

Module 5C: Auditing of Financial Statements

Objectives:

- Understand what auditing is
- Understand accounting assertions
- Obtaining evidence
- Proper working paper documentation
- Using tickmarks
- Numbering working papers
- Additional auditing procedures based on net risk assessment
- Understand how to select a sample of transactions for additional testing

Procedures:

- Determine net risk as defined in Module 4
- Based on the net risk, determine the additional audit procedures to be performed
- Prepare working papers
- Conclude on all working papers
- Select a sample of transactions for additional testing

Information included here is only a summary of the information included in the complete module. Please refer to Module 5C – Auditing for complete information.

Auditing

Auditing is the inspection of business records by an independent person. Auditing involves obtaining and evaluating evidence from independent sources. Auditing also involves verifying accounting assertions. Accounting assertions are assertions made by management related to the financial statements.

Accounting Assertions

There are eight basic assertions.

- Accuracy (AC)
- Completeness (CO)
- Compliance (CM)
- Cutoff (CT)
- Existence (EX)
- Obligation and Ownership (OB and OW)

- Valuation (VA)
- Presentation and Disclosure (PD)

Evidence

The inspector must obtain evidence to support the accounting assertions. Evidence can be written, verbal, or observations.

Working paper documentation

Proper working papers demonstrate professionalism and document the work that was done for the account being audited. The degree of documentation is based on the judgment of the inspector and the adequacy and effectiveness of controls. Working papers should contain sufficient information to allow an experienced inspector having no previous connection with the inspection to ascertain from them the evidence that supports the inspectors' significant conclusions and judgments.

General guidelines for the preparation of working papers are:

- Completeness and Accuracy
- Clarity and Understanding
- Pertinence
- Logical Arrangement
- Legibility and Neatness

Tickmarks

Tickmarks are used to simplify documenting work done and conditions found. A legend that defines each tickmark should be placed on the working paper. Tickmarks should be concise and should adequately explain the results of the audit procedures performed.

Working paper numbering

Generally, working papers need to be numbered so that it identifies its location. Working papers within the same item, should be numbered in a similar format.

Additional audit procedures

The amount of additional auditing that is required for a Significant Activity will depend on what your net risk assessment is. (As calculated in Module 4).

- If the net risk assessment is low, the Significant Activity has a lower-than-average probability of a material adverse impact on its capital and earnings (surplus) in the foreseeable future.
 - Since the risk is low, then no additional auditing needs to be performed.
- If the net risk assessment is moderate, the Significant Activity has an average probability of a material adverse impact on its capital and earnings (surplus) in the foreseeable future.
 - In order to offset the moderate risk, some additional auditing steps will need to be performed.
- If the net risk assessment is high, then the Significant Activity could potentially result in a higher than average probability of a material adverse impact on its capital and earnings (surplus) in the foreseeable future.
 - In order to offset this high net risk, then the inspector needs to perform many additional auditing steps to reduce this risk.

Sampling

There are two basic methods for calculating the sample size: 1) the asset method; 2) the liability and income and expense method. Depending on the type of the account, use the appropriate method. These methods are described in more detail in the document labeled Sampling.