Materiality and Importance of Audit Evidence

This Subject provides guidance about concepts underlying the third standard of field work: "The auditor must obtain sufficient appropriate audit evidence by performing audit procedures to afford a reasonable basis for an opinion regarding the financial statements under audit." So here I want to give information about the audit evidence mainly I focused on the concept of audit evidence and its related information like materiality and importance of audit evidence. Here, we understand it in following matter…

- **Definition/meaning of *audit evidence***
- **Defines *relevant assertions* and discusses their use in assessing risks and designing appropriate further audit procedures.**
- **Discusses qualitative aspects that the auditor considers in determining the sufficiency and appropriateness of audit evidence; and in last**
- **Description of various audit procedures and discusses the purposes for which they may be performed.**

What is Audit Evidence?

- Audit evidence is all the information used by the auditor in arriving at the conclusions on which the audit opinion is based and includes the information contained in the accounting records underlying the financial statements and other information.
- Auditors are not expected to examine all information that may exist. Audit evidence, which is cumulative in nature, includes audit evidence obtained from audit procedures performed during the course of the audit and may include audit evidence obtained from other sources, such as previous audits and a firm's quality control procedures for client acceptance and continuance.
- Accounting records generally include the records of initial entries and supporting records, such as checks and records of electronic fund transfers; invoices; contracts; the general and subsidiary ledgers, journal entries, and other adjustments to the financial statements that are not reflected in formal journal entries; and records such as worksheets and spreadsheets supporting cost allocations, computations, reconciliations, and disclosures. The entries in the accounting records are often initiated, authorized, recorded, processed, and reported in electronic form. In addition, the accounting records may be part of integrated systems that share data and support all aspects of the entity's financial reporting, operations, and compliance objectives.
- For financial audits, audit evidence includes information from accounting records used to prepare the report and other relevant information. Accounting records

generally include data from accounting entries and supporting documents. These include cheques and details of electronic fund transfers, invoices, contracts, general and subsidiary ledgers, and journal entries. Work sheets and spreadsheets supporting cost allocations, computations, reconciliations and disclosures are also examples.

- For performance audits, audit evidence gathered is usually broader than that obtained for the audit of a financial report. Some examples include strategic plans, tender documents, business cases, Cabinet submissions, consultant's reports, legal opinions and contracts with private providers.
- Other information that the auditor may use as audit evidence includes minutes of meetings; confirmations from third parties; industry analysts' reports; comparable data about competitors (benchmarking); controls manuals; information obtained by the auditor from such audit procedures as inquiry, observation, and inspection; and other information developed by or available to the auditor that permits the auditor to reach conclusions through valid reasoning.
- These documents can be accessed even if they are in draft form or subject to privacy restrictions. However, persuasive audit evidence must have the same characteristics whether it is obtained as part of a financial or performance audit. That is, the evidence must be sufficient and appropriate. Audit evidence is cumulative and is also gathered to corroborate management representations.

Sufficient Appropriate Audit Evidence

- **Sufficiency** is a measure of the quantity of audit evidence. In assessing sufficiency, the Auditor-General and his staff consider whether enough evidence has been obtained to draw a reasonable conclusion.
- **Appropriateness** is a measure of the quality of evidence. The quality of all audit evidence is affected by the relevance and reliability of the information it is based on.
- The reliability of information is influenced by its source, nature and how it is obtained. For example, a bank statement obtained directly from the bank is more reliable than a bank statement provided by the entity being audited, and an original bank statement is more reliable than a photocopy of a bank statement.
- The reliability of audit evidence is influenced by its source and by its nature and is dependent on the individual circumstances under which it is obtained. Generalizations about the reliability of various kinds of audit evidence can be made; however, such generalizations are subject to important exceptions. Even when audit evidence is obtained from sources external to the entity, circumstances may exist that could affect the reliability of the information obtained. For example, audit

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evidence obtained from an independent external source may not be reliable if the source is not knowledgeable. While recognizing that exceptions may exist, the following generalizations about the reliability of audit evidence are useful:

1. Audit evidence is more reliable when it is obtained from knowledgeable independent sources outside the entity.
2. Audit evidence that is generated internally is more reliable when the related controls imposed by the entity are effective.
3. Audit evidence obtained directly by the auditor (for example, observation of the application of a control) is more reliable than audit evidence obtained indirectly or by inference (for example, inquiry about the application of a control).
4. Audit evidence is more reliable when it exists in documentary form, whether paper, electronic, or other medium (for example, a contemporaneously written record of a meeting is more reliable than a subsequent oral representation of the matters discussed).
5. Audit evidence provided by original documents is more reliable than audit evidence provided by photocopies or facsimiles.

- The auditor may consider the relationship between the cost of obtaining audit evidence and the usefulness of the information obtained. However, the matter of difficulty or expense involved is not in itself a valid basis for omitting an audit procedure for which there is no appropriate alternative.
- In forming the audit opinion, the auditor does not examine all the information available (evidence) because conclusions ordinarily can be reached by using sampling approaches and other means of selecting items for testing. Also, the auditor may find it necessary to rely on audit evidence that is persuasive rather than conclusive; however, to obtain reasonable assurance, the auditor must not be satisfied with audit evidence that is less than persuasive. The auditor should use professional judgment and should exercise professional skepticism in evaluating the quantity and quality of audit evidence, and thus its sufficiency and appropriateness, to support the audit opinion.

The use of assertion in obtaining audit evidence

- Management is responsible for the fair presentation of financial statements that reflect the nature and operations of the entity.5 In representing that the financial statements are fairly presented in conformity with generally accepted accounting principles,6 management implicitly or explicitly makes assertions regarding the recognition, measurement, presentation, and disclosure of information in the financial statements and related disclosures.

- Assertions used by the auditor fall into the following categories:

  A. Assertions about classes of transactions and events for the period under audit:

  1. Occurrence. Transactions and events that have been recorded have occurred and pertain to the entity.
  2. Completeness. All transactions and events that should have been recorded have been recorded.
  3. Accuracy. Amounts and other data relating to recorded transactions and events have been recorded appropriately.
  4. Cutoff. Transactions and events have been recorded in the correct accounting period.
  5. Classification. Transactions and events have been recorded in theproper accounts.

  B. Assertions about account balances at the period end:

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

  C. Assertions about presentation and disclosure:

  1. Occurrence and rights and obligations. Disclosed events and transactions have occurred and pertain to the entity.
  2. Completeness. All disclosures that should have been included in the financial statements have been included.
  3. Classification and understandability. Financial information is appropriately presented and described and disclosures are clearly expressed.
  4. Accuracy and valuation. Financial and other

- The auditor may use the relevant assertions as they are described above or may express them differently provided aspects described above have been covered. For example, the auditor may choose to combine the assertions about transactions and events with the assertions about account balances. As another example, there may not be a separate assertion related to cutoff of transactions and events when the occurrence and completeness assertions include appropriate consideration of recording transactions in the correct accounting period.

- Relevant assertions are assertions that have a meaningful bearing on whether the account is fairly stated. For example, valuation may not be relevant to the cash account unless currency translation is involved; however, existence and completeness are always relevant. Similarly, valuation may not be relevant to the gross amount of the accounts receivable balance but is relevant to the related allowance accounts. Additionally, the auditor might, in some circumstances, focus on the presentation and disclosure assertion separately in connection with the period-end financial reporting process.

Audit Procedure for obtaining Audit Evidence

- A combination of audit procedures is used to obtain audit evidence during the conduct of both financial and performance audits. These include:

1. **Enquiry:-**

   seeking information from knowledgeable people within and outside the entity, ranging from formal written enquiries to informal discussions

   Inquiry may involves:

   - Considering the knowledge, objectivity, experience, responsibility, and qualifications of the individual to be questioned.
   - Asking clear, concise, and relevant questions.
   - Using open or closed questions appropriately
   - Listening actively and effectively.
   - Considering the reactions and responses and asking follow-up questions.
   - Evaluating the response.

2. **Inspection:-**

   examining records or documents in paper or electronic form

   inspection may involves

   - Inspection of tangible assets
   - Inspection of records or documents

3. **Observation:-**

   Observation consists of looking at a process or procedure being performed by others. Examples include observation of the counting of inventories by the entity's personnel and observation of the performance of control activities. Observation provides audit evidence about the performance of a process or procedure but is limited to the point in time at which the observation takes place and by the fact that the act of being observed may affect how the process or procedure is performed.

4. **external confirmation:-**

   obtaining a written confirmation directly from a third party, such as a bank or debtor

5. **recalculation:-**

   checking the mathematical accuracy of documents or records

6. **re-performance:-**

   independently re-performing procedures or controls that were originally performed as part of the entity's internal control

7. **Analytical procedures:-**

   Evaluating financial information made by a study of plausible relationships among both financial and nonfinancial data.

- While enquiry may provide important audit evidence, enquiry alone usually does not provide sufficient audit evidence upon which to form a conclusion. Auditors are required to corroborate evidence obtained via enquiry through other means, such as inspecting relevant documents or confirming the information with an independent third party (e.g. a bank).
- The auditor must perform risk assessment procedures to provide a satisfactory basis for the assessment of risks at the financial statement and relevant assertion levels. Risk assessment procedures by themselves do not provide sufficient appropriate audit evidence on which to base the audit opinion and must be supplemented by further audit procedures in the form of tests of controls, when relevant or necessary and substantive procedures.
- As described in Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained, the auditor should plan and should perform substantive procedures to be responsive to the related planned level of detection risk, which includes the results of tests of controls, if any. The auditor's risk assessment is judgmental, however, and may not be sufficiently precise to identify all risks of material misstatement. Further, there are inherent limitations in internal control, including the risk of management override, the possibility of human error, and the effect of systems changes. Therefore, regardless of the assessed risk of material misstatement, the auditor should design and perform substantive procedures for all relevant assertions related to each material class of

transactions, account balance, and disclosure to obtain sufficient appropriate audit evidence.

- The nature and timing of the audit procedures to be used may be affected by the fact that some of the accounting data and other information may be available only in electronic form or only at certain points or periods in time. Source documents, such as purchase orders, bills of lading, invoices, and checks, may be replaced with electronic messages. For example, entities may use electronic commerce or image processing systems. In electronic commerce, the entity and its customers or suppliers use connected computers over a public network, such as the Internet, to transact business electronically. Purchasing, shipping, billing, cash receipt, and cash disbursement transactions are often consummated entirely by the exchange of electronic messages between the parties. In image processing systems, documents are scanned and converted into electronic images to facilitate storage and reference, and the source documents may not be retained after conversion. Certain electronic information may exist at a certain point in time. However, such information may not be retrievable after a specified period of time if files are changed and if backup files do not exist. An entity's data retention policies may require the auditor to request retention of some information for the auditor's review or to perform audit procedures at a time when the information is available.

Confidentiality

- Last but not least. The Auditor-General, his staff and contractors are required to maintain the confidentiality of any information gathered in an audit.
- This is the basic and fundamental rules which related to the audit evidence. In this auditor and his staff who may be article or employee they must keep silence about the information about business or entity.
- If they not obtain silence than they disobey the ethical value of auditor so they must keep the information confidently. They can not disclose the information without obtaining priority from authority.

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