

# SA 500 (AAS 5)

## AUDIT EVIDENCE

*(Effective for all audits relating to  
accounting periods beginning on or after January 1, 1989)*

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Standard on Auditing (SA) 500\*, “Audit Evidence” should be read in the context of the “Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services”<sup>1</sup>, which sets out the authority of SAs.

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\* Issued in May, 1988.

<sup>1</sup> Published in the July 2007 issue of the Journal.

## **Introduction**

1. Standard on Auditing (SA) 200, "Basic Principles Governing an Audit", states (paragraphs 15-17):

"The auditor should obtain sufficient appropriate audit evidence through the performance of compliance and substantive procedures to enable him to draw reasonable conclusions therefrom on which to base his opinion on the financial information.

Compliance procedures are tests designed to obtain reasonable assurance that those internal controls on which audit reliance is to be placed are in effect.

Substantive procedures are designed to obtain evidence as to the completeness, accuracy and validity of the data produced by the accounting system.

They are of two types:

- (i) tests of details of transactions and balances;
- (ii) analysis of significant ratios and trends, including the resulting enquiry of unusual fluctuations and items."

The purpose of this Standard is to amplify the basic principle outlined above. In this Standard, the term "financial information" encompasses financial statements.

## **Sufficient Appropriate Audit Evidence**

2. Sufficiency and appropriateness are interrelated and apply to evidence obtained from both compliance and substantive procedures. Sufficiency refers to the quantum of audit evidence obtained; appropriateness relates to its relevance and reliability. Normally, the auditor finds it necessary to rely on evidence that is persuasive rather than conclusive. He may often seek evidence from different sources or of different nature to support the same assertion (see paragraphs 5 and 6).

3. The auditor should evaluate whether he has obtained sufficient appropriate audit evidence before he draws his conclusions therefrom. The audit evidence should, in total, enable the auditor to form an opinion on the financial information. In forming such an opinion, the auditor may obtain audit evidence on a selective basis by way of judgmental or statistical sampling

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procedures. For example, the auditor may select only certain accounts receivable for confirmation purposes, or make a selection of personnel records for the purpose of testing that changes in payroll rates have been properly authorised.

4. The auditor's judgement as to what is sufficient appropriate audit evidence is influenced by such factors as:

- (a) The degree of risk of misstatement which may be affected by factors such as:
  - (i) the nature of the item;
  - (ii) the adequacy of internal control;
  - (iii) the nature or size of the business carried on by the entity;
  - (iv) situations which may exert an unusual influence on management;
  - (v) the financial position of the entity.
- (b) The materiality of the item.
- (c) The experience gained during previous audits.
- (d) The results of auditing procedures, including fraud or error which may have been found.
- (e) The type of information available.
- (f) The trend indicated by accounting ratios and analysis.

5. Obtaining audit evidence from compliance procedures is intended to reasonably assure the auditor in respect of the following assertions:

- |               |                                                                                         |
|---------------|-----------------------------------------------------------------------------------------|
| Existence     | – that the internal control exists.                                                     |
| Effectiveness | – that the internal control is operating effectively.                                   |
| Continuity    | – that the internal control has so operated throughout the period of intended reliance. |

6. Obtaining audit evidence from substantive procedures is intended to reasonably assure the auditor in respect of the following assertions:

- |            |                                                          |
|------------|----------------------------------------------------------|
| Existence  | – that an asset or a liability exists at a given date.   |
| Rights and | – that an asset is a right of the entity and a liability |

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|                             |                                                                                                                                                                |
|-----------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Obligations                 | is an obligation of the entity at a given date.                                                                                                                |
| Occurrence                  | – that a transaction or event took place which pertains to the entity during the relevant period.                                                              |
| Completeness                | – that there are no unrecorded assets, liabilities or transactions.                                                                                            |
| Valuation                   | – that an asset or liability is recorded at an appropriate carrying value.                                                                                     |
| Measurement                 | – that a transaction is recorded in the proper amount and revenue or expense is allocated to the proper period.                                                |
| Presentation and Disclosure | – an item is disclosed, classified, and described in accordance with recognised accounting policies and practices and relevant statutory requirements, if any. |

The extent and nature of substantive procedures to be performed will vary with respect to each of the above assertions.

Obtaining evidence relevant to one of the above assertions will not compensate for failure to do so with respect to another matter concerning the same item, e.g., existence of inventory and its valuation.

7. The reliability of audit evidence depends on its source - internal or external, and on its nature - visual, documentary or oral. While the reliability of audit evidence is dependent on the circumstances under which it is obtained, the following generalisations may be useful in assessing the reliability of audit evidence:

- ◆ External evidence (e.g. confirmation received from a third party) is usually more reliable than internal evidence.
- ◆ Internal evidence is more reliable when related internal control is satisfactory.
- ◆ Evidence in the form of documents and written representations is usually more reliable than oral representations.
- ◆ Evidence obtained by the auditor himself is more reliable than that obtained through the entity.

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8. The auditor may gain increased assurance when audit evidence obtained from different sources or of different nature is consistent. In these circumstances, he may obtain a cumulative degree of assurance higher than that which he attaches to the individual items of evidence by themselves. Conversely, when audit evidence obtained from one source is inconsistent with that obtained from another, further procedures may have to be performed to resolve the inconsistency.

9. The auditor should be thorough in his efforts to obtain evidence and be objective in its evaluation.

10. When the auditor is in reasonable doubt as to any assertion of material significance, he would attempt to obtain sufficient appropriate evidence to remove such doubt. If he is unable to obtain sufficient appropriate evidence he should not express an unqualified opinion.

### **Obtaining Audit Evidence**

11. The auditor obtains evidence in performing compliance and substantive procedures by one or more of the following methods:

- ◆ Inspection
- ◆ Observation
- ◆ Inquiry and confirmation
- ◆ Computation
- ◆ Analytical review

The timing of such procedures will be dependent, in part, upon the periods of time during which the audit evidence sought is available.

#### **Inspection**

12. Inspection consists of examining records, documents, or tangible assets. Inspection of records and documents provides evidence of varying degrees of reliability, depending on their nature and source and the effectiveness of internal controls over their processing. Four major categories of documentary evidence, which provide different degrees of reliability to the auditor, are:

- ◆ documentary evidence originating from and held by third parties;
- ◆ documentary evidence originating from third parties and held by the entity;

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- ◆ documentary evidence originating from the entity and held by third parties; and
  - ◆ documentary evidence originating from and held by the entity.
- Inspection of tangible assets is one of the methods to obtain reliable evidence with respect to their existence but not necessarily as to their ownership or value.

### **Observation**

13. Observation consists of witnessing a process or procedure being performed by others. For example, the auditor may observe the counting of inventories by client personnel or the performance of internal control procedures that leave no audit trail.

### **Inquiry and Confirmation**

14. Inquiry consists of seeking appropriate information from knowledgeable persons inside or outside the entity. Inquiries may range from formal written inquiries addressed to third parties to informal oral inquiries addressed to persons inside the entity. Responses to inquiries may provide the auditor with information which he did not previously possess or may provide him with corroborative evidence.

15. Confirmation consists of the response to an inquiry to corroborate information contained in the accounting records. For example, the auditor requests confirmation of receivables by direct communication with debtors.

### **Computation**

16. Computation consists of checking the arithmetical accuracy of source documents and accounting records or performing independent calculations.

### **Analytical Review**

17. Analytical review consists of studying significant ratios and trends and investigating unusual fluctuations and items.

### **Effective Date**

18. This Standard on Auditing becomes operative for all audits relating to accounting periods beginning on or after January 1, 1989.