

Audit Evidence – Possible Application Material Related to Selected Topics Discussed in Agenda Item 2

This paper presents possible application material related to selected topics related to ISA 500 that have been explained in **Agenda Item 2**. It is intended to provide context to the Board on how the matters may be articulated in ISA 500. The Audit Evidence Task Force (AETF) is *not* seeking the Board's views on the drafting in this paper. However, should the Board have specific suggestions on the drafting, the AETF welcomes such input and requests the Board to provide drafting suggestions offline to the IAASB Staff.

The possible application material in this paper is organized according to the relevant sections of **Agenda Item 2**.

The possible application material in this paper does not reflect track changes from extant ISA 500 because it is not a complete reflection of all the application material, and there are extensive changes proposed by the AETF. A track change version of the application material will be provided to the Board when the full standard is presented in June 2021.

Section C of Agenda Item 2 – Information Intended to be Used as Audit Evidence

Availability, Accessibility and Understandability of Information Intended to be Used as Audit Evidence

Paragraphs 48–49 of **Agenda Item 2**

C.1 Obtaining and evaluating audit evidence is an iterative process whereby the auditor considers the availability of information intended to be used as audit evidence and whether it can be obtained at a reasonable cost and within a reasonable time.¹ In doing so, the auditor may consider whether the information will be understandable, i.e., whether the auditor will be able to interpret the information for the auditor's purposes.

Example:

- Digital information may be maintained on a private blockchain, and the information may not be available to the auditor because the auditor has not been granted permission to access the blockchain.
- The information may be highly encrypted and the auditor may not have the decryption key, resulting in the auditor not being able to interpret and understand the information.

C.2 If the auditor considers that the information is available and understandable and plans to use the information as audit evidence, the requirements of this ISA apply.

C.3 In some cases, information in digital form may be available on a continuous basis.

Example:

Records maintained on a distributed ledger, such as a blockchain, may be available on a

¹ ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*, paragraph A50

continuous basis. The auditor may use automated tools and techniques that operate on a real time basis and are designed to test the information maintained in the blockchain.

- C.4 Some information intended to be used as audit evidence may be available only at certain points or periods in time, or it may be destroyed after a specified period of time. This may affect the nature and timing of the audit procedures to be performed or the auditor may find it necessary to request retention of some information for the auditor’s review.

Example:

The entity may use artificial intelligence technology to predict the recoverability of accounts receivable, which is designed to continually evolve for updates and changes in the underlying data (e.g., payment history, customer credit scores or economic factors). In such cases, the auditor may need to perform audit procedures close to the financial reporting date when the information generated by the technology is current, since performing audit procedures at a later date may render a different outcome.

- C.5 ISA 200² describes the inherent limitations of an audit. However, the inherent limitations of an audit, information that is not available or understandable, or restrictions on access to information is not a justification for the auditor to be satisfied with less than persuasive audit evidence. Access to information can be restricted for many reasons, such as restrictions imposed by the source providing the information, laws or regulations or other conditions, for example, war, civil unrest or outbreaks of disease. In many cases, the auditor may be able to overcome restricted access to information. However, if the auditor is unable to access information in performing planned procedures to obtain sufficient appropriate audit evidence, or the information is not available, the auditor seeks alternative information to obtain sufficient appropriate audit evidence. If the auditor is unable to obtain sufficient appropriate audit evidence (i.e., a limitation of scope), the auditor is required to express a qualified opinion or disclaim the opinion on the financial statements in accordance with ISA 705 (Revised).

The Relevance and Reliability of Information Intended to be Used as Audit Evidence

Paragraphs 38–43 of **Agenda Item 2**

- C.6 The relevance of information intended to be used as audit evidence deals with the degree to which the information relates to fulfilling the purpose of the audit procedure.

Examples of attributes that may be considered by the auditor in considering the degree to which information intended to be used as audit evidence is relevant:

Relation	The information logically relates to, or bears upon, the purpose of an audit procedure, including, when appropriate, the assertion under consideration.
Precision	The exactness or level of detail of the information for the purpose of the audit procedure.

- C.7 The reliability of information intended to be used as audit evidence deals with the degree to which the auditor may depend on such information.

² ISA 200, paragraphs A47–A52

<i>Examples of attributes that may be considered by the auditor in considering the degree to which information intended to be used as audit evidence is reliable</i>	
Authenticity	The source noted actually generated or provided the information, and was authorized to do so, and the information has not been inappropriately altered.
Accuracy	The information is free from error in its reflection of the underlying events and conditions, including attributing the appropriate time period or point in time to the conditions or events.
Bias	The information is free from intentional and unintentional bias in its reflection of the underlying events or conditions.
Completeness	The information reflects all of the underlying events or conditions.
Credibility	The source has the competence to generate the information to a required standard, and the source can be trusted.

C.8 The auditor's consideration of the relevance and reliability of information intended to be used as audit evidence and evaluation of whether it is sufficiently relevant and reliable for the auditor's purposes may take into account:

- How much work effort is needed to consider the relevance and reliability of information intended to be used as audit evidence.
- Which attributes may need to be considered, since not all attributes may be relevant in all circumstances.

Example:

It may not be necessary to consider the completeness of information intended to be used as audit evidence in performing audit procedures to test the accuracy of management's calculations on the depreciation of property plant and equipment.

- The degree to which the attributes need to apply to information intended to be used as audit evidence (i.e., the attributes of relevance and reliability).

Example:

Information intended to be used in performing analytical procedures near the end of the audit may not need to be as accurate as information intended to be used in developing an expectation of recorded amounts in response to an assessed risk of material misstatement at the assertion level.

C.9 The factors that may influence the auditor's consideration of the relevance and reliability of information intended to be used as audit evidence and whether it is sufficiently relevant and reliable for the auditor's purposes include:

- The nature and purpose of the audit procedure.

Examples:

- Information intended to be used in performing risk assessment procedures may not need to be as reliable as information intended to be used in performing further audit procedures.
- Information intended to be used to perform tests of controls to determine that only authorized users obtained access to an IT application may be relevant if it includes how users are authorized, how they obtain access to the IT application, how users' log-in information is secured, a list of authorized users, and a log of which users accessed the IT application.
- If the purpose of an audit procedure is to test for completeness of revenue, the auditor may focus on the completeness of the information intended to be used as audit evidence.

- The source of the information intended to be used as audit evidence.

Example:

Information from a third-party pricing service may be less prone to management bias. Instead, the authenticity and credibility of the source may of particular importance.

- The nature of the information intended to be used as audit evidence.

Example:

Information about average real estate rental prices for a country may not be sufficiently precise to use in performing further audit procedures to test revenue for a real estate entity. However, information about average real estate rental prices for a particular suburb may be sufficiently precise for use in testing revenue for a real estate entity.

- The controls over the preparation and maintenance of the information intended to be used as audit evidence.

Example:

The auditor may evaluate the design and implementation of the entity's controls over the preparation of information intended to be used as audit evidence. If the auditor determines that the controls were designed appropriately and have been implemented, the auditor's work effort to consider the reliability of the information may be less extensive than in circumstances when the entity lacks controls or the auditor has not considered the design and implementation of the controls.

- How the information intended to be used as audit evidence has been obtained by the auditor, and the form of the information.

Examples:

- The auditor's work effort to consider the reliability of information obtained directly by the auditor, such as physically attending an inventory count, may be less extensive

than in circumstances when the information has been obtained indirectly or by inference, such as watching a video recorded by the entity of an inventory count.

- In testing the validity of revenue transactions, the auditor may focus more on the authenticity of invoices and shipping documents generated in digital form, than invoices and shipping documents that are in hard-copy form with evidence of the customer's signature of receipt.

- The relative importance of the information intended to be used as audit evidence to the overall purpose of the audit procedure.

Example:

If the information is the only information the auditor will use to perform the audit procedure that is designed to test a particular assertion for a material account balance, the auditor's work effort to consider the relevance and reliability of that information may be more extensive than in circumstances when multiple pieces of information will be used in performing the audit procedure.

- In relation to information intended to be used by the auditor in performing further audit procedures, the assessed risks of material misstatement, including the nature of the risk of material misstatement and the relevant assertions, and the reasons for the assessment.

Example:

The nature of the risk of material misstatement relates to the accuracy of management's performance bonuses that are determined based on net profit, and the auditor intends to recalculate management's performance bonuses using net profit information provided by the entity. In considering the relevance and reliability of the net profit information, the auditor may focus on the degree of bias and the accuracy of the information provided by the entity.

- Whether the information appears to corroborate or contradict management's assertions.
- The extent of change from prior audits, if applicable, in relation to the information intended to be used as audit evidence, such as changes in how the information has been prepared and changes in underlying controls.

Example:

The entity may use an IT application to calculate the recoverability of accounts receivable, using historical payment information for each customer and their credit ratings. In the previous audit, the auditor may have tested the algorithms supporting the IT application and was satisfied that the IT application generated information that is sufficiently reliable for the auditor's purposes in testing the valuation of accounts receivable. In the current period, the entity upgrades the IT application, and the new version uses more extensive information in its algorithms that calculate the recoverability of accounts receivable. Accordingly, in the current audit, the auditor may need to extend the nature and extent of the audit procedures to consider the relevance and reliability of the information.

- C.10 In some circumstances, it may not be practicable for the auditor to consider certain attributes in considering the reliability of information intended to be used as audit evidence.

Example:

For information obtained from a source external to the entity, the auditor may not be able to consider the accuracy and completeness of such information, and instead may focus on the credibility of the source providing the information.

- C.11 The consideration of the relevance and reliability of information intended to be used as audit evidence may be performed concurrently with other audit procedures to obtain sufficient appropriate audit evidence.

Example:

The auditor is testing the completeness of revenue transactions for an entity that has only online sales. The entity has a contract with a shipping agent to exclusively use the shipping agent to deliver items to customers. The auditor obtains a report of revenue transactions for the period from the entity. The auditor uses the monthly statements from the entity's shipping agent to trace individual shipments to the report of revenue transactions. This audit procedure addresses the completeness (reliability) of the information intended to be used as audit evidence (i.e., the report of revenue transactions), and concurrently provides audit evidence to address the risk of material misstatement related to the completeness of revenue (i.e., it is also a further audit procedure).

- C.12 In some circumstances, the results of the tests of controls over the preparation and maintenance of the information may assist the auditor in considering the relevance and reliability of information intended to be used as audit evidence.

Section D of Agenda Item 2 – Sufficient Appropriate Audit Evidence, and the Persuasiveness of Audit Evidence

The Factors that Affect the Sufficiency and Appropriateness of Audit Evidence

Paragraphs 53–64 of **Agenda Item 2**

- D.1 The measure of whether audit evidence is sufficient appropriate audit evidence is affected by the assessed risks of material misstatement, including the:
- Nature of the risk of material misstatement and the relevant assertions;
 - Reasons for the assessment; and
 - Results of audit procedures performed, including whether any instances of fraud or error were identified.
- D.2 The degree of appropriateness of audit evidence, and whether it is sufficient, is affected by the following factors:
- The information to be used as audit evidence, including;
 - The auditor's consideration of the relevance and reliability of the information to be used as audit evidence.

Example:

Information obtained directly from a highly reputable and well-known third-party pricing service may be more reliable, and therefore more persuasive, than similar pricing information obtained from an investment custodian appointed on the entity's behalf.

- The extent to which information to be used as audit evidence is consistent or inconsistent with other information.

Example:

If the auditor has multiple pieces of information in relation to an asset value and the information is inconsistent, the information may be less persuasive and the auditor may determine it appropriate to seek further audit evidence.

- Information from a single source versus multiple sources.

Example:

When information is not available from a highly reputable and well-known third-party pricing service, information obtained from multiple investment custodians may be more persuasive than information obtained only from a single investment custodian appointed on the entity's behalf.

- The effectiveness of the auditor's procedures, and whether the audit procedures have been appropriately applied, including:
 - The nature, timing and extent of audit procedures performed.

Examples:

- Inspection or external confirmation procedures may be more persuasive than inquiry.
- External confirmations may be less persuasive relating to the recoverability of accounts receivable balances than in supporting conclusions about the existence of accounts receivable balances.
- Audit procedures that are more extensive (e.g., selecting more items for audit sampling purposes) may be more persuasive.
- Analytical procedures that use a visualization depicting the composition of a population to illustrate the volume and monetary value of items in the population may lack preciseness and be less persuasive than analytical procedures that recalculate expected recorded amounts.

- How the audit procedures have been performed by the auditor, such as whether:
 - There was adequate planning;
 - The audit procedures were performed by engagement team members with appropriate knowledge and experience to properly perform the procedures;

- The engagement team members appropriately exercised professional skepticism; and
- There was appropriate direction, supervision and review.

Example:

In making inquiries of management and others in the entity regarding fraud, a senior member of the engagement team may challenge and probe management more rigorously compared to a junior member of the engagement team, resulting in more persuasive audit evidence.

Section E of Agenda Item 2 – Designing and Performing Audit Procedures to Obtain Sufficient Appropriate Audit Evidence

The Effectiveness of Audit Procedures and Appropriate Application of Audit Procedures

Paragraphs 72–76 of **Agenda Item 2**

E.1 As explained in ISA 200, detection risk relates to the nature, timing and extent of the auditor's procedures that are determined by the auditor to reduce audit risk to an acceptably low level. It is therefore a function of the effectiveness of an audit procedure and of its application by the auditor.³ ISA 200 provides examples of matters that enhance the effectiveness of an audit procedure and of its application. Such matters include the proper assignment of personnel to engagement teams as well as supervision and review of the audit work performed. ISA 220 (Revised) deals with the quality management at the engagement level and the responsibilities of the engagement partner, which includes responsibilities for:

- Appropriate resources to perform the engagement; and
- The direction and supervision of the members of the engagement team and the review of their work.

As a result, in considering whether audit procedures to obtain audit evidence provide a basis for concluding on the sufficiency and appropriateness of audit evidence, the auditor may consider whether the audit procedures are effective and have been appropriately applied by the auditor. In doing so, the auditor may consider the appropriateness of the resources used to perform the audit procedures, and the direction and supervision of the members of the engagement team performing the audit procedures and the review of their work.

Types of Audit Procedures

Paragraphs 77–78 of **Agenda Item 2**

E.2 The types of audit procedures performed to obtain audit evidence may include:

- Inspection;
- Observation;
- Confirmation;

³ ISA 200, paragraph A45

- Recalculation;
- Reperformance;
- Analytical procedures; and
- Inquiry.

E.3 In obtaining audit evidence, the auditor may use one, or a combination, of different types of procedures. The auditor may use manual or automated tools and techniques, individually or in combination with each other, to perform audit procedures to obtain audit evidence. In some circumstances, due to the form of the underlying information, the auditor may need to use an automated tool and technique, or an automated tool and technique may provide more persuasive audit evidence than a manual technique.

Example:

The auditor may use an automated tool and technique when there is a large set of data that can be easily interrogated, to obtain a deeper understanding about the characteristics or composition of the data in performing risk assessment procedures.

E.4 The auditor may use the same procedure and the same information to achieve the objective of more than one audit procedure.

Example:

In identifying and assessing the risks of material misstatement regarding revenue, the auditor performs analytical procedures using automated tools and techniques, in order to identify transactions that do not meet certain criteria, such as transactions with unauthorized customers, transactions without matching shipping documents or transactions with unusual delivery timeframes. Such transactions may be assessed as having a higher risk of material misstatement.

In performing those procedures, the auditor is also able to obtain audit evidence about the occurrence of revenue. Specifically, the auditor's risk assessment procedures provide evidence about transactions that do meet certain criteria, such as transactions with authorized customers, transactions with matching shipping documents, and transactions with normal delivery.

Inspection

E.5 Inspection involves an examination (being physically present or using remote inspection tools) of an asset or an examination of records or documents, whether internal or external, in paper form, digital form, or other media.

Examples:

- To test a control, the auditor may inspect records, using manual or automated techniques, for evidence of authorization.
- The auditor may inspect the terms of revenue contracts with customers using a text-recognition program, which extracts the pricing and payment terms. The auditor may use the extracted information to undertake additional analytical procedures to test revenue.

Observation

E.6 Observation consists of looking at a process or procedure being performed by others. 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. See ISA 501 for further guidance on observation of the counting of inventory.⁴

Examples:

- The auditor may observe inventory counting by the entity's personnel.
- The auditor may observe entity personnel performing controls through remote observation tools, such as through live video or video footage from a drone.

Confirmation

E.7 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 digital or other media. See ISA 505 for further guidance.⁵

Examples:

The auditor may request confirmation of:

- Bank accounts and bank facilities with the bank. In some cases, this may be facilitated through third-party web-based platforms.
- Account balances, such as accounts receivable and accounts payable.
- The terms of agreements or transactions an entity has with third parties.
- Whether any modifications have been made to an agreement and, if so, what the relevant details are.
- Whether "side agreements" have been entered into that may influence revenue recognition.

Recalculation

E.8 Recalculation consists of checking the mathematical accuracy of information.

Example:

The auditor may use automated tools and techniques to perform a recalculation of the closing inventory values for each inventory item on hand at period end.

Reperformance

E.9 Reperformance involves the independent execution of procedures or controls that were originally performed as part of the entity's internal control.

⁴ ISA 501, *Audit Evidence—Specific Considerations for Selected Items*

⁵ ISA 505, *External Confirmations*

Examples:

The auditor may:

- Use automated tools and techniques to reperform the reconciliation of accounts payable balances at year end, through matching creditor's statements to the transactions in the underlying accounting records.
- Develop an auditor's point estimate or range to evaluate management's point estimate and related disclosures about estimation uncertainty, in accordance with ISA 540 (Revised).⁶

Analytical Procedures

E.10 Analytical procedures consist of evaluations of information through analysis of plausible relationships among both financial and non-financial data. Analytical procedures also encompass such investigation as is necessary of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount. See ISA 520⁷ for further guidance.

Inquiry

E.11 Inquiry consists of seeking information from knowledgeable persons within the entity or outside the entity. Inquiry is used extensively throughout the audit in addition to other audit procedures. Inquiries may range from formal written inquiries to informal oral inquiries. Although inquiry may provide important audit evidence, and may even produce evidence of a misstatement, inquiry alone ordinarily does not provide sufficient appropriate audit evidence of the absence of a material misstatement at the assertion level, nor of the operating effectiveness of controls.

E.12 Evaluating responses to inquiries is an integral part of the inquiry process. Responses to inquiries may provide the auditor with new information, or with information that is either consistent or inconsistent with other information. Responses to inquiries may provide a basis for the auditor to modify or perform additional audit procedures.

E.13 Although corroboration of evidence obtained through inquiry is often of particular importance, in the case of inquiries about management's intent, the information available to support management's intent may be limited. In these cases, understanding management's past history of carrying out its stated intentions, management's stated reasons for choosing a particular course of action, and management's ability to pursue a specific course of action may provide relevant information to corroborate the evidence obtained through inquiry.

E.14 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. See ISA 580 for further guidance.⁸

⁶ ISA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*

⁷ ISA 520, *Analytical Procedures*

⁸ ISA 580, *Written Representations*