



Auditing and Assurance Standards Council

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*Philippine Auditing Practice Statement 1000Ph (Revised)*

**AUDIT EVIDENCE – PRACTICAL PROBLEMS  
IN AUDIT OF FINANCIAL STATEMENTS**

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**CONTENTS**

	<b><u>Paragraphs</u></b>
Introduction.....	1-2
Effective Date.....	3
Understanding Management Responsibilities.....	4-8
Emphasizing Certain Auditor’s Responsibilities.....	9-13
Steps that the Auditor Can Take When the Client is Unable to Prepare Certain Audit Requirements.....	14-16
Reporting and Other Considerations.....	17-18

Philippine Auditing Practice Statements (PAPS or Statements) are issued by the Auditing and Assurance Standards Council (AASC) to provide practical assistance to auditors in implementing the Philippine Standards on Auditing (PSAs) or to promote good practice. Statements do not have the authority of PSAs.

This PAPS does not establish any new basic principles or essential procedures; its purpose is to assist auditors, and to develop good practice, by providing guidance on the application of the PSAs when conducting an audit of financial statements. The auditor exercises professional judgment to determine the extent to which any of the audit procedures described in this PAPS may be appropriate in the light of the requirements of the PSAs and the entity’s particular circumstances.

The applicability of this PAPS on Philippine public sector entities has not been addressed by the Council. It is the understanding of the Council that this matter will be addressed by the Commission on Audit itself in due course.

This particular PAPS issued by the Auditing and Assurance Standards Council is not based on a specific International Auditing Practice Statement (IAPS) issued by the International Auditing Practices Committee of the International Federation of Accountants but was issued to address specific situations in the Philippines.

# **Audit Evidence – Practical Problems in Audit of Financial Statements**

## **Introduction**

1. This Philippine Auditing Practice Statement (PAPS) provides practical guidance to auditors on how to deal with situations where clients are unable to prepare and submit to the auditor information, such as supporting schedules, reports, computations and similar information that the auditor needs in the performance and completion of his audit work.
2. The scope and objectives of this PAPS follow the applicable provisions of the following:
  - Philippine Standards on Auditing (PSA) 200 (Revised and Redrafted), Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Philippine Standards on Auditing
  - PSA 210 (Redrafted), Agreeing the Terms of Audit Engagements
  - PSA 260 (Revised and Redrafted), Communication with Those Charged with Governance
  - PSA 300 (Redrafted), Planning an Audit of the Financial Statements
  - PSA 320 (Revised and Redrafted), Materiality in Planning and Performing an Audit
  - PSA 500 (Redrafted), Audit Evidence
  - PSA 501 (Redrafted), Audit Evidence-Specific Considerations for Selected Items
  - PSA 560 (Redrafted), Subsequent Events
  - PSA 620 (Revised and Redrafted), Using the Work of an Auditor's Expert
  - Code of Ethics for Professional Accountants in the Philippines in relation to the following:
    - (a) Preparation of accounting records and financial statements (Ref. Para. 290.166-168)
    - (b) General provisions relating to self-review threats involving an auditor in the preparation of accounting records and financial statements on listed and non-listed entities (Ref. Para 290.169-172)

- Securities and Exchange Commission (SEC) SRC Rule 68, paragraph 2(b) and SRC Rule 68.1, paragraph 3 (a), Responsibility for Financial Statements
- SEC Memorandum Circular No.16, Series of 2009, Preparation and Audit of Annual Financial Statements, Section II, paragraphs 2 and 3

## **Effective Date**

3. This PAPS is effective for audits of financial statements for periods beginning on or after January 1, 2010.

## **Understanding Management Responsibilities**

4. The objective of the auditor is to accept an audit engagement only when the basis upon which it is to be performed has been agreed upon in accordance with paragraph 3 of PSA 210 (Redrafted), Agreeing the Terms of Audit Engagement. PSA 210 (Redrafted) requires the auditor to obtain an agreement with management and, where appropriate, those charged with governance that it acknowledges and understands its responsibility in relation to the audit of the financial statements and therefore will provide the auditor access to all information relevant to the financial statements.
5. PSA 200 (Revised and Redrafted), Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Philippine Standards on Auditing, paragraph 4, states that the financial statements subject to audit are the responsibility of the management of the entity with oversight from those charged with governance. The audit of the financial statements does not relieve management or those charged with governance of those responsibilities. As indicated in paragraph 13 of PSA 200 (Revised and Redrafted), those responsibilities, include the following, among others:
  - (a) Preparation and presentation of the financial statements in accordance with the applicable financial reporting framework.
  - (b) Providing the auditor with:
    - (i) All information, such as records and documentation, and other matters that are relevant to the preparation and presentation of the financial statements;
    - (ii) Any additional information that the auditor may request from management and where appropriate, from those charged with governance; and
    - (iii) Unrestricted access to those within the entity from whom the auditor determines it necessary to obtain audit evidence.
6. In accordance with the SEC SRC Rule 68, paragraph 2(b), the financial statements filed with the SEC are primarily the responsibility of the management of the reporting company and management shall be required to acknowledge their

responsibility over their financial statements through submission of “statement of management responsibility” along with the audited financial statements with the SEC. It is therefore the responsibility of the management of the entity to provide all schedules, reports, computations/projections, reconciliations, reports, analyses and other financial information (collectively referred to subsequently in this PAPS as audit information requirements) needed by the auditor to complete the audit and provide an opinion on the overall fairness of the financial statements.

7. As indicated in SEC Memorandum Circular No. 16, Series of 2009, the company should neither allow nor require its auditor to prepare its financial statements and/or any of its supporting documents. The auditor’s duty is to conduct an independent examination of the company’s financial statements and supporting documents pursuant to the prescribed auditing standards and practices.
8. The following, among others, are examples of audit information requirements that the management shall provide to the auditor, where applicable, in relation to his audit of the financial statements:

(a) Schedules

- Obsolete inventory items due to lack of reliable inventory records.
- Trade receivables, including the aging of such receivables.
- Details of fixed asset movements.
- Segment information to support disclosures on reportable segments in accordance with PFRS 8, Operating Segment.
- Transactions, outstanding balances, and extent of related party relationships with related parties in accordance with Philippine Accounting Standards (PAS) 24, “Related Parties.”
- Disclosures and analysis required under PFRS 7, “Financial Statements: Disclosures”, such as classes and categories of financial instruments, fair value disclosures, and nature of extent and risks arising from financial instruments.

(b) Computations/ projections

- Impairment analysis for certain assets (i.e., receivables, inventories, investments, intangible assets, property plant and equipment, other financial assets).
- Analysis and computation of current and deferred income taxes including the assessment of recoverability of deferred tax assets.
- Determination of the fair values of financial instruments in accordance with PAS 39, “Financial Instruments” or PFRS 9, “Financial Instruments

(effective January 1, 2013) and Investment Properties carried at FV under PAS 40.

- Current and long-term portions of loans with adequate disclosure on consideration for default situations.

(c) Reconciliations

- Bank reconciliation statements.
- Reconciliation of general ledger and subsidiary ledger balances of significant accounts.
- Reconciliation of confirmed balance of cash in bank, receivables, payables and intercompany accounts with recorded book balance.
- Reconciliation of general ledger beginning balances of certain balance sheet accounts with balances appearing in the previous year audited financial statements.
- Reconciliation of count of inventory items with the stock cards or their equivalent.

(d) Reports, analyses and other financial information

- Trial balance.
- Adjusting journal entries.
- If there are differences in reporting dates of the parent and any of its subsidiaries, material intervening transactions (such as sales, purchases, loans or advances, shared or joint costs) occurring between the parent's year-end date and the year-end dates of its subsidiaries.
- Actuarial valuation of retirement benefit plans in accordance with PAS 19, "Employee Benefits" as prepared by an expert.
- Draft of financial statements, including the corresponding notes to the financial statements and required annex/es and/or schedule/s in accordance with Philippine regulatory bodies.
- If applicable, draft of consolidated financial statements, including note disclosures, and all the necessary elimination entries for intercompany balances and transactions.
- Regulatory and legal rulings/findings of the Philippine regulatory bodies (e.g., SEC, BIR, BSP, IC and the Courts of Law).

## **Emphasizing Certain Auditor's Responsibilities**

9. In planning the audit, the auditor shall consider, in its overall audit strategy and audit plan, the process of communication with management and, where appropriate, those charged with governance on the audit requirements and timetable, among others.
10. The auditor shall not limit the discussion of audit requirements to middle management. It is prudent to involve the top management, audit committee or board of directors on the discussion of audit requirements and timetable.
11. The auditor shall ensure that information provided by management was appropriately reviewed by responsible management personnel.
12. If the auditor is unable to obtain the necessary audit information requirements, the auditor shall consider identifying and taking additional steps.
13. However, the auditor shall not prepare the audit information requirements himself. The preparation of the audit information requirements by the auditor may give rise to specific threats to compliance with the fundamental principles under the Code of Ethics for Professional Accountants in the Philippines and may create a self-review threat when the financial statements are subsequently audited by the auditor which may result in a breach of the independence rules under the Code.

## **Steps that the Auditor Can Take When the Client is Unable to Prepare Certain Audit Information Requirements**

14. In planning the audit and after communicating the audit information requirements and timetable in accordance with paragraphs 7 to 8, if management and/or those charged with governance have determined that they cannot provide the required audit information requirements, the auditor shall discuss with management and/or those charged with governance the possibility of management getting assistance from a third party to help them prepare the audit information requirements, for example, outsourcing the preparation of these audit information requirements to third party service providers.
15. During the performance of the audit, in the event that the client management is unable to provide the audit information requirements the following procedures, among others, may be performed:
  - (a) Communicate in writing and discuss with management or those charged with governance the audit information requirements that were not provided during the audit.
  - (b) Obtain and evaluate the reasons why management is unable to prepare the audit information requirements.
  - (c) If the client does not know how to prepare the audit information requirements, consider assisting the client, for example, by preparing a pro forma reconciliation statement or schedule format for the client to complete or use as

a guide, advising the client's staff how the statements or schedules can be prepared in the most efficient and effective way, and/or providing a guide or approach in addressing difficult accounting computations but should observe the requirements/limits of the auditor's role in providing such assistance to the client on independence rules under the Code of Ethics for Professional Accountants in the Philippines as discussed in paragraph 13..

- (d) If despite of assistance provided, as stated above, the client still cannot prepare the required audit information requirements within a reasonable period of time, discuss with management and/or those charged with governance the possibility of outsourcing the preparation of audit information requirements to third party service providers, if applicable.
16. In situations where the client provided incomplete and insufficient audit information requirements, the auditor shall perform the following procedures, among others:
- (a) Communicate in writing and discuss the issues and concerns on the incomplete and insufficient audit information requirements with management and/or those charged with governance.
  - (b) Discuss if the audit information requirements can be revised to meet adequately the needs of the auditor.
  - (c) Consider assisting the client, for example, by advising how to complete the insufficient information in an efficient and effective way and preparing a list of items that the client shall look for to complete the information.
  - (d) If the client cannot revise the incomplete and insufficient audit information requirements within a reasonable period, the auditor shall discuss with management and/or those charged with governance the possibility of outsourcing the completion of the information to third party service providers.

### **Reporting and Other Considerations**

17. If the client, after exhausting the alternatives provided in paragraphs 15 and 16, is still unable to provide the audit information requirements, this situation may constitute a limitation on the auditor's scope of work and may result in the inability of the auditor to obtain sufficient appropriate audit evidence.

18. If the auditor is unable to obtain sufficient appropriate audit evidence, paragraphs 7 and 10 of PSA 705 (Revised and Redrafted) state that the auditor shall express a qualified opinion. If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive so that a qualification of the opinion would be inadequate to communicate the gravity of the situation, the auditor shall:
- (i) Withdraw from the audit, where practicable and not prohibited by law or regulation; or
  - (ii) If resignation from the audit before issuing the auditor's report is not practicable or possible, disclaim an opinion on the financial statements.

This PAPS 1000Ph (Revised), “Audit Evidence – Practical Problems in Audit of Financial Statements,” was unanimously approved for adoption on July 26, 2010 by the members of the Auditing and Assurance Standards Council.

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