

THE MATERIALITY AND SURVEY IN THE FINANCIAL AUDIT

PRAGUL DE SEMNIFICAȚIE ȘI PROCESUL DE EȘANTIONARE ÎN AUDITUL FINANCIAR

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Abstract. *We know that the product of accounting is the information provided to all those interested, and its quality certification is the responsibility of financial auditors. Planning the financial audit requires taking into consideration of a threshold of significance, because there is an inversely proportional relationship between the materiality and extent of the audit process. In other words, the cost of the audit varies inversely with the level of materiality. In addition, to increase the efficiency the financial audit, one of the techniques used in collecting samples is the survey technique. By using the techniques of sampling, an auditor reduces the time needed to conduct an audit and the audit costs. In this article, we prove that determining the correct materiality and sampling in the audit have an important role in reducing the costs of the audit in its entirety.*

Key words: financial audit, materiality, survey technique, audit cost.

Rezumat. *Știm că produsul contabilității este reprezentat de informația contabilă furnizată tuturor celor interesați, iar atestarea calității acesteia cade în sarcina auditorilor financiari. Planificarea auditului financiar impune, printre altele, luarea în considerare a unui prag de semnificație, deoarece există o relație invers proporțională între nivelul pragului de semnificație și amploarea activităților procesului de audit. Altfel spus, costul auditului variază invers proporțional cu nivelul pragului de semnificație. În plus, pentru eficientizarea auditului financiar, una din tehnicile utilizate în colectarea probelor are în vedere tehnica sondajului. Prin utilizarea tehnicilor de eșantionare, un auditor reduce atât timpul necesar desfășurării unei misiuni de audit, cât și costul auditului. În acest articol, dorim să demonstrăm că stabilirea corectă a pragului de semnificație și eșantionarea în audit au un rol important în reducerea costurilor procesului de audit, în ansamblul său.*

Cuvinte cheie: audit financiar, prag de semnificație, tehnica sondajului, costul auditului.

INTRODUCTION

The activities performed by the financial auditor aim at limiting *the risk of issuing an erroneous opinion on the accounts subject to certification, within the limit of the significance threshold*. It is known that the information supplied by a company substantiates the decisions made by a multitude of users.

The beneficiaries of the information provided by the accounting office sometimes display *a lack of confidence* in relation to the fair image of the financial position, of the outcomes and modifications of the financial position of the company.

*The guarantee of providing accurate and quality information should be ensured by the **financial auditor** via the opinion issued in relation to the validity and accuracy of the annual financial statements.* But, in order to form an opinion about the balance sheet, the auditor makes use of procedures that enable him to obtain *a reasonable degree of certainty* regarding the fact that the financial statements are accurately elaborated.

Inevitably, it is possible for inexactitudes (calculation, registration errors, imprecise numbers) or even significant irregularities (actions or omissions that violate statutory laws and provisions) not to be discovered. In fact, financial audit is planned depending on *risk factors* and their *relative significance*.

MATERIAL AND METHOD

In order to prove that the accurate determination of the significance threshold and audit sampling play an important role in the reduction of the costs of auditing, we have commenced our research with the analysis of the international auditing standards which regulate these aspects.

Moreover, we have studied the minimal auditing norms issued at a national level, and which represent a simplified modality of approaching the significance threshold and audit sampling.

The research method was interdisciplinary, as long as we resorted to the technique of the statistical poll used for the sampling process.

We further present the obtained results and conclusions in relation to this topic.

RESULTS AND DISCUSSIONS

As an accounting principle that must be observed for the assessment of the columns comprised in the financial statements of a company, *the significance threshold* is defined in the general Framework for the elaboration and presentation of financial statements as follows: *“all elements that have a significant value must be presented distinctly in the financial statements. Elements with unimportant values, of the same nature or with similar functions, must be summed up, their separate presentation being unnecessary”*. IAS 10 *“Subsequent events to the fiscal closing date”* makes comments on the review of the values of some estimates (for those elements whose value is unsure and which are not included in the financial statements) in order to reflect the subsequent events to the closing date of the fiscal year, circumstances changes, but *only if these values are significant*. Surely, this aspect is valid before the approval of the financial statements. For example, a customer’s bankruptcy after the fiscal closing date is a significant event.

From another perspective, *the significance threshold* is considered in the contact of the qualitative features of the information provided by the financial statements, respectively: *intelligibility, relevance, credibility* and *comparability*. The significance threshold rather provides a *limit* than representing a qualitative feature that the information should have in order to be useful. This statement is

justified by the following comment: “*the information is significant if their omission or erroneous presentation could influence the economic decisions of the users, made based on the financial statements; and the significance threshold depends on the size of the respective element or error*”. According to point 21 of the financial audit and certification norms of balance sheet no. 1/1995, “*a significance threshold represents the level, the size of an amount beyond which the auditor considers that an error, inexactitude or omission may affect the regularity and honesty of the annual accounts*”.

Thus, the significance threshold expresses *the relative significance or importance of a problem in the context of the financial statements*. What matters is the **knowledge of the significance threshold**, respectively of the level beyond which it is appreciated that *the omission or the erroneous declaration* of some items of information could influence the users’ economic decisions, made based on the financial statements. The main problem in relation to the significance threshold refers to *the determination of its size*. International auditing standards constantly refer to the importance of professional reasoning in this aspect. A simple and mathematical method for determining the significance threshold is presented in the minimal auditing norms, recommending that it be established by applying a percentage between 0.5% and 15% to various reference bases, such as: *turnover, net profit, total assets or equity*. The 0.5% - 10% interval constitutes *the zone of uncertainty*. Nevertheless, we must state that this is an indicator and not an absolute rule, especially when the equity or the profit of a company is insignificant (registers low values).

There is a reverse relation between *the significance threshold* and the level of the *audit risk*, that is, the higher the level of the significance threshold, the lower the audit risk, and conversely. Usually, a global significance threshold is established, but one can also establish thresholds for each section of the annual audited accounts, which are no longer called tolerable errors. After determining the significance threshold, the auditor must determine the size of the sample from which will be extracted the elements that are to be tested.

This happens because the auditor cannot exhaustively verify transactions and must study the conclusive elements on a representative sample, by using the **technique of the poll**. Seen as an auditing technique, **the poll** is defined, in the auditing norms, as *a procedure consisting of the selection of a certain number of elements from the ensemble of operations and accounts that form the set to be checked, the application of the techniques for obtaining conclusive elements to these elements and the expansion of the results obtained for the sample for the ensemble of the studied set*.

The use of the poll is justified by the fact that, in case all the operations were part of the verification, the auditing costs would be too great in comparison with the utility of the obtained information following the inspection of some insignificant operations.

Depending on *feature and objective*, we can distinguish between:

- *polls regarding prerogatives*, used when the elements that constitute the set have a common feature;
- *polls regarding the value*, when the analyzed feature represents the value of the heritage elements and of the operations registered in the flow and balance of the accounts.

Polls can also be classified according to the *auditor's professional training* and to the *degree of credibility* he wishes to confer upon his conclusions. Thus, we will have:

- *statistical polls*;
- *non-statistical polls*.

The latter are based on the auditor's experience and intuition, and do not provide a rigorous extrapolation of the results obtained on a set to the entire mass.

Regardless of the type of poll, several **stages** must be observed in order to guarantee the requested strictness.

The precise definition of the objectives implies the idea that the auditor must clearly establish *what it is that he wants to prove*, that is he must define the features of the elements considered errors or anomalies. For example, by comparing the delivery notes and the invoice, the auditor may find deliveries on the point of being invoiced or deliveries that have not been invoiced. At the same time the auditor must establish the *maximal error margin* accepted for internal checks to operate.

Stating the nature of the elements and the time limit of the poll implies, for example, for the verification of the purchases, the analysis of the reception notes that are numbered in the company and not of the bills from the supplier, whose order number are discontinuous.

We mention that the *key elements* in a set are those elements that, either due to their nature (misnamed or unnamed accounts), or to their value (exceeding of the fixed significance threshold) have risks and, consequently, the auditor may decide to fully check them.

After defining the objectives of the poll and choosing the elements that constitute the basis of the poll, the auditor will proceed to the ***de facto execution of the poll***. There are six stages of the poll execution: ***selection of the techniques, determination of the sample size, selection of the sample, study of the sample, evaluation of the results, conclusions of the poll***.

1. ***The selection of the techniques*** is influenced by the nature of the control to be performed (polls regarding prerogatives or polls regarding values) and by resorting or not to statistical techniques and depends on the size of the respective

set, on its capacity of fulfilling the objectives of the poll, on the cost/efficiency ratio of the chosen technique.

2. *The determination of the sample size* will be made depending on several different factors, such as whether the polls focus on prerogatives or on values.

3. *The selection of the sample* implies the fact that this sample must be representative. The selection can be random or systematic, the first element being selected at random or in an empirical manner.

4. *The study of the sample* implies the fact that all the selected elements must be controlled. If this cannot be achieved, then the auditor can resort to alternative control procedures that enable him to express a motivated conclusion regarding the controlled elements.

5. *The evaluation of the results* consists in the examination and appreciation of each anomaly in order to discover whether it is or not representative for the selected set. Exceptional anomalies are analyzed separately.

6. *The conclusions of the poll* comprise the conclusions related to: the key objects that were the object of the control; the registered exceptional anomalies; the rest of the set.

In case the noticed anomalies exceed the fixed threshold, the auditor can draw the conclusion that the internal control procedures do not function in a satisfactory manner and re-discuss its appreciation.

CONCLUSIONS

To conclude, we may say that the method for the determination of the significance threshold is *subjective* and that the auditor's experience, professional training and reasoning are extremely important.

For the determination of the significance threshold one will take into account the necessities of the users of the financial statements, the characteristics of the company (gross margin, in trade; in other fields of activity, the net profit can be taken as a reference point) the characteristics of the elements that are considered to be significant (an error is more important if it occurs in a column of the balance sheet where precision is essential, than an error referring to a column determined via appreciation; for example, an error in the column with the provisions is not as important as an error in a column referring to financial means).

Moreover, in order to make the financial audit efficient, as I have mentioned from the very beginning, one of the techniques used for gathering evidence is the technique of the poll. By using sampling techniques, an auditor reduces the time spent on an auditing mission, as well as the cost of the audit.

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