SINGAPORE STANDARD ON AUDITING

SSA 501

Audit Evidence – Additional Considerations for Specific Items

The “Addendum to SSA 8” was issued by the Council of the Institute of Certified Public Accountants of Singapore in October 1995.

Auditors are required to comply with the auditing standards contained in this SSA in respect of audits of financial statements for periods beginning on or after 1 January 1996.

SSA 501 supersedes “Addendum to SSA 8” of the same title in June 2004. No substantive changes have been made to the original approved text and all cross references have been updated, as appropriate.

This revised SSA 501 supersedes the SSA of the same title in June 2005.

The Audit Risk Standards, comprising SSA 315 “Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement”, SSA 330 “The Auditor’s Procedures in Response to Assessed Risks” and SSA 500 (Revised) “Audit Evidence” gave rise to conforming amendments in this SSA. These amendments are effective for audits of financial statements for periods beginning on or after 15 December 2004.

Singapore Standards on Auditing (SSAs) are to be applied in the audit of financial statements. SSAs are also to be applied, adapted as necessary, to the audit of other information and to related services.

SSAs contain the basic principles and essential procedures (identified in bold type black lettering) together with related guidance in the form of explanatory and other material. The basic principles and essential procedures are to be interpreted in the context of the explanatory and other material that provide guidance for their application.

To understand and apply the basic principles and essential procedures together with the related guidance, it is necessary to consider the whole text of the SSA including explanatory and other material contained in the SSA not just that text which is black lettered.

In exceptional circumstances, an auditor may judge it necessary to depart from an SSA in order to more effectively achieve the objective of an audit. When such a situation arises, the auditor should be prepared to justify the departure.

SSAs need only be applied to material matters.

The Public Sector Perspective (PSP) issued is set out at the end of an SSA. Where no PSP is added, the SSA is applicable in all material respects to the public sector.

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Introduction

1. The purpose of this Singapore Standard on Auditing (SSA) is to establish standards and provide guidance additional to that contained in SSA "Audit Evidence," with respect to certain specific financial statement account balances and other disclosures.

2. Application of the standards and guidance provided in this SSA will assist the auditor in obtaining audit evidence with respect to the specific financial statement account balances and other disclosures addressed.

3. This SSA comprises the following Parts:

   Part A: Attendance at Physical Inventory Counting

   Part B: Superceded by SSA 505 – Part B has been deleted

   Part C: Inquiry Regarding Litigation and Claims

   Part D: Valuation and Disclosure of Long-term Investments

   Part E: Segment Information

PART A: Attendance at Physical Inventory Counting

4. 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 or to ascertain the reliability of the perpetual inventory system.

5. When inventory is material to the financial statements, the auditor should obtain sufficient appropriate audit evidence regarding its existence and condition by attendance at physical inventory counting unless impracticable. The auditor's attendance serves as a test of controls or substantive procedure over inventory depending on the auditor's risk assessment and planned approach. Such attendance enables the auditor to inspect the inventory, to observe compliance with the operation of management's procedures for recording and controlling the results of the count and to provide audit evidence as to the reliability of management's procedures.

6. **If unable to attend the physical inventory count on the date planned due to unforeseen circumstances, the auditor should take or observe some physical counts on an alternative date and, when necessary, perform audit procedures on intervening transactions.**

7. **Where attendance is impracticable, due to factors such as of the nature and location of the inventory, the auditor should consider whether alternative procedures provide sufficient appropriate audit evidence of existence and condition to conclude that the auditor need not make reference to a scope limitation.** For example, documentation of the subsequent sale of specific inventory items acquired or purchased prior to the physical inventory count may provide sufficient appropriate audit evidence.

8. In planning attendance at the physical inventory count or the alternative procedures, the auditor considers the following:
   - 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 the count.
   - The locations at which inventory is held.
   - Whether an expert's assistance is needed.

9. When the quantities are to be determined by a physical inventory count and the auditor attends such a count, or when the entity operates a perpetual system and the auditor attends a count one or more times during the year, the auditor would ordinarily observe count procedures and perform test counts.

10. If the entity uses procedures to estimate the physical quantity, such as estimating a coal pile, the auditor would need to be satisfied regarding the reasonableness of those procedures.

11. When the inventory is situated in several locations, the auditor would consider at which locations attendance is appropriate, taking into account the materiality of the inventory and the risk of material misstatement at different locations.

12. The auditor would review management's instructions regarding:
   (a) the application of control activities, for example, collection of used stocksheets, accounting for unused stocksheets and count and re-count procedures;
   (b) 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; and
   (c) whether appropriate arrangements are made regarding the movement of inventory between areas and the shipping and receipt of inventory before and after the cutoff date.

13. To obtain audit evidence that management's control activities are adequately implemented, the auditor would observe employees' procedures and perform test counts. When performing test counts the auditor performs procedures over both the completeness and the accuracy of the count records by tracing items selected from those records to the physical inventory and items selected from the physical inventory to the count records. The auditor considers the extent to which copies of such count records need to be retained for subsequent audit procedures and comparison.

14. The auditor also considers cutoff procedures including details of the movement of inventory just prior to, during and after the count so that the accounting for such movements can be checked at a later date.

15. For practical reasons, the physical inventory count may be conducted at a date other than period end. This will ordinarily be adequate for audit purposes only when the entity has designed and implemented controls over changes in inventory. The auditor would determine whether, through the performance of appropriate audit procedures, changes in inventory between the count date and period end are correctly recorded.

16. When the entity operates a perpetual inventory system which is used to determine the period end balance, the auditor would evaluate whether, through the performance of additional procedures, the reasons for any significant differences between the physical count and the perpetual inventory records are understood and the records are properly adjusted.

17. The auditor performs audit procedures over the final inventory listing to determine whether it accurately reflects actual inventory counts.

18. When inventory is under the custody and control of a third party, the auditor would ordinarily obtain direct confirmation from the third party as to the quantities and condition of inventory held on behalf of the entity. Depending on materiality of this inventory the auditor would also consider:

- The integrity and independence of the third party.
- Observing, or arranging for another auditor to observe, the physical inventory count.
- Obtaining another auditor's report on the adequacy of the third party's internal control for ensuring that inventory is correctly counted and adequately safeguarded.
- Inspecting documentation regarding inventory held by third parties, for example, warehouse receipts, or obtaining confirmation from other parties when such inventory has been pledged as collateral.

PART B: Superceded by SSA 505 – Part B (Paragraphs 19-30) Has Been Deleted.

PART C: Procedures Regarding Litigation and Claims

31. Litigation and claims involving an entity may have a material effect on the financial statements and thus may be required to be disclosed and/or provided for in the financial statements.

32. **The auditor should carry out audit procedures in order to become aware of any litigation and claims involving the entity which may result in a material misstatement of the financial statements.** Such procedures would include:

- Make appropriate inquiries of management including obtaining representations.
- Review minutes of those charged with governance and correspondence with the entity's legal counsel.
- Examine legal expense accounts.
- Use any information obtained regarding the entity's business including information obtained from discussions with any in-house legal department.

33. When **the auditor assesses a risk of material misstatement regarding** litigation or claims that have been identified or when the auditor believes they may exist, the auditor should seek direct communication with the entity's legal counsel. Such communication will assist 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 reliable. When the auditor determines that the risk of material misstatement is a significant risk, the auditor evaluates the design of the entity's related controls and determines whether they have been implemented. Paragraphs 108-114 of ISA 315, "Understanding the Entity and Assessing the Risks of Material Misstatement" provides further guidance on the determination of significant risks.

34. **The letter, which should be prepared by management and sent by the auditor, should request the entity's legal counsel to communicate directly with the auditor.** When it is considered unlikely that the entity's legal counsel will respond to a general inquiry, the letter would ordinarily specify:

- A list of litigation and claims.
- Management's assessment of the outcome of the litigation or claim and its estimate of the financial implications, including costs involved.
- A request that the entity's 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 legal counsel to be incomplete or incorrect.

35. The auditor considers the status of legal matters up to the date of the audit report. In some instances, the auditor may need to obtain updated information from entity's legal counsel.

36. In certain circumstances, for example, where the auditor determines that the matter is a significant risk, the matter is complex or there is disagreement between management and the entity's legal counsel, it may be necessary for the auditor to meet with the entity's legal counsel to discuss the likely outcome of litigation and claims. Such meetings would take place with management's permission and, preferably, with a representative of management in attendance.

37. **If management refuses to give the auditor permission to communicate with the entity's legal counsel, this would be a scope limitation and should ordinarily lead to a qualified opinion or a disclaimer of opinion.** Where the entity's legal counsel refuses to respond in an appropriate manner and the auditor is unable to obtain sufficient appropriate audit evidence by applying alternative audit procedures, the auditor would consider whether there is a scope limitation which may lead to a qualified opinion or a disclaimer of opinion.

PART D: Valuation and Disclosure of Long-term investments

38. **When long-term investments are material to the financial statements, the auditor should obtain sufficient appropriate audit evidence regarding their valuation and disclosure.**

39. Audit procedures regarding long-term investments ordinarily include obtaining audit evidence as to whether the entity has the ability to continue to hold the investments on a long term basis and discussing with management whether the entity will continue to hold the investments as long-term investments and obtaining written representations to that effect.

40. Other audit procedures would ordinarily considering related financial statements and other information, such as market quotations, which provide an indication of value and comparing such values to the carrying amount of the investments up to the date of the auditor's report.

41. If such values do not exceed the carrying amounts, the auditor would consider whether a write-down is required. If there is an uncertainty as to whether the carrying amount will be recovered, the auditor would consider whether appropriate adjustments and/or disclosures have been made.

PART E: Segment Information

42. **When segment information is material to the financial statements, the auditor should obtain sufficient appropriate audit evidence regarding its presentation and disclosure in accordance with the applicable financial reporting framework.**

43. The auditor considers segment information in relation to the financial statements taken as a whole, and is not ordinarily required to apply audit procedures that would be necessary to express an opinion on the segment information standing alone. However, the concept of materiality encompasses both quantitative and qualitative factors and the auditor's procedures recognise this.

44. Audit procedures regarding segment information ordinarily consist of analytical procedures and other audit procedures as appropriate in the circumstances.

45. The auditor would discuss with management the methods used in determining segment information, and consider whether such methods are likely to result in disclosure in accordance with the applicable financial reporting framework and perform audit procedures over the application of such methods. The auditor would consider sales, transfers and charges between segments, elimination of inter-segment amounts, comparisons with budgets and other expected results, for example, operating profits as a percentage of sales, and the allocation of assets and costs among segments including consistency with prior periods and the adequacy of the disclosures with respect to inconsistencies.