

ISA 500 – Audit Evidence

Bassam Daoud Sobh, CPA



“The objective of the auditor is to obtain **sufficient appropriate audit evidence** regarding the **assessed risks of material misstatement**, through **designing and implementing appropriate responses to those risks.**” – ISA 330

Evidence is anything that can make a person believe that a fact, proposition, or assertion is true or false.



Audit Evidence

- The objective of the auditor is to design and perform audit procedures in such a way as to enable the auditor to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion. – ISA 500
- Reasonable assurance is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk to an acceptably low level. – ISA 200

Source of Evidence

- Internally generated:
physical inventory count
- Externally generated:
confirmation of balance
- Self generated:
test of controls, substantive procedures

The auditor will obtain and **CORROBORATE** evidences from the different sources to reach a conclusion.

Sufficient Appropriate Audit Evidence

- *Sufficiency* is the measure of the **quantity** of audit evidence



- *Appropriateness* is the measure of **quality** of audit evidence, its **reliability** and **relevance** in providing support for detecting, misstatements in account balances, disclosures and



The auditor's judgment as to what constitutes sufficient audit evidence is influenced by

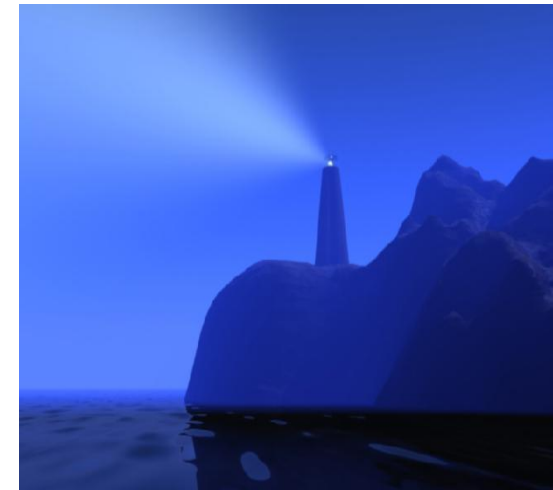
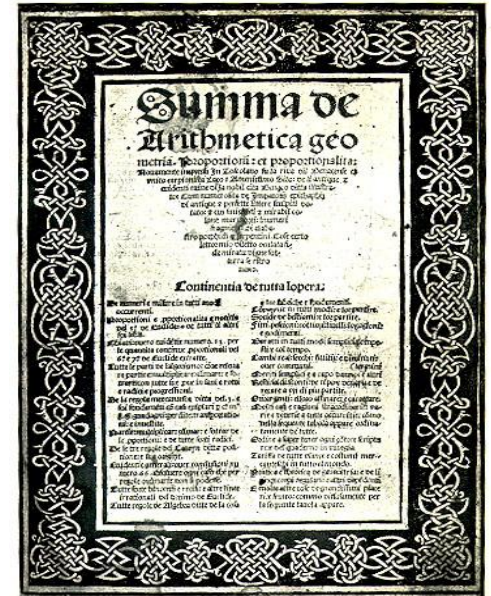
- ☑ Materiality
- ☑ understanding of the entity and its environment, including its internal control.
- ☑ the effectiveness of management's responses and controls to address the risks (computerized vs manual controls)
- ☑ Reliance on Effective Controls
- ☑ the experience gained during previous audits with respect to similar potential misstatements – “CAKE”
- ☑ Audit findings: if other audit evidence found not to be reliable as expected → further Evidence will be required
- ☑ Reliability of Information - persuasiveness of the audit evidence (based on Source);

Sufficient: *(illustration)*

<i>Consideration</i>	<i>Sufficient and appropriate evidence</i>
Materiality of the item being examined	The more material the item the greater the amount of evidence required.
Effectiveness of management's responses to risk	More effective management responses to risk and controls decreases quality and quantity of evidence required.
Prior audit experience with the client	Prior audit experience with the client will indicate how much evidence was taken before and if that was enough.
Auditor's assessment of inherent and control risks	The higher the inherent or control risk, the greater the amount of evidence required.
Reliability of the available information.	The less reliable the source of information, the greater the amount of evidence required.
Whether fraud or error is suspected.	If fraud is suspected, the amount of evidence required increases.

Appropriate:

- ▶ Relevance: which evidence is required to (related to) support the financial statement assertions
- ▶ Reliability is the quality of information when it is free from material error and bias
 - Reliability of Audit Evidence is dependent on the Circumstances under which it is gathered; it is also influenced by its source & Nature.
 - Key Assertions for Reliability are the Accuracy & Completeness of Information



Relevance

Anytime, management issues financial statements, it makes implicit assertions in three categories:

1. account balances (i.e. mainly statement of financial position);
2. classes of transactions and events (i.e. mainly statement of comprehensive income); and
3. presentation and disclosures.

ASSERTIONS about account balances at the period end

Existence	Assets, liabilities, and equity interests exist
Rights and obligations	The entity holds or controls the rights to assets and liabilities are the obligations of the entity
Completeness	All assets, liabilities and equity interests that should have been recorded have been recorded
Valuation and Allocation	Assets, liabilities and equity interests are included in the financial statements at appropriate amounts and any resulting valuation adjustments are appropriately recorded (asset impairment, NRV and depreciation)

ASSERTIONS about classes of transactions and events for the period under audit

Occurrence	Transactions and events that have been recorded have occurred and pertain to the entity.
Completeness	All transactions and events that should have been recorded have been recorded.
Accuracy	Amounts and other data relating to recorded transactions and events have been recorded appropriately.
Cutoff	Transactions and events have been recorded in the correct accounting period
Classification	Transactions and events have been recorded in the proper accounts

ASSERTIONS about presentation and disclosure

Occurrence & rights and obligations	Disclosed matters have occurred and pertain to the entity.
Completeness	All disclosures that should have been included in the financial statements have been included
Classification and understandability	financial information is appropriately presented and described, and disclosures are clearly expressed
Accuracy and valuation	Financial and other information are disclosed fairly and at appropriate amounts

Reliability of audit evidence

Influenced by its
Source & Nature

- 👉 External v Internal: Audit evidence is more reliable when it is obtained from independent sources outside the entity.
- 👉 Direct v Indirect: Audit evidence obtained directly by the auditor (e.g., observation, re-performance) is more reliable than audit evidence obtained indirectly or passed on by client.
- 👉 Written v Oral: Audit evidence is more reliable when it exists in documentary form, whether paper, electronic, or other medium.
Audit evidence provided by original documents is more reliable than audit evidence provided by photocopies or facsimiles
- 👉 The effectiveness of the client's internal control structure has a significant impact on reliability of evidence.

Ranking Evidence

Let us see example 1

- 👍 Auditor's personal knowledge & Observation
- 👍 External Evidence (direct then Indirect)
- 👍 Internal Evidence
- 👍 Observation

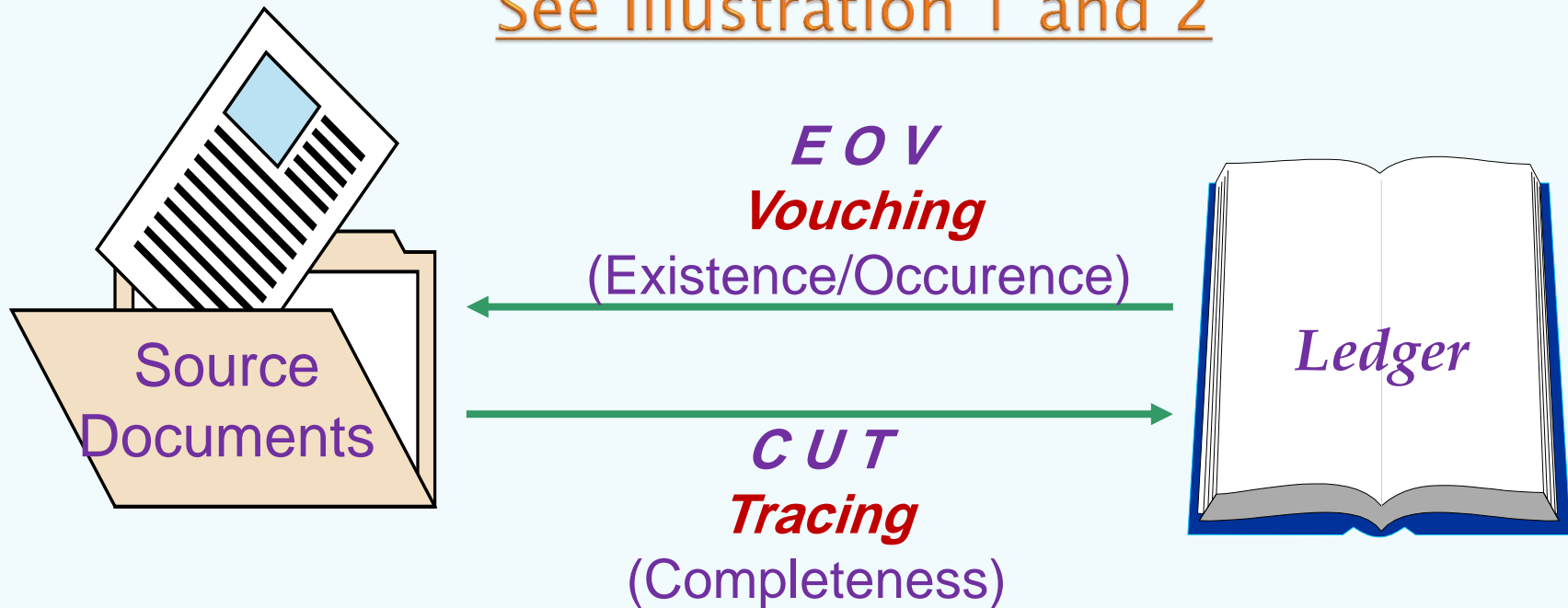
Where risk is high:

- Reduced reliance on internally generated evidence
- Increased focus on external evidence.
- If senior management is involved: cannot rely on their representations.

Direction of Testing

Depending on the assertions for which evidence is sought

See Illustration 1 and 2



See Illustration 3

Nature of Audit Evidence

Records of
initial entries and
supporting records

Invoices

Spreadsheets
supporting cost
allocations

General
and subsidiary
ledgers

Worksheets

Adjustments
to financial
statements

Contracts

Other
computations,
reconciliations, and
disclosures

Obtaining Audit Evidence

Specific acts
performed by the auditor
to gather evidence to determine
if specific assertions are
being met.

Risk assessment
procedures

Test of
controls

Substantive
procedures

Risk Assessment

- ▶ **Risk assessment** procedures include understanding internal control & assessing its design and implementation
- ▶ But alone, Risk Assessment is not enough to provide sufficient appropriate audit evidence. Supplemented by TOC and/or Substantive procedures

Test of Controls

- ✚ **Test of controls** are audit procedures designed to evaluate the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements at the assertion level.
- ✚ The greater the reliance the auditor places on the effectiveness of a control, the more persuasive the audit evidence the auditor must obtain. – ISA 330.



Test of Controls

The auditor must design and perform **tests of controls** if:

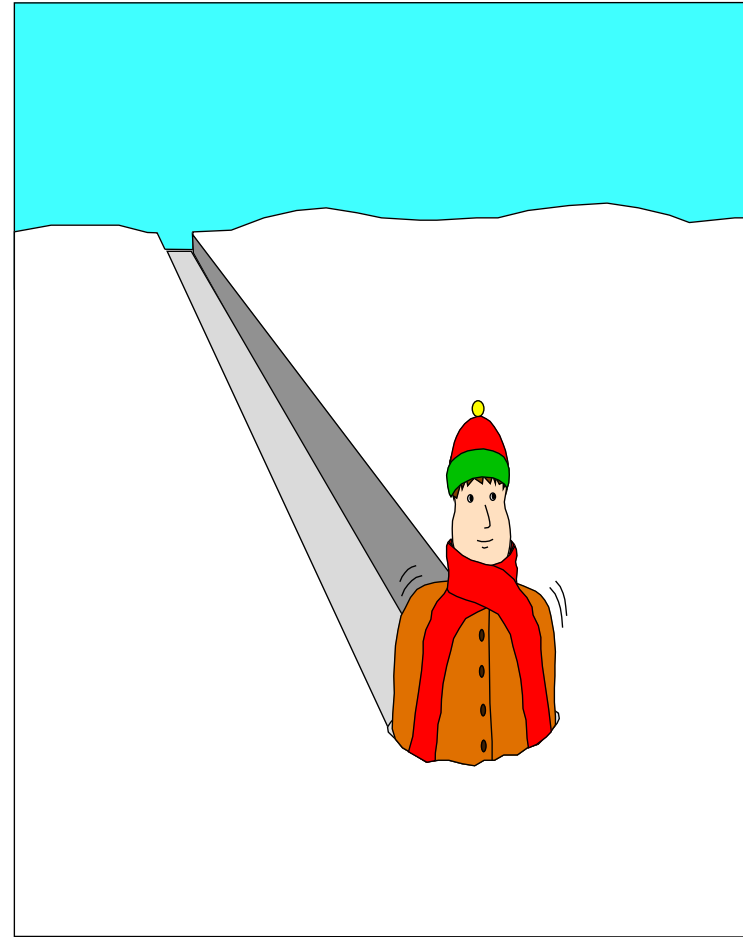
- ▶ The auditor's assessment of risks of material misstatement at the assertion level includes an expectation that the **controls are operating effectively** (the auditor will rely on the operating effectiveness of controls in determining substantive procedures); or
- ▶ **Substantive procedures alone cannot** provide sufficient appropriate audit evidence at the assertion level.



Substantive Procedures

A Substantive procedure is an audit procedure designed to detect material misstatements at the management's assertion level.

Two types – (1) tests of details of classes of transactions, account balances, and disclosures and (2) substantive analytical procedures



Substantive Procedures

The Extent of Subst. procedures is based on:

1. Auditor's Risk Assessment;
2. The adequacy and Operating effectiveness of Internal Controls

So More Control Procedures (operating effectiveness of Internal Controls → Less Substantive Audit Tests

*Remember : $AR = IR * CR * DR$*

And there are Inherent Limitations in Controls → Substantive Procedures are required (materiality)

Audit Procedures for Gathering Audit Evidence

Inspection
of records and
documents

Recalculation

Observation

Inquiry

Scanning

Inspection
of tangible
assets

Confirmation

Reperformance

Analytical
procedures

Audit Procedures for Gathering Audit Evidence

Inspection
of records and
documents

Evidence obtained from external documents is more reliable than evidence obtained from internal documents.

Confirmation

Information Frequently Confirmed by Auditors	Source of Confirmation
Cash balance	Bank
Accounts receivable	Individual customers
Inventory on consignment	Consignee
Accounts payable	Individual vendors
Bonds payable	Bondholders/trustee
Common stock outstanding	Registrar/transfer agent
Insurance coverage	Insurance company
Collateral for loans	Creditors

Audit Procedures for Gathering Audit Evidence

Inquiry

In conducting inquiry, the auditor should:

- Consider the knowledge, objectivity, experience, responsibility, and qualifications of the person to be questioned
- Ask clear, concise, and relevant questions.
- Use open or closed questions appropriately.
- Listen actively and effectively.
- Consider the reactions and responses, then ask follow-up questions.
- Evaluate the response.



Audit Procedures for Gathering Audit Evidence

Recalculation

Checking the mathematical accuracy of documents or records.

Re-performance

The auditor's independent execution of procedures or controls that were originally performed as part of the internal control system.

Audit Procedures for Gathering Audit Evidence

Observation



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graph LR; A([Observation]) --> B[The process of watching a process or procedure being performed by others.];
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The process of watching a process or procedure being performed by others.

Inspection of Intangible Assets



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graph LR; C([Inspection of Intangible Assets]) --> D[Physical examination of a tangible asset];
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Physical examination of a tangible asset

Audit Procedures for Gathering Audit Evidence

Scanning

Review of accounting data to identify significant or unusual items

Analytical Procedures

Evaluations of financial information made by a study of plausible relationships among both financial and nonfinancial data.

Example 2 : Procedures Exercise
Example 3: Trade Receivables

Direction of testing & Assertions

- 📄 When knowing the objective of Audit tests, what assertions to cover;
- 📄 We can design audit tests (audit programs) to meet the objectives and assessments of the required procedures
- 📄 *Ref to Illustration: Matching auditing procedures to Specific assertions*

Nature, timing and Extent of Substantive procedures

Nature:

↔ **Tests of details of transactions** are audit procedures related to **examining the processing** of particular classes of **transactions** through the accounting systems.

Used when Control Risk is set as Higher than Low (so more substantive Tests – level of transaction testing is higher → more Sample size)

👁️ **Analytical procedures** large volume of transactions that tend to be predictable

Used when Control Risk is set as Minimum (Strong Control Environment and adequate operating effectiveness of Controls)

Nature, timing and Extent of Substantive procedures

↔ **Tests of balances** are substantive tests that provide either reasonable assurance of the validity of a **general ledger balance** or identifies a misstatement in the account.

Why is tests of balances so important?

☞ Because the auditor's ultimate objective is to **express an opinion** on financial statements that are made up of account balances

Illustration 4: Nature of Substantive testing

Nature, timing and Extent of Substantive procedures

- ▶ **Timing** of an audit procedure refers to when it is performed, or the period or date to which the audit evidence applies.
- ❖ In some instances, primarily as a practical matter, substantive procedures may be **performed at an interim date**. Only using interim testing procedures will **increase the risk that misstatements** existing at the period end will not be detected.
- ❖ Performing audit procedures at an interim date may assist the auditor in identifying and resolving issues at an early stage of the audit.

Nature, timing and Extent of Substantive procedures

- ▶ **Extent** of an audit procedure refers to the quantity to be performed, for example, a sample size or the number of observations of a control activity.
- ▶ the greater the risk of material misstatement, the greater the extent of substantive procedures → Greater Sample Size
- ▶ Extent of Substantive Procedures may consider:
 - selecting large (e.g. material) or unusual items from a population; or
 - stratifying the population into homogeneous sub-populations for sampling

Thank You for Your Attention

Any Questions?

