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# Nature And Type Of Audit Evidence

## CHAPTER 7

*This chapter deals with the types of evidence decisions auditors make, the evidence available to auditors, and the use of that evidence in performing audits and documenting the results.*

# Nature And Type Of Audit Evidence

- 1 Contrast audit evidence with evidence used by other professions.
- 2 Identify the four audit evidence decisions that are needed to create an audit program.
- 3 Specify the characteristics that determine the persuasiveness of evidence.



# Nature And Type Of Audit Evidence

- 4 Identify and apply the eight types of evidence used in auditing.
- 5 Understand the purposes of audit documentation.
- 6 Prepare organized audit documentation.
- 7 Describe how technology affects audit evidence and audit documentation.





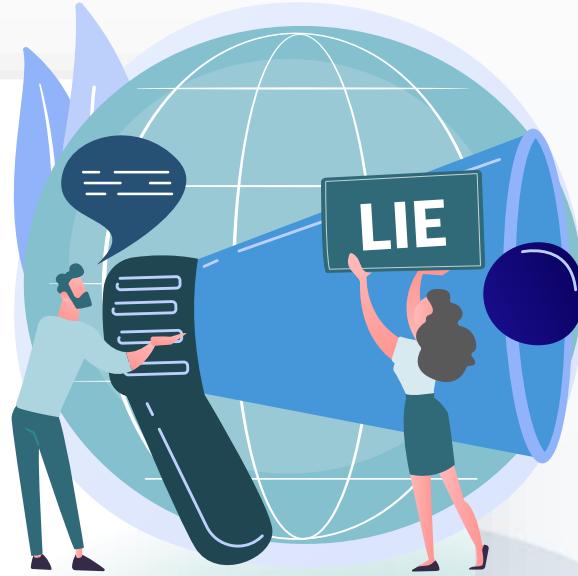
## Evidence



*any information used by the auditor to determine whether the information being audited is stated in accordance with the established criteria*

## The use of evidence

*is not unique to auditors*



## Evidence

*is also used by scientists, lawyers, and historians*

## Auditors use evidence

*to help them draw conclusions*

**TABLE 7-1****Characteristics of Evidence for a Scientific Experiment, Legal Case, and Audit of Financial Statements**

<b>Basis of Comparison</b>	<b>Scientific Experiment Involving Testing a Medicine</b>	<b>Legal Case Involving an Accused Thief</b>	<b>Audit of Financial Statements</b>
Use of the evidence	Determine effects of using the medicine	Decide guilt or innocence of accused	Determine whether statements are fairly presented
Nature of evidence used	Results of repeated experiments	Direct evidence and testimony by witnesses and parties involved	Various types of audit evidence generated by the auditor, third parties, and the client
Party or parties evaluating evidence	Scientist	Jury and judge	Auditor
Certainty of conclusions from evidence	Vary from uncertain to near certainty	Requires guilt beyond a reasonable doubt	High level of assurance
Nature of conclusions	Recommend or not recommend use of medicine	Innocence or guilt of party	Issue one of several alternative types of audit reports
Typical consequences of incorrect conclusions from evidence	Society uses ineffective or harmful medicine	Guilty party is not penalized or innocent party is found guilty	Statement users make incorrect decisions and auditor may be sued



# AUDIT EVIDENCE DECISIONS

2

*Which audit procedures to use*

*What sample size to select  
for a given procedure*

*Which items to select from  
the population*

*When to perform the  
procedures (timing)*



*Which audit procedures to use*

*What sample size to select  
for a given procedure*

*Which items to select from  
the population*

*When to perform the  
procedures (timing)*

*It includes a list of the  
audit procedures  
the auditor considers  
necessary.*

*Sample sizes  
Items to select  
Timing of the tests*

*Many auditors use  
audit software  
packages to generate  
audit programs.*

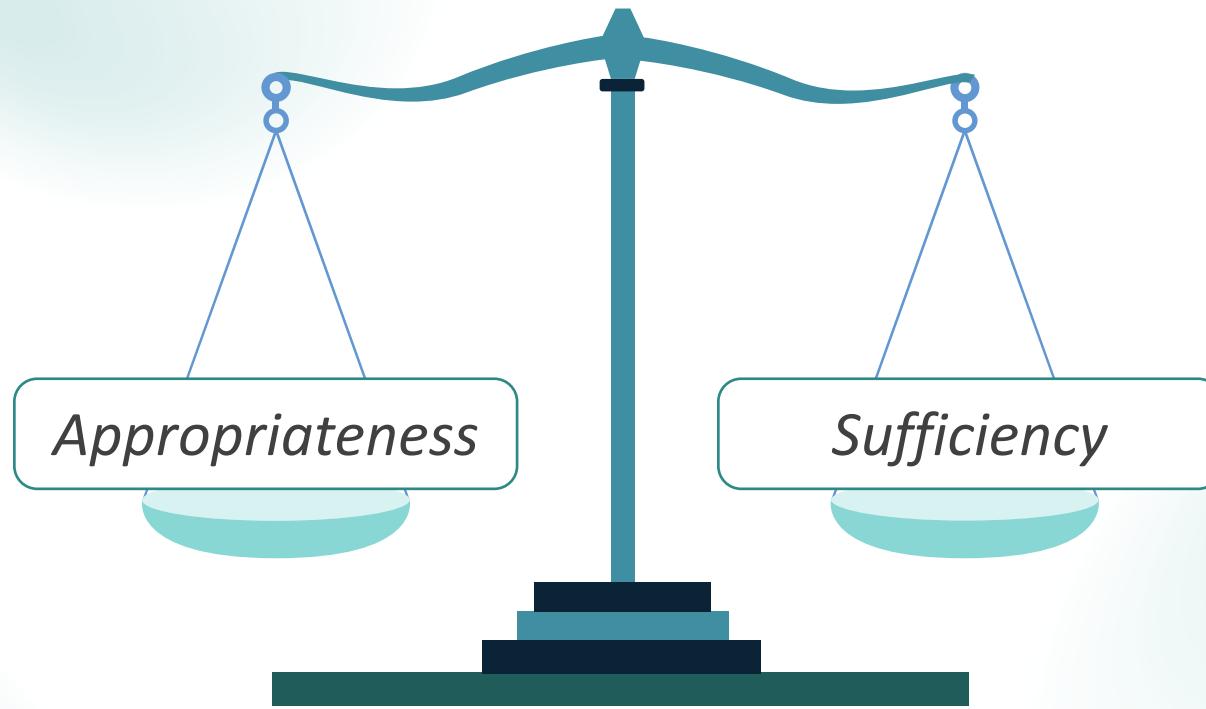
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# PERSUASIVENESS OF EVIDENCE

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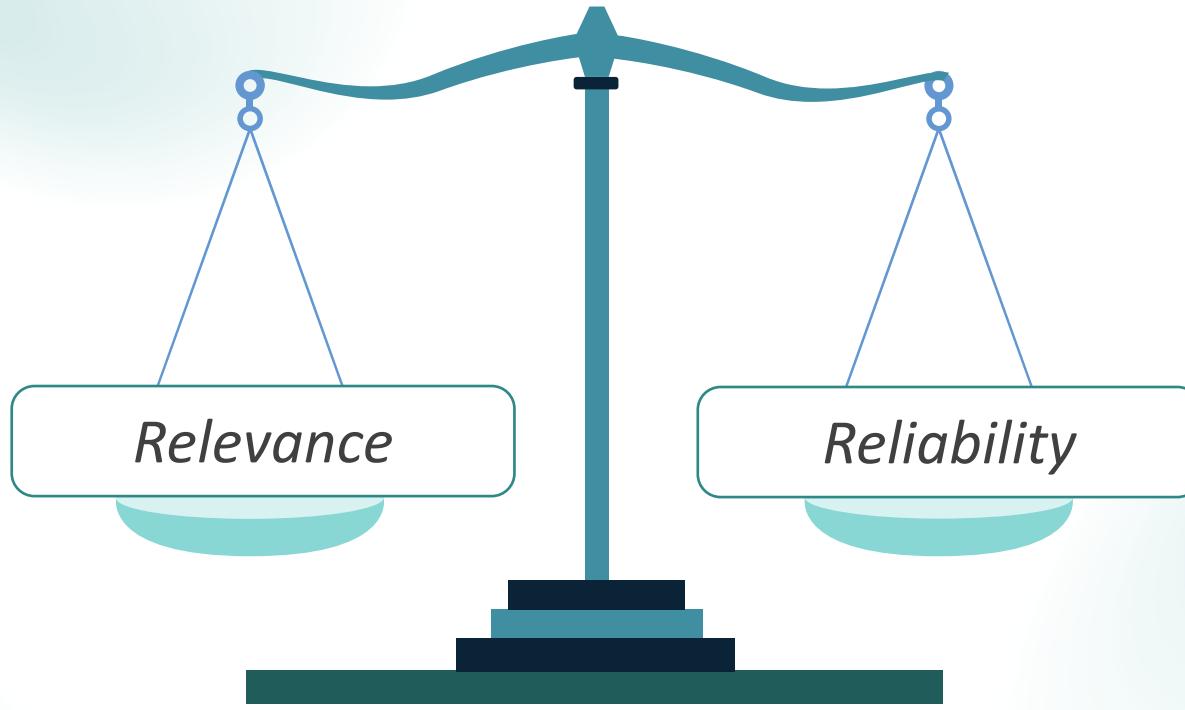
## Two determinants



**The persuasiveness of evidence**  
*can be evaluated only after considering the combination of appropriateness and sufficiency.*



## Appropriateness of Evidence



*Note that appropriateness of evidence deals only with the audit procedures selected.*





## Six Characteristics of Reliable Evidence

*Degree of objectivity*

*Qualification of individuals providing the information*

*Auditor's direct knowledge*

*Effectiveness of client's internal controls*

*Independence of provider*

*Timeliness*





*The quantity of evidence obtained determines its sufficiency.*

*Two main factors determine the appropriate sample size in audits:*

*The auditor's expectation of the misstatements*

*The effectiveness of the client's internal controls*



**TABLE 7-2****Relationships Among Evidence Decisions and Persuasiveness**

<b>Audit Evidence Decisions</b>	<b>Qualities Affecting Persuasiveness of Evidence</b>
Audit procedures and timing	Appropriateness Relevance Reliability Independence of provider Effectiveness of internal controls Auditor's direct knowledge Qualifications of provider Objectivity of evidence Timeliness When procedures are performed Portion of period being audited
Sample size and items to select	Sufficiency Adequate sample size Selection of proper population items



# PERSUASIVENESS AND COST



3

*In making decisions about evidence for a given audit, both persuasiveness and cost **must be considered.***



*The auditor's goal is to obtain a sufficient amount of appropriate evidence at the **lowest total cost.***

# 4 TYPES OF AUDIT EVIDENCE



*Every audit procedure obtains **one or more** of these types of evidence.*

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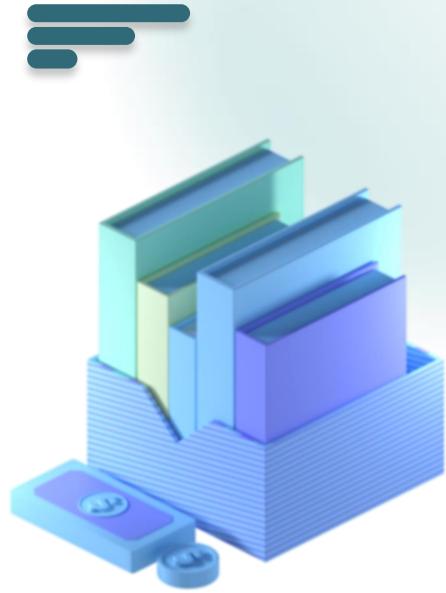
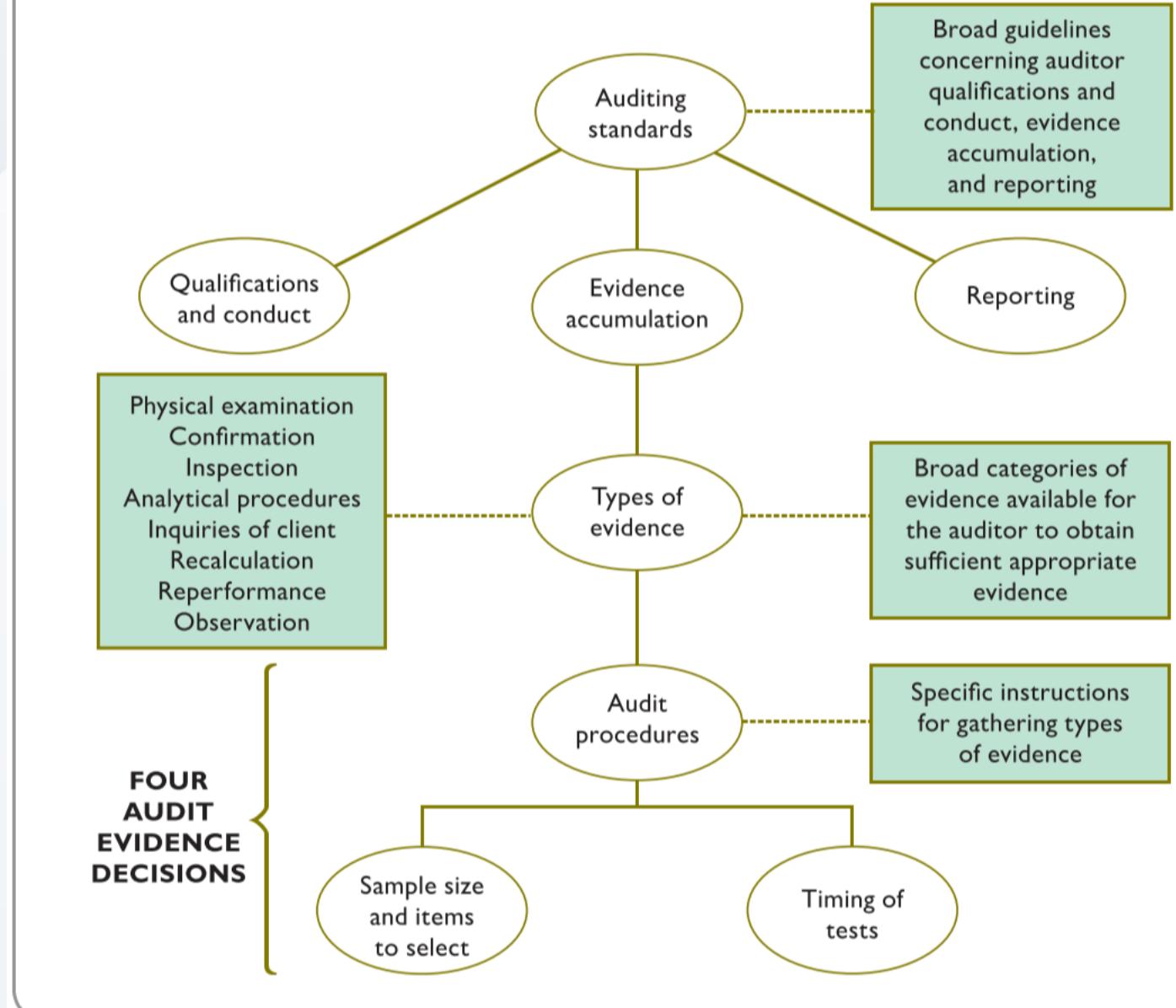
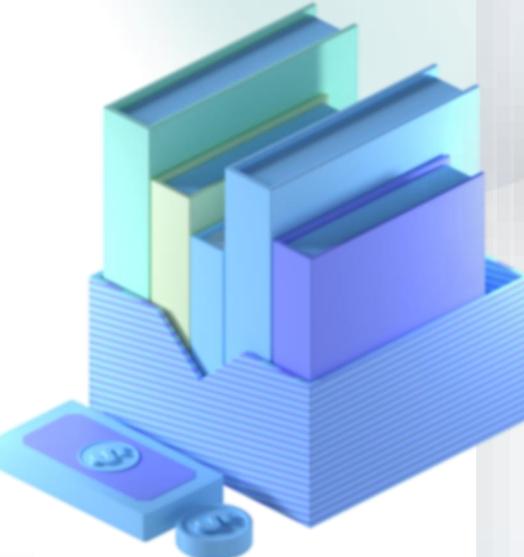


FIGURE 7-1

Relationships Among Auditing Standards, Types of Evidence, and the Four Audit Evidence Decisions

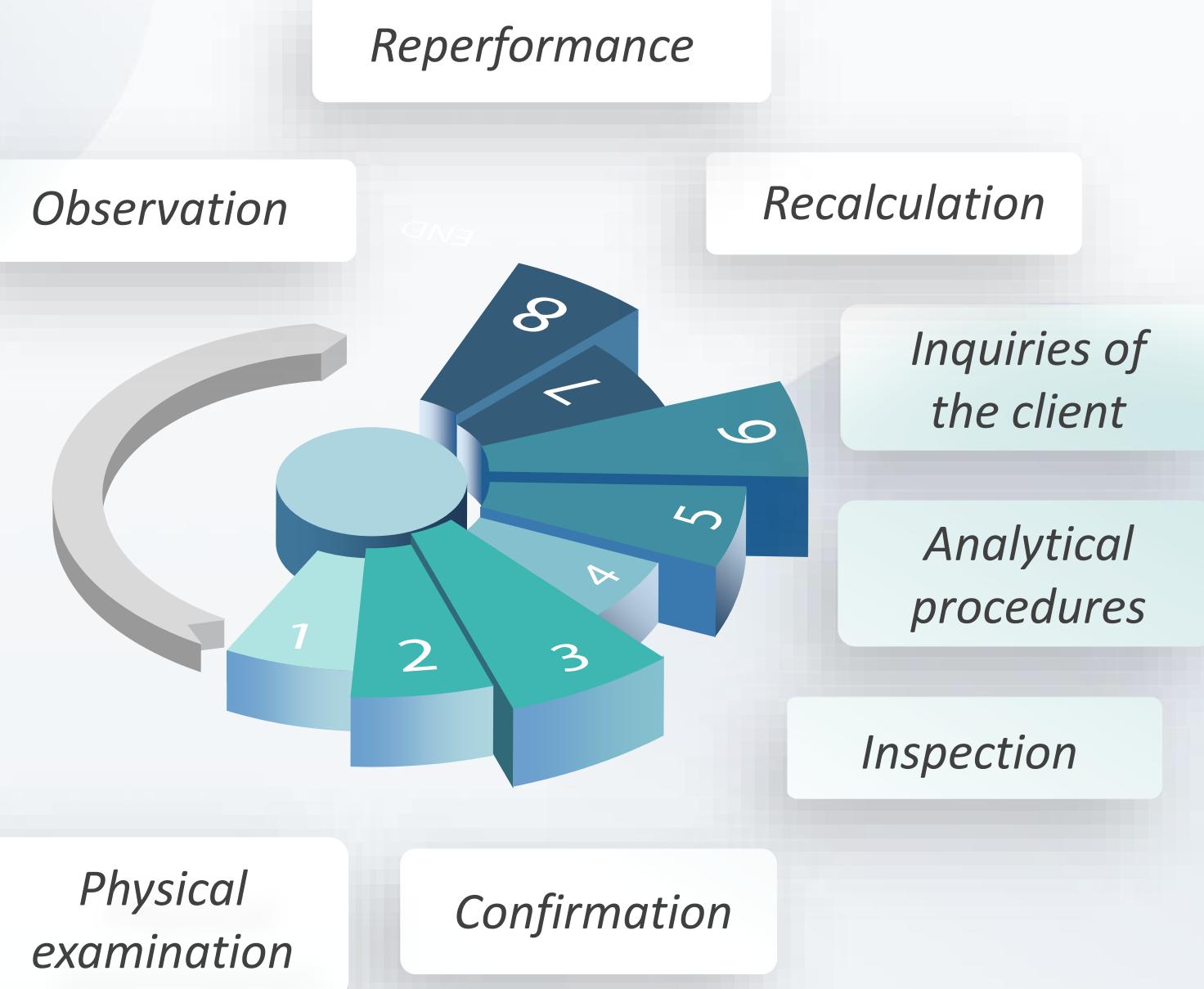


# 4 TYPES OF AUDIT EVIDENCE

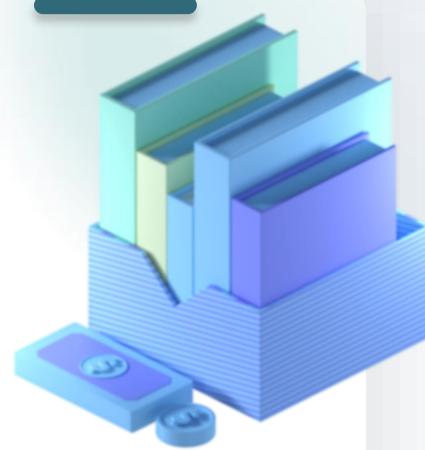


## 8 types of Audit Evidence

more



# 4 TYPES OF AUDIT EVIDENCE



## 8 types of Audit Evidence



### 1. PHYSICAL EXAMINATION

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*It is the inspection or count by the auditor of a tangible asset.*



*This type of evidence is most often associated with inventory and cash.*



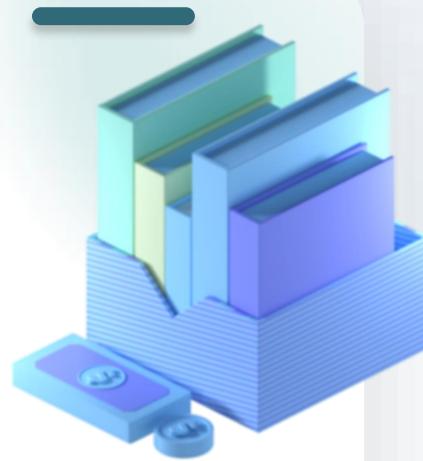
# 4 TYPES OF AUDIT EVIDENCE



## 8 types of Audit Evidence

### 2. CONFIRMATION

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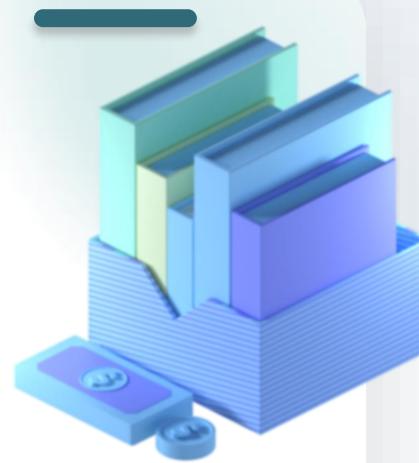
describes the **receipt** of a **direct written response** from a **third party** verifying the accuracy of information that was **requested by the auditor**

TABLE 7-3 Information Often Confirmed

Information	Source
<b>Assets</b>	
Cash in bank	Bank
Marketable securities	Investment custodian
Accounts receivable	Customer
Notes receivable	Maker
Owned inventory out on consignment	Consignee
Inventory held in public warehouses	Public warehouse
Cash surrender value of life insurance	Insurance company
<b>Liabilities</b>	
Accounts payable	Creditor
Notes payable	Lender
Advances from customers	Customer
Mortgages payable	Mortgagor
Bonds payable	Bondholder
<b>Owners' Equity</b>	
Shares outstanding	Registrar and transfer agent
<b>Other Information</b>	
Insurance coverage	Insurance company
Contingent liabilities	Bank, lender, and client's legal counsel
Bond indenture agreements	Bondholder
Collateral held by creditors	Creditor

# TYPES OF AUDIT EVIDENCE

4



**8 types of Audit Evidence**



**3.  
INSPECTION**

[more](#)

*It is the **auditor's examination** of the client's documents and records.*

**Internal documents**



**External document**



# 4 TYPES OF AUDIT EVIDENCE



4



## 8 types of Audit Evidence



### 4. ANALYTICAL PROCEDURES

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*evaluations of financial information through analysis of plausible relationships among financial and nonfinancial data*

**Understand the Client's Industry and Business**



**Assess the Entity's Ability to Continue as a Going Concern**

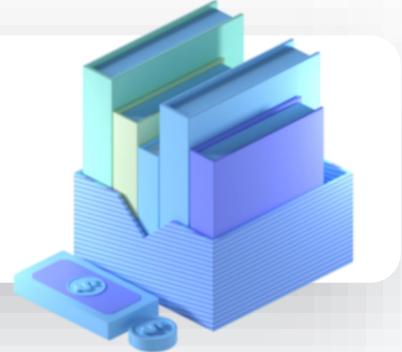


**Indicate the Presence of Possible Misstatements in the FS**

**Provide Evidence Supporting an Account Balance**



## 8 types of Audit Evidence

[more](#)

### 5. Inquiry

*is the obtaining of **written** or **oral** information from the client in response to questions from the auditor*



### 6. Recalculation

*involves rechecking a sample of calculations made by the client*



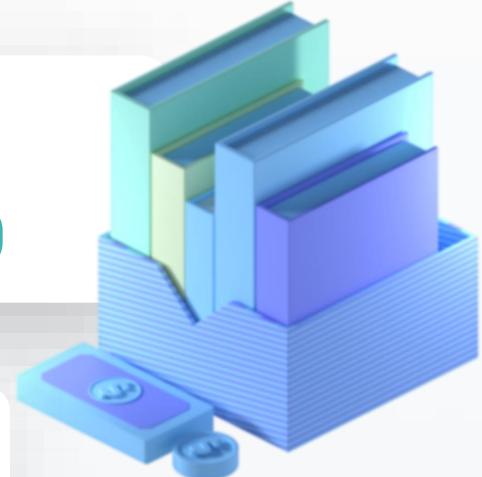
### 7. Reperformance

*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*





## 8 types of Audit Evidence

[more](#)

### 8. Observation

*consists of looking at a process or procedure being performed by others*

**Use one's senses to assess client activities**

**Tour plant to obtain a general impression of client's facilities**

**Observation is rarely sufficient by itself**

**Often need to corroborate with another kind of evidence**



# TERMS AND TYPES OF EVIDENCE

4



## Terms

*Examine*

*Scan*

*Read*

*Compute*

*Recompute*

*Foot*

*Trace*

*Compare*

*Count*

*Observe*

*Inquire*

*Vouch*

## Type of Evidence

*Inspection*

*Analytical procedures*

*Inspection*

*Analytical procedures*

*Recalculation*

*Recalculation*

*Inspection/Reperformance*

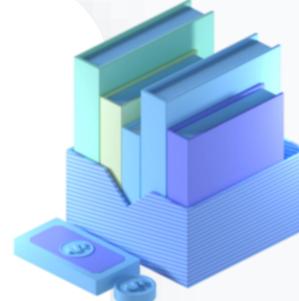
*Inspection*

*Physical examination*

*Observation*

*Inquiries of client*

*Inspection*



# TYPES OF AUDIT

## 4

**TABLE 7-4**

### Appropriateness of Types of Evidence

<b>Type of Evidence</b>	<b>Independence of Provider</b>	<b>Criteria to Determine Appropriateness</b>			
		<b>Effectiveness of Client's Internal Controls</b>	<b>Auditor's Direct Knowledge</b>	<b>Qualifications of Provider</b>	<b>Objectivity of Evidence</b>
Physical examination	High (auditor does)	Varies	High	Normally high (auditor does)	High
Confirmation	High	Not applicable	Low	Varies—usually high	High
Inspection	Varies—external documents more independent than internal documents	Varies	Low	Varies	High
Analytical procedures	High/low (auditor does/client responds)	Varies	Low	Normally high (auditor does/client responds)	Varies—depends on reliability of data
Inquiries of client	Low (client provides)	Not applicable	Low	Varies	Varies—low to high
Recalculation	High (auditor does)	Varies	High	High (auditor does)	High
Reperformance	High (auditor does)	Varies	High	High (auditor does)	High
Observation	High (auditor does)	Varies	High	Normally high (auditor does)	Medium



# EVIDENCE TYPES OF AUDIT

4

TABLE 7-5

## Types of Evidence and Four Evidence Decisions for a Balance-Related Audit Objective for Inventory\*

Type of Evidence	Audit Procedure	Evidence Decisions		
		Sample Size	Items to Select	Timing
Observation	Observe client's personnel counting inventory to determine whether they are properly following instructions	All count teams	Not applicable	Balance sheet date
Physical examination	Count a sample of inventory and compare quantity and description to client's counts	120 items	40 items with large dollar value, plus 80 randomly selected	Balance sheet date
Documentation	Compare quantity on client's perpetual records to quantity on client's counts	70 items	30 items with large dollar value, plus 40 randomly selected	Balance sheet date



TABLE 6-5

**Hillsburg Hardware Co.: Management Assertions and Balance-Related Audit Objectives Applied to Inventory**

<b>Management Assertions About Account Balances</b>	<b>General Balance-Related Audit Objectives</b>	<b>Specific Balance-Related Audit Objectives Applied to Inventory</b>
Existence	Existence	All recorded inventory exists at the balance sheet date.
Completeness	Completeness	All existing inventory has been counted and included in the inventory summary.
Valuation and allocation	Accuracy  Classification  Cutoff  Detail tie-in Realizable value	Inventory quantities on the client's perpetual records agree with items physically on hand. Prices used to value inventories are materially correct. Extensions of price times quantity are correct and details are correctly added. Inventory items are properly classified as to raw materials, work in process, and finished goods. Purchase cutoff at year-end is proper. Sales cutoff at year-end is proper. Total of inventory items agrees with general ledger. Inventories have been written down where net realizable value is impaired.
Rights and obligations	Rights and obligations	The company has title to all inventory items listed. Inventories are not pledged as collateral.



## Audit Documentation

*is the record of the audit procedures performed, relevant audit evidence, and conclusions the auditor reached.*



## Purpose of Audit documentation

*A Basis for Planning the Audit*

*A Record of the Evidence Accumulated and the Results of the Tests*

*Data for Determining the Proper Type of Audit Report*

*A Basis for Review by Supervisors and Partners*



# AUDIT DOCUMENTATION

5

## Ownership of audit files

*Audit files are the property of the auditor*



## Confidentiality of Audit Files

*A member shall not disclose any confidential information obtained in the course of a professional engagement except with the consent of the client*



## Requirements for Retention of audit Documentation

*Audits of private companies - minimum of five years  
Auditors of public companies - not less than seven years*

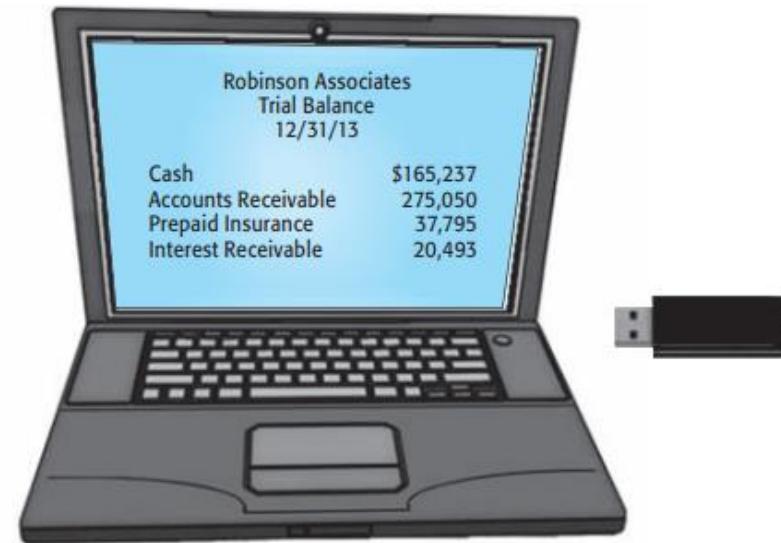


# AUDIT FILE CONTENTS AND ORGANIZATION

6

FIGURE 7-2

Audit File Contents and Organization



- Financial Statements and Audit Report
- Working Trial Balance
- Adjusting Journal Entries
- Contingent Liabilities
- Operations
- Liabilities and Equity
- Assets
- Analytical Procedures
- Tests of Controls & Substantive TOT
- Internal Control
- General Information
- Audit Programs
- Permanent Files



## Permanent files

*contain data of a historical or continuing nature pertinent to the current audit*



*Extracts or copies of such company documents of continuing importance as the articles of incorporation, bylaws, bond indentures, and contracts.*

*Analyses from previous years of accounts that have continuing importance to the auditor.*

*Information related to understanding internal control and assessing control risk.*

*The results of analytical procedures from previous years' audits.*



*The current files include all audit documentation applicable to the year under audit*

*Working trial balance*

*General information*

*Audit program*

*Adjusting and reclassification entries*

*Supporting schedules*

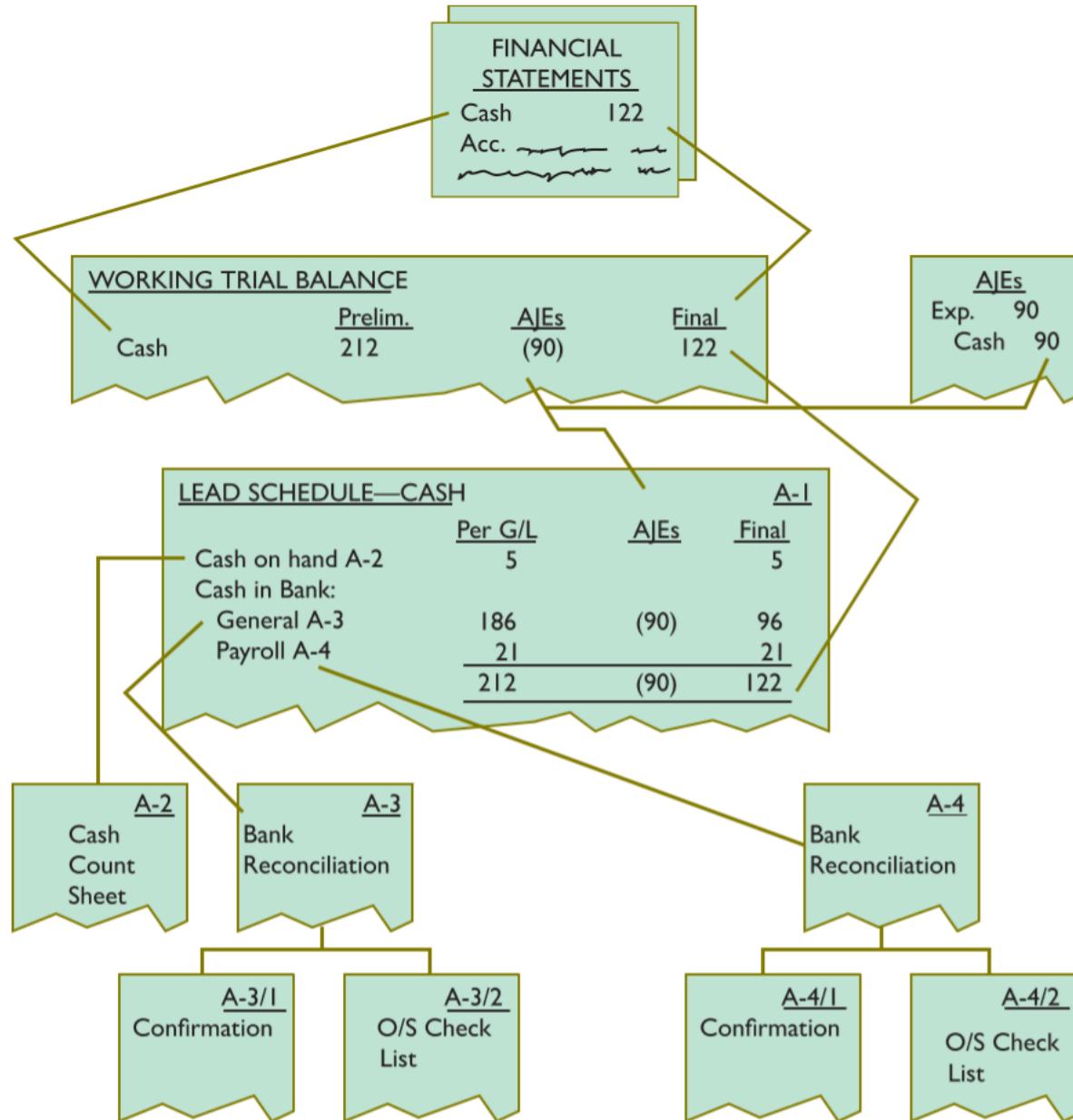


# CURRENT FILES

6

FIGURE 7-4

## Relationship of Audit Documentation to Financial Statements





# Types of Supporting Schedules



*Analysis*

*Summary of procedures*

*Trial balance or list*

*Examination of supporting documents*

*Reconciliation of amounts*

*Informational*

*Tests of reasonableness*

*Outside documentation*



# PREPARATION OF AUDIT DOCUMENTATION

6

FIGURE 7-5 Common Characteristics of Proper Audit Documentation

The screenshot shows a Microsoft Excel spreadsheet titled "Common Characteristics of Proper Audit Documentation". The title bar includes standard Office menu items: Home, Insert, Page Layout, Formulas, Data, Review, View. The ribbon tabs are Home, Insert, Page Layout, Formulas, Data, Review, View. The font, alignment, number, styles, cells, and editing tabs are visible.

The main content is a table of notes receivable:

Customer's Name	Interest Rate (percent)	Issue Date	Maturity Date	Face Amount	Accrued Interest
Graham Metal Works	6.0	10/04/16	12/03/16	x 300,000 P	2,850.00 @
Lopez Hardware Co.	7.0	11/15/16	01/07/17	x 178,000 P	519.17 @
Boise Hinge	5.5	10/09/16	12/08/16	x 400,000 P	3,177.78 @
Eastam Mfg. Co.	7.5	11/10/16	01/02/17	x 144,000 P	600.00 @
Toledo Fabricators	7.0	11/20/16	01/12/17	x 250,000 P	486.11 @
Manor Appliance Co.	6.5	10/21/16	12/20/16	x 112,000 P	808.89 @
Commercial Copper	6.0	10/30/16	12/29/16	x 340,000 P	1,756.67 @
				<u>1,724,000</u>	<u>10,198.62</u>

**Tick mark symbols**

- x Agreed face amount, interest rate, issue and maturity dates to note receivable document.
- P Positive confirmation received. No exceptions noted in face amount, issue and maturity dates, interest rate, and accrued interest (w/p C-2).
- @ Recalculated accrued interest. No exceptions noted.
- f Footed.
- t/b Traced and agreed to trial balance.

**Cross-reference to general ledger trial balance**

**Conclusion:** Notes receivable balance at 11/30/16 appears fairly stated. The collectibility of all notes was discussed with the controller. Per our conversation, all appear to be collectible. In my opinion, no loss provision is necessary.

J.B.

**Audit file reference**

**Initials of preparer**

**Date prepared**

**Explanation of audit procedures performed**

**Auditor's conclusion**



*Auditors must evaluate **how electronic information affects** their ability to gather evidence*

*Audit evidence is **increasingly in electronic form***

*Auditors use **computers to read and examine** evidence*

*Software programs are typically Windows-based*



MINI GAME  
MINI GAME MINI GAME

# MINIGAME

# FINDING EVIDENCE



# QUESTION

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1

2

3

4

5



1



2



3



4



5



About us . . .

## Nature And Type Of Audit Evidence

GROUP 1  
**Thank you everyone**

End

