

**STATEMENT 3.230**  
**AUDITING GUIDELINE**  
**AUDIT EVIDENCE**

**Introduction**

1. Paragraph 7 of the Statement of Auditing Standard No. 3.101 "Audit Approach" states that:

'The auditor should obtain relevant and reliable audit evidence sufficient to enable him to draw reasonable conclusions therefrom.'

This Auditing Guideline, which gives guidance on how that paragraph may be applied, should be read in conjunction with the Explanatory Foreword to Auditing Standards and Guidelines including the Glossary of Terms.

**Background**

**The nature of audit evidence**

2. Audit evidence is information obtained by the auditor in arriving at the conclusions on which he bases his opinion on the financial statements. Sources of audit evidence include the accounting systems and underlying documentation of the entity, its tangible assets, management and employees, its customers, suppliers and other third parties who have dealings with, or knowledge of, the entity or its business.
3. The sources and amount of evidence needed to achieve the required level of assurances are questions for the auditor to determine by exercising his judgement in the light of the opinion called for under the terms of his engagement. He will be influenced by the materiality of the matter being examined, the relevance and reliability of evidence available from each source and the cost and time involved in obtaining it. Often the auditor will obtain evidence from several sources which, together, will provide him with the necessary assurance.

**Sufficiency**

4. The auditor can rarely be certain of the validity of the financial statements. However, he needs to obtain sufficient relevant and reliable evidence to form a reasonable basis for his opinion thereon. The auditor's judgement as to what constitutes sufficient relevant and reliable audit evidence is influenced by such factors as:
  - a. his knowledge of the business of the entity and the industry in which it operates;

- b. the degree of risk of misstatement through errors or irregularities; this risk may be affected by such factors as:
  - i. the nature and materiality of the items in the financial statements;
  - ii. the auditor's experience as to the reliability of the management and staff of the entity and of its records;
  - iii. the financial position of the entity;
  - iv. possible management bias;
- c. the persuasiveness of the evidence.

### **Relevance**

5. The relevance of the audit evidence should be considered in relation to the overall audit objective of forming an opinion and reporting on the financial statements. To achieve this objective the auditor needs to obtain evidence to enable him to draw reasonable conclusions in answer to the following questions.

#### Balance sheet items

- a. Have all of the assets and liabilities been recorded?
- b. Do the recorded assets and liabilities exist?
- c. Are the assets owned by the entity and are the liabilities properly those of the entity?
- d. Have the amounts attributed to the assets and liabilities been arrived at in accordance with the stated accounting policies, on an acceptable and consistent basis?
- e. Have the assets, liabilities and capital and reserves been properly disclosed?

#### Profit and loss account items

- f. Have all income and expenses been recorded?
- g. Did the recorded income and expense transactions in fact occur?
- h. Have the income and expenses been measured in accordance with the stated accounting policies, on an acceptable and consistent basis?
- i. Have income and expenses been properly disclosed where appropriate?

### **Reliability**

6. Although the reliability of audit evidence is dependent upon the particular circumstances, the following general presumptions may be found helpful:

- a. documentary evidence is more reliable than oral evidence;
  - b. evidence obtained from independent sources outside the entity is more reliable than that secured solely from within the entity;
  - c. evidence originated by the auditor by such means as analysis and physical inspection is more reliable than evidence obtained from others.
7. The auditor should consider whether the conclusions drawn from differing types of evidence are consistent with one another. When audit evidence obtained from one source appears inconsistent with that obtained from another, the reliability of each remains in doubt until further work has been done to resolve the inconsistency. However, when the individual items of evidence relating to a particular matter are all consistent, then the auditor may obtain a cumulative degree of assurance higher than that which he obtains from the individual items.

### **Procedures**

#### **Obtaining audit evidence**

8. Audit evidence is obtained by carrying out audit tests which may be classified as 'substantive' or 'compliance' according to their primary purpose. Both such purposes are sometimes achieved concurrently. Substantive tests are defined as those tests of transactions and balances, and other procedures such as analytical review, which seek to provide audit evidence as to the completeness, accuracy and validity of the information contained in the books of account or in the financial statements. Compliance tests are defined as those tests which seek to provide audit evidence that internal control procedures are being applied as prescribed.
9. The auditor may rely on appropriate evidence obtained by substantive testing to form his opinion, provided that sufficient of such evidence is obtained. Alternatively, he may be able to obtain assurance from the presence of a reliable system of internal control, and thereby reduce the extent of substantive testing. The audit procedures which are appropriate when the auditor wishes to place reliance on the entity's internal controls are set out in the Auditing Guideline No. 3.240 Internal Controls.

#### **Techniques of audit testing**

10. Techniques of audit testing fall into the following broad categories:
- a. Inspection — reviewing or examining records, documents or tangible assets. Inspection of records and documents provides

evidence of varying degrees of reliability depending upon their nature and source (see paragraph 6b above). Inspection of tangible assets provides the auditor with reliable evidence as to their existence, but not necessarily as to their ownership, cost or value.

- b. Observation — looking at an operation or procedure being performed by others with a view to determining the manner of its performance. Observation provides reliable evidence as to the manner of the performance at the time of observation, but not at any other time.
- c. Enquiry — seeking relevant information from knowledgeable persons inside or outside the entity, whether formally or informally, orally or in writing. The degree of reliability that the auditor attaches to evidence obtained in this manner is dependent on his opinion of the competence, experience, independence and integrity of the respondent.
- d. Computation — checking the arithmetical accuracy of books of account or performing independent calculations.

#### **Analytical review procedures**

11. In addition to the above techniques, there are analytical review procedures, referred to in paragraph 8 above. These procedures include studying significant ratios, trends and other statistics and investigating any unusual or unexpected variations. The precise nature of these procedures and the manner in which they are documented will depend on the circumstances of each audit.
12. The comparisons which can be made will depend on the nature, accessibility and relevance of the data available. Once the auditor has decided on the comparisons which he intends to make in performing his analytical review, he should determine what variations he expects to be disclosed by them.
13. Unusual or unexpected variations, and expected variations which fail to occur, should be investigated. Explanations obtained should be verified and evaluated by the auditor to determine whether they are consistent with his understanding of the business and his general knowledge. Explanations may indicate a change in the business of which the auditor was previously unaware in which case he should reconsider the adequacy of his audit approach. Alternatively they may indicate the possibility of misstatements in the financial statements; in these circumstances the auditor will need to extend his testing to determine whether the financial statements do include material misstatements.