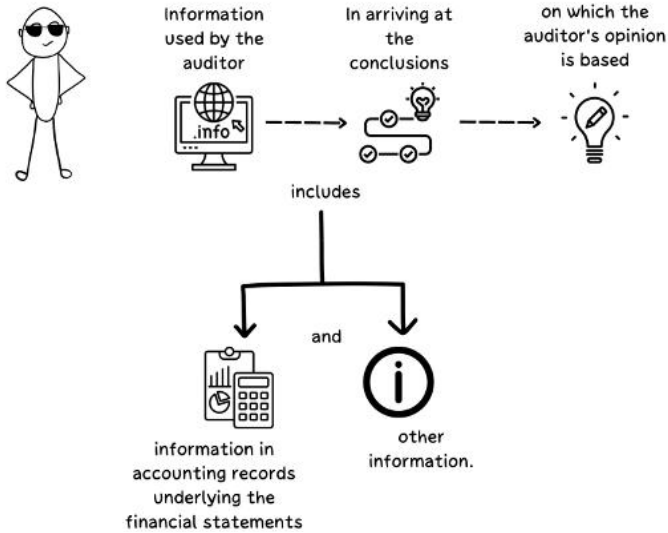


Chapter 4 – Audit Evidence

SA 500 Audit Evidence

Meaning of Audit Evidence



Information contained in the accounting records

Accounting records include

- the records of initial accounting entries and supporting records, such as checks and records of electronic fund transfers;
- Invoices;
- Contracts
- the ledgers, journal entries and other adjustments to the financial statements.
- records such as worksheets and spreadsheets supporting cost allocations, computations, reconciliations and disclosures.

Other information

Other information that authenticates the accounting records and also supports the auditor’s rationale behind the true and fair presentation of the financial statements:

Other information which the auditor may use as audit evidence includes, for example

- minutes of the meetings,
- written confirmations from trade receivables and trade payables,
- manuals containing details of internal control etc

A combination of tests of accounting records and other information is generally used by the auditor to support his opinion on the financial statements.

| Other Points related to Audit Evidence and Its Nature. | | |
|--|-----------------------|------------------------|
| Cumulative in Nature | | |
| Primarily from | Audit Procedures | |
| Include info | from other sources | Such as previous audit |
| AE comprises both | Info that supports | |
| | Info that contradicts | |
| Absence of info (For ex. Mgt not providing Written Representations) | Also Audit Evidence | |
| Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence. | | |

Suniti, a CA student, is part of an engagement team conducting an audit of a company TIM Private Limited. According to the audit programme, she is responsible for verifying purchases and PPE items appearing in books of accounts from records/bills of the company. Besides, she has also been entrusted with responsibility to obtain written representation from management regarding carrying out physical verification of inventories during the year. During course of her work, she finds that:

- One purchase bill amounting to ₹ 5.00 lacs pertaining to TIM Industries has been entered in books of TIM Private Limited.
- The management has refused to provide a written representation relating to physical verification of inventories during the year. She has brought it to the knowledge of the engagement partner who has decided to use lack of such a representation as audit evidence.

Discuss whether each of the above constitutes audit evidence. State reasoning for your answer

(ICAI MTP1, May 2024, 4 Marks)

| Relation of Audit Evidence and Opinion of the Auditor | | |
|---|-----------------------------|---|
| Very important relationship | | |
| Helps auditor to form an opinion | | |
| AE supports Auditor's Opinion and report | | |
| Auditor's objective | Obtain reasonable assurance | Reasonable assurance is obtained when auditor obtains Sufficient and Appropriate evidence To Reduce Audit risk to appropriately low level |

Sufficient and Appropriate Audit Evidence

| Sufficiency | | | |
|---|--|---|---|
| measure of the quantity of audit evidence | | | |
| Affected by | Materiality | Significance of AB/T/PD to the users of FS | Less Material, Less Evidence and Vice versa |
| | ROMM | risk that the financial statements are materially misstated prior to audit. | Lower ROMM, Less Evidence |
| | Size of population | number of items included in the population | Smaller, Homogeneous items, Less Evidence |
| Obtaining more evidence | Cannot compensate for poor quality of audit evidence | | |

Sales Revenue Verification

High-quality evidence: Sales invoices matched with delivery receipts and customer confirmations. Low-quality evidence: Large number of unsigned internal sales records. Issue: Even if thousands of internal sales records are presented, they lack authenticity without external corroboration.

Appropriateness of Audit Evidence

measure of the quality of audit evidence

Relevance Reliability

In providing support for conclusions for auditors opinion

Relevance / Competence

Relationship of the evidence with audit procedure and the assertion being checked

An Audit procedures may provide evidence for some assertions but not others.

audit evidence from different sources or of a different nature may often be relevant to the same assertion.

Important Examples

Example

confirmation of balance from a customer
 ↓
 relevant evidence as regards existence of receivable,
 ↓
 not be relevant as regards collectability of the balance due from customer
 ↓
 Subsequent payments, credit history, financial health, and aging analysis are better indicators of recoverability.

physical observation of inventories
 ↓
 relevant evidence relating to existence
 ↓
 not appropriate evidence to ensure that the entity owns the inventories

Checking the terms of the agreement and confirming the same from the third party.

One more example of relevance: To Check if a purchase is complete you don't look at the Purchase contract. For checking the completeness of purchase we will check that goods or services were received. For this we will check various documents and records related to receiving goods like stock registers

Reliability of Audit Evidence

Measured by assessing the credibility of evidence.
 Auditor's approach → Maintain professional skepticism.
 Reliable evidence → Entity's information must be complete & accurate for audit procedures.

Factors Influencing Reliability

| | | |
|--|---|--|
| Source & Nature (Direct, indirect, oral, written, original, photocopies). | | |
| Circumstances of Obtaining (Preparation & maintenance controls). | | |
| General Reliability Principles: | | |
| Independent external sources → More reliable as they are free from management bias. | | |
| Internally generated evidence → More reliable if entity's internal controls over preparation and maintenance are effective. | | |
| Documentary evidence → More reliable than oral representations, as written records provide concrete proof. | | |
| Organizational circumstances (e.g., weak controls, conflicts of interest) can reduce reliability. | | |
| Original documents → More reliable than photocopies or digital versions, as alterations or tampering are less likely. | | |
| Direct auditor-obtained evidence → More reliable than evidence obtained indirectly (e.g., observing a control vs. inquiring about it). | | |
| The above general principles are subject to important exceptions. | audit evidence obtained from sources external to the entity, circumstances may exist that could affect its reliability. | 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. |

Audit Procedures to Obtain Audit Evidence

| | | |
|--|---|-----------------------|
| Audit evidence to draw reasonable conclusions on which to base the auditor's opinion is obtained by performing | risk assessment procedures, | |
| | Further audit procedures, which comprise: | Tests of controls |
| audit procedures be used as risk assessment procedures, tests of controls or substantive procedures | A | Analytical procedures |
| | E | Enquiry |
| | I | Inspection |
| | O | Observation |
| | U | Recalculation |
| | Reperformance | |
| | External Confirmation | |

| Inspection | | |
|-----------------------------------|---|---|
| examining records or documents | internal or external, | |
| | paper form, electronic form, | |
| | Provide evidence of varying degree of reliability | Documents created and maintained within the organization might be less reliable compared to those received from independent external sources. |
| Physical examination of an asset. | | |
| Examples | For Test of Control | Inspecting Documentation related to authorisation. |
| | Documents like stock or bond certificates directly evidence asset existence | may not necessarily provide audit evidence about ownership or value |
| | Inspecting a signed contract | can give evidence on an entity's revenue recognition policy application. |
| | inspecting tangible assets | confirms existence, but may not verify rights, obligations, or value |
| | Auditor may inspect inventory items during inventory count observation. | |

Observation

- Observation consists of **witnessing a process** or procedure being performed by others.
 - For example, the auditor may observe the counting of inventories being performed by client's personnel.

External Confirmation – SA 505

- 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.
 - Example: Auditors may request confirmation of terms of agreements or transactions an entity has with third parties.
 - External confirmation procedures also are used to obtain audit evidence about the absence of certain conditions.
 - Example: Absence of a "side agreement" that may influence revenue recognition.

Recalculation

- Recalculation consists of **checking the mathematical accuracy** of documents or records. Recalculation may be performed manually or electronically.
- Checking the accuracy of calculation of the conversion of foreign currency into Indian rupees for export invoices

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.
- Re-performing the reconciliation of bank statement, re-performing the ageing of accounts receivable

