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80

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AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Amendment to Statement on Auditing Standards No. 31, *Evidential Matter*

(Amends Statement on Auditing Standards No. 31, AICPA, Professional Standards, vol. 1, AU sec. 326.)

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Amendment to Statement on Auditing Standards No. 31, *Evidential Matter*

(Amends Statement on Auditing Standards No. 31,
AICPA, Professional Standards, vol. 1, AU sec. 326.)^o

1. The third standard of fieldwork is:

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 audit.

2. Most of the independent auditor's work in forming his *or her* opinion on financial statements consists of obtaining and evaluating evidential matter¹ concerning the assertions in such financial statements. The measure of the validity of such evidence for audit purposes lies in the judgment of the auditor; in this respect, audit evidence differs from legal evidence, which is circumscribed by rigid rules. Evidential matter varies substantially in its influence on the auditor as he *or she* develops ~~his~~ *an* opinion with respect to financial statements under audit. The pertinence of the evidence, its objectivity, its timeliness, and the existence of other evidential matter corroborating the conclusions to which it leads all bear on its competence.

Nature of Assertions

3. Assertions are representations by management that are embodied in financial statement components. They can be either explicit or implicit and can be classified according to the following broad categories:

- Existence or occurrence
- Completeness

^o *New language is shown in boldface italic, and deleted language is shown by strike-through.*

¹ See AU section 319A.61–.64, "Consideration of the Internal Control Structure in a Financial Statement Audit" (AICPA, *Professional Standards*, vol. 1), for further guidance on evidential matter.

- Rights and obligations
- Valuation or allocation
- Presentation and disclosure

4. Assertions about existence or occurrence ~~deal with~~ **address** whether assets or liabilities of the entity exist at a given date and whether recorded transactions have occurred during a given period. For example, management asserts that finished goods inventories in the balance sheet are available for sale. Similarly, management asserts that sales in the income statement represent the exchange of goods or services with customers for cash or other consideration.

5. Assertions about completeness ~~deal with~~ **address** whether all transactions and accounts that should be presented in the financial statements are so included. For example, management asserts that all purchases of goods and services are recorded and are included in the financial statements. Similarly, management asserts that notes payable in the balance sheet include all such obligations of the entity.

6. Assertions about rights and obligations ~~deal with~~ **address** whether assets are the rights of the entity and liabilities are the obligations of the entity at a given date. For example, management asserts that amounts capitalized for leases in the balance sheet represent the cost of the entity's rights to leased property and that the corresponding lease liability represents an obligation of the entity.

7. Assertions about valuation or allocation ~~deal with~~ **address** whether asset, liability, **equity**, revenue, and expense components have been included in the financial statements at appropriate amounts. For example, management asserts that property is recorded at historical cost and that such cost is systematically allocated to appropriate accounting periods. Similarly, management asserts that trade accounts receivable included in the balance sheet are stated at net realizable value.

8. Assertions about presentation and disclosure ~~deal with~~ **address** whether particular components of the financial statements are properly classified, described, and disclosed. For example, management asserts that obligations classified as long-term liabilities in the balance sheet will not mature within one year. Similarly, management asserts that amounts presented as extraordinary items in the income statement are properly classified and described.

Use of Assertions in Developing Audit Objectives and Designing Substantive Tests

9. In obtaining evidential matter in support of financial statement assertions, the auditor develops specific audit objectives in the light of those assertions. In developing the audit objectives of a particular engagement, the auditor should consider the specific circumstances of the entity, including the nature of its economic activity and the accounting practices unique to its industry. For example, one audit objective related to the assertion about completeness that an auditor might develop for inventory balances is that inventory quantities include all products, materials, and supplies on hand.

10. There is not necessarily a one-to-one relationship between audit objectives and procedures. Some auditing procedures may relate to more than one objective. On the other hand, a combination of auditing procedures may be needed to achieve a single objective. The Appendix provides illustrative audit objectives for inventories of a manufacturing company for each of the broad categories of assertions listed in paragraph 3 and examples of substantive tests that may achieve those audit objectives.

11. In selecting particular substantive tests to achieve the audit objectives he *or she* has developed, an auditor considers, among other things, the risk of material misstatement of the financial statements, including the assessed levels of control risk, and the expected effectiveness and efficiency of such tests. ~~His~~ *These* considerations include the nature and materiality of the items being tested, the kinds and competence of available evidential matter, and the nature of the audit objective to be achieved. For example, in designing substantive tests to achieve an objective related to the assertion of existence or occurrence, the auditor selects from items contained in a financial statement amount and searches for relevant evidential matter. On the other hand, in designing procedures to achieve an objective related to the assertion of completeness, the auditor selects from evidential matter indicating that an item should be included in the relevant financial statement amount and investigates whether that item is so included.

12. The auditor's specific audit objectives do not change whether ~~accounting data~~ *information* is processed manually or ~~by computer~~

electronically. However, the methods of applying audit procedures to gather evidence may be influenced by the method of ~~data~~ processing. The auditor ~~can~~ **may** use either manual auditing procedures, ~~computer~~ **information technology**-assisted audit techniques, or a combination of both to obtain sufficient competent evidential matter. ~~However, in some accounting systems that use a computer for processing significant accounting applications,~~ **Because of the growth in the use of computers and other information technology, many entities process significant information electronically.** ~~Accordingly,~~ it may be difficult or impossible for the auditor to ~~obtain access~~ certain ~~data~~ **information** for inspection, inquiry, or confirmation without ~~computer assistance~~ **using information technology** to access that data.

13. The nature, timing, and extent of the procedures to be applied on a particular engagement are a matter of professional judgment to be determined by the auditor, based on the specific circumstances. However, the procedures adopted should be adequate to achieve the ~~audit~~ **auditor's specific** objectives ~~developed by the auditor,~~ and **reduce detection risk to a level acceptable to the auditor.** ~~The~~ the evidential matter obtained should be sufficient for the auditor to form conclusions concerning the validity of the individual assertions embodied in the components of financial statements. The evidential matter provided by the combination of the auditor's assessment of inherent risk and control risk and on substantive tests should provide a reasonable basis for his **or her** opinion (see AU sec. 319A.61–.64, "Consideration of the Internal Control Structure in a Financial Statement Audit," AICPA, *Professional Standards*, vol. 1).

14. In entities where significant information is transmitted, processed, maintained, or accessed electronically, the auditor may determine that it is not practical or possible to reduce detection risk to an acceptable level by performing only substantive tests for one or more financial statement assertions. For example, the potential for improper initiation or alteration of information to occur and not be detected may be greater if information is produced, maintained, or accessed only in electronic form. In such circumstances, the auditor should perform tests of controls to gather evidential matter to use

in assessing control risk,² or consider the effect on his or her report (see paragraph 25 of this Statement).

Nature of Evidential Matter

~~14.~~ **15.** Evidential matter supporting the financial statements consists of the underlying accounting data and all corroborating information available to the auditor.

~~15.~~ **16.** The books of original entry, the general and subsidiary ledgers, related accounting manuals, and ~~such informal and memorandum~~ records **such as work sheets and spreadsheets** supporting cost allocations, computations, and reconciliations all constitute evidence in support of the financial statements. **These accounting data are often in electronic form.** ~~By itself, a~~ Accounting data **alone** cannot be considered sufficient support for financial statements; on the other hand, without adequate attention to the propriety and accuracy of the underlying accounting data, an opinion on financial statements would not be warranted.

~~16.~~ **17.** Corroborating evidential matter includes ~~documentary material~~ **both written and electronic information** such as checks; **records of electronic fund transfers**; invoices; contracts; ~~and~~ minutes of meetings; confirmations and other written representations by knowledgeable people; information obtained by the auditor from inquiry, observation, inspection, and physical examination; and other information developed by, or available to, the auditor which permits him **or her** to reach conclusions through valid reasoning.

18. *In certain entities, some of the accounting data and corroborating evidential matter are available only in electronic form. Source documents such as purchase orders, bills of lading, invoices, and checks are replaced with electronic messages. For*

² AU section 319A.63 states that ordinarily the assessed level of control risk cannot be sufficiently low to eliminate the need to perform any substantive tests for significant account balances and transaction classes and, consequently, the auditor should perform substantive tests for such balances and classes regardless of the assessed level of control risk.

example, entities may use Electronic Data Interchange (EDI) or image processing systems. In EDI, the entity and its customers or suppliers use communication links to transact business electronically. Purchase, shipping, billing, cash receipt, and cash disbursement transactions are often consummated entirely by the exchange of electronic messages between the parties. In image processing systems, documents are scanned and converted into electronic images to facilitate storage and reference, and the source documents may not be retained after conversion. Certain electronic evidence may exist at a certain point in time. However, such evidence may not be retrievable after a specified period of time if files are changed and if backup files do not exist. Therefore, the auditor should consider the time during which information exists or is available in determining the nature, timing, and extent of his or her substantive tests, and, if applicable, tests of controls.

~~17.~~ **19.** The auditor tests underlying accounting data by (a) analysis and review, by (b) retracing the procedural steps followed in the accounting process and in developing the work sheets and allocations involved, by (c) recalculation, and by (d) reconciling related types and applications of the same information. ~~In a soundly conceived and carefully maintained system of accounting records, there is internal consistency discoverable through such procedures that constitutes persuasive evidence that the financial statements do present financial position, results of operations, and cash flows in conformity with generally accepted accounting principles.~~ *Through the performance of such procedures, the auditor may determine that the accounting records are internally consistent. Such internal consistency ordinarily provides evidence about the fairness of presentation of the financial statements.*

~~18.~~ **20.** The pertinent documentary material *accounting data and corroborating evidential matter* to support entries in the accounts and assertions in the financial statements ordinarily ~~is on hand in~~ *are available from* the ~~company's~~ *entity's* files and ~~available~~ *accessible* to the auditor for examination *at certain points or periods in time*. Both within the ~~company's~~ *entity's* organization and outside it are knowledgeable people to whom the auditor can direct inquiries. Assets having physical existence are available to the auditor for his *or her* inspection. Activities of ~~company~~ *the entity's* personnel can be observed. Based on ~~certain~~ *observations of these or other* conditions or circumstances, ~~as he observes them, for example, a low assessed level of control risk, he can reason to~~ *the auditor may reach* conclusions with respect to *about* the validity of various assertions in the financial statements.

Competence of Evidential Matter

~~19.~~ **21.** To be competent, evidence, *regardless of its form*, must be both valid and relevant. The validity of evidential matter is so dependent on the circumstances under which it is obtained that generalizations about the reliability of various ~~types~~ *kinds* of evidence are subject to important exceptions. If the possibility of important exceptions is recognized, however, the following presumptions, which are not mutually exclusive, about the validity of evidential matter in auditing have some usefulness:

- a. When evidential matter can be obtained from independent sources outside an entity, it provides greater assurance of reliability for the purposes of an independent audit than that secured solely within the entity.
- b. The more effective the internal control structure, the more assurance it provides about the reliability of the accounting data and financial statements.
- c. The independent auditor's direct personal knowledge, obtained through physical examination, observation, computation, and inspection, is more persuasive than information obtained indirectly.

Sufficiency of Evidential Matter

~~20.~~ **22.** The independent auditor's objective is to obtain sufficient competent evidential matter to provide him *or her* with a reasonable basis for forming an opinion. The amount and kinds of evidential matter required to support an informed opinion are matters for the auditor to determine in the exercise of his *or her* professional judgment after a careful study of the circumstances in the particular case. *However, in* ~~in~~ the great majority of cases, the auditor *has* ~~finds it necessary~~ to rely on evidence that is persuasive rather than convincing. Both the individual assertions in financial statements and the overall proposition that the financial statements as a whole ~~present financial position, results of operations, and cash flows in conformity with generally accepted accounting principles,~~ *are fairly presented* are of such a nature that even an experienced auditor is seldom convinced beyond all doubt with respect to all aspects of the statements being audited.

~~21.~~ **23.** An auditor typically works within economic limits; ~~his~~ **the auditor's** opinion, to be economically useful, must be formed within a reasonable length of time and at reasonable cost. The auditor must decide, again exercising professional judgment, whether the evidential matter available to him **or her** within the limits of time and cost is sufficient to justify expression of an opinion.

~~22.~~ **24.** As a guiding rule, there should be a rational relationship between the cost of obtaining evidence and the usefulness of the information obtained. The matter of difficulty and expense involved in testing a particular item is not in itself a valid basis for omitting the test.

Evaluation of Evidential Matter

~~23.~~ **25.** In evaluating evidential matter, the auditor considers whether specific audit objectives have been achieved. The independent auditor should be thorough in his **or her** search for evidential matter and unbiased in its evaluation. In designing audit procedures to obtain competent evidential matter, he **or she** should recognize the possibility that the financial statements may not be **fairly** presented in conformity with generally accepted accounting principles **or a comprehensive basis of accounting other than generally accepted accounting principles.**³ In developing his **or her** opinion, the auditor should ~~give consideration to~~ relevant evidential matter regardless of whether it appears to corroborate or to contradict the assertions in the financial statements. To the extent the auditor remains in substantial doubt about any assertion of material significance, he **or she** must refrain from forming an opinion until he **or she** has obtained sufficient competent evidential matter to remove such substantial doubt, or ~~he~~ **the auditor** must express a qualified opinion or a disclaimer of opinion.⁴

26. This amendment is effective for engagements beginning on or after January 1, 1997. Earlier application is encouraged.

[The Appendix will not change.]

³ *The term comprehensive basis of accounting other than generally accepted accounting principles is defined in AU section 623.4, "Special Reports" (AICPA, Professional Standards, vol. 1).*

⁴ *See AU section 508.20–34 and .61–63, "Report on Audited Financial Statements" (AICPA, Professional Standards, vol. 1) for further guidance on expression of a qualified opinion or a disclaimer of opinion.*

This Statement entitled Amendment to Statement on Auditing Standards No. 31, Evidential Matter, was adopted unanimously by the fifteen members of the board.

Auditing Standards Board (1996)

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