

Conducting Statutory Financial Audit in India using Audit Evidences: A Review of Select Standards on Auditing (SAs)

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Abstract

The study initially deduces that quality of financial reporting depends upon quality of statutory financial audit. Adequacy and reliability of audit evidences may influence quality of audit. While collecting audit evidences, the auditor has to depend upon a few internal and external members of the company, such as internal auditors, auditor's expert, external third parties (e.g. Banks, Debtors, Creditors, etc.). Statutory auditors' responsibilities with respect to collection of sufficient and appropriate evidences from these parties are governed by their respective standards. The current study conceptually reviews statutory auditors' responsibilities with respect to 'using the work of internal auditors', 'external confirmations', and 'using the work of auditor's expert' in light of their governing auditing standards.

Keywords: Internal Auditor, External Confirmation, Auditor's Expert, ICAI, SAs.

1. Introduction

Quality of auditors' report is a basic element to augment the trustworthiness of financial statements to those interested stakeholders. It depends upon quality of audit evidences used during audit process and professional judgement of the statutory auditors. Quality of people working alongside statutory auditors in collecting evidences also influences quality of audit. In narrow parlance, they are external third parties professionally related with the client organisation, internal auditor employed by the client company and auditor's expert appointed by an accounting firm (Zakari & Ahmed, 2014). Nature, timing and scope of audit procedure actually depend upon internal control system of the client organisation. Internal auditor monitors this system and communicates their views to the statutory auditors. On the other hand, select account balances, such as debtors, creditors and banks mentioned in the company's books are ratified by the respective third parties. In addition to that, statutory auditors often refer to the works of auditor's expert where they do not have necessary expertise. Adequacy and quality of audit evidences depends upon quality of responses from each of these parties which ultimately facilitates quality of audit (Glover, et. al., 2004).

There have been several studies globally considering these issues and their impact on overall audit quality. However, a limited number of similar studies have been made in India (Faraj and Akbar, 2010). Hence, in order to improve the accountability of accounting profession, it is imperative to conceptually study each of the aforementioned issues in light of governing auditing standards. In India, Standards on Auditing (SAs) issued by the Institute of Chartered Accountants of India (ICAI) have been consulted for this purpose. In the current study, an attempt has been made to conceptually discuss statutory auditors' responsibilities with respect to the aforesaid issues in collecting quality audit evidences in the light of SA-610 titled, 'Using the work of internal auditors', and SA-505 titled, 'External confirmations' and SA-620 titled, 'Using the work of an auditor's expert'.

2. Involvement of Internal and External Factors in Collection of Audit Evidences

Statutory auditors apply several audit procedures to collect sufficient and appropriate evidences. Sometimes, that involves collecting information from parties internal or external to the organisation. When statutory auditors request for confirmation on certain account balance from external third parties professionally related to the business enterprise, it is called 'External Confirmations'. However, there are situations when statutory auditors refer to the work of others within the organisation to collect sufficient and appropriate evidences.

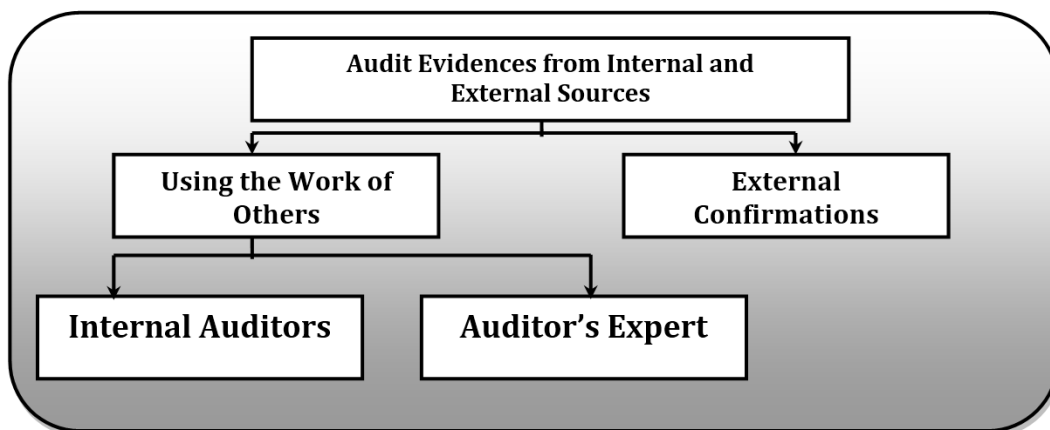


Exhibit-1: Audit Evidences from Internal and External Sources

Predominantly, there are two bodies within the organisation that help an auditor in this respect. Firstly, Internal Auditors, who are appointed by the client entity, entrusted with the responsibility of monitoring internal control mechanism of the company and communicating the same to the external auditors. On the other hand, Auditor’s Expert is appointed by the accounting firm as a part of the engagement team to report on certain key aspects where statutory auditors do not have necessary expertise. In the following segments, statutory auditors’ responsibilities with respect to ‘using the work of internal auditors’, ‘external confirmations’ and ‘using the work of an auditor’s expert’ are reviewed in the light of their governing SAs.

3. Using the work of Internal Auditors [Based on SA–610]

Internal auditors are responsible for maintaining internal control system in a company. A strong internal control reduces auditors’ burden. Therefore, auditor has to depend on the work performed by the internal auditor. However, the nature and extent of using such work depends upon the provision of SA–610 (Revised) titled ‘Using the Work of Internal Auditors’. The external auditor should evaluate (a) adequacy of internal auditors’ work; (b) nature and extent of internal auditors’ work that could be used by the external auditor; (c) independence, technical competence and professional care by internal auditors; (d) effective communication between internal and external auditors; (e) risk of material misstatement at the assertion levels; (f) degree of subjectivity involved in evaluating internal auditors’ work.

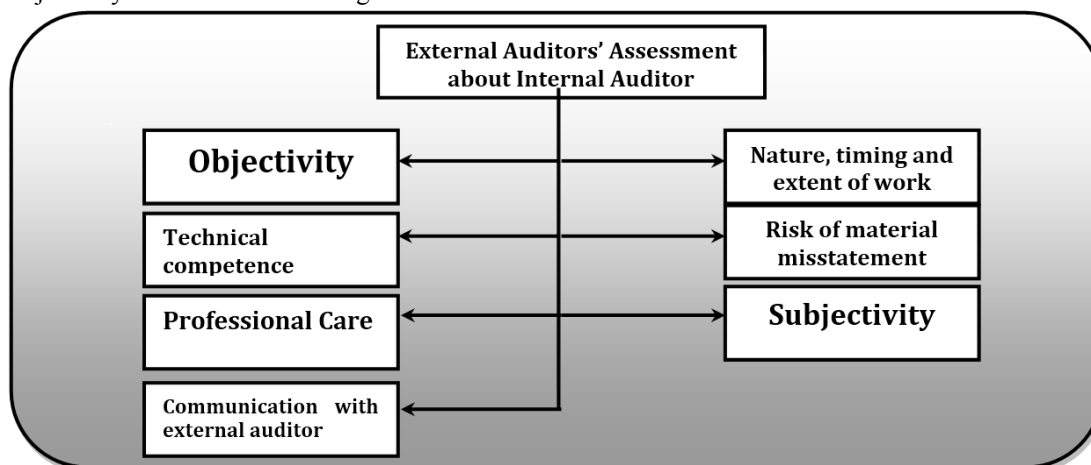


Exhibit-2: External Auditors’ Assessment about Internal Auditors’ Work
 (Source: Adapted from Bansal, 2015)

The external auditor could use the work of an internal auditor for a specific purpose. For that reason the external auditor should evaluate (a) competence of internal auditor for that purpose; (b) scope of review and supervision on internal auditors’ work; (c) audit evidences obtained by internal auditors; (d) appropriateness of conclusions reached by internal auditors; (e) resolution of any unusual matters. Adequacy of internal auditors’ work with respect to specific purpose should be properly documented.

As stated earlier, given the limited time and scope, it is not possible for the external auditor to test entire class of transactions, account balances or disclosures made in the financial statement. Therefore, they depend on the company’s system of internal control. Internal auditor supervises internal control function and communicates their findings to the external auditors and helps them plan their audit procedure. Therefore, before accepting

internal auditors work, the auditor is required to critically evaluate the stated requirements. If internal auditors work can be relied upon, audit risk could be minimised and a quality audit can be performed.

4. External Party Confirmation [Based on SA–505]

Statutory auditors' responsibilities with respect to external confirmations are discussed in SA–505 (Revised) titled, '*External Confirmations*'. As external third party confirmations form important audit evidence, requirements of this standard should be followed by the statutory auditors. The auditor should maintain absolute control on the outside party confirmation requests with respect to (a) information to be established; (b) confirming parties; (c) plan of confirmation requests; and (d) process of confirmation and follow up of confirmation. If management refuse to allow the auditor to obtain confirmation from external parties, the auditor should try to find out clarification from the management on their refusal and assess the impact of such denial on risk of material misstatement. The auditor also looks for different process to gather pertinent and dependable information. If management has no basis for negative response or if the auditor is unable to apply any alternative procedure, the auditor should inform the matter to those charged with governance.

The auditor should verify reliability of responses to outside confirmations and apply other audit procedures if they are not dependable. The auditor should obtain appropriate evidences in case of non–response or oral responses. Written response is necessary for positive confirmation requests. If there is an omission to the previous condition, the auditor should investigate the possibilities of misstatement. The auditor should try to keep away from negative confirmations as a measure of persuasive audit evidence. The auditor should evaluate the adequacy and appropriateness of audit evidences collected through external confirmations.

Financial statements are prepared based on transactions entered with external parties. Therefore, integrity of the financial information of a company can be checked by comparing it with figures mentioned in books of external parties. Therefore, if auditor gets confirmation from an external party for a class of transaction or an account balance, integrity of the financial information is ensured and auditors can draw up a quality report. However, if any external party are associated with the management, the process of confirmation would not provide any fruitful result. Therefore, the auditors should evaluate quality of such external confirmation which ultimately determines quality of audit.

5. Using the work of an Auditor's Expert [Based on SA–620]

An external auditor can use the work of an auditors' expert to verify critical issues beyond the reach of the auditor. In order to gather sufficient and appropriate evidence through this route, the ICAI has issued SA–620 (Revised) titled '*Using the Work of an Auditor's Expert*'. The auditor is required to take help from an expert in some significant areas of auditing where auditor does not have required know–how. The auditor should change his nature, scope and timing of audit procedures based on (a) nature of the work to which the skill of auditor's expert relates; (b) risk of material misstatement where expertise of the auditor's expert is required; (c) importance of the work of auditor's expert; (d) auditors' information about work of auditor's expert; (e) coverage of the work of auditor's expert by the quality control policies of the firm. The auditor should evaluate the ability and independence of the auditor's expert. The auditor should have awareness on the fields of knowledge of the expert to determine nature and extent of their services.

The auditor should sign the accord with auditor's expert on the roles and liability of the later, communication between auditor and auditor's expert and secrecy of client's information. The auditor should assess the adequacy of auditor's expert work on the basis of (a) relevance and reasonableness of their findings; (b) reasonableness of the assumptions taken by them; (c) reliability of the data used by them. If auditor thinks that the work of auditor's expert is not sufficient, the auditor may ask them to take up further procedure, or auditor may themselves take up additional audit procedure. The auditor should not refer the work of an expert in his report unless it is obligatory as per applicable laws and regulations. Depending on the work of auditors' expert does not decrease responsibility of the auditor.

An auditor is not supposed to be an expert in all the fields. However, when an auditor is engaged to perform audit services he has to gather sufficient appropriate evidences on those issues in which he does not have any expertise. In those situations, the auditor needs to take help from an expert employed by the engagement team. Effective and reliable evidences can be obtained from the work of these experts, if auditors comply with provision of this standard.

6. Conclusions

Statutory audit cannot be conducted ignoring several forms of audit evidences. Without involvement of certain internal as well external parties, statutory auditors would not be able to complete an audit procedure with adequate quality. At the very beginning of the audit process, when auditors test the client company's internal control system, they depend upon the reports of internal auditors. However, before considering their report, the statutory auditors should satisfy themselves about the competence and independence of internal auditors. One of

the important means of collecting audit evidences is external confirmations. While such confirmations are taken from debtors, creditors and banks of the client company, their relationship with client should be evaluated before accepting their report. Finally, there ought to be certain areas where statutory auditors do not necessary expertise, such as valuation of assets or accounting estimates. Hence, in addition to management's expert, statutory auditor depends upon an auditor's expert appointed by the accounting firm. Their report substantiates management's assertion on the aforesaid issues. However, competence and independence of auditor's expert should also be checked by the auditors before relying upon their reports. The current paper enumerates all the important provisions of SA-610, SA-505 and SA-620 governing 'using the work of internal auditors', 'external confirmations' and 'using the work of an auditor's expert' keeping in view overall audit quality. It is observed that the standards are well arranged along with lucidly written and they facilitate quality audit process. However, a proper enforcement of these standards through Council of Chartered Accountants of India is absolutely important to reap their actual benefits.

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