RESULTS (ERRORS) ASSESSMENT IN FINANCIAL AUDIT

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Abstract: : The quality of audit represents an important desideratum that the auditor considers when developing his activities. Therefore, a good interpretation of the results obtained after applying the procedures established in the planning stage, represents an essential step in stating an adequate audit opinion that will precisely represent the reality and will allow the entity to fully understand the problems and to take proper actions for normalizing the activity. In what follows, we will present the main procedures that are specific for the audit execution that will set the path towards obtaining highly accurate results.

JEL classification: H83, H87

Key words: financial audit, material error, assessing errors, samples

1. INTRODUCTION

An audit mission, in its execution stage, asks for a very complex work from the auditor, that needs to fully comply with the audit programme established and in which verifications will be made for each element selected for testing. Afterwards, the auditor will have to test the controls and to undertake the substantive testing, based on which he will state an audit conclusion concerning the audit controls (if they were enough or not) and tests (if they were able or not to identify material errors that will influence the audit opinion). Based on this conclusion, the auditor will have to decide if the audit is appropriate, sufficient and trustworthy. Also, he will have to decide if the stated activity supports or not stating an audit opinion or if they are problems that need to be reported back to the entity's administration.

In this context, since the audit cannot, normally, verify all recordings from a category of operations, he will have to evaluate errors identified throughout the ongoing of the audit process. This activity has the purpose to calculate the impact of errors on the audit opinion, and to establish the auxiliary activity that the audit needs to actually execute. In fact, this operation reduces the risk that the auditor to be placed in a situation with not enough audit evidences, that would allow him to finish the audit mission, or that the auditor, in the process of funding an opinion, to use unreal information, as an effect of an incorrect examination and analysis operations of the audit proofs.

2. ANALYSES

Evaluating the non-detection risk can also be considered as an auto evaluation of the auditor, while considering that certain critical points of the analyzed activities were not noticed in the audit conclusions funding stage, based on which the opinion is stated. As a result, the non-detection risk depends especially on the self-critical attitude of auditor in analyzing and orienting his own attitude towards the manner in which the audit mission will be approached.

During the audit process, the auditor may find errors or weaknesses in the control system, situation in which he must investigate on how and why these occurred. Considering that errors discovered during the tests, especially while testing key-elements or high value elements, often imply weaknesses, the audit must relook at the risk assessment and to use the discovered errors for bringing to date the estimated errors. Thus, if the base materiality increases or decreases by more than 10% of that determined by the auditor in planning phase, then it will adjust it accordingly at a material level. Considering these modifications, a new size of samples will be calculated for the substantive tests.

In evaluating the results of audit procedures, auditors frequently use professional judgment. Therefore, evaluation should be well documented and conducted by the entire team of auditors. In this way is ensured that the findings and consequences were analyzed circumferentially before the financial statements to be certified.

Auditor general assessment should include all sources of audit insurance, which together provide an overall opinion on the financial statements.

Should be noted that such an assessment involves evaluating results of each analytical procedure used for all tests (procedures) and substantive direct control tests were performed during the execution of the audit engagement.

Evaluation of analytical procedures is made given their characteristics and stages**.** As the analytical procedures are an useful instrument that allows the auditor to state that certain values are reasonable, applying them seems suitable for operations in which values are easy to estimate (ex: salaries, local taxes).

Analytical procedures involve three steps, during which the auditor, based on forecast calculations and subsequent comparisons, evaluates the results, concluding on them.

The first stage of an analytical procedure involves **estimating** (calculating forecast) the volume of transactions category that is subject to audit. This estimation is performed by the auditor solely on the independent data accounts, knowing this time the values enshrined in financial situations. The volume of processed data, their typology, depends primarily on the trust that the auditor has in the data.

After the final calculation of the forecast, the second stage begins, in which the auditor determines the *acceptable difference* between weather expected of him and the values recorded in the audited financial statements considering the relationship between the total amount of operations and basis of materiality. Thus, the acceptable difference will be the result of the product between the level of materiality and the square root of the ratio between the operation category value and the basis of materiality.

For example:

We assume that for an entity A, an auditor calculates the level of materiality at 225.000 euro. The materiality basis is represented by the total revenues of 25.000.000

euro (materiality coefficient= 0,5%). The auditor is undertaking a mission that implies operation categories specific for the sale of finished products worth 15.000.000 euro.

The auditor will determine the acceptable difference like this: 15.000.000 divided by 25.000.000 equals 0,6 from which we extract the square root and we obtain 0,7746. This result wil be multiplied with the materiality level, respectively 225.000 euro thus resulting an acceptable difference of 174.285 euro.

There are times when the value of a category of transactions may be greater than the materiality basis chosen by the auditor. In this case the auditor shall determine the acceptable difference as equal to the level of materiality.

If the amounts in the account exceed the difference acceptable, the auditor should request the management entity an explanation regarding this situation, interviewing two or more persons independent of the entity's management, while ensuring the reasonableness of their explanations. We emphasize that overcoming acceptable difference does not mean that the accounts contain errors. Being unable to thrust in this case, the analytical procedure, the auditor should perform substantive direct testing to determine whether or not the values in the accounts contain material errors.

Evaluation of the results of direct substantive procedures envisages two situations, namely if they were applied to all operations or only on a sample of them**.**

In the first case, the evaluation is to analyze the results of direct substantive procedures that were applied to all transactions (complete testing). In fact, fully tested populations are composed of significant transactions or have significant value.

Specific to this type of evaluation is that withheld errors do not extrapolate since their impact is limited, as they only are specific for transactions in which they were identified. Thus, the auditor knows the entire area of the error since all the elements have been tested.

If the audited transactions were selected based on sampling, the errors found in the sample can be estimated for the entire population, through the operation known as *errors extrapolation*. It must be emphasized here that the way in which the auditor extrapolates the errors depends on the sample selection method, respectively on the fact if the sampling was made based on monetary units (MUS) or if the sample was extracted through simple random sampling (RANDOM).

Samplings made based on the MUS method is used in audit missions that involve resting numerous series of operations, homogenous and generally, of small value, for which the evaluated error risk is small (ex: auditing payment rolls).

If the auditor will use the MUS sampling only when the risk that the audited financial situation to contain material errors is small. As a result, the auditor will previously conduct analytical procedures.

Sampling through MUS is based on certain monetary units individually considered, and operations are selected according to their size. The auditor will determine the extent to which each item sampled is wrong, then extrapolate the error over the entire range of sampling within the category of those transactions and not only in relation to the size of the operation.

For example, consider a sample obtained through the method MUS was determined for the operating expenses of a government agency. We set the sampling interval to the value of 200,000 euros. The test is a bill for an external service provider. Checking that document reveals an error generated by the use of incorrect currency,

leading to registration in the records of an undervalued stock with 180 euros or 3200 euros instead of 3380 euros.

By extrapolation, the aforementioned error is 11.250 euro. Setting this value entails first determining the error rate which skews the sample selected, reporting the initial error to the registered value (180/3200). Then the error rate thus obtained (0.05625) is multiplied by the sampling interval, considering that the item tested is representative and any mistake (error) detected is supposed to reappear at the same frequency throughout the range.

To assess the test results of samples selected through the simple method RANDOM the auditor sets the error as a percentage of the total value of transactions tested before extrapolation.

Referring to the previous example, we assume that the auditor tests, this time using simple random sampling, 25 selected items related to operations (sample) totaling 175,000 euros. The error detected is 360 euros and covers misstatement of an amount, ie 3,730 euros instead of 3370 euros (understatement). The total population in the year audited was 3.5 million euros. We calculate the error rate and determine that it is 0.205% (360/175.000). Making extrapolation by multiplying the total population error rate, we get an error in the extrapolated value of 7.175 euro (3,500,000 x 0.205%).

After extrapolation, for each class of operation, the auditor should compare the undervaluation and overstatements to their compensation. This operation is necessary because there may be material understatement and overstatement individually and yet the overall financial statements to be materially correct (not to exceed the materiality).

We emphasize, however, that if the auditor determines very high rates of error, he may reconsider the assessment of the risk level determined at the planning stage of the audit year to increase the risk factor which inevitably lead to further tests.

Another aspect of assessing errors aims at their limitation when the auditor finds errors with financial impact arising in so-called *special circumstances*. For example, the errors were detected within the purchasing activity of the audited entity and refer to transactions relating to a particular supplier. In this case, if the auditor is satisfied that that type of error occurs only with that particular supplier, he will not extrapolate the error to the entire population from which the sample was selected but only to the subpopulation consisting of operations carried out with that supplier.

An important aspect of the process of evaluating the results of audit is the evaluation of the *regularity errors*. In this context, the auditor must evaluate the irregularities found during an audit in order to determine their impact on the audit opinion.

It was noted that regularity errors can have a different impact compared to the impact of monetary errors (errors with financial impact). Therefore knowing that audited entities are able to correct cash errors, but it is less likely to correct regularity errors, the auditor should evaluate irregularities to determine if they have a material impact on the financial statements. Also he must consider whether irregularities are material in nature, as this influences the type of audit opinion.

For example, consider that a government payment agency earned an income in the amount of 300,000 euros from teaching courses. Although this work did not involve a loss of public funds, but the contrary, however, considering that the institution's financial regulations do not permit such classes, it follows that the total income registers an irregularity and the income is material. Given that the agency in

question cannot take immediate action in order to change the character of such income because it requires the approval of the Legislature, the opinion expressed by the auditor on the financial statements will be reserved.

Specific for the regularity errors is that they do not extrapolate because they represent a level of financial irregularities that required a similar level of error in the flow category of operations audited. They rather represent unauthorized operation rather because they are not made in accordance with the laws and regulations.

As you can see, concluding on the results goes towards the auditor establishing the material character of the retained errors, both for operation category and for the entire financial situations.

If, after audit tests, the auditor assesses the errors and finds out that they are reduced when compared with the materiality and do not pass its level even when adding a permitted level of undetected error of 50% from the materiality, it obtained the wanted level of insurance, the financial situations do not have material errors, and the opinion stated is a non-qualified one.

3. CONCLUSIONS

However, determining material errors in the financial statements requires the auditor promotion of measures that may lead (or not) to avoid expressing an opinion or even denial of opinion. This is a serious option and is therefore important for the auditor to identify, since the early stages of the audit, the possibility of existence of material errors in order to work towards one of the following measures:

A. To request the audited management additional activities for categories of problem operations, as it is his responsibility to provide additional insurance on the non-existence of material error in the financial statements.

B. To realize even more activities, resulting in additional audit procedures to determine whether there is sufficient evidence to lead to the conclusion that no material errors in the financial statements. In this regard, the auditor will increase the sample dimension also taking into account the sampling method used to determine the initial sample. Thus, in order not to alter the statistical validity of the sample initially establish, when establishing am additional sample must use the same method of sampling (MUS / RANDOM).

C. Limiting the scope of the audit opinion is another scenario applied by the auditor when the above measures do not provide this level of assurance required on the error. This measure is applied where additional work would have no effect on the auditor's opinion on overcoming the materiality, nay should strengthen our belief that the level is exceeded.

In conclusion, evaluation of audit results, preliminary stage of formulating the audit opinion and the audit report, subscribes to the overall objective of the audit, which is to provide assurance that the financial statements examined are complete and prepared accurately and the economic operations-were conducted in accordance with the relevant laws and regulations in force.

REFERENCES

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