

**Title: Demistifying the Auditor's Gathering of Evidence**

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Summary: This essay discusses the criteria for auditing which is based basically on the established accounting standards. Auditing standards emphasizes competency and sufficiency of evidence. The essay further discusses the needed criteria for sufficiency and competency of evidence.

**DEMISTIFYING THE AUDITOR'S GATHERING OF EVIDENCE**

The result of a company's daily transaction of business is summarized in the financial statements. In these statements, we can see how established the company is, if it is earning or not, and if it is using its resources well. As such, the preparation of the financial statements is a complete managerial responsibility. Just because the management has absolute control on the data presented in the financial statements, the users, such as creditors and government regulatory bodies, cannot put a high reliance on it. This is the reason why CPA's are hired to conduct audits.

The auditor's responsibility is to express an opinion as to whether the financial statements are presented in accordance with certain criteria, usually generally accepted accounting principles. As part of the process, the auditor has the primary objective of detecting material understatements or overstaterments embodied in the financial statements. In order to do so, the auditor gathers evidence to provide an adequate basis for his opinion.

To guide the auditor in performing the activity, the Auditing Standards and Practices Council (ASPC) issued Statement of Auditing Standards of the Philippines

(SASP) No. 7 – Audit Evidence and Documentation. In this statement, the third standard of fieldwork is laid:

*“Sufficient competent evidential matter is to be obtained through inspection, observation, inquiries, and confirmations to afford a reasonable basis for an opinion regarding the financial statements under examination.”*

It could be noted that the evidential matter should be “sufficient” and “competent.” What constitute sufficiency and competence of evidence is a question that constantly perplexes the auditor in planning and performing the audit. Different situations call for different approach; unfortunately, there are no fast rules that can be readily applied to all situations. However, there are some generalizations made to guide the auditor in obtaining evidence, and these principles affect both the competence and sufficiency of evidence.

Competence relates to the *quality* of evidence obtained, and is evaluated in terms of relevance and validity. The relevance of evidence should address and meet the audit objective being tested. Let us illustrate the audit of inventory to expound on this characteristic. The auditor should not only satisfy himself with the reconciliation of inventory amounts with the books of accounts with supporting documents such as purchase orders or delivery receipts. To test if the inventory is properly accounted, the auditor would first review the inventory-taking procedures then observe the actual counting to get a first-hand evidence that the procedures are properly observed. Once

satisfied, he could place a higher degree of reliance on the assertion that inventory is complete and properly valued.

The validity of evidence is dictated by the circumstances in which it is obtained amidst all the risks and factors that could influence such, and is more erratic in nature. The following general principles serve the auditor useful guides in ensuring the validity of the evidence gathered:

1. Evidence obtained from independent sources outside the client provides greater reliability than that secured solely within the company. This is so due to the fact that the client has no hand in the processing of these evidences. As such, bank statements are more reliable than the balances appearing in the cashbooks as much as billing statements from customers/clients are more reliable than vouchers or purchase orders.

2. Accounting records and other internally generated documents are more reliable if they are a product of an effective internal control. If the processing of cash receipts transactions employs the proper segregation of receipt and recording duties, the possibility of collusion or any form of irregularity will be minimized as there is an automatic check-and-balance control. The process will have to go through numerous personnel, which will ensure the correctness of the transaction.

3. Direct acquiring of evidence by the auditor himself is more persuasive than information obtained indirectly. This is the main reason why auditor uses the audit

technique of confirmation in auditing receivables and loans where they sent a letter to the debtor or creditor to verify the amounts reflecting in the financial statements.

In addition to these generalizations, the competence of evidential matter is increased when the auditors are able to obtain additional information to support the original evidence. In testing the ownership of land declared in the financial statements, the auditors would naturally inspect its title. If they could secure a certification from the local government's Assessor's Office or Registry of Deeds that the said land was under the name of the client, the evidence gathered is more persuasive, perhaps convincing, rather than basing the evaluation on the title alone.

On the other hand, sufficiency of evidential matter relates to the *quantity* of evidence the auditors should obtain. As previously mentioned, there are no fast rules fixing the number of evidence the auditor should have. In this aspect, the auditor exercises professional judgment, taking in consideration the circumstances in the particular case and the cost of obtaining the evidence. The following principles may aid the auditor in determining the quantity of evidence he may gather:

1. The more competent the evidential matter, the less amount of evidence is needed to support his opinion. If the internal control on the processing of credit sales has been evaluated to be effective, from the time sales has been recognized to the eventual payment of the receivable, the auditor could put more confidence that the eventual

recording of the transaction is likewise proper. The substantive testing needed for the Receivables and Sales accounts could be reduced to the minimum.

2. The more material a financial statement item is, the greater the need for competent evidence. The Salaries and Wages account normally gets more attention from the auditor than Representation or Office Supplies Expense because the former is usually the bulk of a company's expenditure. Depending on the nature of the business, the ordinary and direct expenses related to the income-generating activity of the client are more material than the incidental costs of the business.

3. As the risk of material misstatement associated with a particular engagement increases, the more evidence the auditor gathers. If the auditors are engaged to determine if there is fraud involved, the accounting records may not be reliable at all. The risk involved will cause the auditors to assign different weights to various types of evidence than they otherwise would.

In evaluating the evidential matter, the auditor considers whether specific audit objectives have been achieved. These objectives are the backbone of the audit procedures the auditor would accomplish in order to have a reasonable basis for his opinion. In doing so, his mind set should be geared on the possibility that there may be material misstatements in the financial statements, and the audit procedures designed should be sufficient to determine such. Having considered relevant evidential matter, regardless of whether it corroborates or contradicts the assertions in the financial

statement, the auditor should obtain first sufficient competent evidence before issuing an opinion.

References:

1. Auditing Standards and Practices Council (ASPC) Statement of Auditing Standards of the Philippines. No. 7 – Audit Evidence and Documentation (December 1988)
2. Principles of Auditing, Whittington and Pany, 1992