

CAMBODIAN INTERNATIONAL STANDARD ON AUDITING 501
AUDIT EVIDENCE—SPECIFIC CONSIDERATIONS
FOR SELECTED ITEMS

(Effective for audits of financial statements for periods beginning on or after
December 15, 2009)

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<p>CAMBODIAN INTERNATIONAL STANDARD ON AUDITING (CISA) 501, <i>Audit Evidence—Specific Considerations for Selected Items</i>, should be read in conjunction with CISA 200, <i>Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Cambodian International Standards on Auditing</i>.</p>

Introduction

Scope of this CISA

1. This CAMBODIAN INTERNATIONAL STANDARD ON AUDITING (CISA) deals with specific considerations by the auditor in obtaining sufficient appropriate audit evidence in accordance with CISA 330,¹ CISA 500² and other relevant CISAs, with respect to certain aspects of inventory, litigation and claims involving the entity, and segment information in an audit of financial statements.

Effective Date

2. This CISA is effective for audits of financial statements for periods beginning on or after December 15, 2009.

Objective

3. The objective of the auditor is to obtain sufficient appropriate audit evidence regarding the:
 - (a) Existence and condition of inventory;
 - (b) Completeness of litigation and claims involving the entity; and
 - (c) Presentation and disclosure of segment information in accordance with the applicable financial reporting framework.

Requirements

Inventory

4. If inventory is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by:
 - (a) Attendance at physical inventory counting, unless impracticable, to: (Ref: Para. A1–A3)
 - (i) Evaluate management’s instructions and procedures for recording and controlling the results of the entity’s physical inventory counting; (Ref: Para. A4)
 - (ii) Observe the performance of management’s count procedures; (Ref: Para. A5)
 - (iii) Inspect the inventory; and (Ref: Para. A6)
 - (iv) Perform test counts; and (Ref: Para. A7–A8)
 - (b) Performing audit procedures over the entity’s final inventory records to determine whether they accurately reflect actual inventory count results.
5. If physical inventory counting is conducted at a date other than the date of the financial statements, the auditor shall, in addition to the procedures required by paragraph 4, perform audit

¹ CISA 330, *The Auditor’s Responses to Assessed Risks*

² CISA 500, *Audit Evidence*

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procedures to obtain audit evidence about whether changes in inventory between the count date and the date of the financial statements are properly recorded. (Ref: Para. A9–A11)

6. 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.
7. If attendance at physical inventory counting is impracticable, the auditor shall perform alternative audit procedures to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory. If it is not possible to do so, the auditor shall modify the opinion in the auditor’s report in accordance with CISA 705 (Revised).³ (Ref: Para. A12–A 14)
8. If inventory under the custody and control of a third party is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence 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. (Ref: Para. A15)
 - (b) Perform inspection or other audit procedures appropriate in the circumstances. (Ref: Para. A16)

Litigation and Claims

9. 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, including: (Ref: Para. A17–A19)
 - (a) Inquiry of management and, where applicable, others within the entity, including in-house legal counsel;
 - (b) Reviewing minutes of meetings of those charged with governance and correspondence between the entity and its external legal counsel; and
 - (c) Reviewing legal expense accounts. (Ref: Para. A20)
10. If the auditor assesses a risk of material misstatement regarding litigation or claims that have been identified, or when audit procedures performed indicate that other material litigation or claims may exist, the auditor shall, in addition to the procedures required by other CISAs, 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. If law, regulation or the respective legal professional body prohibits the entity’s external legal counsel from communicating directly with the auditor, the auditor shall perform alternative audit procedures. (Ref: Para. A21–A 25)
11. If:
 - (a) management refuses to give the auditor permission to communicate or meet with the entity’s external legal counsel, or the entity’s external legal counsel refuses to respond appropriately to the letter of inquiry, or is prohibited from responding; and

³ CISA 705 (Revised), *Modifications to the Opinion in the Independent Auditor’s Report*

- (b) the auditor is unable to obtain sufficient appropriate audit evidence by performing alternative audit procedures,

the auditor shall modify the opinion in the auditor’s report in accordance with CISA 705 (Revised).

Written Representations

12. The auditor shall request management and, where appropriate, those charged with governance to provide written representations that all known actual or possible litigation and claims whose effects should be considered when preparing the financial statements have been disclosed to the auditor and accounted for and disclosed in accordance with the applicable financial reporting framework.

Segment Information

13. The auditor shall obtain sufficient appropriate audit evidence regarding the presentation and disclosure of segment information in accordance with the applicable financial reporting framework by: (Ref: Para. A26)
- (a) Obtaining an understanding of the methods used by management in determining segment information, and: (Ref: Para. A27)
- (i) Evaluating whether such methods are likely to result in disclosure in accordance with the applicable financial reporting framework; and
- (ii) Where appropriate, testing the application of such methods; and
- (b) Performing analytical procedures or other audit procedures appropriate in the circumstances.

Application and Other Explanatory Material

Inventory

Attendance at Physical Inventory Counting (Ref: Para. 4(a))

- A1. Management ordinarily establishes procedures under which inventory is physically counted at least once a year to serve as a basis for the preparation of the financial statements and, if applicable, to ascertain the reliability of the entity’s perpetual inventory system.
- A2. Attendance at physical inventory counting involves:
- Inspecting the inventory to ascertain its existence and evaluate its condition, and performing test counts;
 - Observing compliance with management’s instructions and the performance of procedures for recording and controlling the results of the physical inventory count; and

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- Obtaining audit evidence as to the reliability of management’s count procedures.

These procedures may serve as test of controls or substantive procedures depending on the auditor’s risk assessment, planned approach and the specific procedures carried out.

A3. Matters relevant in planning attendance at physical inventory counting (or in designing and performing audit procedures pursuant to paragraphs 4–8 of this CISA) include, for example:

- The risks of material misstatement related to inventory.
- The nature of the internal control related to inventory.
- Whether adequate procedures are expected to be established and proper instructions issued for physical inventory counting.
- The timing of physical inventory counting.
- Whether the entity maintains a perpetual inventory system.
- The locations at which inventory is held, including the materiality of the inventory and the risks of material misstatement at different locations, in deciding at which locations attendance is appropriate. CISA 600⁴ deals with the involvement of other auditors and accordingly may be relevant if such involvement is with regard to attendance of physical inventory counting at a remote location.
- Whether the assistance of an auditor’s expert is needed. CISA 620⁵ deals with the use of an auditor’s expert to assist the auditor to obtain sufficient appropriate audit evidence.

Evaluate Management’s Instructions and Procedures (Ref: Para. 4(a)(i))

A4. Matters relevant in evaluating management’s instructions and procedures for recording and controlling the physical inventory counting include whether they address, for example:

- The application of appropriate control activities, for example, collection of used physical inventory count records, accounting for unused physical inventory count records, and count and re-count procedures.
- The accurate identification of the stage of completion of work in progress, of slow moving, obsolete or damaged items and of inventory owned by a third party, for example, on consignment.
- The procedures used to estimate physical quantities, where applicable, such as may be needed in estimating the physical quantity of a coal pile.
- Control over the movement of inventory between areas and the shipping and receipt of inventory before and after the cutoff date.

Observe the Performance of Management’s Count Procedures (Ref: Para. 4(a)(ii))

A5. Observing the performance of management’s count procedures, for example, those relating to control over the movement of inventory before, during and after the count, assists the auditor in

⁴ CISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

⁵ CISA 620, *Using the Work of an Auditor’s Expert*

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obtaining audit evidence that management’s instructions and count procedures are adequately designed and implemented. In addition, the auditor may obtain copies of cutoff information, such as details of the movement of inventory, to assist the auditor in performing audit procedures over the accounting for such movements at a later date.

Inspect the Inventory (Ref: Para. 4(a)(iii))

- A6. Inspecting inventory when attending physical inventory counting assists the auditor in ascertaining the existence of the inventory (though not necessarily its ownership), and in identifying, for example, obsolete, damaged or aging inventory.

Perform Test Counts (Ref: Para. 4(a)(iv))

- A7. Performing test counts, for example, by tracing items selected from management’s count records to the physical inventory and tracing items selected from the physical inventory to management’s count records, provides audit evidence about the completeness and the accuracy of those records.
- A8. In addition to recording the auditor’s test counts, obtaining copies of management’s completed physical inventory count records assists the auditor in performing subsequent audit procedures to determine whether the entity’s final inventory records accurately reflect actual inventory count results.

Physical Inventory Counting Conducted Other than at the Date of the Financial Statements (Ref: Para. 5)

- A9. For practical reasons, the physical inventory counting may be conducted at a date, or dates, other than the date of the financial statements. This may be done irrespective of whether management determines inventory quantities by an annual physical inventory counting or maintains a perpetual inventory system. In either case, the effectiveness of the design, implementation and maintenance of controls over changes in inventory determines whether the conduct of physical inventory counting at a date, or dates, other than the date of the financial statements is appropriate for audit purposes. CISA 330 establishes requirements and provides guidance on substantive procedures performed at an interim date.⁶
- A10. Where a perpetual inventory system is maintained, management may perform physical counts or other tests to ascertain the reliability of inventory quantity information included in the entity’s perpetual inventory records. In some cases, management or the auditor may identify differences between the perpetual inventory records and actual physical inventory quantities on hand; this may indicate that the controls over changes in inventory are not operating effectively.
- A11. Relevant matters for consideration when designing audit procedures to obtain audit evidence about whether changes in inventory amounts between the count date, or dates, and the final inventory records are properly recorded include:
- Whether the perpetual inventory records are properly adjusted.
 - Reliability of the entity’s perpetual inventory records.
 - Reasons for significant differences between the information obtained during the physical count and the perpetual inventory records.

Attendance at Physical Inventory Counting Is Impracticable (Ref: Para. 7)

⁶ CISA 330, paragraphs 22–23

- A12. 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 CISA 200,⁷ 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.
- A13. In some cases 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.
- A14. In other cases, however, 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, CISA 705 (Revised) requires the auditor to modify the opinion in the auditor's report as a result of the scope limitation.⁸

Inventory under the Custody and Control of a Third Party

Confirmation (Ref: Para. 8(a))

- A15. CISA 505⁹ establishes requirements and provides guidance for performing external confirmation procedures.

Other Audit Procedures (Ref: Para. 8(b))

- A16. Depending on the circumstances, for example, 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, for example, warehouse receipts.
- Requesting confirmation from other parties when inventory has been pledged as collateral.

Litigation and Claims

Completeness of Litigations and Claims (Ref: Para. 9)

⁷ CISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*, paragraph A50

⁸ CISA 705 (Revised), paragraph 13

⁹ CISA 505, *External Confirmations*

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- A17. 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.
- A18. In addition to the procedures identified in paragraph 9, other relevant procedures include, for example, using information obtained through risk assessment procedures carried out as part of obtaining an understanding of the entity and its environment to assist the auditor to become aware of litigation and claims involving the entity.
- A19. Audit evidence obtained for purposes of identifying litigation and claims that may give rise to a risk of material misstatement also may provide audit evidence regarding other relevant considerations, such as valuation or measurement, regarding litigation and claims. CISA 540¹⁰ establishes requirements and provides guidance relevant to the auditor’s consideration of litigation and claims requiring accounting estimates or related disclosures in the financial statements.

Reviewing Legal Expense Accounts (Ref: Para. 9(c))

- A20. Depending on the circumstances, the auditor may judge it appropriate to examine related source documents, such as invoices for legal expenses, as part of the auditor’s review of legal expense accounts.

Communication with the Entity’s External Legal Counsel (Ref: Para. 10–11)

- A21. Direct communication with the entity’s external legal counsel assists the auditor in obtaining sufficient appropriate audit evidence as to whether potentially material litigation and claims are known and management’s estimates of the financial implications, including costs, are reasonable.
- A22. In some cases, the auditor may seek direct communication with the entity’s external legal counsel through a letter of general inquiry. For this purpose, a letter of general inquiry requests the entity’s external legal counsel to inform the auditor of any litigation and claims that the counsel is aware of, together with an assessment of the outcome of the litigation and claims, and an estimate of the financial implications, including costs involved.
- A23. If it is considered unlikely that the entity’s external legal counsel will respond appropriately to a letter of general inquiry, for example, if the professional body to which the external legal counsel belongs prohibits response to such a letter, the auditor may seek direct communication through a letter of specific inquiry. For this purpose, a letter of specific inquiry includes:
- (a) A list of litigation and claims;
 - (b) Where available, management’s assessment of the outcome of each of the identified litigation and claims and its estimate of the financial implications, including costs involved; and
 - (c) 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 by the entity’s external legal counsel to be incomplete or incorrect.
- A24. In certain circumstances, the auditor also may judge it necessary to meet with the entity’s external legal counsel to discuss the likely outcome of the litigation or claims. This may be the case, for example, where:
- The auditor determines that the matter is a significant risk.

¹⁰ CISA 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*

- The matter is complex.
- There is disagreement between management and the entity’s external legal counsel.

Ordinarily, such meetings require management’s permission and are held with a representative of management in attendance.

A25. In accordance with CISA 700 (Revised),¹¹ the auditor is required to date the auditor’s report no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor’s opinion on the financial statements. Audit evidence about the status of litigation and claims up to the date of the auditor’s report may be obtained by inquiry of management, including in-house legal counsel, responsible for dealing with the relevant matters. In some instances, the auditor may need to obtain updated information from the entity’s external legal counsel.

Segment Information (Ref: Para. 13)

A26. Depending on the applicable financial reporting framework, the entity may be required or permitted to disclose segment information in the financial statements. The auditor’s responsibility regarding the presentation and disclosure of segment information is in relation to the financial statements taken as a whole. Accordingly, the auditor is not required to perform audit procedures that would be necessary to express an opinion on the segment information presented on a standalone basis.

Understanding of the Methods Used by Management (Ref: Para. 13(a))

A27. Depending on the circumstances, 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:

- Sales, transfers and charges between segments, and elimination of intersegment amounts.
- Comparisons with budgets and other expected results, for example, operating profits as a percentage of sales.
- The allocation of assets and costs among segments.
- Consistency with prior periods, and the adequacy of the disclosures with respect to inconsistencies.

¹¹ CISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*, paragraph 49