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# ISA 500, Considering the Relevance and Reliability of Audit Evidence.

## By IEC's Committee on Auditing.

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**ISA 500, Considering the Relevance and Reliability of Audit Evidence.**

## A. Introduction.

A.1. The purpose of this International Standard on Auditing (ISA) is to establish standards and to provide guidance on what constitutes audit evidence in an audit of financial statements, the quantity and quality of audit evidence to be obtained, and the audit procedures that auditors use for obtaining that audit evidence.

A.2. **The auditor should obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the audit opinion.**

## B. Concept of Audit Evidence.

B.1. "Audit evidence" is all the information used by the auditor in arriving at the conclusions on which the audit opinion is based, and includes the information contained in the accounting records underlying the financial statements and other information. Audit Evidence, which is cumulative in nature, includes audit evidence obtained from audit procedures performed during the course of the audit and may include audit evidence obtained from other sources such as previous audits and a firm's quality control procedures for client acceptance and continuance.

B.2. Accounting records generally include the records of initial 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 formal journal entries ; and records such as work sheets and spreadsheets supporting cost allocations, computations, reconciliations and disclosures. The accounting records may be part of integrated systems that share data and support all aspects of the entity's financial reporting, operations and compliance objectives.

B.3. Management is responsible for the preparation of the financial statements based upon the accounting records of the entity. The auditor obtains some audit evidence by testing the accounting records, for example, through analysis and review, reperforming procedures followed in the financial reporting process, and reconciling related types and applications of the same information.

B.4. Other information that the auditor may use as audit evidence includes minutes of meetings ; confirmations from third parties ; analysts' reports ; comparable data about competitors (benchmarking) ; controls manuals ; information obtained by the auditor from such audit procedures as inquiry, observation, and inspection ; and other information developed by, or available to, the auditor that permits the auditor to reach conclusions through valid reasoning.

## C. Sufficient Appropriate Audit Evidence.

C.1. Sufficiency is the measure of the quantity of audit evidence. The quantity of audit evidence needed is affected by the risk of misstatement (the greater the risk, the more audit evidence is likely to be required) and also by the quality of such audit evidence (the higher the quality, the less may be required).

C.2. A given set of audit procedures may provide audit evidence that is relevant to certain assertions, but not others. For example :

- Inspection for records and documents related to the collection of receivables after the period end.

- Analyzing the aging accounts receivable to obtain audit evidence relating to the valuation of the allowance for doubtful accounts.

C.3. The reliability of audit evidence is influenced by its source and by its nature and is dependent on the individual circumstances under which it is obtained. While recognizing

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

- Audit evidence is more reliable when it is obtained from independent sources outside the entity.

- Audit evidence that is generated internally is more reliable when the related controls imposed by the entity are effective.

- Audit evidence obtained directly by the auditor is more reliable than audit evidence obtained indirectly or by inference.

- 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.

C.4. **When information produced by the entity is used by the auditor to perform audit procedures, the auditor should obtain audit evidence about the accuracy and completeness of the information.** In order for the auditor to obtain reliable audit evidence, the information upon which the audit procedures are based needs to be sufficiently complete and accurate.

C.5. The auditor ordinarily obtains more assurance from consistent audit evidence obtained from different sources or of a different nature than from items of audit evidence considered individually. In addition, obtaining audit evidence from different sources or of a different nature may indicate that an individual item of audit evidence is not reliable.

C.6. The auditor considers the relationship between the cost of obtaining audit evidence and the usefulness of the information obtained. However, the matter of difficulty or expense involved is not in itself a valid basis for omitting an audit procedure for which there is no alternative.

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C.7. In forming the audit opinion the auditor does not examine all the information available because conclusions ordinarily can be reached by using sampling approaches and other means of selecting items for testing.

## D. The Use of Assertions in Obtaining Audit Evidence.

D.1. **The auditor should use assertions for classes of transactions, account balances, and presentation and disclosures in sufficient detail to form a basis for the assessment of risks of material misstatement and the design and performance of further audit procedures.** The auditor uses assertions in assessing risks by considering the different types of potential misstatements that may occur, and thereby designing audit procedures that are responsive to the assessed risks. Other ISAs discuss specific situations where the auditor is required to obtain audit evidence at the assertion level.

D.2. Assertions used by the auditor fall into the following categories :

(a) Assertions about classes of transactions and events for the period under audit :

(i) Occurrence : transaction and events that have been recorded have occurred and pertain to the entity.

(ii) Completeness : all transactions and events that should have been recorded have been recorded.

(iii) Accuracy : amounts and other data relating to recorded transactions and events have been recorded appropriately.

(iv) Cut-off : transactions and events have been recorded in the correct accounting period.

(v) Classification : transactions and events have been recorded in the proper accounts.

(b) Assertions about account balances at the period end :

(i) Existence : assets, liabilities, and equity interests exist.

(ii) Rights and obligations : the entity holds or controls the rights to assets, and liabilities are the obligations of the entity.

(iii) Completeness : all assets, liabilities and equity interests that should have been recorded have been recorded.

(iv) Valuation and allocation : assets, liabilities, and equity interests are included in the financial statements at appropriate amounts and any resulting valuation or allocation adjustments are appropriately recorded.

(c) Assertions about presentation and disclosure :

(i) Occurrence and rights and obligations : disclosed events, transactions, and other matters have occurred and pertain to the entity.

(ii) Completeness : all disclosures that should have been included in the financial statements have been included.

(iii) Classification and understand ability : financial information is appropriately presented and described, and disclosures are clearly expressed.

(iv) Accuracy and valuation : financial and other information are discloses fairly and at appropriate amounts.

D.3. The auditor may use the assertions as described above or may express them differently provided all aspects described above have been covered. For example, the auditor may choose to combine the assertions about transactions and events with the assertions about account balances. As another example, there may not be a separate assertion related to cut-off of transactions and events when the occurrence and completeness assertions include appropriate consideration of recording transactions in the correct accounting period.

## E. Audit Procedures for Obtaining Audit Evidence.

E.1. The auditor obtains evidence to draw reasonable conclusions on which to base the audit opinion by performing audit procedures to :

(a) Obtain an understanding of the entity and its environment, including its internal control, to assess the risks of material misstatement at the financial statement and assertion levels.

(b) When necessary or when the auditor has determined to do so, test the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements at the assertion level.

(c) Detect material misstatements at the assertion level (audit procedures performed for this purpose are referred to in the ISAs as "substantive procedures").

E.2. The auditor always performs risk assessment procedures to provide a satisfactory basis for the assessment of risks at the financial statement and assertion levels.

E.3. Tests of controls are necessary in two circumstances. When the auditor's risk assessment includes an expectation of the operating effectiveness of controls, the auditor is required to test those controls to support the risk assessment. In addition, when substantive procedures alone do not provide sufficient appropriate audit evidence, the auditor is required to perform tests of controls to obtain audit evidence about their operating effectiveness.

E.4. The auditor plans and performs substantive procedures to be responsive to the related assessment of the risks of material misstatement, which includes the results of tests of controls, if any. The auditor's risk assessment is judgmental, however, and may not be sufficiently precise to identify all risks of material misstatement. Further, there are inherent limitations to internal control, including the risk of management override, the possibility of human error and the effect of systems changes. Therefore, substantive procedures for material classes of transactions, account balances, and disclosures are always required to obtain sufficient appropriate audit evidence.

E.5. The auditor uses one or more types of audit procedures described in paragraphs 26-38 below. These audit procedures, or combinations thereof, 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. In certain circumstances, audit evidence obtained from previous audits may provide audit evidence where the auditor performs audit procedures to establish its continuing relevance.

E.6. When the information is in electronic from, the auditor may carry out certain of the audit procedures described below through CAATs.

## F. Inspection of Records or Documents.

F.1. Inspection consists of examining records or documents, whether internal or external, in paper form, electronic form, or other media. 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. An example of inspection used as a test of controls is inspection of records or documents for evidence of authorization.

F.2. Some documents represent direct audit evidence of the existence of an asset, for example, a document constituting a financial instrument such as a stock or bond. Inspection of such documents may not necessarily provide audit evidence about ownership or value. In addition, inspecting an executed contract may provide audit evidence relevant to the entity's application of accounting policies, such as revenue recognition.

## G. Inspection of Tangible Assets.

Inspection of tangible assets consists of physical examination of the assets. 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 ordinarily accompanies the observation of inventory counting.

## H. Observation.

Observation consists of looking at a process or procedure being performed by others. Examples include observation of the counting of inventories by the entity's personnel and observation of the performance of control activities. Observation provides audit evidence about the performance of a process or procedure, but is limited to the point in time at which the observation takes place and by the fact that the act of being observed may affect how the process or procedure is performed.

## I. Inquiry.

I.1. Inquiry consists of seeking information of knowledgeable persons, both financial and non-financial, throughout the entity or outside the entity. Inquiry is an audit procedure tat is used extensively throughout the audit and often is complementary to performing other audit procedures.

I.2. Responses to inquiries may provide the auditor with information not previously possessed or with corroborative audit evidence.

I.3. The auditor performs audit procedures is addition to the use of inquiry to obtain sufficient appropriate audit evidence.

I.4. In respect of some matters, the auditor obtains written representations from management to confirm responses to oral inquiries. For example, the auditor ordinarily obtains written representations from management on material matters when other sufficient appropriate audit evidence obtained is of a lower quality. See ISA 580, "Management Representations" for further guidance on written representations.

## J. Confirmation.

Confirmation, which is a specific type of inquiry, is the process of obtaining a representation of information or of an existing condition directly from a third party. For example, the auditor may seek direct confirmation of receivables by communication with debtors. Confirmations are frequently used in relation to account balances and their components, but need not be restricted to these items.

## K. Recalculation.

Recalculation consists of checking the mathematical accuracy of documents or records.

## L. Reperformance.

Reperformance is the auditor's independent execution of procedures or controls that were originally performed as part of the entity's internal control, either manually or through the use of CAATs, for example, reperforming the aging of accounts receivable.

## M. 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. See ISA 520, "Analytical Procedures" for further guidance on analytical procedures.

The 10th of September 2007,

On Behalf on the Committee on Auditing,

Miloud Stoti, Chairman