**Audit Evidence**

Evidence is any *information used by the auditor* to determine whether the information being audited is stated in accordance with the established criteria. Evidence includes information that is highly persuasive, such as the auditor’s count of marketable securities, and less persuasive information, such as responses to questions of client employees. Sometimes the most important evidence is not found in accounting records.

**Audit evidence decisions**

A major decision facing every auditor is determining the *appropriate types and amounts* of evidence needed to be satisfied that the client’s financial statements are fairly stated.There are four *decisions* about what evidence to gather and how much of it to accumulate:

1. Which audit procedures to use?

2. What sample size to select for a given procedure?

3. Which items to select from the population?

4. When to perform the procedures?

An **audit procedure** is the detailed instruction that explains the audit evidence to be obtained during the audit. It is common to spell out these procedures in sufficiently specific terms so an auditor may follow these instructions during the audit. For example, the following is an audit procedure for the verification of cash disbursements:

• Examine the cash disbursements journal in the accounting system and compare the payee, name, amount, and date with online information provided by the bank about checks processed for the account.

Once an audit procedure is selected, auditors can vary the **sample size** from one to all the items in the population being tested. In an audit procedure to verify cash disbursements, suppose 6,600 checks are recorded in the cash disbursements journal. The auditor might select a sample size of 50 checks for comparison with the cash disbursements journal. The decision of how many **items to test** must be made by the auditor for each audit procedure. The sample size for any given procedure is likely to vary from audit to audit. After determining the sample size for an audit procedure, the auditor must decide which items in the population to test. If the auditor decides, for example, to select 50 cancelled checks from a population of 6,600 for comparison with the cash disbursements journal, several different methods can be used to select the specific checks to be examined. 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 randomly, 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.

In addition **timing** is Key in audit evidence. An audit of financial statements usually covers a period such as a year. Normally an audit is not completed until several weeks or months after the end of the period. The timing of audit procedures can therefore vary from early in the accounting period to long after it has ended.

The list of audit procedures for an audit area or an entire audit is called an **audit program**. The audit program always includes a list of the audit procedures, and it usually includes sample sizes, items to select, and the timing of the tests. Normally, there is an audit program, including several audit procedures, for each component of the audit. Therefore, there will be an audit program for accounts receivable, one for sales, and so on.

Many auditors use electronic audit software packages to generate audit programs. These software programs help the auditor address risks and other audit planning considerations and select appropriate audit procedures.

**Persuasiveness of evidence**

Audit standards require the auditor to accumulate *sufficient appropriate evidence to support the opinion issued*. Because of the nature of audit evidence and the costconsiderations of doing an audit, it is unlikely that the auditor will be completelyconvinced that the opinion is correct. However, the auditor must be persuaded that theopinion is correct with a high level of assurance. By combining all evidence from theentire audit, the auditor is able to decide when he or she is persuaded to issue an auditreport. The two determinants of the **persuasiveness of evidence** are *appropriateness* and *sufficiency*.

**Appropriateness of evidence** is a measure of the quality of evidence, meaning its relevance and reliability in meeting audit objectives for classes of transactions, account balances, and related disclosures. If evidence is considered highly appropriate, it is a great help in persuading the auditor that financial statements are fairly stated. Note that appropriateness of evidence deals only with the audit procedures selected. Appropriateness cannot be improved by selecting a larger sample size 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* that the auditor is testing before it can be appropriate. For example, assume that theauditor is concerned that a client is failing to bill customers for shipments (completenesstransaction objective). If the auditor selects a sample of duplicate sales invoices andtraces each to related shipping documents, the evidence is *not relevant* for the completeness objective and therefore is not appropriate evidence for that objective. A relevantprocedure is to trace a sample of shipping documents to related duplicate sales invoicesto determine whether each shipment was billed. The second audit procedure is relevantbecause the shipment of goods is the normal criterion used for determining whether asale has occurred and should have been billed. By tracing from shipping documents toduplicate sales invoices, the auditor can determine whether shipments have been billed tocustomers. In the first procedure, when the auditor traces from duplicate sales invoices toshipping documents, it is impossible to find unbilled shipments.

Relevance can be considered only in terms of specific audit objectives, because evidence may be relevant for one audit objective but not for a different one. In the previous shipping example, when the auditor traced from the duplicate sales invoices to related shipping documents, the evidence was relevant for the occurrence transaction objective. Most evidence is relevant for more than one, but not all, audit objectives.

**Reliability of Evidence**

**Reliability of evidence** refers to the degree to which evidence can be believable or worthy of trust. Like relevance, if evidence is considered reliable it is a great help in persuading the auditor that financial statements are fairly stated. For example, if an auditor counts inventory, that evidence is more reliable than if management gives the auditor its own count amounts.

Reliability, and therefore appropriateness, depends on the following six characteristics of reliable evidence:

1. *Independence of provider.* Evidence obtained from a source outside the entity is more reliable than that obtained from within. Communications from banks, attorneys, or customers is generally considered more reliable than answers obtained from inquiries of the client. Similarly, documents that originate from outside the client’s organization, such as an insurance policy, are considered more reliable than are those that originate within the company and have never left the client’s organization, such as a purchase requisition.

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. For example, if internal controls over sales and billing are effective, the auditor can obtain more reliable evidence from sales invoices and shipping documents than if the controls were inadequate.

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. For example, if the auditor calculates the gross margin as a percentage of sales and compares it with previous periods, the evidence is more reliable than if the auditor relies on the calculations of the controller.

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. Therefore, communications from attorneys and bank confirmations are typically more highly regarded than accounts receivable confirmations from persons not familiar with the business world. Also, evidence obtained directly by the auditor may not be reliable if the auditor lacks the qualifications to evaluate the evidence. For example, examining an inventory of diamonds by an auditor not trained to distinguish between diamonds and glass is not reliable evidence for the existence of diamonds.

5. *Degree of objectivity.* Objective evidence is more reliable than evidence that requires considerable judgment to determine whether it is correct. Examples of objective evidence include confirmation of accounts receivable and bank balances, the physical count of securities and cash, and adding (footing) a list of accounts payable to determine whether it agrees with the balance in the general ledger. Examples of subjective evidence include a letter written by a client’s attorney discussing the likely outcome of outstanding lawsuits against the client, observation of obsolescence of inventory during physical examination, and inquiries of the credit manager about the collectibility of noncurrent accounts receivable. When the reliability of subjective evidence is being evaluated, it is essential for auditors to assess the qualifications of the person providing the evidence.

6. *Timeliness.* The timeliness of audit evidence can refer either to when it is accumulated or to the period covered by the audit. Evidence is usually more reliable for balance sheet accounts when it is obtained as close to the balance sheet date as possible. For example, the auditor’s count of marketable securities on the balance sheet date is more reliable than a count 2 months earlier. 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.

**Sufficiency of evidence**

The *quantity* of evidence obtained determines its sufficiency. **Sufficiency of evidence** is measured primarily by the sample size the auditor selects. For a given audit procedure, the evidence obtained from a sample of 100 is ordinarily more sufficient than from a sample of 50. Several factors determine the appropriate sample size in audits. The two most important ones are the auditor’s expectation of misstatements and the effectiveness of the client’s internal controls. To illustrate, assume in the audit of Jones Computer Parts Co. that the auditor concludes that there is a high likelihood of obsolete inventory because of the nature of the client’s industry. The auditor will sample more inventory items for obsolescence in this audit than one where the likelihood of obsolescence is low. Similarly, if the auditor concludes that a client has effective rather than ineffective internal controls over recording fixed assets, a smaller sample size in the audit of acquisitions of fixed assets may be warranted.

In addition to sample size, the individual items tested affect the sufficiency of evidence. Samples containing population items with large dollar values, items with a high likelihood of misstatement, and items that are representative of the population are usually considered sufficient. In contrast, most auditors usually consider samples insufficient that contain only the largest dollar items from the population unless these items make up a large portion of the total population amount.

**Types of Audit Evidence**

In deciding which audit procedures to use, the auditor can choose from eight broad categories of evidence, which are called *types of evidence*. Every audit procedure obtains one or more of the following types of evidence:

1. Physical examination

2. Confirmation

3. Documentation

4. Analytical procedures

5. Inquiries of the client

6. Recalculation

7. Re-performance

8. Observation

**Physical examination** is the inspection or count by the auditor of a *tangible asset*. This type of evidence is most often associated with inventory and cash, but it is also applicable to the verification of securities, notes receivable, and tangible fixed assets. There is a distinction in auditing between the physical examination of assets, such as marketable securities and cash, and the examination of documents, such as cancelled checks and sales documents. If the object being examined, such as a sales invoice, has no inherent value, the evidence is called documentation. For example, before a check is signed, it is a document; after it is signed, it becomes an asset; and when it is cancelled, it becomes a document again. For correct auditing terminology, physical examination of the check can occur only while the check is an asset. Physical examination is a direct means of verifying that an asset actually exists (existence objective), and to a lesser extent whether existing assets are recorded (completeness objective). It is considered one of the most reliable and useful types of audit evidence. Generally, physical examination is an objective means of ascertaining both the quantity and the description of the asset. In some cases, it is also a useful method for evaluating an asset’s condition or quality. However, physical examination is not sufficient evidence to verify that existing assets are owned by the client (rights and obligations objective), and in many cases the auditor is not qualified to judge qualitative factors such as obsolescence or authenticity (realizable value objective). Also, proper valuation for financial statement purposes usually cannot be determined by physical examination (accuracy objective).

**Confirmation** describes the *receipt* of a *direct written response* from a *third party* verifying the accuracy of information that was *requested by the auditor*. The response may be in electronic or paper form. The request is made to the client, and the client asks the third party to respond directly to the auditor. Because confirmations come from sources independent of the client, they are a highly regarded and often-used type of evidence. However, confirmations are relatively costly to obtain and may cause some inconvenience to those asked to supply them. Therefore, they are not used in every instance in which they are applicable.

**Information often confirmed**

|  |  |
| --- | --- |
| ***Information*** | ***Source*** |
| ***Assets*** |  |
| Cash in bank | Bank |
| Marketable Securities | Investment Custodian |
| Accounts receivables | Customer |
| Notes Receivables | Maker |
| Owned inventory out on consignment | Consignee |
| Inventory held in public warehouses | Public Warehouse |
| Cash surrender value of life insurance | Insurance company |
|  |  |
| ***Liabilities*** |  |
| Accounts payable | Creditor |
| Notes payable | Lender |
| Advances from customers | Customer |
| Mortgages payable | Mortgager |
| Bonds payable | Bondholder |
|  |  |
| ***Owners equity*** |  |
| Shares outstanding | Registrar or transfer agent |
|  |  |
| ***Other information*** |  |
| Insurance coverage | Insurance |
| Contingent Liabilities | Bank, lender, legal counsel of client |
| Bond indenture agreements | Bondholder |
| Collateral held by creditors | Creditor |
|  |  |

Source:

To be considered reliable evidence, confirmations must be controlled by the auditor from the time they are prepared until they are returned. If the client controls the preparation of the confirmation, does the mailing, or receives the responses, the auditor has lost control and with it independence; thus reducing the reliability of the evidence. Auditors often attempt to authenticate the identity of the confirmation respondent, especially for facsimile or electronic confirmation responses.

**Documentation** is the auditor’s inspection of the *client’s documents and records* to substantiate the information that is, or should be, included in the financial statements. The documents examined by the auditor are the records used by the client to provide information for conducting its business in an organized manner, and may be in paper form, electronic form, or other media. Because each transaction in the client’s organization is normally supported by at least one document, a large volume of this type of evidence is usually available. For example, the client often retains a customer order, a shipping document, and a duplicate sales invoice for each sales transaction. These same documents are useful evidence for the auditor to verify the accuracy of the client’s records for sales transactions. Documentation is widely used as evidence in audits because it is usually readily available at a relatively low cost. Sometimes, it is the only reasonable type of evidence available.

Documents can be conveniently classified as internal and external. An **internal document** has been prepared and used within the client’s organization and is retained withoutever going to an outside party. Internal documents include duplicate sales invoices,employees’ time reports, and inventory receiving reports. An **external document** has beenhandled by someone outside the client’s organization who is a party to the transactionbeing documented, but which are either currently held by the client or readily accessible.

In some cases, external documents originate outside the client’s organization and end up in the hands of the client. Examples of external documents include vendors’ invoices, cancelled notes payable, and insurance policies. Some documents, such as cancelled checks, originate with the client, go to an outsider, and are finally returned to the client.

The primary determinant of the auditor’s willingness to accept a document as reliable evidence is whether it is internal or external and, when internal, whether it was created and processed under conditions of effective internal control. Internal documents created and processed under conditions of weak internal control may not constitute reliable evidence. Original documents are considered more reliable than photocopies or facsimiles. Although auditors should consider the reliability of documentation, they rarely verify the authenticity of documentation. Auditors are not expected to be trained or be experts in document authentication.

Because external documents have been in the hands of both the client and another party to the transaction, there is some indication that both members are in agreement about the information and the conditions stated on the document. Therefore, external documents are considered more reliable evidence than internal ones. Some external documents, such as title to land, insurance policies, indenture agreements, and contracts, have exceptional reliability because they are almost always prepared with considerable care and often have been reviewed by attorneys or other qualified experts.

When auditors use documentation to support recorded transactions or amounts, the process is often called **vouching**. To vouch recorded acquisition transactions, the auditor might, for example, verify entries in the acquisitions journal by examining supporting vendors’ invoices and receiving reports and thereby satisfy the occurrence objective. If the auditor traces from receiving reports to the acquisitions journal to satisfy the completeness objective, however, it is not appropriate to call it vouching. This latter process is called **tracing**.

**Analytical procedures** use comparisons 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. Analytical procedures are used extensively in practice, and are *required during the planning and completion phases on all audits*. The purposes of analytical procedures are:

* **Understand the Client’s Industry and Business** Auditors must obtain knowledge about a client’s industry and business as a part of planning an audit. By conducting analytical procedures in which the current year’s unaudited information is compared with prior years’ audited information or industry data, changes are highlighted. These changes can represent important trends or specific events, all of which will influence audit planning. For example, a decline in gross margin percentages over time may indicate increasing competition in the company’s market area and the need to consider inventory pricing more carefully during the audit. Similarly, an increase in the balance in fixed assets may indicate a significant acquisition that must be reviewed.
* **Assess the Entity’s Ability to Continue as a Going Concern** Analytical procedures are often a useful indicator for determining whether the client company has financial problems. Certain analytical procedures can help the auditor assess the likelihood of failure. For example, if a higher-than-normal ratio of long-term debt to net worth is combined with a lower-than-average ratio of profits to total assets, a relatively high risk of financial failure may be indicated. Not only will such conditions affect the audit plan, they may indicate that substantial doubt exists about the entity’s ability to continue as a going concern, which requires a report modification.
* **Indicate the Presence of Possible Misstatements in the Financial Statements**

Significant unexpected differences between the current year’s unaudited financial data and other data used in comparisons are commonly called **unusual fluctuations**. Unusual fluctuations occur when significant differences are not expected but do exist, or when significant differences are expected but do not exist. In either case, the presence of an accounting misstatement is one possible reason for the unusual fluctuation. If the unusual fluctuation is large, the auditor must determine the reason and be satisfied that the cause is a valid economic event and not a misstatement. For example, in comparing the ratio of the allowance for uncollectible accounts receivable to gross accounts receivable with that of the previous year, suppose that the ratio has decreased while, at the same time, accounts receivable turnover also decreased. The combination of these two pieces of information indicates a possible understatement of the allowance. This aspect of analytical procedures is often called “attention directing” because it results in more detailed procedures in the specific audit areas where misstatements might be found.

* **Reduce Detailed Audit Tests** When an analytical procedure reveals no unusual fluctuations, this implies the possibility of a material misstatement is minimized. In such cases, the analytical procedure constitutes substantive evidence in support of the fair statement of the related account balances, and it is possible to perform fewer detailed tests in connection with those accounts. In other cases, certain audit procedures can be eliminated, sample sizes can be reduced, or the timing of the procedures can be moved farther away from the balance sheet date.

**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 cannot be regarded as conclusive because it is not from an independent source and may be biased in the client’s favour. Therefore, when the auditor obtains evidence through inquiry, it is normally necessary to obtain corroborating evidence through other procedures. (Corroborating evidence is additional evidence to support the original evidence.) As an illustration, when the auditor wants to obtain information about the client’s method of recording and controlling accounting transactions, the auditor usually begins by asking the client how the internal controls operate. Later, the auditor performs audit tests using documentation and observation to determine whether the transactions are recorded (completeness objective) and authorized (occurrence objective) in the manner stated.

**Recalculation** involves rechecking a sample of calculations made by the client. Rechecking client calculations consists of testing the client’s arithmetical accuracy and includes such procedures as extending sales invoices and inventory, adding journals and subsidiary records, and checking the calculation of depreciation expense and prepaid expenses. A considerable portion of auditors’ recalculation is done by computer assisted audit software.

**Re-performance** 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. Whereas recalculation involves rechecking a computation, re-performance involves checking other procedures. For example, the auditor may compare the price on an invoice to an approved price list, or may re-perform the aging of accounts receivable. Another type of re-performance is for the auditor to recheck transfers of information by tracing information included in more than one place to verify that it is recorded at the same amount each time. For example, the auditor normally makes limited tests to ascertain that the information in the sales journal has been included for the proper customer and at the correct amount in the subsidiary accounts receivable records and is accurately summarized in the general ledger.

**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 tour 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. Observation is rarely sufficient by itself because of the risk of client personnel changing their behaviour because of the auditor’s presence. They may perform their responsibilities in accordance with company policy but resume normal activities once the auditor is not in sight. Therefore, it is necessary to follow up initial impressions with other kinds of corroborative evidence. Nevertheless, observation is useful in most parts of the audit.

**Application of Types of Evidence to the Four Evidence Decisions**

The overall objective is to obtain persuasive evidence at minimum cost to verify that inventory is materially correct. The auditor must therefore decide:

• Which audit procedures to use to satisfy each balance-related audit objective?

• What the sample size should be for each procedure?

• Which items from the population to include in the sample?

• When to perform each procedure?

For example, an auditor was auditing inventory of an organization. For the objective “inventory quantities on the client’s perpetual records agree with items physically on hand,” the auditor selected the three types of evidence included in the table below;

**Table 2: Types of Evidence and Four Evidence Decisions for a Balance-Related Audit Objective for**

**Inventory (EXAMPLE)**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **Evidence Decisions** | | | |
| **Type of Evidence** | **Audit procedure** | **Sample size** | **Items to Select** | **Timing** |
| Observation | Observe client’s personnel counting inventory to determine whether they are properly following instructions | All count teams | N/A | Balance sheet date |
| Physical Examination | Count a sample of inventory and compare quantity and description of clients’ counts. | 120 items | 40 items with large value, plus  80 randomly selected | Balance sheet date |
| Documentation | Compare quantity on clients’ perpetual records to quantity on clients’ counts. | 70 items | 30 items with large value, plus  40 randomly selected | Balance sheet date |

**Audit Documentation**

Auditing standards state that **audit documentation** is the *principal record of auditing procedures applied, evidence obtained, and conclusions reached by the auditor in the engagement*. Audit documentation should include all the information the auditorconsiders necessary to adequately conduct the audit and to provide support for theaudit report. Audit documentation may also be referred to as **working papers**, althoughaudit documentation is often maintained in computerized files.

**Purposes of Audit Documentation**

**A Basis for Planning the Audit** If the auditor is to plan an audit adequately, the necessary reference information must be available in the audit files. The files may include such diverse planning information as descriptive information about internal control, a time budget for individual audit areas, the audit program, and the results of the preceding year’s audit.

**A Record of the Evidence Accumulated and the Results of the Tests** Audit documentation is the primary means of documenting that an adequate audit was conducted in accordance with auditing standards. If the need arises, the auditor must be able to demonstrate to regulatory agencies and courts that the audit was well planned and adequately supervised; the evidence accumulated was appropriate and sufficient; and the audit report was proper, considering the results of the audit.

When audit procedures involve sampling of transactions or balances, the audit documentation should identify the items tested. The audit files should also document significant audit findings or issues, actions taken to address them, and the basis for the conclusions reached. For example, the auditor should document specific transactions at year-end to determine whether transactions were recorded in the proper period. If misstatements are detected during these cut-off tests, the auditor should document the additional procedures performed to determine the extent of cut-off misstatements, the conclusion as to whether the account balances affected are fairly stated, and whether any audit adjustments should be proposed.

**Data for Determining the Proper Type of Audit Report** Audit documentation provides an important source of information to assist the auditor in deciding whether sufficient appropriate evidence was accumulated to justify the audit report in a given set of circumstances. The data in the files are equally useful for evaluating whether the financial statements are fairly stated, given the audit evidence.

**A Basis for Review by Supervisors and Partners** The audit files are the primary frame of reference used by supervisory personnel to review the work of assistants. The careful review by supervisors also provides evidence that the audit was properly supervised.

**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. If auditors divulged this information to outsiders or to client employees who have been denied access, their relationship with management would be seriously strained. Furthermore, having access to the audit files would give employees an opportunity to alter the files. For these reasons, care must be taken to safeguard the audit files at all times.

**Requirements for Retention of Audit Documentation**

Auditing standards require that records for audits of private companies be retained for a minimum of five years. The law requires auditors of public companies 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 not less than seven years. The law makes the knowing and wilful destruction of audit documentation within the seven-year period a criminal offense subject to financial fines and imprisonment.

**Contents and Organization of Audit Documentation**

|  |  |  |
| --- | --- | --- |
| Financial statements and audit report | Operations | Tests of controls & substantive tests of controls |
| Contingent Liabilities | Liabilities and equity | Internal controls |
| Working trial balance | Assets | General information |
| Adjusting journal entries | Analytical procedures | Audit programs |
|  |  | Permanent files |

**Permanent files** contain data of a *historical or continuing nature* pertinent to the current audit. These files provide a convenient source of information about the audit that is of continuing interest from year to year. The permanent files typically include the following:

• *Extracts or copies of such company documents of continuing importance as the articles of incorporation, bylaws, bond indentures, and contracts.* The contractsmay include pension plans, leases, stock options, and so on. Each of thesedocuments is significant to the auditor for as many years as it is in effect.

• *Analyses from previous years of accounts that have continuing importance to the auditor.* These include accounts such as long-term debt, stockholders’ equityaccounts, goodwill, and fixed assets. Having this information in the permanentfiles enables the auditor to concentrate on analyzing only the changes in thecurrent year’s balance while retaining the results of previous years’ audits in aform accessible for review.

• *Information related to understanding internal control and assessing control risk.* This includes organization charts, flowcharts, questionnaires, and other internalcontrol information, including identification of controls and weaknesses in thesystem. These records are used as a starting point for documenting the auditor’sunderstanding of the control system, since aspects of the systems are oftenunchanged from year to year.

• *The results of analytical procedures from previous years’ audits.* Among these data are ratios and percentages computed by the auditor and the total balance or the balance by month for selected accounts. This information is useful in helping

The **current files** include all audit documentation applicable to the year under audit. There is one set of permanent files for the client and a set of current files for each year’s audit. The following are types of information often included in the current file:

**Audit Program** Auditing standards require a written audit program for every audit. The audit program is ordinarily maintained in a separate file to improve the coordination and integration of all parts of the audit, although some firms also include a copy of the audit program with each audit section’s audit documentation. As the audit progresses, each auditor initials or electronically signs the program for the audit procedures performed and indicates the date of completion. The inclusion in the audit files of a well-designed audit program completed in a conscientious manner is evidence of a high-quality audit.

**General Information** Some audit files include current period information of a general nature rather than evidence designed to support specific financial statement amounts. This includes such items as audit planning memos, abstracts or copies of minutes of the board of directors meetings, abstracts of contracts or agreements not included in the permanent files, notes on discussions with the client, supervisors’ review comments, and general conclusions.

**Working Trial Balance** Because the basis for preparing the financial statements is the general ledger, the amounts included in that record are the focal point of the audit.

As early as possible after the balance sheet date, the auditor obtains or prepares a listing of the general ledger accounts and their year-end balances. This schedule is the **working trial balance**. Software programs enable the auditor to download the client’s ending general ledger balances into a working trial balance file.

The technique used by many firms is to have the auditor’s working trial balance in the same format as the financial statements. Each line item on the trial balance is supported by a **lead schedule**, containing the detailed accounts from the general ledger making up the line item total. Each detailed account on the lead schedule is, in turn, supported by proper schedules supporting the audit work performed and the conclusions reached.

**Adjusting and Reclassification Entries** When the auditor discovers material misstatements in the accounting records, the financial statements must be corrected.

For example, if the client failed to properly reduce inventory for obsolete raw materials, the auditor can propose an adjusting entry to reflect the realizable value of the inventory.

Even though adjusting entries discovered in the audit are often prepared by the auditor, they must be approved by the client because management has primary responsibility for the fair presentation of the statements.

**Supporting Schedules** The largest portion of audit documentation includes the detailed **supporting schedules** prepared by the client or the auditors in support of specific amounts on the financial statements. Auditors must choose the proper type of schedule for a given aspect of the audit in order to document the adequacy of the audit and to fulfil the other objectives of audit documentation. Here are the major types of supporting schedules:

• *Analysis.* An analysis is designed to show the *activity in a general ledger* account during the entire period under audit, tying together the beginning and ending balances. This type of schedule is normally used for accounts such as marketable securities; notes receivable; allowance for doubtful accounts; property, plant, and equipment; long-term debt; and all equity accounts. The common characteristic of these accounts is the significance of the activity in the account during the year. In most cases, the analysis has cross-references to other audit files.

• *Trial balance or list.* This type of schedule consists of the *details that make up a year-end balance* of a general ledger account. It differs from an analysis in that itincludes only those items making up the end-of-the-period balance. Commonexamples include trial balances or lists in support of trade accounts receivable,trade accounts payable, repair and maintenance expense, legal expense, andmiscellaneous income.

• *Reconciliation of amounts.* Reconciliation *supports a specific amount* and is normally expected to tie the amount recorded in the client’s records to another source of information. Examples include the reconciliation of cash balances with bank statements, the reconciliation of subsidiary accounts receivable balances with confirmations from customers, and the reconciliation of accounts payable balances with vendors’ statements.

• *Tests of reasonableness.* A test of reasonableness schedule, as the name implies, contains information that enables the auditor to evaluate whether the client’s

**Effect of Technology on Audit Evidence and Audit Documentation**

Audit evidence is often available only in electronic form, and auditors must evaluate how this affects their ability to gather sufficient appropriate evidence. In certain instances, electronic evidence may exist only at a point in time. That evidence may not be retrievable later if files are changed and if the client lacks backup files. Therefore, auditors must consider the availability of electronic evidence early in the audit and plan their evidence gathering accordingly. When evidence can be examined only in machine-readable form, auditors use computers to read and examine evidence. Commercial audit software programs, such as Audit Command Language (ACL) and Interactive Data Extraction and Analysis (IDEA) software, are designed specifically for use by auditors. These programs are typically Windows-based and can easily be operated on the auditor’s desktop or notebook computer. The auditor obtains copies of client databases or master files and uses the software to perform a variety of tests of the client’s electronic data. These audit software packages are relatively easy to use, even by auditors with little IT training, and can be applied to a wide variety of clients with minimal customization. Auditors may also use spreadsheet software to perform audit tests.

Auditors often use engagement management software to organize and analyze audit documentation. Using audit management software, an auditor can prepare a trial balance, lead schedules, supporting audit documentation, and financial statements, as well as perform ratio analysis. The software also facilitates tracking audit progress by indicating the performance and review status of each audit area. Tick marks and other explanations, such as reviewer notes, can be entered directly into computerized files. In addition, data can be imported and exported to other applications, so auditors may download a client’s general ledger or export tax information to a commercial tax preparation package. Auditors also use local area networks and group share software programs to access audit documentation simultaneously from remote locations.