

SA-500 AUDIT EVIDENCE

This is a 11 Paragraph standard

Scope of this SA

Para.1. This Standard on Auditing (SA) explains what constitutes audit evidence in an audit of financial statements, and deals with the auditor's responsibility to design and perform audit procedures to obtain sufficient appropriate audit evidence(SAAE) to be able to draw reasonable conclusions on which to base the auditor's opinion.

Para.2. This SA is applicable to all the audit evidence obtained during the course of the audit.

Other SAs deal with specific aspects of the audit (for example, SA 315), the audit evidence to be obtained in relation to a particular topic (for example, SA 570), specific procedures to obtain audit evidence (for example, SA 520), and the evaluation of whether SAAE has been obtained (SA 200 and SA 330).

Effective Date

Para.3. This SA is effective for audits of financial statements for periods beginning $\geq$ 01.04.2009.

Objective

Para.4. The objective of the auditor is to design and perform audit procedures in such a way as to enable the auditor to obtain SAAE to be able to draw reasonable conclusions on which to base the auditor's opinion.

Definitions

Para.5. For purposes of the SAs, the following terms have the meanings attributed below:

(a) Accounting records – The records of

initial accounting entries and supporting records, such as checks and records of electronic fund transfers;

invoices;

contracts;

the general and subsidiary ledgers,

journal entries and other adjustments to the financial statements that are not reflected in journal entries; and

records such as work sheets and spreadsheets supporting cost allocations, computations, reconciliations and disclosures.

(b) Appropriateness (of audit evidence) – The measure of the quality of audit evidence; that is, its relevance and its reliability in providing support for the conclusions on which the auditor's opinion is based.

(c) Audit evidence – 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.

(d) Management's expert – An individual or organization possessing expertise in a field other than accounting or auditing, whose work in that field is used by the entity to assist the entity in preparing the financial statements.

(e) Sufficiency (of audit evidence) – The measure of the quantity of audit evidence. The quantity of the audit evidence needed is affected by the auditor's assessment of the risks of material misstatement and also by the quality of such audit evidence.

Requirements

Sufficient Appropriate Audit Evidence(SAAE)

Para.6. The auditor shall design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining SAAE.

Audit evidence comprises both information that supports and corroborates management's assertions, and any information that contradicts such assertions.

Audit procedures to obtain audit evidence can include inspection, observation, confirmation, recalculation, reperformance and analytical procedures, often in some combination, in addition to inquiry.

Audit Procedures for Obtaining Audit Evidence

As required by, and explained further in, SA 315 and SA 330, audit evidence to draw reasonable conclusions on which to base the auditor's opinion is obtained by performing:

- (a) Risk assessment procedures; and
- (b) Further audit procedures, which comprise:
 - (i) Tests of controls, when required by the SAs or when the auditor has chosen to do so; and
 - (ii) Substantive procedures, including tests of details and substantive analytical procedures.

Inspection

Inspection involves examining records or documents, whether internal or external, in paper form, electronic form, or other media, or a physical examination of an asset.

Inspection of records and documents provides audit evidence of varying degrees of reliability, depending on their nature and source and, in the case of internal records and documents, on the effectiveness of the controls over their production.

Some documents represent direct audit evidence of the existence of an asset.

Inspection of tangible assets may provide reliable audit evidence with respect to their existence, but not necessarily about the entity's rights and obligations or the valuation of the assets. Inspection of individual inventory items may accompany the observation of inventory counting.

Observation

Observation consists of looking at a process or procedure being performed by others, for example, the auditor's observation of inventory counting by the entity's personnel, or of the performance of control activities.

External Confirmation

An external confirmation represents audit evidence obtained by the auditor as a direct written response to the auditor from a third party (the confirming party), in paper form, or by electronic or other medium.

External confirmation procedures frequently are relevant when addressing assertions associated with certain account balances and their elements. However, external confirmations need not be restricted to account balances only.

Recalculation

Recalculation consists of checking the mathematical accuracy of documents or records. Recalculation may be performed manually or electronically

Reperformance

Reperformance involves the auditor's independent execution of procedures or controls that were originally performed as part of the entity's internal control.

Analytical Procedures

Analytical procedures consist of evaluations of financial information made by a study of plausible relationships among both financial and non-financial data. Analytical procedures also encompass the investigation of identified fluctuations

and relationships that are inconsistent with other relevant information or deviate significantly from predicted amounts.

Inquiry

Inquiry consists of seeking information of knowledgeable persons, both financial and non- financial, within the entity or outside the entity. Inquiry is used extensively throughout the audit in addition to other audit procedures.

In respect of some matters, the auditor may consider it necessary to obtain written representations from management and, where appropriate, those charged with governance to confirm responses to oral inquiries.

Information to Be Used as Audit Evidence

Para.7. When designing, and performing audit procedures, the auditor shall consider the **relevance and reliability** of the information to be used as audit evidence.

Relevance

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.

For example, if the purpose of an audit procedure is to test for overstatement in the existence or valuation of accounts payable, testing the recorded accounts payable may be a relevant audit procedure.

On the other hand, when testing for understatement in the existence or valuation of accounts payable, testing the recorded accounts payable would not be relevant, but testing such information as subsequent disbursements, unpaid invoices, suppliers' statements, and unmatched receiving reports may be relevant.

Tests of controls are designed to evaluate the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements at the assertion level.

Substantive procedures are designed to detect material misstatements at the assertion level.

Reliability

The 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.

For example, information obtained from an independent external source may not be reliable if the source is not knowledgeable, or a management's expert may lack objectivity.

While recognizing that exceptions may exist, the following generalizations about the reliability of audit evidence may be useful:

- The reliability of audit evidence is increased when it is obtained from independent sources outside the entity.
- The reliability of audit evidence that is generated internally is increased when the related controls, including those over its preparation and maintenance, imposed by the entity are effective.
- Audit evidence obtained directly by the auditor (for example, observation of the application of a control) is more reliable than audit evidence obtained indirectly or by inference (for example, inquiry about the application of a control).
- Audit evidence in documentary form, whether paper, electronic, or other medium, is more reliable than evidence obtained orally
- Audit evidence provided by original documents is more reliable than audit evidence provided by photocopies or facsimiles, or documents that have been filmed, digitised or otherwise transformed into electronic form, the reliability of which may depend on the controls over their preparation and maintenance.

Para.8. 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.

Reliability of Information Produced by a Management's Expert

The preparation of an entity's financial statements may require expertise in a field other than accounting or auditing, such as actuarial calculations, valuations, or engineering data.

The entity may employ or engage experts in these fields to obtain the needed expertise to prepare the financial statements.

Failure to do so when such expertise is necessary increases the risks of material misstatement.

When information to be used as audit evidence has been prepared using the work of a management's expert, the requirement in paragraph 8 of this SA applies.

The nature, timing and extent of audit procedures in relation to the requirement in paragraph 8 of this SA, may be affected by such matters as:

- The nature and complexity of the matter to which the management's expert relates.
- The risks of material misstatement in the matter.
- The availability of alternative sources of audit evidence.
- The nature, scope and objectives of the management's expert's work.
- Whether the management's expert is employed by the entity, or is a party engaged by it to provide relevant services.
- The extent to which management can exercise control or influence over the work of the management's expert.
- Whether the management's expert is subject to technical performance standards or other professional or industry requirements.
- The nature and extent of any controls within the entity over the management's expert's work.
- The auditor's knowledge and experience of the management's expert's field of expertise.
- The auditor's previous experience of the work of that expert.

Competence, Capabilities and Objectivity of a Management's Expert

-Competence relates to the nature and level of expertise of the management's expert.

-Capability relates to the ability of the management's expert to exercise that competence in the circumstances.

-Objectivity relates to the possible effects that bias, conflict of interest or the influence of others may have on the professional or business judgment of the management's expert.

Information regarding the competence, capabilities and objectivity of a management's expert may come 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, membership of a professional body or industry association, license to practice, or other forms of external recognition.
- Published papers or books written by that expert.
- An auditor's expert, if any, who assists the auditor in obtaining SAAE with respect to information produced by the management's expert.

Obtaining an Understanding of the Work of the Management's Expert

Aspects of the management's expert's field relevant to the auditor's understanding may include:

- Whether that expert's field has areas of specialty within it that are relevant to the audit.
- Whether any professional or other standards, and regulatory or legal requirements apply.
- 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 nature of internal and external data or information the auditor's expert uses.

Evaluating the Appropriateness of the Management's Expert's Work

Considerations when evaluating the appropriateness of the management's expert's work as audit evidence for the relevant assertion may include:

- 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;
- If that expert's work involves use of significant assumptions and methods, the relevance and reasonableness of those assumptions and methods; and
- If that expert's work involves significant use of source data, the relevance, completeness, and accuracy of that source data.

Para.9. When using information produced by the entity, the auditor shall evaluate whether the information is sufficiently reliable for the auditor's purposes, including as necessary in the circumstances:

- (a) Obtaining audit evidence about the accuracy and completeness of the information; and
- (b) Evaluating whether the information is sufficiently precise and detailed for the auditor's purposes.

Information Produced by the Entity and Used for the Auditor's Purposes

In order for the auditor to obtain reliable audit evidence, information produced by the entity that is used for performing audit procedures needs to be sufficiently complete and accurate.

Obtaining audit evidence about the accuracy and completeness of such information may be performed concurrently with the actual audit procedure applied to the information when obtaining such audit evidence is an integral part of the audit procedure itself.

Selecting Items for Testing to Obtain Audit Evidence

10. When designing tests of controls and tests of details, the auditor shall determine means of selecting items for testing that are effective in meeting the purpose of the audit procedure.

The means available to the auditor for selecting items for testing are:

- (a) Selecting all items (100% examination);
- (b) Selecting specific items; and
- (c) Audit sampling.

-100% examination is unlikely in the case of tests of controls; however, it is more common for tests of details. 100% examination may be appropriate when, for example:

- The population constitutes a small number of large value items;
- There is a significant risk and other means do not provide sufficient appropriate audit evidence; or
- The repetitive nature of a calculation or other process performed automatically by an information system makes a 100% examination cost effective.

-Specific items selected may include:

- High value or key items. The auditor may decide to select specific items within a population because they are of high value, or exhibit some other characteristic.
- All items over a certain amount. The auditor may decide to examine items whose recorded values exceed a certain amount so as to verify a large proportion of the total amount of a class of transactions or account balance.

- Items to obtain information. The auditor may examine items to obtain information about matters such as the nature of the entity or the nature of transactions.

-Audit sampling is designed to enable conclusions to be drawn about an entire population on the basis of testing a sample drawn from it. Audit sampling is discussed in SA 530.

Inconsistency in, or Doubts over Reliability of, Audit Evidence

Para.11. If:

- (a) audit evidence obtained from one source is inconsistent with that obtained from another; or
- (b) the auditor has doubts over the reliability of information to be used as audit evidence, the auditor shall determine what modifications or additions to audit procedures are necessary to resolve the matter, and shall consider the effect of the matter, if any, on other aspects of the audit.

Obtaining audit evidence from different sources or of a different nature may indicate that an individual item of audit evidence is not reliable, such as when audit evidence obtained from one source is inconsistent with that obtained from another.

This may be the case when, for example, responses to inquiries of management, internal audit, and others are inconsistent, or when responses to inquiries of those charged with governance made to corroborate the responses to inquiries of management are inconsistent with the response by management.

SA 230 includes a specific documentation requirement if the auditor identified information that is inconsistent with the auditor's final conclusion regarding a significant matter.