Chapter 5—Overview of the Audit Process

1—existence or occurrence

The existence or occurrence assertion deals with whether assets or liabilities exist at a given date and whether recorded transactions have occurred.

A misrepresentation would occur if fictitious sales were recorded. A main concern here relates to overstatement of financial statement elements.

2—completeness

Completeness assertions deal with whether all transactions and accounts that should be in the financial statements are included.
Our focus here relates to possible understatement of financial statement elements.

3—rights and obligations

This assertion deals with whether assets are the rights of the entity and liabilities are the obligations of the entity.

4—valuation or allocation

This assertion is focused on whether asset, liability, revenue, and expense accounts are stated at appropriate amounts. Keep in mind that:

--any amount must be determined in accordance with GAAP

--any amount must be mathematically correct
5—presentation and disclosure

This assertion addresses whether specific elements of the financial statements are properly classified, described, and disclosed.

Audit Risk

The auditor must consider audit risk not only for each account balance and transaction class but for each assertion relevant to material account balances or transaction classes.

Auditors usually describe audit risk as function of three components contained in the audit risk model.
Inherent risk

One good example of inherent risk factors are economic and competitiveness forces that can affect an entity’s earnings, cash flows, and survival.

Control risk

In today’s climate, information processing controls are becoming increasingly important. Moreover, auditors are learning to place more emphasis on those controls that reduce the opportunity to commit fraud.
Audit Evidence Decisions

1—which audit procedures to use

Examples:

--physical inventory counts, comparisons of canceled checks with cash disbursements, shipping document details

Persuasiveness of Evidence

1—competence

--refers to the degree to which evidence is believable
--competence deals only with the audit procedures selected

The six characteristics of competent evidence are:
1—relevance

Example:

An auditor is concerned a client is failing to bill customers for shipments. Compare a sample of shipping documents to related duplicate sales invoices.

4—auditor’s direct knowledge

It is more competent than evidence obtained indirectly.

5—qualifications of those providing the information

Example

Confirmations from attorneys and bankers
6—degree of objectivity

--Objective evidence is more reliable. An example is A/R confirmations.
2—sufficiency

b) the particular items tested affect sufficiency

e.g., items with large $ values are considered sufficient that are representative of the population

Audit Procedures Classification

1. procedures to obtain an understanding

--field work standard #2 requires an understanding of the client’s internal controls

--the auditor may inquire of management about internal controls
--auditors inspect client accounting manuals and flowcharts

--observations of client activities and operations also yield knowledge of IC

--design of IC is the auditor’s concern

2.  tests of controls

--done to yield evidence concerning the effectiveness of the design and operation of the client’s IC

--includes inquiries of employers as to actually doing control procedures
3. substantive tests

These include:

--analytical procedures

--tests of details of transactions—review support for individual debits and credits posted to an account

--tests of details of balances—the auditor looks at support for an ending balance

  e.g., cash account > bank statements, deposit slips, canceled checks