



THEORETICAL AND PRACTICAL ASPECTS ON THE AUDIT PROJECTS FOR TANGIBLE ASSETS

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Abstract

Audit evidence is the information used by the auditor to issue the conclusions on which the auditor's opinion is based. They include both the information contained in the accounting records, financial statements and other relevant information. An essential step in the audit mission is the collection of audit evidence. This research has described the audit procedures to obtain audit evidence for auditing tangible assets. At the same time, the author has classified the audit evidence required for the audit of tangible assets in dependence of their credibility. Taking over the experience of other researchers, the author has formulated some solutions to obtain qualitative audit evidence.

Key words: audit, tangible assets, audit evidence, audit procedures, audit documentation.

JEL Classification: M42

I. Introduction

An essential step within the framework of an audit mission is the collection of audit evidence. This is the information used by the auditor to draw the conclusions on which his/her opinion is based and which can be collected from the accounting records.

Being the basic element of an entity, the tangible assets require more thorough auditing, thus a number of problems may arise in collecting audit evidence to draw a conclusion as close to reality as possible.

The purpose of this article is to investigate the audit procedures for obtaining the audit evidence required in the audit of property, plant and equipment.

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To achieve this goal, the following objectives were set:

- description of the theoretical and practical aspects of audit evidence, identifying the problems and solutions that may arise in their collection, while carrying on the tangible assets auditing activity;
- characterization of the audit procedures necessary for obtaining audit evidence in auditing tangible assets;
- clasificarea probelor de audit necesare pentru auditarea imobilizărilor corporale în funcție de calitatea și credibilitatea lor.

Methods and materials

In the framework of this research, there were used the provisions of the International Audit Standard 500 "Audit evidence" (hereinafter ISA 500), as well as, published in specialized journals, the works of scientists and researchers from Romania, the Republic of Moldova and the United States of America.

The research method used predominantly in this paper is the method of document analysis, as the analysis of the bibliographic sources together with the interpretations of the experts from the specialty literature allow for a content analysis of the issues addressed.

Another method used by the author is the inductive method, which implies the elaboration of generalizations from the analyzed and synthesized facts. The author formulates the conclusions on each case, expressing his own opinion and the opinions of other authors.

II. Results and discussions

The basis for any audit is the evidence that has been stored and evaluated by the auditor. The auditor should have the necessary knowledge and skills to collect sufficient basic evidence within each audit, so as to meet the standards defined for the profession as a whole (Arens et al., 2003, 206).

According to ISA 500 audit evidence is the information used by the auditor to issue conclusions on which the auditor's opinion is based. Audit evidence includes both the information contained in the accounting records, on which the financial statements are based and other information (ISA, 2015, paragraph 5).



Audit evidence is required to justify the auditor's opinion and report. They are cumulative in nature and are mainly obtained through the audit procedures performed during the audit. However, audit evidence may also include information obtained from other sources such as previous audits (provided that the auditor has determined whether there have been changes since the date of the previous audit, that may affect relevance to the current audit) or quality control procedures of a firm for accepting a customer or continuing keeping the relationship. In addition to other sources inside or outside the entity, the entity's accounting records are an important source of audit evidence. Also, the information that can be used as audit evidence may have been drawn by using the work of a management expert. Audit evidence includes both information that justifies and complements management assertions and any information that conflicts with such statements. In addition, in some cases, the lack of information (for example, management's refusal to provide the required statement) is used by the auditor, and, consequently, constitutes audit evidence as well (ISA, 2015: A1).

The American scholars Arens and Loebbecke characterize audit evidence as any information used by the auditor to determine whether the audited information is presented in accordance with predetermined criteria. The samples can take many forms, including the testimonies of the auditee (the client), the written communications with the third parties outside the entity, and personal observations of the auditor. They state that it is important to obtain sufficient quality and quantity of evidence to achieve the purpose of the audit. Determining the types and quantities of evidence required, as well as assessing the consistency between the information and the pre-established criteria, is the decisive component of any audit (Arens et al., 2003: 12).

Much of the auditor's work in formulating the auditor's opinion is to obtain and evaluate audit evidence. University Professor Victor Munteanu from Bucharest asserts that the auditor obtains a series of audit evidence by testing the accounting records using analysis and review procedures, by checking the procedures used, making financial reporting situations and reconciling the categories and applications related to the same information. The result of these tests concludes that the accounting records are consistent at the domestic level and are in line with the financial statements. However, the accounting records do not provide sufficient audit evidence, which is why the auditor also uses other audit evidence (Munteanu et al., 2016: 123).



Researchers such as Menu, Panaitescu, and others believe that during the course of their work, the auditor is confronted with the need to choose and use various types of audit evidence that can be classified by their nature or source.

From the point of view of the source, audit evidence can be:

- obtained by the auditor - these tests are considered safer than those obtained from other sources;
- obtained by third parties - if complete and independently obtained, they are safer than those from the audited entity;
- obtained from the audited entity - can be credible, if the accounting system and internal control system are correct, legally organized and operate in an appropriate manner.

From the point of view of its essence, audit evidence can be:

- documentation - are the most secure and are usually presented in the form of supporting documents provided by the entity, but also in the form of documents obtained directly by the auditor or third parties;
- visual - they are very secure, when there is a need to confirm the existence of goods, and less secure, if it is necessary to determine the source of the property or its value;
- verbal - are considered to be the least secure and need to be confirmed by documents (Menu et al., 2009: 102).

Therefore, in order to have a better quality of tangible assets audit, it is advisable for the auditors to obtain by their own as much evidence as possible only on a documentary basis in order to be as secure as possible.

The audit procedures necessary to obtain audit evidence may include inspection, observation, confirmation, recalculation, repetition of execution and analytical procedures, often in certain combinations, in addition to interviewing. Although interviewing can provide important audit evidence, and may even generate evidence of distortion, only interviewing alone does not provide sufficient audit evidence of the absence of significant misstatements in assertions or the operational effectiveness of controls (ISA, 2015: paragraph A2).

Inspection involves the examination of records or of internal or external documents in printed, electronic or other form, or the physical examination of an asset.



The inspection of records and documents provides audit evidence with varying degrees of credibility, depending on the nature and source of the records, and, in the case of internal records and documents, depending on the effectiveness of the controls exercised during their acquisition. An example of an inspection used as a controlling test is the inspection of records as evidence of authorization (ISA, 2015: paragraph A14).

The inspection of tangible assets may provide credible auditing evidence of their existence, but not necessarily with respect to the rights and obligations of the entity or to asset valuation (ISA, 2015: paragraph A16). In practice, audit evidence about the existence of tangible assets can be obtained by inventorying them. The auditor may participate as a member of the inventory committee, so the results obtained will have a high credibility.

The scientist Munteanu et al. (2016: 123) has approximately the same opinion. According to him, the inspection of tangible assets and other assets consists in their physical examination (verification), providing reliable audit evidence, especially regarding their existence. However, the evidence obtained from the application of this procedure offers less reliability, or may not provide any assurance (for example) of the rights and obligations of the entity in relation to those assets. The inspection of individual tangible items typically accompanies observation of their inventory.

Observation consists in supervising a process or procedure that is performed by other parties, for example, the auditor's observation of inventory by the entity's personnel or controlling activities. Observation provides audit evidence of a process or procedure, but is limited to the time at which the observation is being performed, and to the fact, that the act of being observed may affect the way in which the process or procedure is conducted (ISA, 2015: paragraph A17). Accordingly, when auditing tangible assets, the auditor may participate both in their inventory and in the internal controlling activities, that are performed by the entity's personnel in order to gather evidence as accurate as possible even from within the entity. If it is noticed that some of the facts have been concealed by the staff of the entity, this can be considered as evidence, as it may cause suspicion of fraud.

An external confirmation is the audit evidence obtained by the auditor in the form of a written response received by the auditor directly from the third party (the confirming party), on paper, in electronic form or by any other means. External confirmation



procedures are often relevant, when addressing statements associated with certain account balances and their elements. Nevertheless, the external confirmations should not be restricted to only account balances. For example, the auditor may request confirmation of the terms of the agreements or transactions, that the entity has entered into with third parties; the requested confirmation may have the purpose of inquiry whether any change to the contract has been made and, if so, what are the relevant details. External confirmation procedures are also used to obtain audit evidence about the absence of certain conditions, e.g. the absence of a "sub-contract" that may influence the recognition of income (ISA, 2015: paragraph A17).

When auditing tangible assets, the auditor may request from the entity's suppliers or customers a balancing act or a confirmation of reciprocal balances. For example, if an entity creates a tangible asset, the auditor may request from the suppliers of raw materials or services a confirmation of reciprocal balances to see, if they have indeed not artificially increased the costs of their production. Also, if in the prior periods there have been transactions for the sale or acquisition of tangible assets, the auditor may request mutual confirmation papers to compare whether balances between suppliers and customers coincide.

The Romanian specialists Ionaş and Curpăn believe that the use of confirmations is indicated, when there is a well-informed person independent of the audited entity and when other relevant alternative evidence is not available. The persons who are able to provide such confirmations are those, who have business relationships with the entity under audit and who hold bilateral information reflected in the entity's accounts. These people are usually borrowers, creditors, banks, credit institutions, custodians of the entity, etc. It is in the interest of these persons to correctly record their relationship with the audited entity and to respond at any time to the auditor's confirmation requests to ensure that any differences are identified and settled (Ionaş et al., 2004: 44).

At the same time, they also draw attention to the form of submission of the inquiry to debtors, creditors, etc. As a rule, the request must be presented in a manner that facilitates the other party's response. This can be done by using a standard form with space for response and attaching a self-addressed stamped envelope. However, there is a conflict between the promptness of the answers and the confidence in them. For example,



the other party may confirm the information without its prior verification. Fortunately, these situations rarely occur (Ionaş et al., 2004: 45).

Another issue may arise in relation to the function of the person to whom the request is addressed. Large entities have separate control departments or internal auditors, so it is advisable to submit the request to them. Smaller entities typically have a smaller accounting department or even one or a few accountants, so it is suggested the request to be forwarded to the chief accountant or the division accountant. It is inappropriate to pass it on to the manager of the entity, as they may consider it inappropriate, may ignore it or sign without verifying it.

Recalculation consists in verifying the mathematical correctness of documents or records. Recalculation can be done manually or electronically (ISA, 2015: paragraph A19). In the case of auditing of tangible assets, it is necessary for the auditor to verify the correctness of the mathematical formula used for calculating the fixed tangible assets depreciation, depending on the calculation method used according to the accounting policies.

Repetition of the execution involves the auditor in independently performing the procedures or controls, that were initially performed as part of the entity's internal controlling (ISA, 2015: paragraph A20). The auditor may resort to this procedure, when there are doubts as to the inventory of tangible assets previously carried out by the responsible persons within the audited entity. The auditor may request re-inventory and may also participate in the inventory committee to obtain more credible evidence.

Analytical procedures are assessments of the financial information made through a study of plausible relationships between financial and non-financial data. The analytical procedures also include investigating fluctuations and identified relationships, that are not consistent with other relevant information or that deviate significantly from the projected values (ISA, 2015: paragraph A21). When auditing tangible assets, it is essential that the auditors verify whether the subsequent measurement of the tangible assets and their depreciation have been carried out in accordance with the accounting legislation and whether they are reflected in the entity's financial statements at their fair value.

Interviewing consists of requesting both financial and non-financial information from the informed persons, either from inside or outside the entity. Interviewing is extensively used in auditing in addition to other audit procedures. Interviews may range



from written official interviews to verbal non-official interviews. The evaluation of interview responses is an integral part of the interview process (ISA, 2015: paragraph A22). In the case of tangible property audits, interviewing informants outside the entity is similar to the external confirmation method. Inside the entity they may interview people who have direct contact with the assets, such as the branch accountant, the chief accountant, the chiefs of department etc. If there are discrepancies between the accounting statements and the heads of department (especially in the case of capital repairs that have been capitalized), then thorough checks are necessary.

An important factor in collecting audit evidence is the audit documentation. Specialists from the Court of Accounts of the Republic of Moldova, such as Angela Curchin, mention the necessity of drawing up the documentation in the audit mission. The use of standardized working papers can improve the efficiency of auditing, especially with regards to collecting information (evidence), drawing up and reviewing these documents. At the same time, the documentation serves the auditor as evidence that the audit standards have been met. Auditors must demonstrate through the acts, documents and information obtained all the findings and conclusions of the audit mission. The documentation should also link the carried out audit work and its outcomes (Curchin, 2012: 108).

The audit documentation should allow any user to better understand the risks involved, the assertions tested, the procedures applied, the way in which the evidence and the conclusions were obtained. They are also the main "pieces" in the audit files (permanent, current) on the procedures applied and the evidence obtained (Curchin, 2012: 108).

In the case of auditing of tangible assets, a working document of the execution stage should include the following:

1. The work done: including the auditing techniques applied by the auditor (examination, observation, confirmation, recalculation, interviewing, re-performing) according to the examples above;
2. Findings: the results obtained by applying the test - criterion (how should it be?), condition (what is it actually?), cause (why?), effect (what does it lead to?);
3. Conclusions: the auditor's deductions based on the established problems;
4. Recommendations: the auditor's proposals to solve the established problems.



The researchers at the "Alexandru Ioan Cuza" University of Iasi, such as the university lecturer Dr. Ionela-Corina Chersan argue that in order for the auditor's opinion to be as credible as possible, the audit evidence on which it is based should be of quality (appropriate to the purpose for which they were obtained) and in sufficient quantity. The degree of appropriateness and the sufficiency audit evidence are inter-related.

Adequacy is the measure of the quality of audit evidence. In its turn, the quality of the audit evidence is affected by the relevance and credibility of the information in providing justification for the conclusions on which the auditor's opinion is based. Relevance addresses the logical link between the purpose of the audit procedure and the statement taken into account. It is also the reason, why the relevance of the information used as evidence can be affected by the intention of testing (Ghersan, 2011: 57).

For example, if the purpose of an audit procedure is to verify the existence of all tangible assets recorded in de-facto accounting, testing the recording of property, plant and equipment can be considered as an appropriate test. Instead, if testing for the subsequent assessment of tangible assets is not relevant any more, testing of information such as: previous annual financial statements, operations and accounting notes for further evaluation, etc. becomes relevant.

The credibility of the information used as audit evidence is influenced by its source and nature, as well as by the circumstances in which it is obtained. The auditor uses different procedures to obtain valid, relevant and unbiased evidence. There are several types of evidence, but the auditor has to base their findings on those evidence, that is considered to be truly relevant and credible (Ghersan: 2011, 58).

The same specialists have a hierarchy of evidence depending on their credibility, as follows:

1. Direct personal knowledge, obtained by direct observation and by their own mathematical calculations, is considered the most credible evidence.
2. Documentary evidence obtained directly from external sources to the entity is considered to be highly credible.
3. Documentary evidence that originates outside of the firm but has been received and processed by the client is believed to be credible; a great importance in this assessment is the way of conceiving and functioning of internal control.



4. Internal evidence consisting of documents that are produced, circulated and archived in the entity have a low credibility. However, these samples are widely used when the internal control is considered satisfactory. Moreover, the internal samples are sometimes the only ones available.
5. Verbal and written presentations provided by the director, owners and employees are considered to be the least credible evidence. They must necessarily be corroborated with other types of evidence (Ghersan, 2011: 58).

The American scholars Arens and Loebbecke mention two factors that determine the evidence to be conclusive: profoundness and sufficiency. The profoundness of the evidence relates to the extent to which evidence can be considered plausible or trustworthy. If the evidence is thorough, it contributes a lot to the auditor's conviction that the financial statements represent a true and fair view. Most auditors use the term reliability of evidence as a synonym for the notion of profoundness (Arens et al., 2003: 209). The sufficiency of the evidence is determined mainly by the size of the sample selected by the auditor. For a certain audit procedure, evidence from a sample of 200 units will generally be more sufficient than those obtained from a sample of 100 units (Arens et al., 2003: 211). In conclusion, the two factors mentioned above are nothing but the quality and quantity of evidence.

Some authors such as Boulescu, Ghiță or Mareș believe that audit evidence still needs to be reasonable. The reasonable audit test is the information, that complies with the principle of economy and efficiency in terms of collection costs. Thus, it is necessary to achieve the audit objectives at the lowest possible cost by evaluating alternative audit approaches from the beginning of the audit process to judge and decide, which of them will achieve the desired results in the most economically possible way (Boulescu et al, 2001, 35).

We believe, that when the audited entity has a small number of tangible assets, they can be fully tested in order to obtain much more qualitative audit evidence. In the case when the audited entity is larger and the time spent on the audit is short, it is recommended that the auditor determines a particular sample and selects a smaller number of test assets, but which is relevant in comparison with all the tangible assets. The determination of the sample may be different: you can choose the tangible assets with the highest book value or the new entrants (for example, from the last 3 years) or those, which



are considered by the auditor to be more susceptible to errors or some other random form. This will create a complete picture of the entity's standing, while saving time and resources.

There are many circumstances in which the auditor may obtain erroneous audit evidence. The American scholars Lusk & Halperin (2015: 26) suggest that the causes of errors in an audit mission may be as follows:

- **Fatigue:** auditors are required to perform routine activities for periods that compromise their accuracy. These may require a certain number of hours in a day or a week to complete, especially in some demanding seasons.
- **Monotony:** auditors performing repetitive tasks and/or not stimulating thinking at the level of data transfer or processing.
- **Inappropriate workspace:** auditors whose workspace is not properly lit, too warm, too cold or too chaotic.
- **Sight difficulties:** auditors who do not have the right glasses.
- **Distractions:** auditors who are distracted while performing their tasks.
- **Informational overloading:** this phenomenon can occur either because of too much data or too short time required to perform the tasks.
- **Diversion and deception:** because of the lack of task division, there are identified dysfunctions that allow for the occurrence of all sorts of errors

When auditing an entity, particularly auditing tangible assets, auditors may find themselves in all of the above-mentioned situations, therefore, in order to obtain qualitative audit evidence, audit engagement officers or audit entity leaders must do their best to avoid the above-mentioned factors. The credibility of audit evidence depends on the way in which these factors can be avoided.

III. Conclusions

The lack of sufficient audit evidence can be the auditor's greatest concern, as certain situations may arise, such as cases of trial, in which the auditor may be accused of negligence and be held accountable. That is why, we suggest the auditors to collect as much and more qualitative audit evidence as possible in order to make the best decision in their mission.



Audit evidence is required to justify the auditor's opinions and report. The audit procedures to obtain audit evidence may include inspection, observation, confirmation, recalculation, repetition of the exercise and analytical procedures, often in different combinations in addition to interviewing.

In practice, to collect audit evidence when auditing tangible assets, we consider it reasonable first of all to inventory them. We recommend that the auditor participate as a member of the inventory committee as well as in the internal control activities performed by the entity's staff in order to obtain results with great credibility. If it is identified that some of the facts are being hidden by the entity's staff, this can still be considered as evidence, as it can cause suspicion of fraud.

Another method of obtaining audit evidence in auditing tangible assets is to request from the suppliers or customers of the entity the acts of verification of balances or the confirmation of reciprocal balances. We suggest this procedure in particular to entities that create tangible assets to see if their creation costs have not been artificially increased. Similarly, when prior to sale or acquisition of tangible assets, the auditor may request mutual confirmation papers to see whether the balances with suppliers, customers, and others coincide.

In the case of audit of tangible assets, we consider it appropriate for the auditor to verify the correctness of the mathematical formulae, especially the calculation of the depreciation of tangible assets, depending on the calculation method used according to the accounting policies.

An important factor is the audit documentation, which should allow any user to better understand the risks involved, the assertions tested, the procedures applied, the way the evidence were obtained and respectively the conclusions made. It is recommended that the documentation includes the used audit techniques, findings, conclusions and recommendations.

We believe, that when the audited entity has a small number of tangible assets, they can be fully tested in order to obtain much more qualitative audit evidence, and if the audited entity is larger and the time allocated to the audit is short, we advise the auditor to establish a particular sample, select a smaller number of test assets, but relevant to the total of the tangible assets.



Last but not least, we propose, when auditing tangible assets for obtaining of qualitative and quantitative evidence, auditors should benefit from increased comfort in order to best focus on the collection of evidence.

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