AUDIT EVIDENCE – TOP ARGUMENT FOR FINAL AUDIT OPINION

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Abstract: The following research aims to emphasize the importance of audit evidences, their quality characteristics and the professional judgment used to measure and to evaluate them in order to express their final audit opinion. There is no mathematical formula, neither a specific model in order to evaluate the quality of audit evidences. Their quality depends upon the professional judgment concerning the audit technical standards, the accounting references and nevertheless upon the auditor's ethics. This is one of the reasons for which the financial audit is one of the edges of economical research, highlighting the credibility of financial statements.

Documentation is the supreme quality test of an assurance mission. One of the key elements of the documentation is provided by the audit evidence.

Audit evidence means any type of information obtained and used by the financial auditor in order to establish whether the financial statements are an accurate presentation of the financial results and position of a company, reflect the economic reality of the performed transactions and are impartial, cautious, relevant and credible.

Audit evidence is useful in establishing an accurate presentation of the financial statements.

The auditor is responsible for the planning and performing of the audit, so as to get a reasonable assurance regarding the presence or absence of significant erroneous information within the financial statements, regardless of the causes that have generated it.

In order to fulfill their goal, auditors should get **sufficient** audit evidence so as to confirm all the managerial target-criteria (assertions) within the financial statements. The audit technical standards request for the auditor to get **sufficient quality evidence** to formulate a well-supported conclusion.

- ***Is there any unit for measuring the amount of audit evidence? What are the classification criteria of the predication judgments, within the audit evidence? How can we get high-quality audit evidence when sometimes the most important probative information is not to be found in the accounting documents?*** The answer to the above mentioned questions is certainly a combination of theoretical information given by the following set of standards:

ISA 500- Audit Evidence

ISA 501- Audit Evidence – Additional considerations for specific elements;

ISA 505 – External Confirmation

ISA 520- Analytic Procedures

ISA 530- Audit sampling and other selective testing procedures, completed by

Minimal Audit Regulations, issued by CAFR and the International Audit Standards; the professional expertise and the value judgments issued by the auditor with regard to any decision concerning the audit evidence.

The Audit Program is defined by the **major decision** of the auditor regarding the **nature** and **adequate amount** of evidence that he needs to collect. This judgment is important, considering the cost related to the examining and evaluation of all the available elements.

In order to correctly fundament his opinion, the auditor defines within **the audit program** the **procedures** that need to be performed in order to generate **the audit evidence**, so as for the auditor to be able to formulate reasonable conclusions to support his final opinion.

Audit procedures are detailed as a set of instructions formulated in sufficiently specific terms regarding the collecting of audit evidence types that are to be obtained at a given moment, during the audit process, so as to contain probative information, evaluated by the auditor.

In order to get such information, the auditor should have the necessary knowledge and skills to collect each assertion included in the audited financial statements, i.e. sufficient and solid evidence so as to comply with the defined standards of financial audit.

The development of the audit program reflects the auditor's skills in making major decisions with regard to the following:

1. *The audit procedures that need to be used*;
2. The nature and amount of evidence to be obtained based on the applied procedures;
3. *The scheduling of the audit procedures;*
4. *Establishing the dimension of the audit sample and the population elements that are to be tested;*
5. *Generated costs.*

1. Choosing an audit procedure that would generate **sufficient** and **adequate** audit evidence depends on the **auditor's judgment** and is influenced by various factors such as:

- The evaluation by the auditor of the nature and level of risk inherent for the financial statements, an account balance or a type of transaction;
- The nature of the accountancy and internal control systems, as well as the evaluation of the control risk;
- The significance threshold of the element to be examined;
- Personal expertise accumulated during the previous audit projects;
- The results of the audit procedures, including fraud or errors that might have been revealed;
- The source and credibility of the available information.

The main procedures that can be selected by financial auditors, in order to obtain various types of audit evidence are the following:

Physical examination of the physical assets, as well as of other types of assets – This is the objective method of acknowledging the assets' existence, volume and characteristics; it can also be a useful method of evaluating the state or quality of the same assets.

Confirmation – This describes the receipt of a verbal or written answer from an independent third party confirming or invalidating the accuracy of the information requested by the auditor. Here are some the information most frequently requested by financial auditors for their confirmation:

Table 1

The information most frequently requested

Confirmed info	**Source of confirmation (third parties)**
Liquidity balance (Treasury) and credits	Banks
Liquidity equivalents and other titles	Equity market operators
Outstanding debts and other debtors	Clients and other third parties
Consigned inventory	Consigner
Custody inventory	Custodian
Insurance policy value	Insurance Company
Debts – Suppliers	Supplier
Mortgages to be paid	Mortgage loan creditor
Bonds to be paid	Owner of the bond
Advance payments from clients	Client
Issued shares	Issuing guarantee/Transfer Agent
Other info	
Risk covering	Insurance company
Securities and cautions	Borrowing creditors

Documentation inspection is the examination by the auditor of the documents and evidence of the client, with the goal of justifying the information missing from or that should be included into the financial statements.

Observation is the witnessing of a process or procedure performed by the staff of the audited entity.

Questioning the client refers to obtaining written or verbal information from the client who answers the questions of the auditor.

Reconstruction refers to checking a sample of calculations and information transfer performed by the client during the audited interval of time, checking the arithmetical accuracy of the source documents and the accountancy registers, or of any independently made calculations.

Analytic procedures cover the analysis of the significant indicators and trends, including the investigation of fluctuations and relations that are inconsequent with regard to other relevant information or do not comply with the expected values.

Investigation and confirmation refers to obtaining information about the audited entity from external sources, i.e. banks, suppliers, clients, but also from internal sources of the audited entity, i.e. its management and employees.

The inspection of physical assets, recovering and recalculating provide a higher safety level, as by means of these techniques the auditor directly collects the audit evidence.

Inspection of the accountancy registers and documents – the checking provides a medium safety level.

Calculations - checking the mathematical accuracy of the accountancy technique and/or the performance of independent calculations.

Fundamental procedures aim to detect any significant errors within the financial statements. There are two types of such procedures:

a. Detailed tests of transactions and balances;

b. Analytical procedures regarding the analysis of indicators and significant trends, including the investigation of fluctuations and relations that are inconsequent to other relevant information or do not comply with the expected values.

2. Nature of evidence. Evidence can be collected either visually - which is the safest test for confirming the actual existence of the goods, but less safe for establishing their source, owner or real value – or documentary, i.e. by explanatory documents issued by the audited entity, the auditor or third parties – or orally – which is deemed to be the least safe option and requests the auditor to confirm this information by documents.

The sufficiency of the evidence is determined by the size of the sample selected by the auditor. There are a number of factors determining the size of the sample, the most important ones being errors that the auditor expects to find, and efficiency of the internal client control.

Audit standards request for the auditor to get audit evidence that will support his firm belief that there are no significantly erroneous information included in the financial statements. The relevance of the evidence can only be evaluated following the combined analysis of their solidity and sufficiency, considering the impact of factors influencing these two characteristics.

We can therefore say that sufficiency and solidity have a strong connection.

Sufficiency is the quantity measure of the audit evidence, i.e. the volume of information obtained by means of conformity tests and fundamental procedures applied by the auditor throughout the audit process, and the **adequacy degree** is the quality measure of the audit evidence and their relevance for a certain management assertion, as well as of the reliability and dependability (safety) degree, respectively.

3. Regarding the scheduling of the audit procedures, it is a well known fact they can be scheduled anytime, starting with the early stages of the tax year, until a long time after the closing of the tax year or until the date until when the client wishes to finalize the audit, respectively. The audit scheduling depends on the moment when the auditor considers all the audit evidence to be obtained will have maximum efficaciousness, as well as on the moment when the audit staff is available.

For example, auditors often prefer to complete the physic examination of the inventory as close as possible to the date of the balance closing.

4. After having chosen the audit procedure, the auditor establishes the sample size, which can vary from a single element to all the elements making for the tested population. The size of the sample used for every procedure may differ from one audit to another. After establishing the size of the sample, the auditor should define the elements to be extracted from the population, in order to be tested. The decision regarding the number of elements to be tested is made by the auditor for each and every audit procedure.

For example, if the auditor decides for the sample to be made of 300 issued invoices, he either chooses 300 invoices containing the highest invoiced sums, or randomly chooses those invoices he deems to be most probably containing errors. A third option would be for the auditor to use a combination of these two methods.

5. In the process of establishing the audit evidence to be obtained, as well as the procedures to be applied, the auditor should also consider the generated costs. The goal of the auditor is to obtain solid and sufficient audit evidence for the lowest possible cost, but without eliminating any necessary procedures and without settling for an insufficient sample.

The relation between the audit standards and the procedures generating audit evidence is presented in Graph No. 1.

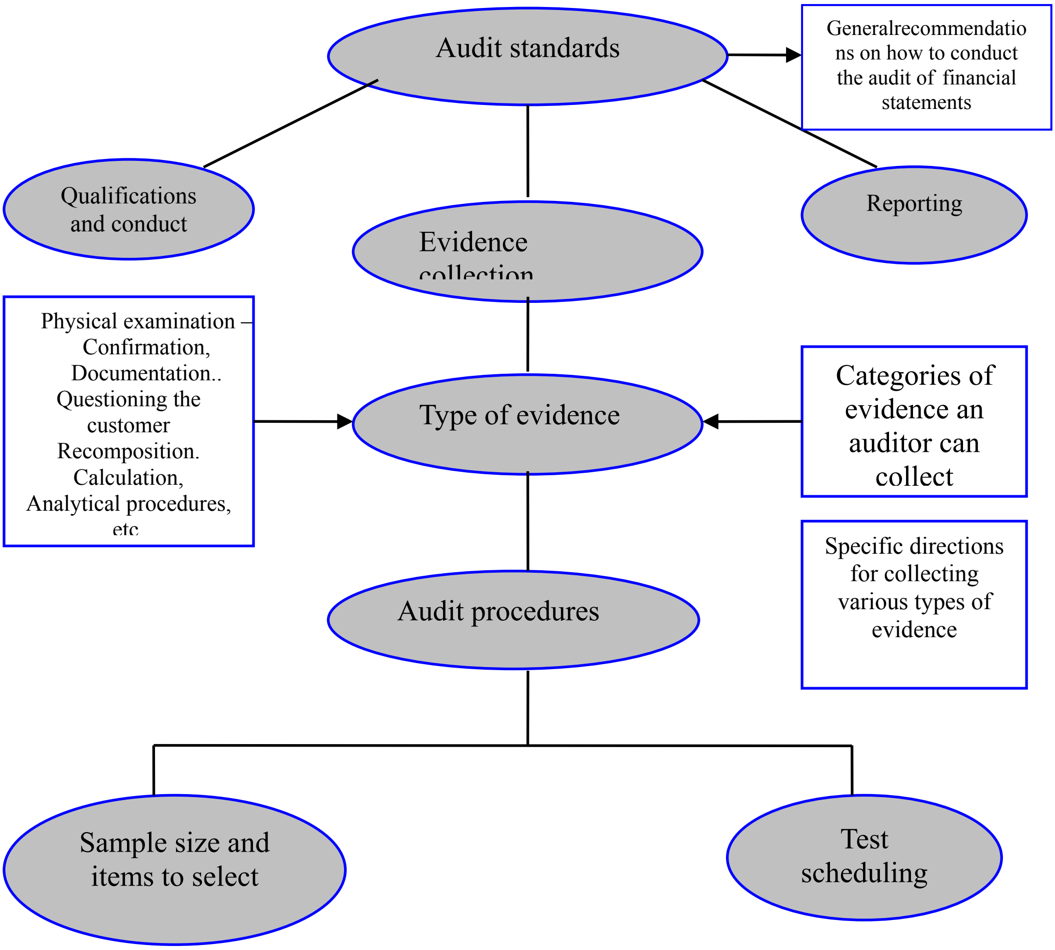

Fig. 1: The relation between the audit standards and the procedures generating audit evidence

Source: W. Boynton, R Johnson, Modern Auditing, www.hccs.cc.tx.us/Discipline/ACCT/acnt2331

Usually, the audit program includes the list of audit procedures for every statement subject to auditing, sample size, items to select and test scheduling. Based on the established agenda, the auditor needs to collect sufficient solid evidence when working in the field, to use it as grounds for his/her opinion.

The reliability of evidence is measured by the extent to which they can be considered as plausible or dependable. The reliability is applied only to the selected audit procedures. It cannot be improved by choosing a larger sample or other selected items. It can only be improved by selecting those audit procedures where the features of the solid evidence have a higher quality.

The reliability (soundness) of the audit evidence is influenced by the following characteristics:

- **Relevance,** namely that the information is pertinent and supports the audit's objectives precisely, also observing the saving principle, in terms of costs, compared to its relevance.

- **Source independence**, which can be internal – from the audited entity, or external – from third parties. Usually, the evidence coming from a source outside the audited entity is more reliable than if collected from within the entity. For instance, confirmation received from third parties.

- Internal control efficiency. When the internal control mechanisms of a customer are efficient, the collected evidence is considered more reliable than if the mechanisms were improper.

- **Direct information of auditor**. The evidence obtained directly by the auditor, after physical examination, observation, calculation and inspection is more reliable than if obtained through indirect methods.

- **Qualification of individuals** conducting the audit. The evidence obtained by the auditor is reliable only if they posses the necessary skills to evaluate the respective evidence.

- **Degree of objectivity**. Objective evidence is more reliable than evidence requiring a considerable level of subjective reasoning to decide whether they are correct or not.

- Opportunity. This concerns either the moment when the evidence is collected, or the period related to the audit.

During the audit of financial statements, the auditor gets the evidence by:

- conducting control tests to obtain those audit evidence related to proper predictions and, respectively, to the actual functioning of the accounting and internal control systems.

- or applying the main procedures by conducting tests intended to detect significant errors in the financial statements (in-depth tests or transactions and balances, analytical procedures.).

When the audit evidence is obtained by control tests, the auditor must consider the sufficiency and adequacy of the audit evidence to support the assessed level of the control risk. As for the accounting and internal control systems, the auditor must get audit evidence with respect to the following:

- **design**: whether the accounting and internal control systems are properly designed to prevent and/or detect and fix significant errors
- **operation**: whether the system is in place and effectively operating over a certain relevant period.

When the audit evidence is obtained through the basic procedures, the auditor must consider the sufficiency and adequacy of the audit evidence obtained by using such procedures, together with any other piece of evidence obtained through the control tests in order to support the management declarations about the financial statements. The declarations about the entity's financial statements are targets of the management, included in the financial statements. The targets concern:

- The existence: an asset item or a liability at a given moment.

- ***Rights and obligations***: an asset item or a liability that belong to the entity at a given moment.

- Occurrence: a transaction or an event occurred over a certain period and relates to the respective entity.

- ***Comprehensiveness*****:** there are no unrecorded assets, liabilities, transactions or events, or any other missing items.

- Evaluation: an asset item or a liability is registered at a proper accounting value.

- ***Matching***: a transaction or an event is registered at the appropriate value and the income or expense is earmarked for the matching period

- ***Information drafting, delivery and reporting****:* an item is presented, grouped and described in accordance with the applicable financial reporting framework.

Normally, for each declaration of the management, there is also a piece of audit evidence in line with the established targets. Obtaining a piece of evidence regarding a certain target cannot compensate for another piece of evidence, regarding another target. For instance, audit evidence on the existence of a stock shall not compensate with audit evidence on evaluation.

However, tests that can provide audit evidence about several declarations can be used. For instance, debt collection can supply audit evidence both on existence and on evaluation.

Conclusions: we can say that audit evidence obtained during the audit of financial statements play a very important role, depending on the outcome and their evaluation conducted by the auditor, who can express an opinion on how the financial statements were drafted, whether they are, in all significant areas, in line with the identified general financial reporting framework.

Type, quality and sufficiency of audit evidence represent the basis of the conclusions used to support the audit opinion.

Sufficiency of audit evidence – depends on the auditor's professional logic to determine the volume of audit evidence required for the audit. Factors responsible for the quantity of audit evidence are: knowing the customer and the field of activity, risk assessment, availability and quality of audit evidence; level of significance of the transaction classes and accounts; distortion risk; population size; population homogeneity – small sample if the statistical population has similar features; quality of audit evidence collected – if the quality is high, their number can be smaller;

Adequacy of audit evidence – represents the measure of their quality if they provide information that is: ***relevant*** (if in line with the accounting norms) and ***credible***: external independent source, physical examination by the auditor-(inspection, observation) or calculation, evaluation of the internal control system, conducted by the auditor.

Reporting – must present a clear statement of the opinion, based on assessing the conclusions drawn according to the evidence obtained during the audit.

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