

SA 500 Revised – Audit Evidence

What do you mean by Audit Evidences?

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.

What is duty of an auditor regarding audit evidences?

As per SA-200 "The auditor should obtain sufficient appropriate audit evidence through the performance of compliance and substantive procedures to enable him to draw reasonable conclusions there from on which to base his opinion on the financial information" **further under point no. 9 of SA-200** "Audit conclusion and reporting", it is concluded that the auditor should review and assess the conclusions drawn from the audit evidence obtained and from his knowledge of business of the entity as the basis for the expression of his opinion on the financial information. Hence from the above we can conclude that auditor's opinion should be supported by reasonable conclusions and reasonable conclusions should be backed by sufficient and appropriate audit evidences. **According to SA500** The auditor shall design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence.

What is Phenomenon of Sufficient and Appropriate Audit Evidence?

SA 500 defined the term Sufficient and Appropriate as follows-

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. **viz. at least two evidences are required to conclude about the balance in bank - copy of Bank Statement and bank reconciliation statement);**

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. **(Copy of bank statement should be duly certified by the bank manager and BRS shall be passed by Managers account and corresponding entries required have been made in books of accounts).**

It is auditor's professional judgement whether he obtained S&A audit evidences or not. It all depends upon how much the item concerned is material, whether risk of misstatement is there or not relating to any item of financial statement, nature and complexity of financial information etc.

What are the sources of Audit Evidences?

According to SA500 (revised) Audit evidences can be obtained by the auditor from sources within the entity (generally known as internal sources) viz. bank reconciliation statement, and Sources independent from the entity (generally known as external sources) viz. Copy of bank statement duly signed by the manager of the bank. Evidences obtained from internal sources commonly known as Internal audit evidences and evidences obtained from source independent of entity is commonly known as external audit evidences. As far as nature of the audit evidences concern they may be documentary (viz. registry of land) , oral (viz. oral confirmation by management) or visual (viz. Physical Verification by management).

What are the Audit Procedures prescribed under SA500?

According to SA-500 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 (previously known as Compliance Procedures), 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.

(a) As Risk Assessment procedures are defined in SA 315 and SA330 let us understand What are test of control and Substantive procedures

(b) Further Audit Procedures

(i) Test of Controls (Previously known as Compliance Procedure in old version of SA500):- Tests of controls are designed to

- evaluate the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements at the assertion level.
- to obtain relevant audit evidence that indicate
 - o performance of a control, and
 - o deviation conditions which indicate departures from adequate performance.

The presence or absence of those conditions can then be tested by the auditor.

Example of Test of Control :- Following is the conversation between the auditor of X Ltd. and accountant of the X. Ltd. on 31.03.2005

Auditor : Do you prepare bank reconciliation statements
Accountant : Yes
Auditor : Please show me the latest BRS
Accountant : This is latest BRS prepared as on 30.10.2009
Auditor : What's this? You have not given any effect to the pending entries from August and September 09. What is your frequency to prepare BRS?
Accountant : Half yearly.

From the above we can conclude that although internal control over the bank operations is in existence but it is neither effective and nor continuously in operation over the period of reliance to be placed on it.

(ii) Substantive Procedures :- Substantive procedures are designed to detect material misstatements at the assertion level. They comprise tests of details and substantive analytical procedures. Designing substantive procedures includes identifying conditions relevant to the purpose of the test that constitute a misstatement in the relevant assertion.

If auditor applies substantive procedure over an item of financial statement like building we can correlate the observations under substantive procedure mentioned above

Existence	Physical verification of the building.
Rights and Obligations	Whether the building is in the name of the company.
Occurrence	Whether it is purchased during the year, modified or renovated during the year or it is an opening balance.
Completeness	Whether it is properly recorded in fixed asset register.
Valuation	that an asset is recorded at an appropriate carrying value.
Measurement	it is recorded in the proper amount and revenue or expense related to insurance and depreciation is allocated to the proper period.
Presentation and Disclosure	an item is disclosed, classified, and described in accordance with recognised accounting policies (AS per Accounting Standards) and practices and relevant statutory requirements (schedule VI in case of company), if any.

What are the various other assisting audit procedure available to the auditor when he want to obtain sufficient and appropriate audit evidence by applying audit procedures risk assessment procedure , test of control or substantive procedure?

The audit procedures described as Following may be used as risk assessment procedures, tests of controls or substantive procedures, depending on the context in which they are applied by the auditor.

1. Inspection
2. Observation
3. External Confirmation
3. Recalculation
4. Re-performance
5. Analytical Procedures
- 6 Enquiry and Confirmation

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. An example of inspection used as a test of controls is inspection of records for evidence of authorisation.

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.

Recalculation

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

Re-performance

Re-performance 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. For example computation and analysis of Gross Profit Ratio, Net Profit Ratio, Debt Equity Ratio etc. 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. Responses to inquiries may provide the auditor with information not previously possessed or with corroborative audit evidence. 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. We will discuss the same in later chapter on SA 580 (Revised).

How an auditor establishes Relevance and Reliability of Audit Evidences?

According to SA500 Revised - "When designing and performing audit procedures, the auditor shall consider the relevance and reliability of the information to be used as an audit evidence". Now the question is - what is relevance and reliability and how it is established by the auditor.

Relevance of Audit evidence

According to SA500 revised 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 we are verifying the existence of building and ownership of building the expert's valuation report of the building is irrelevant but registry of the land and approved map of the building in the name of the owner are relevant. On the other hand if we are verifying the value of the building approved map is irrelevant but expert's valuation report is relevant. A given set of audit procedures may provide audit evidence that is relevant to certain assertions, but not others. For example, obtaining audit evidence regarding a particular assertion, for example, the existence of inventory, is not a substitute for obtaining audit evidence regarding another assertion, for example, the valuation of that inventory.

Reliability of Audit Evidence

Unless auditor obtains reliable audit evidence he can not draw reasonable conclusions. Reliability of audit evidence is depending upon Nature and source of Audit Evidences. While recognising that some exceptions may exist, the following generalisations 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 (that means external audit evidences are more reliable than internal audit evidences). For example **Copy of certified bank statement is more reliable evidence than a Bank reconciliation prepared within 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.

For example - **Bank reconciliation statement will be more reliable than otherwise (not more reliable than copy of bank statement) if the internal control is 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 (for example, Oral confirmation of a decision in board meeting is less reliable than copy of that resolution obtained by the auditor).

- 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.

The auditor gains increased assurance when he obtains audit evidences from different sources or of different nature giving consistent results of observations according to SA-500.

If an Audit evidence is prepared by management's expert what extra care has to be taken by the auditor of the entity?

According to SA500 revised, 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.

CURRENTLY THESE ISSUES ARE ADDRESSED IN SA620

What consideration and auditor is required to observe when he is selecting items for testing to obtain SUFFICIENT audit evidences?

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. In selecting items for testing, the auditor is required by paragraph 7 to determine the relevance and reliability of information to be used as audit evidence; the other aspect of effectiveness (sufficiency) is an important consideration in selecting items to test. Auditor may resort to any one or in combination of the following ways to selecting the items for testing:

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

Selecting All Items

According to SA500 revised - 100% examination is unlikely in the case of tests of controls; however, it is more common for tests of details (i.e. substantive procedures). 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.

Selecting Specific Items

According to SA500 Revised -The auditor may decide to select specific items from a population. In making this decision, factors that may be relevant include the auditor's understanding of the entity, the assessed risks of material misstatement, and the characteristics of the population being tested. 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.

It should be noted that by this way auditor is not following rules of sampling .The results of audit procedures applied to items selected in this way cannot be projected to the entire population; accordingly, selective examination of specific items does not provide audit evidence concerning the remainder of the population.

Audit Sampling

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 (Revised).¹⁷

What is the Audit procedure if auditor found Inconsistency in, or Doubts over Reliability of, Audit Evidence?
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. matter.