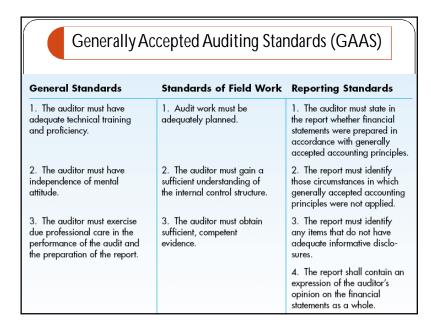
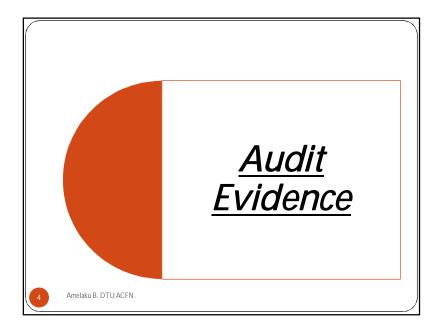


Generally Accepted Auditing Standard (GAAS) There are 10 generally accepted auditing standards (GAAS), which were developed by the AICPA. GAAS fall into three categories: General standards Standards of field work Reporting standards





Audit Evidence

Evidence was defined as <u>any information used by the</u>
 <u>auditor</u> to determine whether the information being audited
 is stated in accordance with the established criteria.

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Why Audit Evidence?

- Generally
 - Audit evidence is required to enable the auditor <u>to express an</u> opinion on the financial statements.
- Specifically: audit evidence is required to:
- Obtain an understanding of the entity and its environment to assess the risks of material misstatement at the financial statement and assertion levels <u>(risk assessment procedures)</u>
- Test the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements at the assertion level (tests of controls)
- Detect material misstatements at the assertion level <u>(substantive procedures)</u>

What audit evidence includes?

- Audit evidence includes the information contained in the
 - <u>accounting records</u> underlying the financial statements and
 - *other information* gathered by the auditors

Which items to select for a given procedure and how?

- Auditors are <u>not expected to look at all the information</u> that might exist. They will often select <u>samples</u> to test.
- Auditors can vary the sample size <u>from one to all</u> the items in the population being tested.
- The auditor can
 - (1) select a week and examine the first 50 checks,
 - (2) select the 50 checks with the *largest amounts*,
 - (3) select the checks <u>randomly</u>, or
 - (4) select those checks that the auditor thinks are most likely to be in error.
- Or, a combination of these methods can be used.



When to accumulate the evidence?

- An audit of financial statements usually covers a period such as a year.
- The timing decision is affected by:
 - > when the client needs the audit to be completed.
 - when the auditor believes the <u>audit evidence</u> will be most effective and when audit staff is available.
 - For example: auditors often prefer to do counts of inventory as close to the balance sheet date as possible.

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Financial statement Assertions

Occurrence: Transactions and events that have been recorded have occurred or disclosed have occurred, and such transactions and events pertain to the entity.

Completeness: All transactions and events that should have been recorded have been recorded, and all related disclosures that should have been included in the financial statements have been included.

Accuracy: Amounts and other data relating to recorded transactions and events have been recorded appropriately, and related disclosures have been appropriately measured and described.

Cut-off: Transactions and events have been recorded in the correct accounting period.

Classification: Transactions and events have been recorded in the proper accounts.

Presentation: Transactions and events are appropriately aggregated or disaggregated and clearly described, and related disclosures are relevant and understandable in the context of the requirements of the applicable financial reporting framework.

Financial statement Assertions

- <u>Management</u> of an entity are <u>responsible</u> for the financial statements, however, <u>auditors are responsible</u> for providing an assurance whether management assertions about financial statements are fairly represent the entity.
- Financial statement assertions are
 - the <u>representations by management</u>, explicit or otherwise, about the financial statements,
 - as <u>used by the auditor</u> to consider the different types of potential misstatements that may occur and design appropriate audit procedure.

Financial statement Assertions

Existence: Assets, liabilities and equity interests exist.

Rights and obligations: The entity holds or controls the rights to assets, and liabilities are the obligations of the entity.

የአዲት ጣሬጋገጫ	ቁጥጥሩን ለመልተሽ የሚቆፀመው የአዲት ስርዓት
ሁኔታ/occurrence/	በሴጀር ተመዝግቦ የተገኘው ሂሣብ የመ/ቤቱ ሂሣብ መሆኑን ማጣራት፡
ምስ-ዕነብ-/Completeness/	ሁሉም ቫውቸር የተቆረጠላቸው ሂሳቦች በሌጆር መመዝባባቸወ ማብራት፣
መኖር /Existence/	በሪፖርት የተጠቀሱት ንብረቶችና እዳዎች ያሉ መሆናቸውን ማጣራት፣
ትክክለኝነት∙/Accuracy	የተመዘገቡ ሂሳቦች የገንዘብ መጠንና ማስረጃዎች ትክክለኝነት ማጣራት፣
/Cut-off& Timing/	የተመዘንቡ ሂሳቦችና የሂሳብ እንቅስቃሴዎች በተመዘንቡበት በጀት ዓመትና ወር የተከሰቱ መሆናቸውን ማጣራት፣
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Financial Statement Assertions and Audit Evidence

- ISA 315 states that the auditor must use assertions in sufficient detail <u>to form the basis for design</u> and performance of further <u>audit procedures</u>
- Financial statement assertions are the <u>basis</u> for determining for which <u>audit evidence and procedure</u> is required and to be used.

Persuasiveness of Evidence

 ISA 315 requires the auditor to accumulate persuasive (<u>sufficient and appropriate</u>) evidence to support the opinion issued.

Persuasiveness of Evidence

- Appropriateness of evidence:
 - is a measure of the <u>quality of evidence</u>, meaning its relevance and reliability in providing support for audit opinion.
- Appropriateness cannot be improved by selecting a <u>larger sample</u> <u>size</u> or different population items.
- It can be improved only by selecting audit procedures that are more *relevant* or provide more *reliable* evidence.
- Relevance of Evidence :
 - Evidence must pertain to or be relevant to the audit objective
 - Relevance deals with the <u>logical connection</u> with the purpose of the audit procedure and the assertion under consideration

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Persuasiveness of Evidence

- Reliability of Evidence :
- Reliability of evidence refers to the <u>degree</u> to which evidence can be <u>believable</u> or worthy of <u>trust</u>.
- Reliability, and therefore appropriateness, depends on the following <u>six</u> <u>characteristics</u> of reliable evidence:
- 1. Independence of provider:
 - Evidence obtained from a source outside the entity is more reliable than that obtained from within.
- 2. Effectiveness of client's internal controls:
 - When a client's internal controls are effective, evidence obtained is more reliable than when they are weak.
- 3. Auditor's direct knowledge.
 - Evidence obtained directly by the auditor through physical examination, observation, recalculation, and inspection is more reliable than information obtained indirectly.



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Persuasiveness of Evidence

- Sufficiency:
 - The *quantity of evidence* obtained determines its sufficiency.
- Sufficiency of evidence is measured primarily by the <u>sample size</u> the auditor selects.
 - For Example: the evidence obtained from a sample of 100 is ordinarily more sufficient than from a sample of 50.
- Factors determine to select appropriate sample size in audits:
- > auditor's expectation of misstatements and
 - For Example, If auditor concludes that there is a high likelihood of obsolete inventory, the auditor will sample more inventory items for obsolescence in this audit than one where the likelihood of obsolescence is low.
- > the effectiveness of the client's internal controls
 - For example, a smaller sample size will be taken if effective.



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Persuasiveness of Evidence

- 4. Qualifications of individuals providing the information.
- Although the source of information is independent, the evidence will not be reliable
 unless the individual providing it is qualified to do so.
- For example, examining an inventory of diamonds by an auditor not trained to distinguish between <u>diamonds and glass</u> is not reliable evidence for the existence of diamonds.
- <u>5. Degree of objectivity.</u>
- Objective evidence is more reliable than evidence that requires considerable judgment to determine whether it is correct.
- <u>6. Timeliness.</u>
- The timeliness of audit evidence can refer either to when it is accumulated or to the period covered by the audit.
- For Example:
 - Evidence is usually more reliable for <u>balance sheet</u> accounts when it is obtained as close to the balance sheet date as possible.
 - For income statement accounts, evidence is more reliable if there is a sample from the entire period under audit, such as a random sample of sales transactions for the entire year, rather than from only a part of the period, such as a sample limited to only the first 6 months.



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Persuasiveness of Evidence

- <u>NB</u>: The persuasiveness of evidence can be evaluated only after considering the <u>combination of appropriateness and sufficiency</u>
- For example:
 - A large sample of evidence provided by an <u>independent</u> party is not persuasive unless it is <u>relevant</u> to the audit objective being tested.
 - A large sample of evidence that is <u>relevant</u> but not <u>objective</u> is also not persuasive.
 - Similarly, a <u>small sample</u> of only one or two pieces of highly appropriate evidence also typically lacks persuasiveness.
- <u>In general</u>, when determining the persuasiveness of evidence, the auditor
 must evaluate the degree to which <u>both appropriateness and</u>
 <u>sufficiency</u> including all factors influencing them, have been met.



Persuasiveness and Cost

- The <u>persuasiveness</u> and <u>cost</u> of all alternatives should be considered before selecting the best type or types of evidence.
- The auditor's goal is to obtain a sufficient amount of appropriate evidence <u>at the lowest possible total cost</u>.
- <u>However</u>, cost is <u>never an adequate justification for</u> <u>omitting a necessary procedure</u> or not gathering an adequate sample size.

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TYPES OF AUDIT EVIDENCE PROCEDURES

- Auditors obtain evidence by one or more of the following procedures. Such as:
 - 1. Physical examination
 - 2. Confirmation
 - 3. Documentation
 - 4. Inquiries of the client
 - 5. Recalculation
 - 6. Re-performance
 - 7. Observation
 - 8. Analytical procedures



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Which audit procedures to use?

 ISA 500 requires Auditors to design and perform audit procedures that are useful to obtain <u>sufficient and</u> <u>appropriate</u> audit evidence.



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1. Physical examination

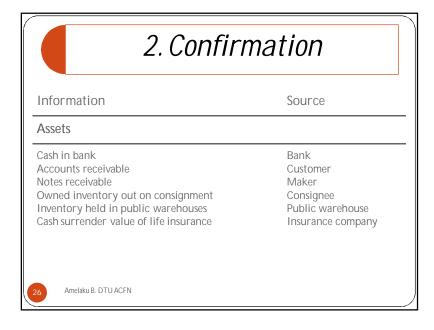
- Physical examination /inspection/
 - is the <u>inspection</u> or <u>count</u> by the auditor of a tangible asset.
- This type of evidence is most often associated with <u>inventory</u>
 <u>and cash</u>, but it is also applicable to the verification of
 securities, notes receivable, and tangible fixed assets.
- Physical examination is a direct means of verifying that an asset actually exists (Existence).

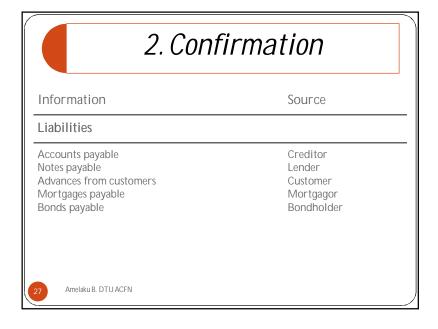


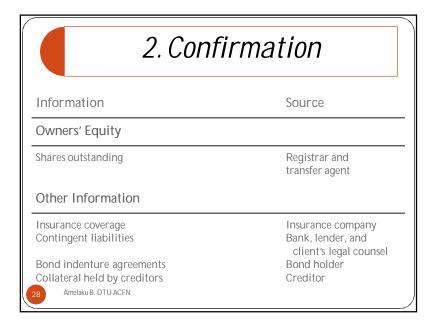
2. Confirmation

- Confirmation
 - describes the receipt of a direct written <u>response from a third</u> <u>party</u> verifying the accuracy of information that was requested by the auditor.
- <u>For Example</u>: Assume the auditor determines that there are two <u>extraordinarily large sales</u> transactions recorded 3 days before year-end. Confirmation of these two transactions may be appropriate.

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3. Documentation

Documentation

- is the auditor's inspection of the client's documents and records to verify the information that is, or should be, included in the financial statements.
- <u>Each transaction</u> in the client's organization is normally supported by at <u>least one document</u>, a large volume of this type of evidence is usually available.
- <u>For example</u>, the client often retains a customer order, a shipping document, and a duplicate sales invoice for each sales transaction.



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5. Recalculation

- Recalculation
- involves <u>rechecking</u> a sample of calculations made by the client.
- Rechecking client calculations consists of testing the client's
 <u>arithmetical accuracy</u> and includes such procedures
 adding journals and subsidiary records, and checking the
 calculation of depreciation expense and prepaid expenses.



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4. Inquiries of the Client

Inquiry

- is the obtaining of *written or oral information from the client in response to* questions from the auditor.
- Although considerable evidence is obtained from the client through inquiry, it usually <u>cannot be regarded as conclusive</u> because it is <u>not from an independent</u> source and may be biased in the client's favor.
- Therefore, when the auditor obtains evidence through inquiry, it is normally necessary to obtain <u>corroborating evidence</u> through other procedures.
- <u>Corroborating evidence</u> is additional evidence to support the original evidence.



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6. Reperformance

• Reperformance

- is the auditor's independent tests of client accounting procedures or controls that were originally done as part of the entity's accounting and internal control system.
- <u>recalculation</u> involves rechecking a computation, <u>reperformance</u> involves checking other procedures.



7. Observation

- Observation
- is the use of the senses to assess client activities.
- Throughout the engagement with a client, auditors have many opportunities to use their senses—sight, hearing, touch, and smell—to evaluate a wide range of items.
- The auditor may <u>tour</u> the plant to obtain a general impression of the client's facilities, or watch individuals perform accounting tasks to determine whether the person assigned a responsibility is performing it properly.



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AUDIT DOCUMENTATION

- Audit documentation
- is the *principal record of <u>auditing procedures</u> applied*, <u>evidence</u> <u>obtained</u>, and <u>conclusions reached</u> by the auditor in the engagement.
- Audit documentation should include all the information the auditor considers <u>necessary to adequately conduct the audit</u> and to provide support for the audit report.
- Also called <u>working papers</u>.



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8. Analytical procedures

- Analytical procedure:
 - use <u>comparisons</u> and relationships to assess whether account balances or other data appear reasonable compared to the auditor's expectations.
- *For example*, an auditor may compare the gross margin percent in the current year with the preceding year's.



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Purposes of Audit Documentation

- The overall objective
- is to <u>aid</u> the auditor in providing reasonable assurance that an adequate audit was conducted in accordance with auditing standards.
- More *specifically*, audit documentation, provides:
 - > A Basis for Planning the Audit
 - > A Record of the Evidence Accumulated and the Results of the Tests
 - i.e. the audit was well planned and adequately supervised; the evidence accumulated was appropriate and sufficient; and the audit report was proper
 - ➤ Data for Determining the Proper Type of Audit Report
 - > A Basis for Review by Supervisors and Partners



Ownership of Audit Files

- is the *property of the auditor*.
- The only time anyone else, including the client, has a legal right to examine the files is when they are <u>requested by a</u> <u>court as legal evidence</u>.



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Requirements for Retention of Audit Documentation

- At the completion of the engagement, audit files are <u>retained</u> on the CPA's premises for future reference.
- Auditing standards require that records for audits of <u>private</u> <u>companies</u> be <u>retained for a minimum of five years.</u>
- The Sarbanes—Oxley Act requires auditors of <u>public companies</u> to prepare and maintain audit files and other information related to any audit report in sufficient detail to support the auditor's conclusions, for a period of <u>not less than seven years</u>.



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Confidentiality of Audit Files

- During the course of the audit, auditors obtain a considerable amount of information of a confidential nature, including:-
 - > officers' salaries,
 - > product pricing and
 - > advertising plans, and
 - > product cost data.
- An auditor shall <u>not disclose</u> any confidential information
 & care must be taken to safeguard the audit files at all times.



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Preparation of Audit Documentation

- The proper preparation of audit documentation should contain the following parts:
- > schedules to document the audit evidence accumulated,
- the evidence obtained and its source
- the results found, and
- > the conclusions reached

