

Week 4 - DQ 2

How does the auditor evaluate the results of audit procedures? What types of qualitative factors might the auditor consider when encountering an error? How might the results affect the audit conclusion?

Response #1

The auditor must perform risk assessment procedures to evaluate the type, magnitude and likelihood of potential misstatements. Once the type is established by recognizing risk factors and then assessing their potential for risk statements, the auditor determines which misstatements are the most significant. After the risks and significance of certain misstatements are identified, the auditor determines the likelihood of a material misstatement occurring to establish the level of substantive tests to conduct. The auditor then performs further risk assessment procedures and makes choices regarding the mix of tests of controls and substantive tests. The auditor then performs initial procedures to determine the propriety of account balances and establish the accounting principles to be used for consistency measures.

Once initial measures are performed, the auditor conducts substantive analytical procedures and determines whether the results of these procedures conform to expectations. This is accomplished by the auditor assessing whether the procedures contribute positively to the acceptable level of detection risk. The decision of whether sampling should be completed is made, and if needed, the sample size and unit is defined and the book value is tested. Once the auditor concludes that the sample data is within the tolerable misstatement determined when designing the sample, it is noted that the population book value is not overstated and the auditor's professional judgment is used to verify the results of audit procedures.

Qualitative factors that may influence the auditor in determining whether misstatements are material include whether misstatements were due to errors, fraud, or differences in application. The auditor should consider evidence from several sources and apply several considerations, such as the existence of regulatory reporting requirements

that may affect materiality thresholds, the potential effect of a misstatement on trends in profitability, and the effects on the entity's compliance agreements to reach an overall conclusion. Depending on acceptable level of misstatements, the auditor may conclude that the sample was a poor representation, the allotted amount of misstatement was inaccurate, or the client's book value is improperly stated and an adjustment is required.

Response #2

An auditor will determine the significance of findings and determine if audit procedures need to be revamped. If there are instances of fraud or error, the auditor will have to evaluate the misstatement and determine if audit strategies need to be revised. "The auditor must conclude that evidence found in audit findings is representative of the unsampled portion of the population. Thus, the auditor's process of evaluating evidence includes both evaluating known evidence and projecting those results on the unsampled portions of audit procedures" (Boyton & Johnson, 2006, p. 213).

Some qualitative guidelines an auditor might consider when encountering an error might include if the error was "5 to 10 percent of net income before taxes, 1/2 to 1 percent of total assets, 1 percent of equity, 1/2 to 1 percent of gross revenue, or a variable percentage based on the greater of total assets or revenue" (Boyton & Johnson, 2006, p. 318). These guidelines could help the auditor determine if the error was material or not.

The auditor might also consider "if a misstatement masks a change in an earnings or sales trend, hides a failure to meet financial analysts' expectations for the company, or if the misstatement changes income into a loss" (Boyton & Johnson, 2006, p. 322-323). If there is an error, the auditor may have to obtain additional evidence or express an opinion related to the limitation of evidence.

Response #3

The auditor evaluates each misstatement is material to the financial statement. In addition, the auditor evaluates if the results of the audit procedure show if there is a material departure from the principles of GAAP. Further, from the results the auditor ascertains if the records are adequate and if they safeguard the assets of the firm. The auditor evaluates the results of the audit procedure to ascertain if the entity has complied with applicable laws and regulations. The misstatements that the auditor finds while evaluating the results of audit procedures should be evaluated as to whether the omission or the commission of an item violates the GAAP or OCBOA. If the procedure reveals a disclosure that is not in accordance with the requirements of the GAAP or OCBOA, material omissions of elements from financial statements, or there is a difference between the amounts that would have been presented under the GAAP or the OCBOA.

The first qualitative factor is whether the misstatement is immaterial to the financial statements taken as a whole. Secondly, the auditor should consider if the error leads to the violation of any law or regulation. If the error represents a substantial weakness in the internal control system or if the error is a part of an elaborate fraud; further the auditor will evaluate if the error was committed to evade tax or to misuse government funds. The auditor should consider if the error is a marked departure from the stated policies of the firm. When encountering an error the auditor should consider if the error undermine the accuracy of accounting and other operating data. The auditor should consider the qualitative factors when encountering an error if it has the potential for undetected abuse within the accounting system or points to neither management nor exercising its responsibility.

The results affect the audit conclusion in several ways. First, the provisions of the SAS 61, Communications with Audit Committee require the auditor to inform the audit committee about the uncorrected misstatements where the management believe that the effect of the misstatements are immaterial to the financial statements taken as a whole.

Response #4