

TIS Section 8345
Evidential Matter – Destruction of Documents

.01 Audit Considerations When Client Evidence and Corroborating Evidence in Support of the Financial Statements Has Been Destroyed by Fire, Flood, or Natural Disaster

Inquiry – Either prior to the commencement of audit procedures or during an audit, a fire, flood, or natural disaster destroys some or all of an entity’s books of original entry; the general and subsidiary ledgers; related accounting manuals; records such as work sheets and spreadsheets supporting cost allocations, computations, and reconciliations; checks; records of electronic fund transfers; invoices; contracts; and minutes of meetings or other evidence and corroborating evidence in support of the financial statements. How would the destruction of evidential matter affect the auditor’s procedures, including the auditor’s report?

Reply – AU 326.16 states in part, without adequate attention to the propriety and accuracy of the underlying accounting data, an opinion on financial statements would not be warranted. The auditor must be able to perform audit procedures sufficient to afford a reasonable basis for an opinion on the financial statements under audit.

If substantially all of an entity’s evidence and corroborating evidence in support of their financial statements has been destroyed and the auditor has been unable to complete audit procedures with respect to financial statement amounts and assertions¹, the auditor should disclaim an opinion on the financial statements as the auditor is unable to form an opinion as to the fairness of presentation of the financial statements in conformity with generally accepted accounting principles or a comprehensive basis of accounting other than generally accepted accounting principles. If the auditor disclaims an opinion, the auditor’s report should give all of the substantive reasons for the disclaimer. The auditor should not identify any procedures that were performed nor include the paragraph describing the characteristics of an audit (that is, the scope paragraph of the auditor’s standard report); to do so may tend to overshadow the disclaimer.

An example of a report disclaiming an opinion resulting from the destruction due to fire, flood or a natural disaster, of substantially all client evidence or corroborating evidence in support of financial statements is as follows:

Independent Auditor’s Report

We were engaged to audit the accompanying balance sheets of X Company as of December 31, 20X2 and 20X1, and the related statements of income, retained earnings, and cash flows for the years then ended.

¹ The auditor should design and perform substantive procedures for all relevant assertions related to each material class of transactions, account balance, and disclosure.

These financial statements are the responsibility of the Company's management.²

Substantially all of the Company's books of original entry; the general and subsidiary ledgers; related accounting manuals; records such as work sheets and spreadsheets supporting cost allocations, computations, and reconciliations; as well as substantially all corroborating evidence in support of the financial statements were destroyed [in a fire, by a flood, by Hurricane Katrina, etc.] which also destroyed the Company's headquarters. The records that remain are not sufficient to permit the application of auditing procedures that would be adequate for us to express an opinion on the accompanying financial statements.

Since the Company was not able to provide evidence or corroborating evidence in support of the accompanying financial statements and we were not able to apply other auditing procedures to satisfy ourselves as to whether the financial statements are presented in accordance with generally accepted accounting principles, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the financial statements.

In the case where the evidence and corroborating evidence is available for some, but not all, of the financial statement accounts and assertions, the auditor would explain which evidence has been destroyed [i.e. evidence supporting the cost of inventory, the valuation of amounts in accounts receivable, etc].

If so engaged by an entity, the auditor may express an opinion on one or more specified elements, accounts, or items of a financial statement [i.e. a schedule of accounts receivable or fixed assets]. If the auditor is so engaged, the guidance in AU 623.11 - .14 should be followed. The auditor should not express an opinion on specified elements, accounts, or items included in a financial statement on which he or she has disclaimed an opinion, if such reporting would be tantamount to expressing a piecemeal opinion on the financial statements. However, an auditor would be able to express an opinion on one or more specified elements, accounts, or items of a financial statement provided that matters to be reported on and the related scope of the audit were not intended to and did not encompass so many elements, accounts, or items as to constitute a major portion of the financial statements. For example, it may be appropriate for an auditor to express an opinion on an entity's schedule of accounts receivable or fixed assets even if the auditor has disclaimed an opinion on the financial statements taken as a whole. However, the

² The wording in the first paragraph of the auditor's standard report is changed in a disclaimer of opinion because of a scope limitation. The first sentence now states that "we were engaged to audit" rather than "we have audited" since, because of the scope limitation, the auditor was not able to perform an audit in accordance with generally accepted auditing standards. In addition, the last sentence of the first paragraph is also deleted, because of the scope limitation, to eliminate the reference to the auditor's responsibility to express an opinion.

report on the specified element, account, or item should be presented separately from the financial statements of the entity.

.02 Considerations When Audit Documentation Has Been Destroyed by Fire, Flood, or Natural Disaster

Inquiry – Prior to issuance of an auditor’s report on financial statements, and either prior to or after the completion of fieldwork, the audit documentation is destroyed by a fire, flood, or natural disaster. To what extent must the auditor recreate the audit documentation in order to express an opinion on the financial statements?

Reply – Audit documentation is the principal record of auditing procedures applied, evidence obtained, and conclusions reached by the auditor in the engagement. In addition, certain Statements on Auditing Standards contain specific documentation requirements. AU 339.03 states that audit documentation serves mainly to (a) provide the principal support for the auditor’s report, including the representation regarding observance of the standards of field work, which is implicit in the reference in the report to generally accepted auditing standards³ and (b) aid the auditor in the conduct and supervision of the audit.

Oral explanations cannot serve as the principal support for the work performed or the conclusions reached.

Since audit documentation is an essential element of an audit performed in accordance with generally accepted auditing standards, the auditor cannot state that he or she has performed an audit in accordance with generally accepted auditing standards without the required audit documentation. In cases where the audit documentation has been destroyed by fire, flood, or a natural disaster prior to the issuance of the auditor’s report, the auditor must either recreate the audit documentation in support of the audit procedures performed or re-perform the audit procedures and create new audit documentation.

In making the determination as to whether to recreate the destroyed audit documentation or to re-perform the audit procedures, the auditor should keep in mind the ultimate objective of the auditing procedures. That is, to obtain sufficient competent evidential matter to afford a reasonable basis for expressing an opinion on the financial statements. For example, the auditor may be able to recreate the documentation that supports certain assertions about accounts receivable by using information contained in the audit documentation with respect to sales revenue (assuming that the sales documentation was not destroyed). In addition, the auditor may be able to recreate the audit program and prepare memorandums sufficient to explain the procedures performed and the results obtained. When considering the sufficiency of such documentation, the auditor should consider the guidance in AU 339.06 which states that audit documentation should be sufficient to (a) enable members of the engagement team with supervision and review

³ However, there is no intention to imply that the auditor would be precluded from supporting his or her report by other means in addition to audit documentation.

responsibilities to understand the nature, timing, extent, and results of audit procedures performed, and the evidence obtained; (b) indicate the engagement team member(s) who performed and reviewed the work; and (c) show that the accounting records agree or reconcile with the financial statements or other information being reported on. Except for perhaps the smallest of audits, it will prove difficult for the auditor to amass sufficient audit documentation by referring to documentation for a related account or by recreating the audit documentation. Consequently, the auditor will usually have to re-perform the audit procedures and create new audit documentation