COLLEGE OF ACCOUNTING

AUDITING/CORPORATE GOVERNANCE | BASIC/INTERMEDIATE

Video Transcription: What are Assertions?

Hello there, my name is Sumaya and this video will help you to understand what is meant by assertions in auditing.

Let's say that you read a biography of Ghandi. Remember, a biography is a history of a person's life written by another person. The readers assume that the account of Ghandi's life history is a fair view of what actually happened in his life and that it is based on actual events occurring during the period covered by the book. So, how can this idea be applied to business?

When an investor (or the reader) of a company reads the financial statements (the Ghandi book), he relies on the directors of the company (the author) providing a fair view of the actual events of the company over the period covered by the financial statements, that is, the financial period.

Remember that the author is communicating the life of Ghandi to a variety of readers through the biography and makes certain claims about Ghandi through the book. We would like to know if the events in the book actually occurred and are an accurate reflection of the events.

So, the directors are communicating the past performance of the company to a variety of users through the numbers and disclosures in the financial statements. The directors make certain claims about aspects of the business through the financial statements. These claims are generally known as management or financial statement assertions.

Remember that the directors are providing information about the historical performance of the company over the past year. Let's have a closer look at the different assertions or management claims that underpin the financial statements. Let's turn to one of the chapters in the financial statements, the income statement. Let us focus on the sales line item in the income statement.

What does the sales line tell the investors? What are the assertions or the management claims that underpin the sales line? The directors are asserting five main things about the R1 million sales-line item.

Firstly, they are claiming that R1 million of sales are genuine sales of the company's goods or services. In other words, they are saying that the sales have actually occurred. Secondly, the directors are saying that the individual sales transactions making up the R1 million have been accurately recorded. Thirdly, the directors are saying that all the sales, which were made, have been recorded in the total sales line. In other words, they are saying that the sales figure is complete. Fourthly, that only sales that have occurred in the accounting period covered by the financial statements are included in the sales line. For example, if the year-end is 31 December 2015, then only sales for the 2015 period are included, and no sales for the 2014 or 2016 period are included. This is referred to as the cut-off assertion. Finally, that the R1 million sales have been classified in the accounting records according to their nature or description. For example, a sale should be recorded as a sale and not advertising income. This means that the directors are claiming that all the sales transactions have been classified correctly.

So, for all transactions and events reported in the income statement, the directors are making the following assertions: occurrence, completeness, accuracy, cut off, classification, and that all are presented and disclosed correctly.

Let's have a look at the next chapter in the financial statements, the balance sheet. Remember, while the income statement is conveying what has happened over a period of time, the balance sheet shows a snapshot of the company at a point in time, at year-end.

So, what are the directors telling us about the buildings at a particular point in time? What assertions are they making with respect to the PPE line item in the balance sheet? Let's focus specifically on buildings. Well, the directors are claiming that all the buildings owned by the company are included in the balance of R20 million stated in the financial statements. That is that the buildings line item is complete. Secondly, the directors are saying that the buildings included in the R20 million are real and that they exist. For example, they have not included buildings that have been destroyed. Thirdly, for all the buildings included in the R20 million, the directors are saying that they own the rights to the building. That is, that they can recognise it as an asset. And finally, the R20 million represents the appropriate value of the building. For example, if the business uses the revaluation model, the R20 million is the fair value and any necessary impairment or depreciation has been correctly accounted for.

So, for all balances reported in the balance sheet – the assets, liabilities and equity, the directors are making the following assertions: completeness, existence, rights, valuation and allocation and that all are presented and disclosed correctly.

Remember that assertions are claims made by management. We can see that financial statement assertions fall into the two categories:

1. Assertions about transactions for the year.
   Those are the line items in the income statement.

2. Assertions about account balances at the reporting date.
   Those are the line items in the balance sheet.

This video should have given you a better understanding of the management assertions that underpin the financial statements.

Thank you for watching this video. Good day.