Audit Evidence
Collection and Documentation
The Basics of Internal Auditing
October 9 - 10, 2014
Stephanie Sgouros, CPA
Owner, Sgouros Enterprises LLC

Agenda

• Audit Evidence Definitions
• Audit Evidence Types
• Standards
• Sufficiency, Competence, Relevance
• Preserving Audit Evidence
• Workpapers

Definitions

• Audit Evidence is defined in the Auditor’s Dictionary, by David O’Regan, as “information that supports or refutes an audit objective”.

• Sawyer’s Guide for Internal Auditors states that Audit Evidence is “the information internal auditors obtain through observing conditions, interviewing people, and examining records.”
Legal Evidence
Similar with a Different Focus

• Legal Evidence
  – More testimonial

• Audit Evidence
  – Relies more on documents

Best Evidence

• Also called Primary Evidence
• More reliable
• More satisfactory proof of a fact
• Original documents, especially if signed or initialed

Secondary Evidence

• Less reliable than primary evidence
• Use professional skepticism!
• Example: copy of an invoice
Secondary Evidence

• Copies of originals
• Oral testimony
• Written summary notes

When is a Copy OK?

• Original was accidentally lost
• Original was accidentally destroyed
• Original is not reasonably available
Direct Evidence

• No presumptions or inferences needed to prove a fact

• Ex. An employee tells you that they are the person who maintains the payroll register.

Circumstantial Evidence

• Proves something other than what you are directly trying to prove

• Relies on others making a logical inference

• Example: Email has “Pancakes” in the subject line.

Circumstantial Evidence

• Never put complete trust in circumstantial evidence

• Use professional skepticism!

• Ex. Email subject line says “French Toast”
Conclusive Evidence

- Incontrovertible
- Only one reasonable conclusion
- Overwhelms other evidence
- Does not require corroboration

Conclusive Evidence

- Can be of any type
- Internal auditors love this type of evidence, but we rarely get it. 😊
- Ex. An employee claims to have a doctor’s appointment but everyone sees him on the Jumb-o-tron at the baseball game.

Corroborative Evidence

- additional evidence, supplementary
- different in character
- concerns the same point
- strengthens or confirms evidence already provided
Opinion Evidence

• may be
  – Biased
  – self-serving
  – uninformed
  – useful
• generally not
  – included in the workpapers
  – admissible in court

Opinion Evidence – Exception
Expert Testimony

• related to a specific topic such as a profession, occupation or industry that is beyond the understanding of the average person
• Experts should possess great skill, knowledge or experience in the area of the testimony and be acknowledged as experts in their area

Opinion Evidence – Exception
Expert Testimony

• Use when audit area is outside your understanding
• expert should be free from potential bias, if possible
• If expert is in audit area, be aware of potential bias.
• Mitigate potential bias with corroborating evidence
Hearsay Evidence
• secondhand evidence
• generally inadmissible in court
• Ex. repeating what someone else said
• Ex. providing a document someone else prepared

Hearsay Evidence – Exception
Business Document
• made in the ordinary course of business
• generally trustworthy
• Assumed valid unless discredited

Hearsay Evidence – Exception
Business Document
• Business documents made in the ordinary course of business include
  – purchase orders
  – vouchers
  – general ledgers
  – competitive solicitation requests (ITB, RFP and ITN)
  – contracts for goods or services
  – logs, exception reports, etc.
Hearsay Evidence
Photographs

• admissible when properly authenticated

• Auditors can observe photographs being taken or take the photographs themselves.

• If observing, auditors should document certain things
AUDIT EVIDENCE

• Audit evidence is what auditors obtain through
  – observation (of conditions)
  – interviews (of people)
  – examination (of records)

AUDIT EVIDENCE

• Audit evidence is used to provide a factual basis for audit opinions, conclusions and recommendations (to findings).
• Categorized as
  – physical,
  – testimonial,
  – documentary, and
  – analytical.

Physical Evidence

• Obtained by observing:
  – People
  – Property
  – Events
Physical Evidence

• Includes:
  – Statements of observation by observer
  – Photos
  – X-rays
  – Charts/Graphs
  – Maps

*Audit horror story*

Crazy Eddie Fraud
Inventory Example

• http://www.youtube.com/watch?feature=player_detailpage&list=PLEF5DBED538D091B1&v=CP8iO5IvCoU

Example:
Photos as Physical Audit Evidence

• Exceptions to Proper Separation of Duties:
Example:
Photos as Physical Audit Evidence
• Proper separation of duties:
Weaknesses of Photographs

A Visit to a Storage Warehouse Restroom
Testimonial Evidence

- Letters, memos, emails
- Responses to surveys/questionnaires, inquiries, interviews
- May be written or oral

Testimonial Evidence

- Not conclusive by itself
- Should be supported by other documentation
- Can be an important lead
- May provide information not obtainable by independent audit testing

Documentary Evidence

- Most common type of evidence
- May be external
- May be internal (originates with auditee)
- Source affects reliability
Analytical Evidence

• Analysis and verification
• Source = computations, comparisons
• Types:
  – Standards
  – Prior year or years’ performance
  – Similar operations
  – Laws/regulations
  – Reasoning
  – Component information

Analytical Evidence
Real Life Examples

• Harry Markopolos on 60 minutes: http://www.youtube.com/watch?v=s68FR1MXT8Q

• Tax Returns

Standards of Audit Evidence

Sufficiency

Competence

Relevance
Standards of Audit Evidence

- Audit evidence must be sufficient, competent and relevant.

- What if it isn’t? Get more!

- Note: Auditor opinions require inconvertible evidence.

Sufficiency

- Is it enough?
- Is the evidence:
  - Factual?
  - Adequate?
  - Convincing?
- Would a layperson come to the same conclusion as the auditor?
- Use your judgment, but be objective

Competence

- Is it reliable?

- Is there better evidence that can be reasonably obtained?

- The Best Evidence Rule applies.

*Audit Horror story*
Relevance

• Is it useful?

• Does the information have a logical, sensible relationship to the issue?

• It can be factual, but not relevant.

Audit Evidence Legal Authority

• Florida Statutes Sections:
  – 20.055 [Inspectors General]
  – 17.03(1) [State CFO – DFS]
  – 11.45 [Auditor General]
  – 215.97 aka Florida Single Audit Act
  – Chapter 119 aka Public Records Law

Audit Evidence Legal Authority

• Internal Audit Charter
• Federal – Freedom of Information Act (FOIA)
• Contracts
• Grant Agreements
• Record Retention Policies
Audit Evidence - Interviews

- When do you use?
- Who do you interview?
- How do you plan the interview?
- Use a question format
- Note taking
- Recording

“If you tell the truth, you don’t have to remember anything.” Mark Twain

File Reviews

- Determine Layout/Order
- Identify Key Documents
- Review Correspondence and Notes
- Look for gaps/inconsistencies
  - Dates
  - Missing pages or signatures
  - Missing sections/information
Document Review
Internal Forms
• Is it the form used in the usual course of business?
• Is it complete?
• Signed by the appropriate parties?
• Are amounts correct? Even automated forms may have errors!

Document Review
External Forms
• Is a receiving process followed? (ex. date stamp received)
• Does the document contain what you might reasonably expect?
• Is the form accurate?
• Are forms from same vendor consistent? (*Audit Horror Story*)

Common Audit Evidence Deficiencies
• Failing to scrutinize important management assertions
• Failing to maintain auditor independence
• Senior audit personnel failing to adequately plan or supervise audit
• Gathering sufficient evidence
### Audit Documentation Type Examples

- Emails
- Faxes
- Vendor Documents (invoices, statements, etc.)
- Internal Memos
- Correspondence
- Other Audit Reports

### Why Preserve Audit Evidence?

- May need for administrative or judicial proceeding
- Memories fade
- Witnesses move away, retire
- Cooperative relationships turn contentious

### Preserving Audit Evidence

- Some tools used to preserve audit evidence:
  - Statements (may be notarized)
  - Affidavits (sworn)
  - Memos of Interview or Understanding
  - Depositions (sworn)
Preserving Audit Evidence

- Copies (or originals) of Records
- Audio and/or Video Recordings
- Photographs
- Scanned Images
- Summary Notes
- Webpage screenshots

Chain of Custody:
Preservation by successive custodians of a piece of evidence or any relevant writing in its original condition.

Charts, Schedules, Summaries
- may summarize large amounts of other evidence
- Use objective, non-prejudicial titles
- Include Source
Preserving Audit Evidence
Notes, Diaries, Workpapers, Memos

- Generally not considered evidence
- May become public records
- May aid recollection
- May impeach evidence
- May be subject to legal inspection

Preserving Audit Evidence
Audio and Video Recordings

- Must be a legal recording
- Not objectionable hearsay
- Often need additional evidence to prove certain details (such as date, person speaking, etc.)

Why is documenting the date important?

*Audit Horror Story*
Workpapers

- Sometimes, if it isn’t written down, it never happened.
- Some things are easy to understand but difficult to document (and vice versa).
- Workpapers are required to document evidence.

Workpapers

Red Book (IIA) Requirements:

2300-1 IA must document relevant information to support conclusions.

PA 2330.A-1 Workpapers include support, review notes, correspondence, regardless of storage. It can be photographs, videos, recordings or other physical evidence obtained.

Audit Documentation Best Practices

- Provide Source and Purpose on Workpapers
- Use a numbering/indexing system
- Use cross-referencing
- Ensure workpapers can “stand alone”.
- Check your office SOP regarding workpapers/documentation.
Audit Documentation

Audit Documentation
Best Practices

- Secure workpapers and limit access, especially to confidential information
- When preparing, do not blindly follow prior year’s workpapers
- Keep an inventory of workpapers and maintain a destruction schedule

Audit Documentation
Audit Program

- Objectives
- Scope
- Legal Authority
- Planning
- Field Work
- Approval

Audit Documentation
Test Results Summary

- Documents:
  - Population
  - Sampling
  - Methodology
  - Evaluation Criteria
  - Audit Trail
  - Results
Audit Documentation

Lead Schedules
• Lists each test item and results for each tested criterion
• Provides a summary of the number tested and the number of exceptions/deviations
• Helpful in writing findings

Helpful Reminders
• Have an open mind – never develop a theory before getting all the facts
• State the obvious
• Look closely at what’s in front of you
• Don’t rely on one photo, one day, one person’s opinion
• Beware of shortcuts

Resources
Sawyer’s Guide for Internal Auditors, 6th Edition (IIA)
Resources

International Professional Practices Framework (IPPF) aka Red Book (IIA)

Resources

Generally Accepted Government Auditing Standards - aka Yellow Book - US GAO
Free online!
http://www.gao.gov/yellowbook/overview

Resources

Florida Statutes
Free online at
http://www.leg.state.fl.us/Statutes/index.cfm?Mode=View%20Statutes&Submenu=1&Tab=statutes&CFID=323186402&CFTOKEN=47559914
Optional Resources

Auditor’s Dictionary by David O’Regan

Optional Resources for your “free” time

“No One Would Listen: A True Financial Thriller” by Harry Markopolos

More Real Case Examples (if we have time)
Photographs can get Quick Results

A Different Visit to a Different Storage Warehouse
WARNING

The following slide contains content that may be considered "gross".

View at your own risk.

Examples of Photos as Evidence in an Investigation

Typical boxes of other employees in same section as employee that filed complaint:
Examples of Photos as Evidence in Investigation

Typical boxes of employee that felt her performance was not accurately reflected by simply reporting on the number of boxes she processed:
Thank you!

Stephanie Sgouros, CPA
Office: Sgouros Enterprises, LLC
Phone: 850-656-1836
Email: stephaniesgouroscpa@gmail.com