

**NEPAL STANDARDS ON AUDITING
AUDIT EVIDENCE**

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Introduction

01. The purpose of this Nepal Standard on Auditing (NSA) is to establish standards and provide guidance on the quality and quantity of audit evidence to be obtained when auditing financial statements, and the procedures for obtaining that audit evidence. This NSA is to be read in conjunction with the Preface to Nepal Standards on Auditing.
02. This NSA contains the basic principles and essential procedures (identified in bold type black lettering) together with related guidance in the form of explanatory and other material.
03. This NSA needs only be applied to material matters.

Audit Evidence

- 04. The auditor should obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the audit opinion.**
05. Audit evidence is obtained from an appropriate mix of tests of control and substantive procedures. In some circumstances, evidence may be obtained entirely from substantive procedures.
06. "Audit evidence" means the information obtained by the auditor in arriving at the conclusions on which the audit opinion is based. Audit evidence will comprise source documents and accounting records underlying the financial statements and corroborating information from other sources.
07. "Tests of control" means tests performed to obtain audit evidence about the suitability of design and effective operation of the accounting and internal control systems.
08. "Substantive procedures" means tests performed to obtain audit evidence to detect material misstatements in the financial statements, and are of two types:

- tests of details of transactions and balances and
- analytical procedures.

Sufficient Appropriate Audit Evidence

09. Sufficiency and appropriateness are interrelated and apply to audit evidence obtained from both tests of control and substantive procedures. Sufficiency is the measure of the quantity of audit evidence; appropriateness is the measure of the quality of audit evidence and its relevance to a particular assertion and its reliability. Ordinarily, the auditor finds it necessary to rely on audit evidence that is persuasive rather than conclusive and will often seek audit evidence from different sources or of a different nature to support the same assertion.
10. In forming the audit opinion, the auditor does not ordinarily examine all of the information available because conclusions can be reached about an account balance, class of transactions or control by way of using judgemental or statistical sampling procedures.
11. The auditor's judgement as to what is sufficient appropriate audit evidence is influenced by such factors as the:
- auditor's assessment of the nature and level of inherent risk at both the financial statement level and the account balance or class of transactions level,
 - nature of the accounting and internal control systems and the assessment of control risk,
 - materiality of the item being examined,
 - experience gained during previous audits,
 - results of audit procedures, including fraud or error which may have been found and
 - source and reliability of information available.
12. **When obtaining audit evidence from tests of control, the auditor should consider the sufficiency and appropriateness of the audit evidence to support the assessed level of control risk.**
13. The aspects of the accounting and internal control systems about which the auditor would obtain audit evidence are:
- (a) design: the accounting and internal control systems are suitably designed to prevent and/or detect and correct material misstatements; and
 - (b) operation: the systems exist and have operated effectively throughout the relevant period.
14. **When obtaining audit evidence from substantive procedures, the auditor should consider the sufficiency and appropriateness of audit evidence from such procedures together with any evidence from tests of control to support financial statement assertions.**
15. Financial statement assertions are assertions by management, explicit or otherwise, that are embodied in the financial statements. They can be categorised as follows:
- (a) existence: an asset or a liability exists at a given date;

- (b) rights and obligations: an asset or a liability pertains to the entity at a given date;
 - (c) occurrence: a transaction or event took place which pertains to the entity during the period;
 - (d) completeness: there are no unrecorded assets, liabilities, transactions or events, or undisclosed items;
 - (e) valuation: an asset or liability is recorded at an appropriate carrying value;
 - (f) measurement: a transaction or event is recorded at the proper amount and revenue or expense is allocated to the proper period; and
 - (g) presentation and disclosure: an item is disclosed, classified, and described in accordance with the applicable financial reporting framework.
16. Ordinarily, audit evidence is obtained regarding each financial statement assertion. Audit evidence regarding one assertion, for example, existence of inventory, will not compensate for failure to obtain audit evidence regarding another, for example, valuation. The nature, timing and extent of substantive procedures will vary depending on the assertions. Tests can provide audit evidence about more than one assertion, for example, collection of receivables may provide audit evidence regarding both existence and valuation.
17. The reliability of audit evidence is influenced by its source: internal or external, and by its nature: visual, documentary or oral. While the reliability of audit evidence is dependent on individual circumstance, the following generalisations will help in assessing the reliability of audit evidence:
- audit evidence from external sources (for example, confirmation received from a third party) is more reliable than that generated internally,
 - audit evidence generated internally is more reliable when the related accounting and internal control systems are effective,
 - audit evidence obtained directly by the auditor is more reliable than that obtained from the entity and
 - audit evidence in the form of documents and written representations is more reliable than oral representations.
18. Audit evidence is more persuasive when items of evidence from different sources or of a different nature are consistent. In these circumstances, the auditor may obtain a cumulative degree of confidence higher than would be obtained from items of audit evidence when considered individually. Conversely, when audit evidence obtained from one source is inconsistent with that obtained from another, the auditor determines what additional procedures are necessary to resolve the inconsistency.
19. The auditor needs to consider the relationship between the cost of obtaining audit evidence and the usefulness of the information obtained. However, the matter of difficulty and expense involved is not in itself a valid basis for omitting a necessary procedure.

20. When in substantial doubt as to a material financial statement assertion, the auditor would attempt to obtain sufficient appropriate audit evidence to remove such doubt. **If unable to obtain sufficient appropriate audit evidence, however, the auditor should express a qualified opinion or a disclaimer of opinion.**

Procedures for Obtaining Audit Evidence

21. The auditor obtains audit evidence by one or more of the following procedures: inspection, observation, inquiry and confirmation, computation and analytical procedures. The timing of such procedures will be dependent, in part, upon the periods of time during which the audit evidence sought is available.

Inspection

22. Inspection consists of examining records, documents, or tangible assets. Inspection of records and documents provides audit evidence of varying degrees of reliability depending on their nature and source and the effectiveness of internal controls over their processing. Three major categories of documentary audit evidence, which provide different degrees of reliability to the auditor, are:
- (a) documentary audit evidence created and held by third parties;
 - (b) documentary audit evidence created by third parties and held by the entity; and
 - (c) documentary audit evidence created and held by the entity. Inspection of tangible assets provides reliable audit evidence with respect to their existence but not necessarily as to their ownership or value.

Observation

23. Observation consists of looking at a process or procedure being performed by others, for example, the observation by the auditor of the counting of inventories by the entity's personnel or the performance of control procedures that leave no audit trail.

Inquiry and Confirmation

24. Inquiry consists of seeking information of knowledgeable persons inside or outside the entity. Inquiries may range from formal written inquiries addressed to third parties to informal oral inquiries addressed to persons inside the entity. Responses to inquiries may provide the auditor with information not previously possessed or with corroborative audit evidence.
25. Confirmation consists of the response to an inquiry to corroborate information contained in the accounting records. For example, the auditor ordinarily seeks direct confirmation of receivables by communication with debtors.

Computation

26. Computation consists of checking the arithmetical accuracy of source documents and accounting records or of performing independent calculations.

Analytical Procedures

27. Analytical procedures consist of the analysis of significant ratios and trends including the resulting investigation of fluctuations and relationships that are inconsistent with other relevant information or deviate from predicted amounts.

Audit Evidence for Specific Financial Statements

28. Audit evidence for specific financial statements is dealt with in the annexure "Audit Evidence-Additional Considerations for Specific Items".

Compliance with International Standards on Auditing

29. Compliance with this NSA ensures compliance in all material respects with ISA 500 (Audit Evidence) and ISA 501 (Audit Evidence-Additional Considerations for Specific Items).

Effective Date

30. This Nepal Standard on Auditing becomes operative for the audit commencing on or after 01 Magh 2060 corresponding to 15 January 2004.

Public Sector Perspective

When carrying out audits of public sector entities, the auditor will need to take into account the legislative framework and any other relevant regulations, ordinances or directives from appropriate authorities which affect the audit mandate and any special auditing requirements. Such requirements might affect, for example, the extent of the auditor's discretion in establishing materiality and judgements on the nature and scope of audit procedures to be applied. Paragraph 11 of this NSA has to be applied only after giving consideration to such restrictions on the auditor's judgement.

ANNEXURE TO NSA 04: AUDIT EVIDENCE

Additional Considerations for Specific Items

1. With respect to specific financial statements, the auditor should obtain audit evidence by following procedures such as:
 - a. Attendance at Physical Inventory Counting;
 - b. Confirmation of Accounts Receivable;
 - c. Inquiry Regarding Litigation and Claims;
 - d. Valuation and Disclosure of Long-term Investments; and
 - e. Segment Information.

Attendance at Physical Inventory Counting

2. **When inventory is material to the financial statements, the auditor should obtain sufficient appropriate audit evidence regarding its existence and condition by attendance at physical inventory counting unless impracticable.** Such attendance will enable the auditor to inspect the inventory, to observe compliance with the operation of management's procedures for recording and controlling the results of the count and to provide evidence as to the reliability of management's procedures.
3. **If unable to attend the physical inventory count on the date planned due to unforeseen circumstances, the auditor should take or observe some physical counts on an alternative date and, when necessary, perform tests of intervening transactions.**
4. **Where attendance is impracticable, due to factors such as the nature and location of the inventory, the auditor should consider whether alternative procedures provide sufficient appropriate audit evidence of existence and condition to conclude that the auditor need not make reference to a scope limitation.** For example, documentation of the subsequent sale of specific inventory items acquired or purchased prior to the physical inventory count may provide sufficient appropriate audit evidence.
5. When inventory is under the custody and control of a third party, the auditor would ordinarily obtain direct confirmation from the third party as to the quantities and condition of inventory held on behalf of the entity.

Confirmation of Accounts Receivable

6. **When the accounts receivable are material to the financial statements and when it is reasonable to expect debtors will respond, the auditor should ordinarily plan to obtain direct confirmation of accounts receivable or individual entries in an account balance.**
7. **When it is expected that debtors will not respond, the auditor should plan to perform alternative procedures.** An example of such alternative procedures would be examining subsequent cash receipts related to the specific account balance or individual entries at period end.

8. **If reply to a positive confirmation is not received, alternative procedures should be applied or the item treated as an error.** An example of such alternative procedure is the examination of subsequent cash receipt or examining sales and dispatch documents. Items for which a reply has not been received and for which alternative procedures have not been performed, would be treated as errors for the purpose of evaluating the audit evidence provided by the audit sample.
9. **When management requests the auditor not to confirm certain accounts receivable balances, the auditor should consider whether there are valid grounds for such a request.** For example, if a particular account is in dispute with the debtor and communication on behalf of the auditor may aggravate sensitive negotiations between the entity and the debtor. **Before accepting a refusal as justified, the auditor should examine any available evidence to support management's explanations. In such cases, the auditor should apply alternative procedures to the accounts receivable not subjected to confirmation.**

Inquiry Regarding Litigation and Claims

10. **The auditor should carry out procedures in order to become aware of any litigation and claims involving the entity which may have a material effect on the financial statements.** Such procedures would include:
 - a. make appropriate inquires of management including obtaining representations;
 - b. review board minutes and correspondence with the entity's lawyers;
 - c. examine legal expense accounts; and
 - d. use any information obtained regarding the entity's business including information obtained from discussions with any in-house legal department.
11. **When litigation or claims have been identified or when the auditor believes they may exist, the auditor should seek direct communication with the entity's lawyers.** Such communication will assist in obtaining sufficient appropriate audit evidence as to whether potentially material litigation and claims are known and management's estimates of the financial implications, including costs, are reliable.
12. **The letter, which should be prepared by management and sent by the auditor, should request the lawyer to communicate directly with the auditor.** When it is considered unlikely that the lawyer will respond to a general inquiry, the letter would ordinarily specify:
 - a. a list of litigation and claims;
 - b. management's assessment of the outcome of the litigation or claims and its estimate of the financial implications, including costs involved; and
 - c. a request that the lawyer confirm the reasonableness of management's assessment and provide the auditor with further information if the list is considered by the lawyer to be incomplete or incorrect.
13. **If the management refuses to give the auditor permission to communicate with the entity's lawyer, this would be a scope limitation and should ordinarily lead to a qualified opinion or a disclaimer of opinion.** Where a lawyer refuses to respond in an appropriate manner and the auditor is unable to obtain sufficient appropriate audit evidence by applying alternative procedures, the auditor would consider whether there is a scope limitation which may lead to a qualified opinion or a disclaimer of opinion.

Valuation and Disclosure of Long-Term Investments

14. **When long-term investments are material to the financial statements, the auditor should obtain sufficient appropriate audit evidence regarding their valuation and disclosure.**
15. If such values do not exceed the carrying amounts, the auditor would consider whether a write-down is required. If there is an uncertainty as to whether the carrying amount will be recovered, the auditor would consider whether appropriate adjustments and/or disclosures have been made.

Segment Information

16. **When segment information is material to the financial statements, the auditor should obtain sufficient appropriate audit evidence regarding its disclosure in accordance with the identified financial reporting framework.**
17. Audit procedures regarding segment information ordinarily consist of analytical procedures and other audit tests appropriate in the circumstances.