the auditor shall evaluate whether the identified related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the applicable financial reporting framework.

In the instant case, Electric Corporation Limited, a Government Company has procured spares for transmitters for ₹700 crore from abroad through a corporation namely PCDC India Limited which is also owned and controlled by Government of India. Even after applying the exemption of Ind AS 24, Electric Corporation Limited has to disclose the matters specified above (i.e.name of Government, nature of its relationship with reporting entity, the nature and amount of transaction etc.). Contention of Management of Corporation regarding no requirement of disclosure for transactions between State Controlled Enterprise is not tenable.

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