**AUDIT EVIDENCE**

Auditor should obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the audit opinion.

**Concept of Audit Evidence**

Audit evidence is all the information used by the auditor in arriving at the conclusions on which his opinion is based and includes the information contained in the accounting records underlying the financial statements and other information. It is obtained from audit procedures performed during the course of audit and may include audit evidence obtained from other sources such as pervious 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 cost allocations, computations, reconciliations and disclosures. The entries in the accounting records are often initiated, recorded, processed and reported in the 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.

Auditor obtains most of the audit evidence from accounting records of the entity. If accounting records do not provide sufficient audit evidence, the auditor obtains other audit evidence.

Other information that the auditor may use as audit evidence includes:

* minutes of meetings;
* confirmations from third parties,
* analysis’ 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.

**Sufficient appropriate Audit Evidence**

Sufficiency: The measure of quantity of audit evidence.

Appropriateness: The measure of quality i.e. relevance and reliability in providing support of

detecting misstatements in account balance classes of transactions and disclosures and relevant assertions.

The quantity of audit evidence needed is affected by:

* the risk of misstatement (the greater the risk, the more audit evidence is likely to be required); and
* the quality of such audit evidence (the higher the quality, the less may be required).

Accordingly sufficiency and appropriateness are interrelated. However, merely obtaining more audit evidence may not compensate for its poor quality.

Audit evidence obtained through same audit procedures may be relevant to certain assertions but not relevant to other assertions.

The auditor often obtains evidence about an assertion from different sources or of different nature. Evidence about an assertion is not a substitute for evidence regarding another assertion.

**Sources of obtaining Audit Evidence**

1. **Internal source** - through accounting system, management, employees, underlying documentation etc.
2. **External source** - third parties, i.e. suppliers, customers bankers legal advisers and other parties who have knowledge of the enterprise.

**Nature of Audit Evidence**

1. Visual
2. Oral
3. Documentary

**Reliability of Audit Evidence - Generalizations**

Following generalizations are considered useful in assessing the reliability of audit evidence (subject to certain important exceptions):

1. Audit evidence obtained from independent sources outside the entity is more reliable.
2. Evidence generated internally is more reliable when related controls are effective.
3. Evidence obtained by an auditor directly is more reliable than that obtained indirectly or by interference e.g. Bank balance confirmation certificate received by an auditor is more reliable than the bank statement obtained from the management or observation of a control rather than making inquiry about the application of a control.
4. Written evidence is more reliable than oral representation.
5. Audit evidence provided by original documents is more reliable than that provided by photocopies and facsimiles.

**Other factors relating to Audit Evidence**

1. Information on which audit procedures are based should be sufficiently accurate and complete. Therefore, auditor should also test the system for generating such information while using it for his procedures.
2. Auditor’s reliance increases when audit evidence obtained from one source is consistent with another source; if it is inconsistent further procedures may be performed.
3. Cost of obtaining the audit evidence is also considered when obtaining it.
4. While forming an audit opinion, the auditor does not have to examine all the items or obtain all the evidences which might be available. He can reach a conclusion by examining a sample of such transactions. He also relies on persuasive evidences. However, if evidence is less than persuasive, he does not consider it reliable.

**Assertions in obtaining Audit Evidence**

1. 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 proper period.
   5. Classification – transactions and events have been recorded in the proper accounts.
2. 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.
3. Assertions about presentation and disclosure:
   1. Occurrence and rights and obligations – disclosed events, transactions and other matters have occurred and pertain to the entity;
   2. Completeness – all disclosures that should have been included in the financial statements have been included; Classification and understandability – financial information is appropriately presented and described, and disclosures are clearly expressed;
4. Accuracy and valuation – financial and other information are disclosed fairly and at appropriate amounts.

**Audit procedures for obtaining audit evidence**

Auditor performs audit procedures to obtain an understanding of the entity, its environment and to assess risks of material misstatement. Procedures are also applied to test operating effectiveness of internal controls and for detection of material misstatements at assertion level.

The auditor always performs risk assessment procedures to provide a satisfactory basis for assessment of risks at financial statement level. In addition to these risk assessment procedures, which alone are not sufficient, the auditor performs audit procedures in the form of tests of control and substantive procedures. Tests of controls are applied when auditor expects to rely on operating controls. Through tests of controls, he tests the controls to support the risk assessment. These are also applied when substantive procedures alone do not provide sufficient appropriate audit evidence.

Nature and timing of audit procedures may be affected by the entity’s data retention policies or their practice to convert source documents into computer images through scanning, means of communication being used by the entity e.g. electronic messaging rather than written purchase orders.

The auditor uses one or more types of audit procedures described below:

1. Inspection of Records or Documents

It consists of examining records or documents whether internal or external, in paper form, electronic form, or other media. Inspection provides evidence of varying degrees of reliability depending on their nature and source and in the case of internal records, on effectiveness of controls over their production.

1. Inspection of Tangible Assets

It consists of physical examination of the assets. It may provide reliable audit evidence of their existence cannot necessarily about other assertions.

1. Inquiry

It means seeking information of knowledgeable persons throughout the entity or outside the entity. Those may be formal written or informal oral. It provides an auditor with new information or corroborative evidences. It may also bring to high information different from the one possessed by the auditor. Certain oral inquiries might be got confirmed through written representations.

1. Confirmations

It is a specific type of inquiry. It is the process of obtaining a representation of information or an existing condition directly from a third party. Confirmations are sought from debtors, creditors, bankers, legal advisors etc.

1. Recalculation

It consists of checking the mathematical accuracy of documents or records. It can be performed through use of information technology.

1. Re-performance

It is the auditor’s independent execution of procedures or controls that were originally performed as part of the entity’s internal control, either manually or through the use of CAATs, for example, re-performing the aging of accounts receivable.

1. Analytical procedures

It consists of evaluations of financial information made by a study of plausible relationship among both financial and non- financial data. It includes investigation of significant fluctuations found and the relationship that are inconsistent.

**SUFFICIENT APPROPRIATE AUDIT EVIDENCE**

**AND**

**TESTING THE SALES SYSTEM**

**Recap:**

Audit evidence includes: the information contained in the accounting records underlying the financial statements.

Audit evidence might include:

* Documents (invoices, credit notes, cash receipts)
* Accounting entries (write down to NRV, depreciation)
* Answers from the management (Provisions)
* Information from third parties (banks, debtors)
* Computations (depreciation, accruals, provisions)
* Observations (inventory count)

Sufficiency: The measure of quantity of audit evidence.

Appropriateness: The measure of quality i.e. relevance and reliability of audit evidence.

Key questions for the auditor to consider therefore will be:

1. Do I have enough evidence to reach a conclusion on this audit area?
2. Is the evidence that I have, reliable enough to, allow me to reach a conclusion on this area of the audit?

**Assertions in obtaining Audit Evidence**

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   2. Completeness – all transactions and events that should have been recorded have been recorded (accruals & depreciation);
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**TESTING THE SALES**

**SYSTEM Control Objectives**

For many businesses, sales are made on credit and so objectives for the sales cycle includes control debtors as well.

These control objectives include:

1. Customers' orders should be authorized, controlled and recorded in order to execute them promptly
2. Goods shipped and work completed should be controlled to ensure that invoices are issued and revenue recorded for all sales.
3. Goods returned and claims by customers (for example, in respect of damaged goods) should be controlled in order to determine the liability for goods returned and claims received. .
4. Invoices and credits should be appropriately checked for accuracy and should be authorized before being entered in the receivables' records.
5. Authorized customer transactions, and only those transactions, should be accurately entered in the accounting records.
6. There should be procedures to ensure that sales invoices are subsequently paid by customers and that doubtful amounts are identified in order to determine any provisions or write offs required

**Control procedures over sales and debtors**

There are a large number of controls that may be required in the sales cycle due to the importance of this area in any business and the possible opportunities that exist for diverting sales and cash receipts away from the business.

Typical control procedures at key stages of the sales cycle are:

1. Orders
2. Dispatch
3. Invoicing and credit notes

Fundamentals of Auditing

* + - 1. Returns inwards
      2. Receivables
      3. Bad Debts
  1. **Orders** 
     1. Existing customers should be allocated a credit limit and it should be ascertained whether this limit is to be exceeded if the new order is accepted. If so the matter should be referred to credit control.
     2. Any new customer should be referred to the credit control department before the order is accepted.
     3. All orders received should be recorded on pre-numbered sales order documents so that a check can be made that all orders have been dealt with -a completeness check.
     4. All orders should be authorized before any goods are dispatched.
     5. The sales order document should be used to produce a dispatch note for the goods outwards department. No goods may be dispatched without a dispatch note.
  2. **Dispatch** 
     1. Dispatch notes should be pre-numbered and a register kept of them to enable them to be matched with relate to sales invoices and customer orders.
     2. Dispatch notes should be authorized before goods leave the company.
     3. Regular checks should be made to ensure that all dispatches have been invoiced.
  3. **Invoicing and Credit Notes** 
     1. Sales invoices should be authorized by a responsible official and matched with the authorized order and dispatch note.
     2. All invoices and credit notes should be entered In daybook records, the sales ledger, and sales ledger control account. Batch totals should be maintained for this purpose.
     3. Sales invoices and credit notes should be checked for prices. casts and calculations by a person other than the one preparing the invoice.
     4. All invoices and credit notes should be serially pre-numbered and regular sequence checks should be carried out.
     5. Credit notes should be authorized by someone unconnected with dispatch or sales ledger functions.
     6. Copies of cancelled invoices should be retained.
     7. Any cancellation of an invoice should lead to a cancellation of the related dispatch note.
     8. Cancelled (and free of charge) invoices should be signed by a responsible official.
     9. Each invoice should distinguish between different types of sales and, if relevant, different rates of VAT or sales tax. Any coding of invoices should be periodically checked independently
  4. **Returns** 
     1. Any goods returned by the customer should be checked for obvious damage and, when accepted. a document should be raised.
     2. All goods returned should be used to prepare appropriate credit notes
  5. **Receivables/Debtors** 
     1. A receivables ledger control account should be prepared regularly and checked to individual sales ledger balances by an Independent official.
     2. Receivables ledger personnel should be independent of dispatch and cash receipt functions.
     3. Statements should be sent regularly to customers.
     4. Formal procedures should exist for following up overdue debts which should be highlighted either by the preparation of an aged list of balances or by the preparation of regular customer statements.
     5. Letters should be sent to customers for collection of overdue debts. A policy should be in place for the Institution of legal proceeds where appropriate.

1. **Bad debts** 
   * 1. The authority to write off a bad debt should be in writing. Appropriate adjustments should be made to the sales ledger and the control account

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1. The use of court action or the writing-off of a bad debt should be authorised by an official independent of the cash receipt function.

**Tests of Control**

Tests of control should be designed to check that the control procedures are being applied and that objectives are being achieved. Tests may be appropriate under the following broad headings.

1. Carry out sequence test checks on invoices, credit notes, dispatch notes and orders. Ensure that all items are included and that there are no omissions or duplications.
2. Check the existence of evidence for authorization in respect of:
   1. acceptance of the order (the creditworthiness check)
   2. dispatch of goods
   3. raising of the invoice or credit note
   4. pricing and discounts
   5. write-off of bad debts.

Check both that the relevant signature exists and that the control has been applied.

1. Seek evidence of checking of the arithmetical accuracy of:
   1. invoices, including pricing, and VAT and sales tax calculations
   2. credit notes,

This is often done by means of a 'grid stamp' containing several signatures on the face of the document. Ensure that the control has been applied by checking the accuracy of such invoices and credit notes.

1. Check dispatch notes and goods returned notes to ensure that they are matched with invoices and credit notes.
2. Check that control account reconciliations have been performed and reviewed.

In all cases, tests should be performed on a sample basis.