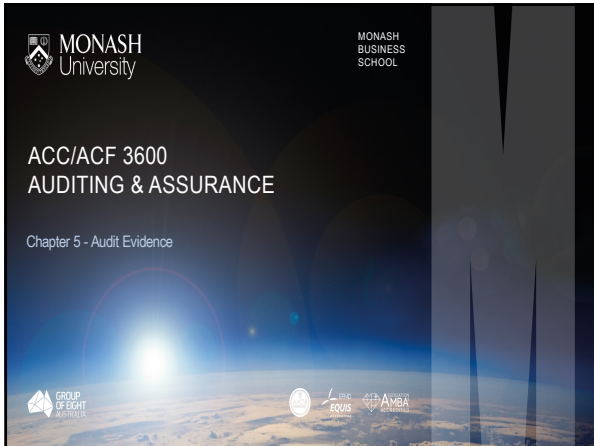




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LEARNING OBJECTIVES

AFTER READING THIS CHAPTER YOU SHOULD BE ABLE TO:

- 5.1 explain the **audit assertions**
- 5.2 explain and appraise **different types of audit evidence** and assess sufficient appropriate audit evidence
- 5.3 describe the **persuasiveness of audit evidence**
- 5.4 explain the issues to consider when **using the work of an expert**
- 5.5 describe the issues to consider when **using the work of another auditor**
- 5.6 explain the **evidence gathering procedures** most often used by auditors.

Adapted from Merriam, Robyn, et al. (2017). *Auditing: A practical approach* (3rd ed.). Wiley.

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AUDIT ASSERTIONS

- Those **charged with governance** of an entity are **responsible** for ensuring that the **financial report gives a true and fair view** of the entity and its operations
- **Management make assertions** about each **account** and **related note disclosures**
- Assertions are statements regarding the **recognition, measurement, presentation** and **disclosure** of items included in the financial report

Adapted from Merriam, Robyn, et al. (2017). *Auditing: A practical approach* (3rd ed.). Wiley.

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AUDIT ASSERTIONS

ASA 315 (ISA 315) requires auditors to **use assertions** when **assessing the risk of material misstatement** and **designing audit procedures**

This means that auditors need to **gather sufficient appropriate evidence about each assertion** for each transaction and account balance or disclosure

Adapted from Marston, Robyn, et al. (2017). *Auditing: A practical approach* (3rd ed.). Wiley

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AUDIT ASSERTIONS

There are three categories of assertions:

- **Classes of transactions and events (P/L)**
- **Account balances (B/S)**
- **Presentation and disclosure.**

Adapted from Marston, Robyn, et al. (2017). *Auditing: A practical approach* (3rd ed.). Wiley

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AUDIT ASSERTIONS

- Assertions about **classes of transactions and events** for the period under audit

Occurrence	Transactions and events that have been recorded have occurred and pertain to the entity.
Completeness	All transactions and events that should have been recorded have been recorded .
Accuracy	Amounts and other data relating to recorded transactions and events have been recorded appropriately.
Cut-off	Transactions and events have been recorded in the correct accounting period .
Classification	Transactions and events have been recorded in the proper accounts .

Adapted from Marston, Robyn, et al. (2017). *Auditing: A practical approach* (3rd ed.). Wiley

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AUDIT ASSERTIONS

- Assertions about **account balances** at year-end

Existence	Assets, liabilities and equity interests exist .
Rights and Obligations	The entity holds or controls the rights to assets, and liabilities are obligations to the entity.
Completeness	All assets, liabilities and equity interests that should have been recorded have been recorded .
Valuation and Allocation	Assets, liabilities and equity interests are included in the financial report at appropriate amounts and any resulting valuation or allocation adjustments are appropriately recorded .

Adapted from Marston, Roben, et al. (2017). *Auditing: A practical approach* (3rd ed.). Wiley

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AUDIT ASSERTIONS

- Assertions about **presentation and disclosure**

Occurrence, Rights and Obligations	Disclosed events, transactions and other matters have occurred and pertain to the entity.
Completeness	All disclosures that should have been included in the financial report have been recorded .
Classification and Understandability	Financial information is appropriately presented and described , and disclosures are clearly expressed .
Accuracy and Valuation	Financial and other information are disclosed fairly and at appropriate amounts .

Adapted from Marston, Roben, et al. (2017). *Auditing: A practical approach* (3rd ed.). Wiley

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AUDIT ASSERTIONS

- Presentation and disclosure assertions relate to the disclosures themselves**, not the underlying asset, liability, equity, revenue or expense items
- e.g. "Classification and understandability" relates to **the classification of the disclosure**, not whether the correct account was used for the transaction or event

Adapted from Marston, Roben, et al. (2017). *Auditing: A practical approach* (3rd ed.). Wiley

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AUDIT EVIDENCE

- Evidence is the information that an auditor uses when arriving at their opinion on the truth and fairness of the client's financial report (ASA 500; ISA 500)
- Auditor must gather sufficient appropriate evidence
 - Sufficiency relates to quantity of evidence
 - Appropriateness relates to quality of evidence
- Audit risk determines what evidence is required

Adapted from Marston, Robyn, et al. (2017). Auditing: A practical approach (3rd ed.). Wiley

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TYPES OF AUDIT EVIDENCE

External confirmations (ASA 505; ISA 505)

- Examples include:
 - Banks: confirm cash balances, securities, loans.
 - Lawyers: confirm documents being held.
 - Creditors: confirm amount owed, terms, by client.
 - Debtors: confirm amount owed to client.
 - Others: confirm description and quantity of assets held.
- Positive form: reply in all circumstances
 - Weakness: Cannot know how carefully (if at all) other party checked their records
- Negative form: reply if information incorrect
 - Weakness: Hard to interpret non-response

Adapted from Marston, Robyn, et al. (2017). Auditing: A practical approach (3rd ed.). Wiley

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TYPES OF AUDIT EVIDENCE

Documentary evidence, includes:

- Invoices,
- suppliers' statements,
- bank statements,
- minutes of meetings,
- correspondence,
- legal agreements

Can be internally or externally generated

Adapted from Marston, Robyn, et al. (2017). Auditing: A practical approach (3rd ed.). Wiley

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TYPES OF AUDIT EVIDENCE

Documentary evidence:

An auditor can

- Verify information in client's records by **reading documents** to confirm **existence, rights and obligations** ("vouching"), or
- **Trace from documents to clients records** to confirm **classification, accuracy, completeness** ("tracing")

Adapted from Marston, Roben, et al. (2017). *Auditing: A practical approach* (3rd ed.). Wiley

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TYPES OF AUDIT EVIDENCE

Representations:

- An auditor can request **a written legal representation**
- **Legal representation letter** is **sent by client to its lawyers** to complete and **return directly to auditor**
 - Can include **opinions on legal matters, details of disagreements with client** etc (ASA 502; ISA 501)

Adapted from Marston, Roben, et al. (2017). *Auditing: A practical approach* (3rd ed.). Wiley

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TYPES OF AUDIT EVIDENCE

Representations:

- An auditor can request **a written management representation**
- **Management representation letter** contains **acknowledgement of management's responsibilities, undertaking about legal compliance, confirmation of discussions**
 - Auditor still needs to gather other evidence
 - ASA 580; ISA 580

Adapted from Marston, Roben, et al. (2017). *Auditing: A practical approach* (3rd ed.). Wiley

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TYPES OF AUDIT EVIDENCE

Verbal Evidence:

- Auditor **documents discussions** with client management and staff.
- Used to **gain understanding** of internal controls; **corroborate other evidence**.

Adapted from Marston, Roben, et al. (2017). Auditing: A practical approach (3rd ed.). Wiley

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TYPES OF AUDIT EVIDENCE

Computational evidence

- Auditor checks **mathematical accuracy**
- **Re-adding** the entries
- Re-computing **complex re-calculations**
- Verifying formula

Adapted from Marston, Roben, et al. (2017). Auditing: A practical approach (3rd ed.). Wiley

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TYPES OF AUDIT EVIDENCE

Physical evidence

- Gathered by **inspecting assets**, to **assess condition**, to **reconcile to client's records**
- **Traces details** of tangible assets on hand back to the **recorded amount**.
- **Inspects** a client's **physical assets**.

Adapted from Marston, Roben, et al. (2017). Auditing: A practical approach (3rd ed.). Wiley

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TYPES OF AUDIT EVIDENCE

Electronic evidence

- Includes data held on client's computer, emails to auditor, and scans and faxes
- No paper trail
- Auditor needs to consider quality of client's computer system when assessing reliability of this evidence

Adapted from Marston, Bollen, et al. (2017). Auditing: A practical approach (3rd ed.). Wiley

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SUMMARY: TYPES OF EVIDENCE

- External confirmations
- Documentary evidence
- Representations
- Verbal evidence
- Computational evidence
- Physical evidence
- Electronic evidence

Adapted from Marston, Bollen, et al. (2017). Auditing: A practical approach (3rd ed.). Wiley

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EVIDENCE GATHERING PROCEDURES

Evidence gathering occurs throughout audit

- Guidance about primary evidence gathering techniques contained in ASA 500; ISA 500
 - Inspection of records and documents
 - Inspection of tangible assets
 - Observation of client staff/procedures
 - Enquiry
 - Recalculations
 - Re-performance
 - Analytical procedures

Adapted from Marston, Bollen, et al. (2017). Auditing: A practical approach (3rd ed.). Wiley

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PERSUASIVENESS OF AUDIT EVIDENCE

- Auditor is seeking evidence to corroborate client's recorded transactions and balances
- Greater corroboration is provided by more persuasive evidence
- Evidence types vary in persuasiveness
- Least to most persuasive:
 - Evidence generated internally by client
 - Evidence generated externally, held by client
 - Externally generated evidence send direct to auditor

Adapted from Moynsey, Roben, et al. (2017). Auditing: A practical approach (3rd ed.). Wiley

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PERSUASIVENESS OF AUDIT EVIDENCE

INTERNALLY GENERATED EVIDENCE:

- Includes records of cheques, copies of invoices and statements sent to customers, purchase orders, client's policies and procedures, contracts, minutes of meetings, journals, ledgers, trial balances, spreadsheets, worksheets, reconciliations, calculations and computations
- Could be held in paper or electronic form
- Least persuasive because it is possible that client could manipulate or omit this type of evidence

Adapted from Moynsey, Roben, et al. (2017). Auditing: A practical approach (3rd ed.). Wiley

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PERSUASIVENESS OF AUDIT EVIDENCE

EXTERNALLY GENERATED HELD BY CLIENT:

- Includes supplier invoices and statements, customer orders, bank statements, contracts, lease agreements, tax assessments
- Originals are more persuasive than photocopies
- More persuasive than internally generated evidence because it is produced by third parties
- Still possible that client could omit or tamper with evidence

Adapted from Moynsey, Roben, et al. (2017). Auditing: A practical approach (3rd ed.). Wiley

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PERSUASIVENESS OF AUDIT EVIDENCE

EXTERNALLY GENERATED, SENT DIRECT TO AUDITOR:

- Includes bank confirmations, debtors' confirmations, correspondence with client's lawyers, experts valuations
- Most reliable type of evidence because it is independent of client
- Client has no opportunity to alter evidence
- More reliable when external party is considered to be more reliable, trustworthy, independent of client

Adapted from Marston, Roben, et al. (2017). Auditing: A practical approach (3rd ed.). Wiley

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USING WORK OF AN EXPERT

- Auditor may engage expert to help in audit when auditor does not possess required skills and knowledge to assess item
- Expert could be member of audit team, audit firm, client, or independent
- ASA 620; ISA 620 provides guidance
 - Is expert required?
 - Determining scope of work for expert
 - Selecting expert – assessing objectivity, capability of expert
 - Assessing work of expert
 - Auditor is responsible for drawing conclusions

Adapted from Marston, Roben, et al. (2017). Auditing: A practical approach (3rd ed.). Wiley

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USING WORK OF AN EXPERT

- Assessing need to use an expert. Consider:
 - Knowledge of audit team
 - Significance and complexity of item being assessed
 - Availability of appropriate alternative corroborating evidence
- The less knowledge held by audit team, the greater risk of material misstatement and less corroborating evidence available, the more likely an expert required

Adapted from Marston, Roben, et al. (2017). Auditing: A practical approach (3rd ed.). Wiley

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USING WORK OF AN EXPERT

• Scope of work to be carried out

- Auditor must set **nature, timing** and **extent** of work
- Use **written instructions** covering issues expert will report on, and **how work will be used** by auditor

Adapted from Marston, Roben, et al. (2017). *Auditing: A practical approach* (3rd ed.). Wiley

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USING WORK OF AN EXPERT

• Assessing capability/objectivity of expert

- Consider expert's **qualifications, membership** of professional body, **reputation** in the field, **experience**
- More objective if not connected to client

Adapted from Marston, Roben, et al. (2017). *Auditing: A practical approach* (3rd ed.). Wiley

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USING WORK OF AN EXPERT

• Assessing the expert's report

- Report should be **understandable** to non-expert
- Include **process, assumptions, data** used by expert
- Auditor considers **consistency** with other information

• Responsibility for the conclusion

- **Auditor** to assess the quality of the evidence provided by an expert and determine whether it is reliable and objective.
- **Auditor** will determine the need for an expert, the scope of the expert's work and the competence and objectivity of the expert.

Adapted from Marston, Roben, et al. (2017). *Auditing: A practical approach* (3rd ed.). Wiley

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USING WORK OF ANOTHER AUDITOR

- **GROUP ENGAGEMENT PARTNER** responsible for signing audit report, but may use other auditors, especially for **remote locations**
- Consider **capacity of component auditors** to undertake the work (ASA 600; ISA 600)
- Component auditor's work must be to **same standard** as group engagement partner
 - **Objectivity**
 - Gathering **sufficient, appropriate evidence**

Adapted from Messner, Bollen, et al. (2017). *Auditing: A practical approach* (3rd ed.). Wiley

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Question 1

Jimmy is the auditor in charge of ABC Company. At the end of 2017, ABC Company had \$1,000,000 account receivables on balance sheet. Jimmy conducted confirmation with several major customers accounting for \$500,000 account receivables. Jimmy was satisfied with the outcomes of confirmation and concluded that there was no material misstatement in account receivables.

Question a: Which assertion of account receivables may be violated?

Question b: How should Jimmy verify the violated assertion?

Adapted from Messner, Bollen, et al. (2017). *Auditing: A practical approach* (3rd ed.). Wiley

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Question 2

Sam is the auditor in charge of XYZ Company. At the end of 2017, Sam went to one of the warehouses of XYZ Company and conducted inventory inspection. Sam found all the inventories on list in the warehouse and was satisfied with the quality. Sam concluded that there was no material misstatement in inventories.

Question a: Which assertion of inventories may be violated?

Question b: How should Sam verify the violated assertion?

Adapted from Messner, Bollen, et al. (2017). *Auditing: A practical approach* (3rd ed.). Wiley

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