

## ***Week 2 - DQ 2***

***The third generally accepted standard of audit fieldwork requires that auditors obtain sufficient, competent audit evidence to afford a reasonable basis for an opinion regarding the financial statements under examination. In considering what constitutes sufficient, competent audit evidence, a distinction should be made between underlying accounting data and all corroborating information available to the auditor. What presumptions can be made about the following?***

- ***The relative competence of evidence obtained from external and internal sources.***
- ***The role of internal control with respect to internal evidence produced by a client's data processing system.***
- ***The relative persuasiveness of auditor observation and recalculation evidence compared to external, external-internal, and internal documentary evidence.***

### ***Response #1***

Relative competence of evidence has to do with the measure of evidence's quality (reliability). Evidence must be relevant to the assertion to be considered competent. Put differently, evidence must have logical precise relevance to management's assertions in the financial statements. In regard to reliability, evidence must be considered worthy of trust. Trustworthiness may be hard to determine from external sources if the source is not alert and fully informed. On the other hand, external sources can be more reliable some times as well, such as in the case of bank statements compared to documents provided by management. In the role of internal control with respect to internal evidence, such evidence produce by a client's data processing system would be considered less reliable evidence if internal control were considered ineffective. On the contrary, if internal control operates effectively then the data would be considered more reliable evidence. In the relative persuasiveness of auditor observation evidence, persuasive evidence is less reliable...there is a higher risk of material misstatement when persuasive evidence is used, whereas with conclusive evidence, there is less risk of material misstatement. In regard to

recalculation evidence, recalculation can consist of using auditing software to match totals, which I would think strengthens reliability.

### *Response #2*

The presumption that can be made about the relative competence of evidence obtained from external and internal sources are that if the information were obtained from an internal source such as a member of management, the evidence would be considered less reliable. If the source of evidence were obtained from an external source such as a bank, the information would be considered more reliable.

The presumption that can be made about the role of internal control with respect to internal evidence produced by a client's data processing system. These presumptions can be made as follows: if the information is obtained from a processing system that the client is using but the internal controls of that system are ineffective, the evidence obtained would be less reliable than information that was obtained from one that operates effectively.

The presumption that can be made about the relative persuasiveness of auditor observation and recalculation evidence compared to external, external-internal, and internal documentary evidence is that the auditor will rarely be convinced without any doubt about the financial statements they are auditing. As per our chapter readings, "Ordinarily, the auditor finds it necessary to rely on audit evidence that is persuasive rather than conclusive" (Boynton & Johnson, 2006, p. 240). This also means that the auditor is not able to give reasonable assurance that the information received, if not satisfied by the auditor, is persuasive.

### *Reference*

Boynton, W. C., & Johnson, R. N. (2006). *Modern auditing: Assurance services and the integrity of financial reporting*. Hoboken, NJ: John Wiley & Sons.

### *Response #3*

The relative persuasiveness of auditor observation and recalculation evidence compared to external, external-internal, and internal documentary evidence. It is clear that external documentation would normally be considered to be highly reliable, and particularly when the auditor received it directly, such as confirmations. There is external evidence which the client receives first but it doesn't have the same level of reliability as the former. Both of those sources rank higher in competency over internally prepared evidence. In the internal case, evidence derived from a well-controlled information system will be more reliable than that produced by a poorly controlled system of accounting information. The statement explains why good internal controls are so important to auditors. If an auditor tests the system of internal controls and concludes that the system can be relied upon, the auditor may be able to limit the testing and possibly even limit some confirmation procedures

There are three types of weaknesses in a poor system of internal control: deficiencies in the design of the controls, deficiencies in the control environment, and deficiencies in the operation of the controls. The order of the items presented in question 3 are exactly the order of competence of evidence. Obviously, observation would be the most credible but it can only work in certain audit areas. An auditor can observe the equipment and the fuel inventory, for example, but he/she can't observe the cash in the bank. Some current assets other than inventory can be observed; for example, stock certificates in the safe are pretty good evidence of ownership. I once audited a bank vault and even then, the bundled cash was thumbbed for possible fraud. The way to think about the value of evidence is to consider the highest level of documentation (among your several choices) and use it. To demonstrate: cash on hand can be observed and counted, cash in the bank can be confirmed, accounts receivable can be confirmed, inventory can be observed and on down the balance sheet.