



Gathering Sufficient Audit Evidence

ICPAU Practitioners seminar
Keep Moving

Hotel Africana
 October 2012

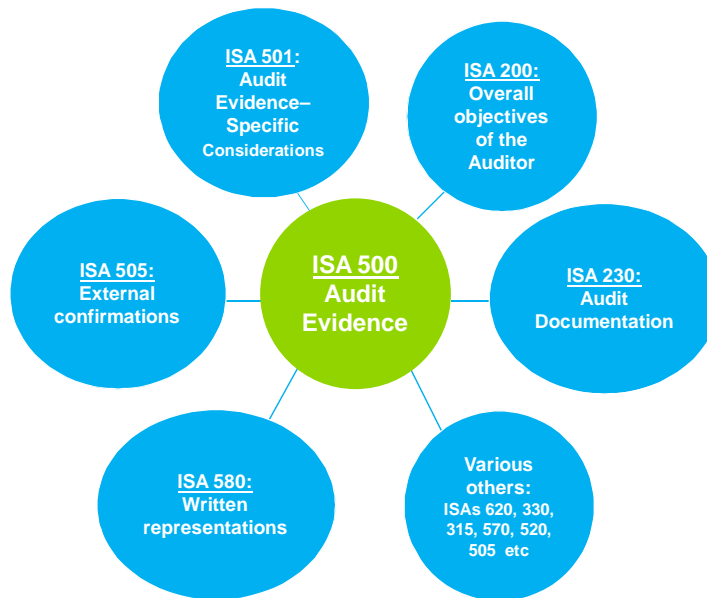


Agenda and objectives of the session

Key Principles and Guidance	<ul style="list-style-type: none"> ➤ What constitutes audit evidence? ➤ What are the available guidance? ➤ Key principles and requirements
Nature and Types of Audit Evidence	<ul style="list-style-type: none"> ➤ What are the different types of audit evidence? ➤ Which ones are preferable?
Sufficiency and Appropriateness	<p>Is the evidence sufficient and appropriate?</p> <ul style="list-style-type: none"> ➤ Quantity and Quality (2Qs)
Other considerations	<ul style="list-style-type: none"> ➤ Professional skepticism ➤ Fraud considerations ➤ Archiving and retention
Wrap-Up	<ul style="list-style-type: none"> ➤ Summary and concluding thoughts

Key Principles and Guidance

Available Professional Guidance (references)



Key definitions

Audit Evidence

“...Information used by the auditor in arriving at the conclusions on which the auditor’s opinion is based.”

Appropriateness

“...The measure of the quality of audit evidence – that is - its relevance and reliability in providing support for the conclusions on which the auditor’s opinion is based.”

Sufficiency

“...The measure of the quantity of audit evidence. The quantity of the audit evidence needed is affected by the auditor’s assessment of the risks of material misstatement and also by the quality of such audit evidence.”

4 ICPAU Practitioners Seminar – October 2012

Key principles and requirements

Objective of Audit Evidence

The objective of the auditor is to design and perform audit procedures in such a way as to enable the auditor to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor’s opinion.

Procedures to obtain audit evidence

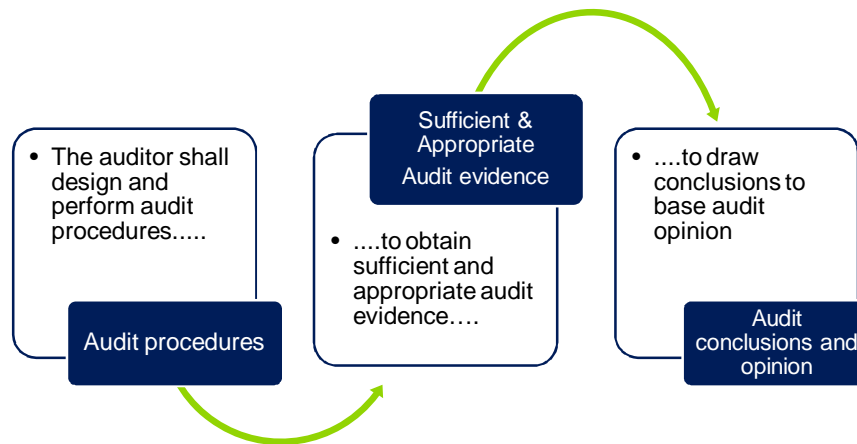
ISA 500 states that the auditor shall design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence.

Audit procedures to obtain audit evidence can include:

- ❖ inspection, observation, confirmation, recalculation, re-performance, and analytical procedures etc.
- ❖ These procedures are often done in some combination, in addition to inquiry.
- ❖ Inquiry alone ordinarily does not provide sufficient audit evidence

5 ICPAU Practitioners Seminar – October 2012

Key principles connecting the dots.....



6 ICPAU Practitioners Seminar – October 2012

Specific considerations – Inventories (ISA 501)

If inventories are material, the auditor shall obtain S&A audit evidence regarding existence and condition of inventories by:

A. Attendance at physical inventory counting to:

- Evaluate management's instructions and procedures
- Observe the performance of the count procedures
- Inspect the inventories and perform test counts

B. Performing procedures over the entity's final inventory records to determine whether they accurately reflect actual inventory count results

7 ICPAU Practitioners Seminar – October 2012

What do you do when you are unable to attend inventory count?

8 ICPAU Practitioners Seminar – October 2012

What do you do when you are unable to attend inventory count?

ISA 501: Audit Evidence - Specific considerations

If the auditor is unable to attend physical inventory counting due to unforeseen circumstances, the auditor shall make or observe some physical counts on an alternative date, and perform audit procedures on intervening transactions.

If attendance at physical inventory counting is impracticable, the auditor shall perform alternative audit procedures to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory.

If it is not possible to do so, the auditor shall modify the opinion in the auditor's report in accordance with ISA 705.3

9 ICPAU Practitioners Seminar – October 2012

Specific considerations – Litigation and claims (ISA 501)

The auditor shall design and perform audit procedures in order to identify litigation and claims involving the entity which may give rise to a risk of material misstatement, including:

- a) Inquiry of management including in-house legal counsel
- b) Review minutes of meetings of those charged with governance
- c) Review correspondence with external legal counsel
- d) Review legal expense accounts

If the risk is assessed to be material, the auditor shall, in addition, seek direct communication with the external legal counsel

The entity does not want to provide for or disclose identified litigation/claims in the financial statements



WHAT DO YOU DO?

Nature and Types of Audit Evidence

Types of Audit Evidence - Hierarchy

1. Evidence from Third Party

2. Auditor Generated Evidence

3. Other Written Evidence

4. Entity Prepared Documents

Nature and Types of Audit Evidence

1. Third party Evidence

- ✓ Best preferred if received directly by the auditor
- ✓ Less preferable if received via the entity

If received via entity, additional procedures should be carried out to ascertain authenticity

Nature and Types of Audit Evidence

2. Auditor Generated Evidence

- ✓ Seen to be least prone to bias
- ✓ Need to establish competence of the team generating the evidence

As an auditor you are taken to be independent and objective and will therefore not manipulate evidence to support the results.

Nature and Types of Audit Evidence

3. Written or Oral Evidence

- ✓ Written is preferred to oral evidence as it allows record in the audit file
- ✓ Oral evidence can become hearsay with people possibly denying later

If oral evidence is the only possible evidence available, it is important to summarize the issues discussed and to ensure the entity agrees with the way you understood the issue.

Nature and Types of Audit Evidence

4. Entity Prepared Documents (EPD)

- ✓ Least preferred form of evidence
- ✓ Prone to inherent bias
- ✓ Often used to support either 3rd party evidence or auditor generated evidence
- ✓ Need to assess relevance and reliability

Note: Majority of evidence received is always EPD

Entity Prepared Documents (EPD)

Relying on EPD

When using EPD, we shall evaluate whether the information is sufficiently reliable including as necessary:

- obtaining evidence about its accuracy and completeness
- evaluating whether the information is sufficiently precise and detailed for audit purposes

Example 1: the effectiveness of auditing revenue by applying standard prices to records of sales volume is affected by the accuracy of the price information and the completeness and accuracy of the sales volume data.

Example 2: Similarly, if we intend to test a population of payments for a certain characteristic (for example, authorization), the results of the Test will be less reliable if the population from which items are selected is not complete.

Entity Prepared Documents (EPD)

Should you put the EPD in the audit file?

There are two different ways of using EPD:

1. Where you just review EPD and document what you saw
2. Where you take a copy of the EPD for the audit file

These should depend on the procedures you are performing:

Example 1: When performing control testing address a particular attribute of the control (e.g. review signatures on an invoice), it may not be necessary to include the invoice in the file, but document the details of the invoice and evidence obtained.

Example 2: When we audit the risk related to validity of trade receivables, it may be necessary to file the reconciliation between the amount recorded and the balance confirmed, and perform tests directly on the reconciliation.

Entity Prepared Documents (EPD)

Evaluating EPD – “Questioning mind” (Professional skepticism)

Ask yourself questions:

- Is the information genuine?
- Could there be risk of error or fraud?
- Could the evidence have been tampered with?
- Is it a photocopy? Where is the original?
- Does the evidence make sense?
- Is it consistent with other known information?

Asking for corroboration through enquiry or documentation does not reflect on your doubting the trustworthiness of the entity's management.

“Don’t stop your enquiries until you are satisfied with the answers ...”

Entity Prepared Documents (EPD)

Use of management experts

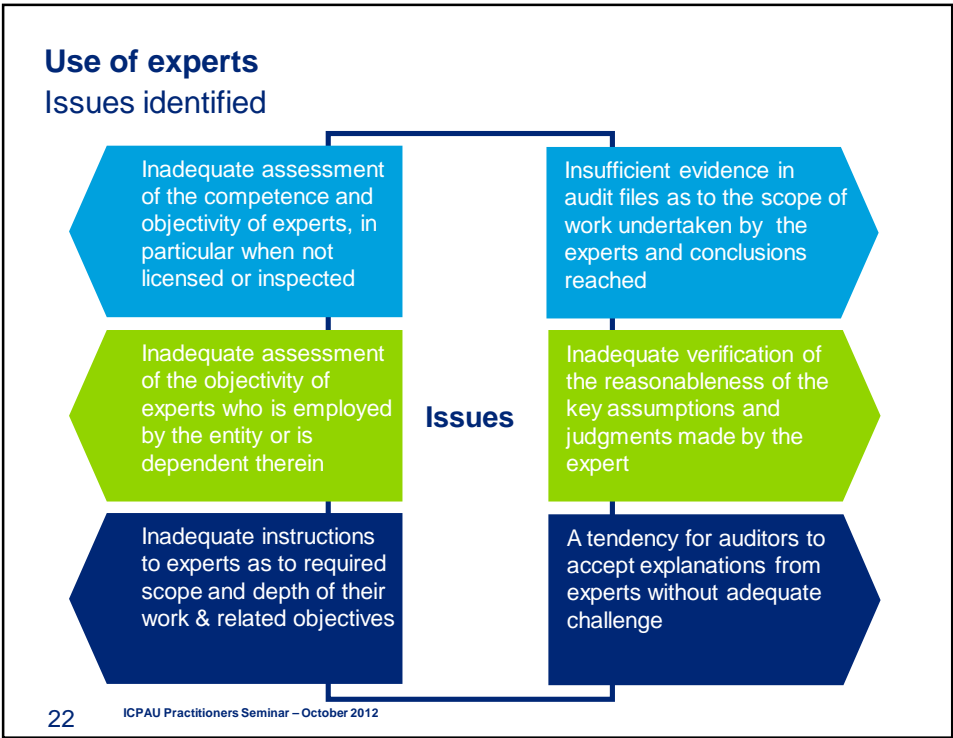
If information used as audit evidence has been prepared using the work of a management’s expert, the auditor shall, to the extent necessary:

- a) Evaluate the competence, capabilities and objectivity of that expert
- b) Obtain an understanding of the work of that expert; and
- c) Evaluate the appropriateness of that expert’s work as audit evidence for the relevant assertion

Competence relates to the nature and level of expertise of the expert

Capability relates the ability of the expert to exercise the competence in the circumstances. Factors influencing capabilities include time, resources, location

Objectivity relates to the possible effects that bias, conflict of interest or the influence of others may have on the expert



Sufficiency and Appropriateness

Sufficiency and Appropriateness

Policy requirements

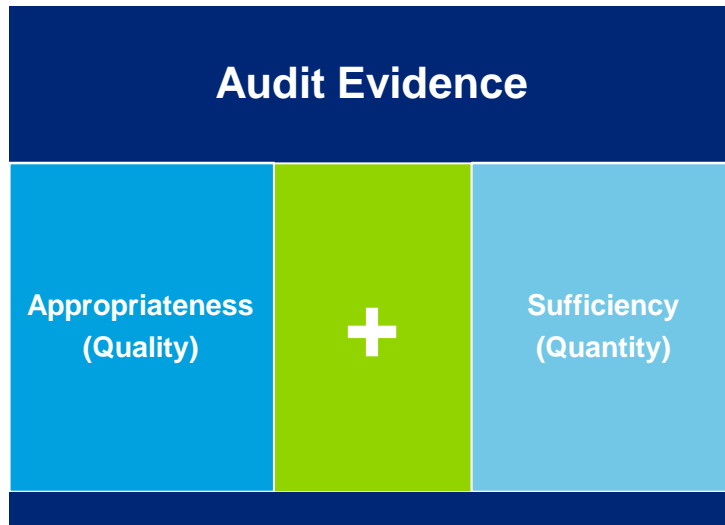
Once we have received the audit evidence, we need to evaluate whether it is sufficient and appropriate enough to enable us draw conclusions upon which to base audit opinion.

Whether sufficient appropriate audit evidence has been obtained is a matter of professional judgment.

ISA 200 contains discussion of the relevant factors that should be considered in exercising professional judgment. Examples:

- Nature of audit procedures
- Balance between benefit and cost
- Significance of the potential misstatement
- Source and reliability of available information
- Persuasiveness of the audit evidence

Sufficiency and Appropriateness



Appropriateness

Quality = relevance + reliability

Relevance

Deals with the logical connection with the purpose of the audit procedure, and where appropriate, assertion under consideration.

Nature and Type of audit test is very important in determining relevance of audit evidence. A given set of audit procedures may provide audit evidence that is relevant to certain assertions, but not others.

Example 1: If the purpose of an audit procedure is to test for the existence of a building, a physical verification would suffice. However, the same evidence may not be relevant evidence for the test of ownership (rights & obligations)

Example 2: Inspection of documents related to collection of receivables after period end may provide audit evidence regarding existence and valuation, but not necessarily cut off .

26 ICPAU Practitioners Seminar – October 2012

Appropriateness

Quality = relevance + reliability

Reliability

The reliability of audit evidence is influenced by its source and nature, and is dependent on the individual circumstances under which it is obtained, including controls over its preparation and maintenance.

Subject to certain exceptions, the following are some generalizations about reliability of audit evidence:

- Reliability of evidence is increased when it is obtained externally
- Reliability of internally obtained evidence is enhanced when the related controls over its generation and maintenance is effective
- Written evidence is more reliable than evidence obtained orally
- Evidence obtained by original documents is more reliable than that obtained from photocopies or facsimile

27 ICPAU Presentation – October 2012

Sufficiency

Sufficiency is about Quantity of audit evidence

Sufficiency (quantity) and appropriateness (quality) of audit evidence are interrelated.

The quantity of audit evidence needed is affected by two main factors:

- a) the auditor's risk assessment –the higher the risk, the more evidence required
- b) the quality of such audit evidence – the higher the quality, the less required

However, obtaining more audit evidence may not compensate for its poor quality.

**What do you do when you have not
obtained Sufficient Appropriate audit
evidence?**

What do you do when there is no sufficient appropriate audit evidence?

ISA 330: Auditor's responses to assessed risks

If we have not obtained sufficient appropriate audit evidence as to a material financial statement assertion, we shall attempt to obtain further audit evidence.

If we are unable to obtain sufficient appropriate audit evidence, we shall express a qualified opinion or disclaim the opinion on the financial statements.”

Other considerations

Professional Skepticism

Definition of Professional Skepticism

- “An attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence.”



Professional skepticism is a mindset that auditors need to have at all times.

32 ICPAU Practitioners Seminar – October 2012

Professional Skepticism, cont.

- We should maintain professional skepticism throughout the audit, recognizing the possibility that a material misstatement due to fraud could exist, notwithstanding our past experience of the honesty and integrity of the entity’s management and those charged with governance.
- Professional skepticism includes being alert to, for example:
 - Audit evidence that contradicts other audit evidence obtained
 - Information that brings into question the reliability of documents and responses to inquiries to be used as audit evidence
 - Conditions that may indicate possible fraud
 - Circumstances that suggest the need for additional audit procedures
- Professional Skepticism is necessary to the critical assessment of audit evidence. Adopt an attitude to question reliability of audit evidence or explanations obtained when confronted with inconsistencies or suspicious circumstances.

33 ICPAU Practitioners Seminar – October 2012

Professional Skepticism, cont.

How can you apply professional skepticism:

- Be inquisitive and skeptical on all engagements, not just the ones that seem risky
- Always verify information obtained for reliability purposes (accuracy and completeness)
- Remain alert for suspicious items – things that do not seem quite right
- Beware that entity management may influence you in your work. You may be deceived by the smooth talking personnel, the Know Alls etc.
- Properly brief and supervise your audit teams. The audit teams are the eyes and ears of the audit partner

In short – don't be satisfied with less than persuasive evidence

34 ICPAU Practitioners Seminar – October 2012

Fraud considerations

- Fraud schemes are everywhere. Do not be fooled.
- Although the primary responsibility for the prevention and detection of fraud rests with management and those charged with governance, as auditors, we are required to obtain reasonable assurance that the financial statements as a whole are free from material misstatement, whether caused by fraud or error.

Parmalat Example:

Part of the fraud scheme was non existent assets including fake bank account balances.

The auditor received a letter on the Bank's letterhead confirming the existence of the account. However, this turned out to have been forged.

35 ICPAU Practitioners Seminar – October 2012

Symptoms of unethical behavior

Overly dominant management

Someone who talks too much and who always wants to know where you have got to on the audit

Extravagant lifestyle and behavioural change

Excessive gambling

My wife has a private income or we have won the lottery or something similar

Never takes holidays or records in a mess

Starts early and finishes late

Insomnia

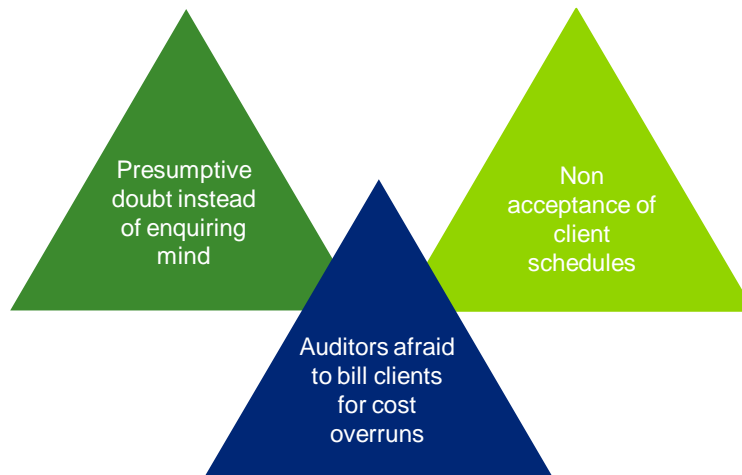
Doesn't allow others to do their work

Someone who avoids meeting us or restricts access to information

An attempt to "bribe" you

36 ICPAU Practitioners Seminar – October 2012

APB's suggestions for debate are strange



37 ICPAU Practitioners Seminar – October 2012

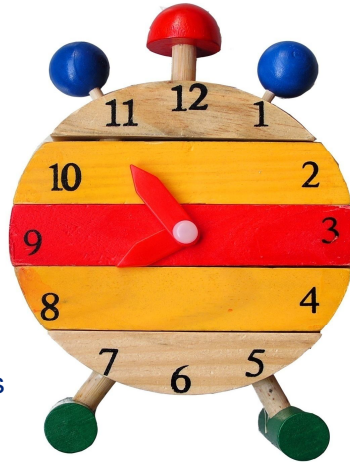
Archiving and retention of audit evidence

Archive files

Within 60 days of audit report
or 45 days for SEC audits

Retention of audit file

7 years, subject to Laws/regulations



Concluding thoughts

Practice Review - Final messages

Embrace the results of practice review and the concept of continuous improvement

Follow up quickly – don't lose another audit season

Monitor and link change to reward

Summary and concluding thoughts

Broad elements:

- **Objective of audit evidence**—audit evidence is the basis of drawing conclusions upon which audit opinion is formed.
- **Guidance**—ISA 500 is the principal guidance and should be read in conjunction with several other auxiliary standards and guidelines
- **Nature and type of audit evidence**—Audit evidence come in different types and the nature and type determines the degree of reliability
- **Sufficiency and Appropriateness**—This is at the core of the concept of audit evidence and its about quality and quantity.
- **Professional skepticism**—As auditors, we are under constant scrutiny. We need to perform the audit

Summary – The Pillars



Summary and concluding thoughts

- While we may be responding to CPAB, and by extension the concerns of IFIAR, it is in our best interest, regardless of the regulator to have a world class, efficient, engaging, effective EQCR process
- We should welcome increased measurement and reporting on audit quality in LDR and TDR; for the majority of our people, we are conducting high quality work everyday and our work should be objectively evaluated and reported upon
- Enabling partners—both EQCR partners and audit engagement partners—to have sufficient time and focus on addressing specific risk and other key elements of EQCR is consistent with our new audit methodology, and should be well received
- We are attempting to develop tools that support efficient review, assessment of quality and compliance with GAAS Standards

Open Q&A Session

The Deloitte logo consists of the word "Deloitte" in a bold, dark blue, sans-serif font. A small green dot is positioned at the end of the word, following the final period.

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee, and its network of member firms, each of which is a legally separate and independent entity. Please see www.deloitte.com/about for a detailed description of the legal structure of Deloitte Touche Tohmatsu Limited and its member firms.

Deloitte provides audit, tax, consulting, and financial advisory services to public and private clients spanning multiple industries. With a globally connected network of member firms in more than 150 countries, Deloitte brings world-class capabilities and high-quality service to clients, delivering the insights they need to address their most complex business challenges. Deloitte's more than 195,000 professionals are committed to becoming the standard of excellence.

© 2012 Legal Entity