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What Are Audit Assertions and Why They Are Important

Businesses and nonprofits regularly prepare their balance sheet, income statement, etc. at the end of an accounting period to provide a clear, correct, and complete record of their financial standing. These documents are useful not only for strategic planning and forecasting, but for auditors, who rely on the organizations they audit to be truthful.

Making sure the *audit assertions* in your company's financial statements are honest and accurate will help you navigate audits more quickly and efficiently, ensure you comply with all applicable financial reporting regulations, and give your planning team, investors, and other stakeholders a clear picture of your company's performance and financial health.

What are Audit Assertions?

Organizations of all sizes and types, from megacorporations to small businesses to nonprofits, prepare financial statements they are obliged to prepare and present as transparently and accurately as possible when audited. Public companies, for example, are required by law to have an annual audit of their financial statements.

Also known as *management assertions* or *financial statement assertions*, audit assertions are the claims made by management certifying the financial statements presented are complete and accurate. They may be *explicit* (i.e., stated directly) or *implicit* (i.e., implied rather than directly stated).

The goal for companies making such assertions is to minimize (or, ideally, avoid) the risk of *material misstatement* by failing to provide financial data that is, in fact, complete and accurate.

For certified public accountants (CPAs) and other auditors, determining the veracity of these assertions involves testing various aspects of the financial records and disclosures.

Should the auditors collect appropriate audit evidence to confirm the company's financial statements pass these tests, the company can be confident their disclosures are complete, accurate, and compliant with accounting standards such as the International Financial Reporting Standards (IFRS).

Issued by the International Accounting Standards Board (IASB), the purpose of the IFRS is to provide a consistent, comprehensive set of transparent and globally applicable accounting auditing standards.

When performing an audit of financial statements, auditors follow the IASB's ISA 315 standards to ensure they've followed the proper risk assessment procedures—and develop testing protocols for both internal controls and substantive procedures in addition to verifying the accuracy, organization, and completeness of financial information recorded for the accounting period being audited.

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The Nine Types of Audit Assertions

In examining the nine different types of audit assertions, it's useful to break them out by category, based on their functions and the evidence used to confirm their veracity and completeness.

Generally speaking, you can sort them into three master groups, with some degree of overlap between the three:

Transaction-Level Assertions are used when reviewing transaction data and journal entries. They include:

- Accuracy
- Classification
- Completeness
- Cut-Off
- Occurrence
- Understandability

Account Balance Assertions are used to examine assets and liabilities, along with equity totals. They include:

- Completeness

- Existence
- Rights and Obligations
- Valuation

Presentation and Disclosure Assertions are used to confirm data is clear, complete, and in the correct format. They include:

- Accuracy
- Classification
- Completeness
- Occurrence
- Understandability

Let’s take a closer look at each of the different assertion types and how they work.

1. Accuracy

When testing for accuracy, auditors compare specific records to the actual associated transactions.

Examples include:

- Confirming accurate calculation, reconciliation, and recording of salaries and wages.
- Confirming all recorded transactions and other information presented in financial statements meet accounting standards for completeness and accuracy.
- Reviewing internal controls.

2. Classification

In addition to the financial data under review, auditors also consider the actual financial statements to ensure they are clear, include the appropriate related disclosures, and are formatted in accordance with accounting standards and the law.

Examples include:

- Reviewing purchase invoices posted to general ledger accounts (e.g., confirming raw materials are not recorded in information technology services)
- Confirming salaries and wages have been allocated in the appropriate amounts to production expenses, administrative costs, etc.
- Verifying special exceptions applied to various classes of transactions (e.g., capitalization of research costs related to developing patents) are recorded properly.

3. Completeness

It’s critically important for *all* transactions in a given accounting period to be recorded properly. When confirming completeness, auditors verify that this is the case.

Examples include:

- Verifying all salaries and wages are fully recorded in the proper accounts and correct accounting period.
- Comparing inventory levels to sales data to confirm all inventory is properly recorded at period end.
- Examining bank statements to verify all deposits made have been properly recorded.

4. Cut-Off

As with completeness, auditors use cut-off to determine transactions are recorded within the proper accounting period. Cut-off has special significance when reviewing payroll and inventory levels.

Examples include:

- Confirming salaries and wages recorded during the current accounting period are related to the same period.
- Verifying accrued or prepaid expenses are recorded in the correct period.
- Tracing receiving documentation and shipping documentation to purchases and sales (respectively) to verify purchases and sales are recorded within the proper fiscal year.

5. Existence

This assertion confirms the liabilities, assets, and equity balances recorded in a financial statement actually (you guessed it) exist. The auditor is required to collect whatever evidence is necessary to establish a connection between the values on the document and their real world counterparts.

Examples include:

- Confirming inventory recorded on a balance sheet physically exists at period end.
- Verifying accounts receivable balances by reviewing all activity related to a given customer.
- Examining bank records to confirm recorded transactions and account balances, verify cash flow reports, etc.

6. Occurrence

Similar to existence, occurrence is used to verify that recorded transactions have actually occurred.

Examples include:

- Cross-checking accounts receivable balances with sales records to confirm a sale happened on the date listed.
- Checking payroll records to ensure the expense account for salaries and wages does not include any unauthorized amounts.
- Confirming recorded transactions are directly connected to the entities indicated by the transaction record (e.g., Company A really did pay $345.24 to Company X for 25 widgets on June 11th).

7. Rights and Obligations

Auditors use this assertion to confirm assets, liabilities, and equity recorded in a company's financial statements actually belong to that same company.

Examples include:

- Verifying bank account balances are actually owned by the business being audited.
- Confirming ownership of assets (e.g., a car) being used by the business.
- Verifying outstanding liabilities and other obligations of the entity are indeed owned by the business and not (for example) the business owner.

8. Understandability

Financial statements are of limited utility if they're not readily understood by stakeholders. Testing this assertion confirms data is presented in a way that provides crystal-clear accessibility with regard to the parties, account balances, and related disclosures involved in all transactions for a given accounting period.

Examples include:

- Confirming all information necessary to contextualize financial information is included.
- Verifying financial statements are formatted for accessibility, readability, and clarity.

9. Valuation

Auditors use the valuation assertion to confirm all financial statements are recorded with the proper value. This is important in understanding (for example) a company's debt profile or ensuring stakeholders have a properly contextualized grasp of readily available assets and cash flow.

Examples include:

- Evaluating the accounts receivable aging report to determine when, or if, outstanding balances will be paid.
- Physically examining inventory to confirm proper valuation and recording of stock on hand.

Make Your Audit Assertions with Confidence

Audits don't have to be frightening or even uncomfortable. Take the time to familiarize yourself with the different types of audit assertions and how analytical procedures used to test them helps establish the truthful disclosure of a company's financial standing. By doing so, you'll be well-prepared to face the audit procedure with financial information that's compliant, complete, and correct. Stakeholders will get the clear understanding they need, and your team will have useful and accurate data they can rely on for effective financial planning and decision making.

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