
Staff Guidance – Insights for Auditors

Evaluating Relevance and Reliability
of Audit Evidence Obtained From
External Sources

October 2021

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OVERVIEW

AS 1105, *Audit Evidence*, explains what constitutes audit evidence and establishes requirements regarding designing and performing audit procedures to obtain sufficient appropriate audit evidence.

Through outreach primarily related to our [research project on data and technology](#), we understand that, among other things, expanded use of information from sources external to the company (“external information” and “external sources”) is affecting the volume and nature of information available to auditors to use in the performance of their audits. We also understand from our ongoing [research project on audit evidence](#) that auditors are seeking additional clarity on applying the requirements in AS 1105 when using information obtained from external sources as audit evidence. As part of our ongoing project, we continue to conduct research activities on other matters that may affect obtaining and evaluating audit evidence.

This PCAOB staff guidance focuses primarily on considerations that address relevance and reliability of information from external sources that the auditor plans to use as audit evidence. It also addresses the relationship between the quality and quantity of audit evidence.

GROWING USE OF INFORMATION FROM EXTERNAL SOURCES

Advancements in technology in recent years have improved accessibility and expanded the volume of information available to companies and their auditors from traditional and newer external sources.

Traditional external sources of information, such as regulatory agencies and industry data providers, are increasingly making certain information more accessible. For example, some

external sources have developed interactive applications that can provide real-time industry data to companies (e.g., occupancy rates and trend reports used in the hospitality industry). In addition, information from relatively newer, nontraditional external sources, such as web data aggregators and social media platforms, is becoming more prevalent. Some companies use external information such as product reviews, weather patterns, and customer web traffic to inform business and financial reporting decisions.

Changes in the company’s use of external information for the purpose of financial reporting may in turn affect audits of the company’s financial statements and internal control over financial reporting. If the auditor plans to use external information as audit evidence, the auditor is required to evaluate the relevance and reliability of the information, regardless of whether it has been used by the company in preparing the financial statements.

EVALUATING RELEVANCE AND RELIABILITY OF INFORMATION FROM EXTERNAL SOURCES

Audit evidence consists of information (including external information) that the auditor uses in arriving at the conclusions on which the auditor’s opinion is based. The auditor is required to obtain sufficient appropriate audit evidence to provide a reasonable basis for the auditor’s opinion.

Sufficiency is the measure of the quantity of audit evidence, and appropriateness is the measure of its quality. To be appropriate, audit evidence must be both relevant and reliable in providing support for the auditor’s conclusions.

The concepts of sufficiency and appropriateness of audit evidence are interrelated – the quantity of audit evidence needed is affected by both the risk of material misstatement (in the audit of financial statements) or the risk associated

with the control (in the audit of internal control over financial reporting) and the quality of the evidence (i.e., its relevance and reliability). Further, the concepts of relevance and reliability are also interrelated – information that is more relevant but obtained from a less reliable source, or information that is less relevant but obtained from a more reliable source, may need to be supplemented by additional information to provide more persuasive audit evidence. The amount of evidence needed also depends on the purpose of the audit procedure – substantive procedures and tests of controls, for example, involve obtaining more persuasive evidence than risk assessment procedures.¹ However, obtaining more of the same type of audit evidence cannot compensate for the poor quality of that evidence.

Overall, as the risk of material misstatement increases, the amount of evidence that the auditor should obtain also increases. Additionally, greater relevance and reliability of audit evidence are needed to address higher levels of risk. In some cases, information that was determined by the auditor to be more relevant may not be the most reliable, and vice versa. To supplement evidence that is less relevant or obtained from a less reliable source, an auditor would need additional evidence, either provided by the company or obtained by the auditor from external sources. As the quality of audit evidence (i.e., relevance and reliability) increases, the need for additional corroborating evidence decreases.

As noted, both relevance and reliability of external information (whether obtained by the auditor directly from the source or through the company) need to be evaluated when the auditor plans to use that information as audit evidence.

In evaluating the relevance and reliability of information from external sources, auditors are encouraged to consider the guidance provided below.²

Considerations Regarding Relevance of Information From External Sources

The relevance of audit evidence refers to its relationship to the assertion or to the objective of the control being tested and depends on the design and timing of the audit procedure. By its nature, some information may be more relevant for purposes of certain audit procedures than other information.

In some situations, whether external information is relevant to the objective of the audit procedure performed (e.g., to respond to the risks of material misstatement) may be readily apparent. For example:

- A year-end price of an actively traded equity security obtained from a stock exchange and used to compare to the company's recorded price would ordinarily provide relevant audit evidence for testing the valuation assertion of financial asset holdings because the exchange price would represent the fair value of the instrument.³
- Information about company sales received via an electronic data interface file from an external source (e.g., orders of pharmaceuticals from wholesalers) might not be relevant for testing the occurrence or allocation of revenue if the information lacks specific transaction data – without which it would not be possible

¹ AS 1105 does not preclude the auditor from designing audit procedures to accomplish more than one purpose.

² This document is not intended to describe all considerations, procedures, or factors that could be relevant in the circumstances of a particular audit. The examples are provided to illustrate the concepts of relevance and reliability. Information discussed in the examples may not constitute sufficient and appropriate audit evidence and may need to be supplemented by another type, or other types, of information. The determination of sufficiency and appropriateness of audit evidence is made based on the facts and circumstances of a particular audit.

³ Appendix A of AS 2501, *Auditing Accounting Estimates, Including Fair Value Measurements*, sets forth audit requirements for using pricing information from third parties when auditing the fair value of financial instruments.

to determine that performance obligations have been satisfied (e.g., contract terms, product codes, location data).

In other situations, however, the relevance of external information may be less apparent. The audit effort needed to evaluate the relevance of external information will vary.

For example, when estimating current expected credit losses, some banks may use historical loss information from other financial institutions (e.g., when the bank does not have a long history with a lending product). The auditor's evaluation of the relevance of the external information could be informed by, for example, whether the loan products of the bank and other financial institutions are similar, the bank's loans and the other institutions' loans were originated with similar underwriting standards, the other financial institutions are similar to the bank in customer base, the borrowers have a similar geographic location, and the economic conditions impacting such historical loss information are similar to the bank's assumptions regarding current and forecasted economic conditions.

As discussed above, we understand that some firms are considering using as audit evidence new information from nontraditional external sources that has become available because of the advances in information technology. To determine the nature and strength of any relationship between this information and the company's transactions, and to substantiate conclusions reached, the auditor may need to perform additional procedures (e.g., correlation or regression analyses). For example:

- A company could use customer reviews of its products from a social media website to monitor customer satisfaction and identify any emerging quality issues. This information may be relevant to the auditor's risk assessment procedures. For example, it could inform the

auditor's understanding of how the company collects information about potential quality problems and identifies a need for changes to warranty reserves. However, to determine whether social media reviews provide relevant evidence to support, for example, conclusions from substantive analytical procedures performed for a warranty reserve, the auditor would need to further understand how closely the negative customer reviews are correlated with product returns or warranty claims, taking into consideration the company's business, the industry, and the nature of the company's products.

- Some research suggests that weather data may be used to predict retail customer behavior and sales trends. However, before using the weather data in developing certain expectations – e.g., for substantive analytical procedures related to product revenue – the auditor would need to understand the relationship between weather data and company activities to determine the relevance of the data to the audit objective. This may involve, among other things, comparing historical weather trends and historical trends in the company's revenue.

Other considerations that may be pertinent to evaluating the relevance of external information include the aggregation and age of external information:⁴

- In some cases, the relevance of external information may increase if the information is disaggregated. For example, when testing the valuation assertion of residential loans that are measured based on the fair value of the collateral, disaggregated sales data for residential properties by geographic location would likely provide more relevant audit evidence than combined sales data for both commercial and residential properties by geographic location. The sales data could be

⁴ Depending on the facts and circumstances of a particular audit, there may be other pertinent considerations to evaluating relevance, in addition to those included in this document.

even more relevant if further disaggregated by residential property type.

- The age of the external information and the time period it covers are also important in considering the information's relevance. For example, in performing substantive analytical procedures over a utility company's revenue, the relevance of census data to the auditor's expectations of revenue and to achieving the desired objective of the procedure could vary depending on whether there have been significant expansions or contractions in the related population since the data was collected.

Further, a certain type of information used as audit evidence in a prior audit may become less relevant in subsequent audits due to changes in the information or the account to which the evidence relates (e.g., the composition of data or the account).

As noted, to be appropriate, information that the auditor plans to use as audit evidence must be both relevant and reliable. Relevant information obtained from a less reliable source (as discussed below) may need to be supplemented by additional other information to provide support for the auditor's conclusions.

Considerations Regarding Reliability of Information From External Sources

The reliability of audit evidence depends on the source and nature of the evidence and the circumstances under which it is obtained. The following are examples of factors that may affect the auditor's evaluation of the reliability of external information that the auditor plans to use as audit evidence. As discussed in more detail below, these and other factors would be considered by the auditor in combination.

Factors Related to the Source of the Information

- *Expertise or reputation of the external source.* Information that is obtained from a reputable

source with proven expertise in the subject matter would likely be considered more reliable than information from a less known source or a source with little or no relevant expertise.

- *Extent of regulatory oversight of the external source.* Information from external sources that are subject to regulatory oversight (e.g., stock exchanges) or a statutory mandate (e.g., governmental organizations that routinely provide industry statistics, census data, and interest rates) typically undergoes rigorous verification processes and would likely be considered more reliable than information from external sources with little or no oversight or statutory authority (e.g., aggregator of social media data).
- *Relationship of the external source to the company.* Information obtained from an external source that can be directly or indirectly influenced by the company may be less reliable than information from an independent external source.

Factors Related to the Nature of the Information

- *Whether the information has been originated, aggregated, or adjusted by the external source.* Some external sources originate and provide data in its original form (e.g., property sales, trade data for a financial instrument). Other external sources aggregate data originated by other parties. Processing errors during the aggregation may reduce the reliability of the output. Further, other external sources may adjust original data using complex methods with multiple assumptions. Adjusted information may be more susceptible to processing error and bias than the original data, which may reduce its reliability – especially if the nature of the adjustment or the methods used is unclear.
- *Whether the information has been subject to review or verification.* Some information may be subject to review or verification by the external source or another external party, demonstrated

by, for example, a description of the verification process or an external assurance over the process. Information that has been subject to review or verification procedures would likely be more reliable than information that has not been reviewed or verified.

Circumstances Under Which Information Is Obtained

- *Whether the information was obtained directly by the auditor.* In general, information obtained directly by the auditor is more reliable than information obtained indirectly. For example, certain external information that is widely available can be obtained by the auditor directly from the source (e.g., the risk-free rate). External information whose distribution is more limited may need to be obtained by the auditor indirectly, for example, by extracting it from the information system of the company being audited (e.g., insurance claims data submitted to an insurer by a third-party healthcare provider). In this scenario, the effectiveness of the company's controls over the external information may also affect the reliability of the information.
- *Whether the information was obtained through a complex process.* A company or an auditor may need to perform a number of steps to extract and use data from an external source. The more complex the process, the greater the likelihood that a processing error may occur, reducing the reliability of the information.

Factors affecting reliability are considered in combination. For example, information obtained directly by the auditor from a more reputable

source generally would be more reliable than information obtained directly by the auditor from a less reputable source. Information, both oral and written (on paper or electronically), that was corroborated by the auditor through one or more other sources may be more reliable than information obtained from a single source. Considering the applicable factors in combination should more fully inform the auditor's evaluation of reliability of a particular type of information or information obtained from a particular source.

Further, if external information is subject to restrictions, limitations, or disclaimers, the auditor should evaluate the effect of the restrictions, limitations, or disclaimers on the reliability of that evidence. Finally, if audit evidence obtained from more than one source is inconsistent with that obtained from another, or if the auditor has doubts about the reliability of external information, the auditor should perform the audit procedures necessary to resolve the matter and should determine the effect, if any, on other aspects of the audit.

WHAT'S NEXT?

The staff will continue to conduct research and engage in outreach activities to inform the analysis of matters that may affect obtaining and evaluating the sufficiency and appropriateness of audit evidence. We will also continue to monitor the activities of other regulators and standard setters that involve developing guidance and revisions to requirements for obtaining sufficient appropriate audit evidence.

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