

Week 5 – Audit Evidence, Auditor's Procedure in response to Assessed Risks & Audit Strategy

Audit Evidence (ASA 500)

- concept where auditor achieves objective of reasonable assurance that none of management's assertions are materially misstated, consists of:

Underlying accounting data	All available corroborating information
Books of original entry	Documents e.g. cheques, authorisations for direct bank transfers, invoices, contracts, etc.
General and subsidiary ledgers	Confirmations and other written representations
Worksheets, schedules, calculations, etc.	Information from inquiry, observations, inspection and physical examination
Related accounting manuals	All other information obtained or developed by the auditor

- auditor required to design & perform audit procedures to obtain SAAE in order to draw reasonable conclusions to base auditor's opinion
- audit evidence is obtained from performance of: risk assessment procedures, tests of controls (internal controls), and substantive testing (financial info)
- **sufficient** = measure of **quantity**; **appropriate** = measure of **quality** (i.e. relevance and reliability)
- audit evidence corroborates (confirms) managements' controls

Types of Audit Evidence

- audit evidence can take several forms: visual observations, oral, documentary, physical (e.g. seeing an asset), electronic
- documentary evidence includes: accg records & supporting docs, board mins of meetings, confirmations, written representations, analytical procedures (fluctuations between sales in different years)

Sources of Audit Evidence (ASA 500.A1 & A7-A9)

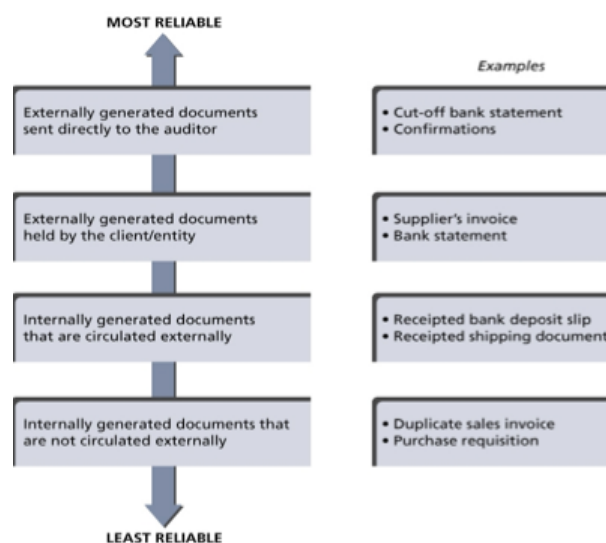
- evidence can be:
 - o created by external parties and transmitted directly to auditor
 - o created by external parties and held by client
 - o created and held by client
 - o electronic documents
- nature and source of evidence affects level of assurance the auditor derives from the info

Audit Procedures in response to Assessed Risks (ASA 500.A14-A25)

- may be used as risk assessment procedures, TOCs or substantive procedures, depending on the context in which they're applied by auditor (ASA 500.A11)
- many of these procedures can be performed/facilitated through use of generalised audit software

Audit Procedures: Enquiry

- consists of seeking info of **knowledgeable persons** (financial & non-financial) within entity or outside entity



- **evaluating responses** to enquiries is integral part of enquiry process (e.g. enquire sales personnel concerning possible excess/obsolete inventory to identify slow-moving, excess, defective or obsolete items)

Audit Procedures: **Inspection and Observation**

- inspection involves examining records/docs (internal/external) in paper form, electronic form or physical examination of an asset (e.g. select a sample of inventory lines and compare with suppliers' invoices to ensure inventories are properly stated at cost)
- observation consists of looking at a process/procedure being performed by others (limited to specific point in time) (e.g. observe inventory test counts by entity's personnel)

Information	Source
Cash at bank	Bank/s
Accounts receivables	Customer/s
Owned inventory on consignment / external warehouses	Consignee / Warehouse
Accounts payable	Creditor
Other loans/payables	Lender/financier

Audit Procedures: **External Confirmation**

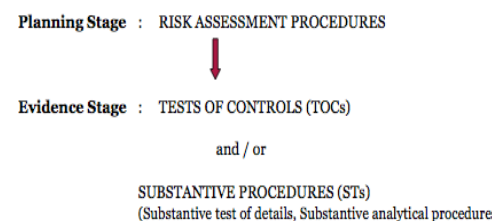
- represents audit evidence obtained as direct written response to auditor from a third party, in paper form, or by electronic or other medium
- often performed in addressing/verifying acct balances (existence)

Audit Procedures: **Re-Calculation and Re-Performance**

- re-calculation consists of checking mathematical accuracy of docs/records (manually/electronically) (e.g. multiplying inventory on hand by inventory cost price to check inventory valuation)
- re-performance involves auditor's independent execution of procedures or controls (e.g. re-performing sales transaction to ensure that inventory control system correctly updates inventory levels)

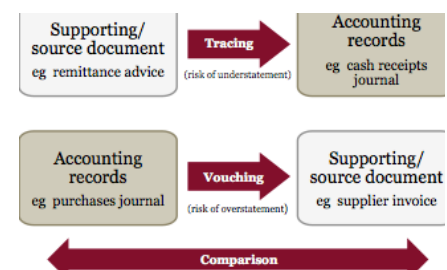
Tests of Controls vs. Substantive Procedures (ASA 330.4)

- TOCs are procedures designed to obtain audit evidence about **operating effectiveness** of controls in preventing, detecting & correcting (authorisation) material misstatements at assertion level
- under ASA 500, some **substantive testing MUST** be done
- **substantive procedures** are designed to obtain audit evidence to **detect material misstatements** at assertion level (provide direct evidence as to the fairness of management's financial statement assertions) and consists of:
 - o substantive analytical procedures (SAP)
 - o tests of details (transactions, balances, disclosures)
- **SAPs** involve comparisons to assess fairness (e.g. comparison of acct balance with previous year's balance), use of ratios and relies on effective controls
- **tests of details of transactions** involve obtaining evidence **of individual Dr and Cr posted to an account** (e.g. vouching Dr in A/R to entries in sales journal and supporting sales invoices)
- **tests of details of balances** involve examining support for closing balance (at year end) (e.g. confirming A/R directly with customers)



Auditing Accounting Estimates (ASA 540)

- some FR items cannot be measured precisely but can only be estimated (e.g. PPE when revaluation model is used)
- degree of estimation uncertainty affects RMM
- auditor needs to obtain SAAE to determine whether accg estimates, including fair value estimates are reasonable



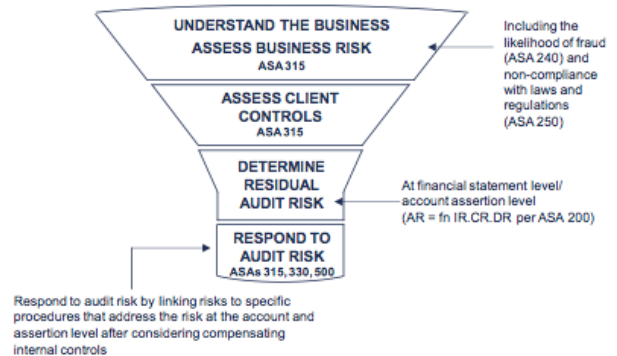
Audit Strategy

Auditor's Responses to Assessed Risks

- auditor determines overall response to address RMM at FR level (e.g. assigning more experienced staff, incorporating unpredictability into selection of audit procedures)
- auditor designs and performs further audit procedures whose nature, timing and extent are responsive to RMM at assertion level (e.g. significant risk and likelihood of misstatement, presence and effectiveness of controls used)

Audit Procedures

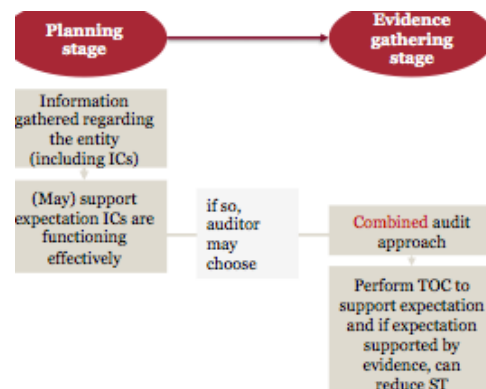
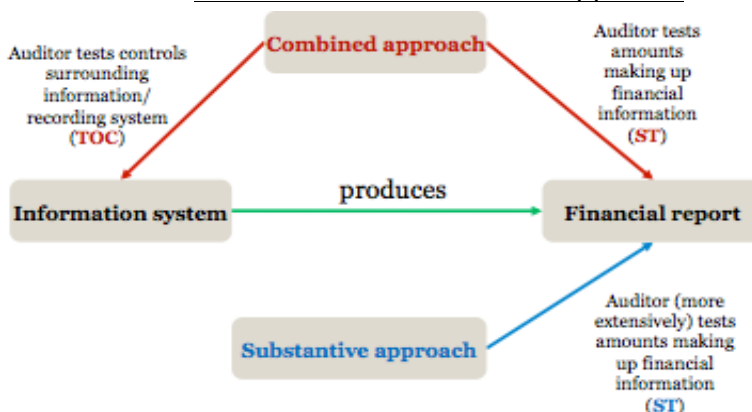
- **Nature** purpose (TOC/ST) and type (inspection, recalculation, etc.)
 - o TOCs: mandatory when **reliance** placed on effectiveness of identified mitigating controls (ASA 330.8)
 - o Substantive tests (ST): mandatory for all **material** accts/disclosures **regardless** of assessed level of risk (or extent of TOC)
 - o Substantive tests of detail (STOD): mandatory for **significant risk** accts/assertions when substantive approach adopted
- **Extent** of procedures (i.e. how much sampling?): function of materiality, assessed risk, planned level of assurance
- **Timing:** (when)
 - o Auditor may perform TOCs at interim date or STs at period end
 - o Higher risk of material misstatement:
 - More effective to perform STs nearer to or at period end
 - More likely to perform audit procedures unannounced
 - o Performing procedures before period end may facilitate identification and resolution of significant matters at early stage
 - o Certain procedures can be performed only at, or after, period end (e.g. agreeing FR to accg records, examining adjustments made while preparing FR)



Audit Strategy/Approach (ASA 330.A3-A4)

- audit strategy/approach at assertion level is determined by the assessment of IR and existence of relevant effective controls (CR)
- **combined approach:** use TOCs **and** substantive procedures (relevant effective ICs identified)
- **substantive approach:** emphasis on substantive procedures (generally where ICs are absent/poor)

Auditor's Selection of Audit Approach



- TOCS are undertaken:
 - To support expectation of operating effectiveness of ICs (i.e. audit reliance on ICs to reduce risk) formed during planning stage of audit
 - When substantive procedures alone do not provide SAAE at assertion level (i.e. audit risk too high without mitigating controls & TOCs)
- STs are:
 - Response to assessed RMM (including results of TOCs) at assertion level
 - Required for material classes of transactions/balances (regardless of extent of TOC)
 - Required (test of details) for significant risk accts/assertions when using substantive approach