

Assurance Services and Audit

Chapter 1 – Demand for Audit and Assurance Services

Assurance Services

- **Assurance services:** independent professional services that improve decision makers
- Improve the reliability and relevance of provided info - Assurance provider is independent/unbiased
- Demand grows as the demand for forward looking info increases and more real time info becomes available online - Audit based on historical data (financial statements)
- Users: investors, managers, regulators

Attestation Services

- **Attestation services:** public accounting firm issues a written communication that expresses a conclusion about the reliability of a written assertion/statement of another party
- **Audit of historical financial statements:** auditor issues a written report expressing an opinion about whether the financial statements are in material conformity with accounting standards
 - High levels of assurance (reasonable)
 - Client makes assertions about their financial condition and results of operations
 - External users make business decisions on financial statements and use the auditor's report as an indication of reliability (users value auditor's opinions)
- **Review of Historical FS:** written report issued by a public accounting firm that provides less assurance than an audit as to whether financial statements are in material conformity with AASB
 - Moderate levels of assurance (limited)
 - Provides assurance without incurring the cost of an audit
 - Requires less evidence

Other Assurance Services

- Not required to issue a written report
- About the reliability and relevance of info which may/may not have been asserted by another party
- Information technology:
 - Internet and e-commerce as increased demand for assurance
 - Concerns over privacy and security of info
 - Principles: online privacy, security, processing integrity, availability, confidentiality, certification authorities

Economic Demand for Auditing

- Need for reliance on financial statements by external users = well defined set of standards for audits
- Issuing opinions is restricted to registered auditors
- Banks make decisions on a company's financial statements to determine an interest rate

Causes of Information Risk

- **Remoteness of information:** impossible to have access to first hand knowledge about organisation (b/w managers + users) = rely on info by others = increases misstated info un/intentionally
- **Biases and motives of the provider:** info provided by someone whose goals are inconsistent with those of the decision maker (management bias - maximises their own wealth – agency theory)
- **Voluminous data:** organisation becomes larger (complex business structures) = larger volume of exchange transactions = increases likelihood of improperly recorded info
- **Complex exchange transactions:** exchange transactions between organisations have become more complex = difficult to record properly

Reducing Information Risk

- **User verifies info:**
 - User goes to premise to examine records and obtain info about reliability of statements
 - Impractical because of costs and inefficient for all users to verify info individually
 - ATO can perform audits
- User shares info risk with management = avoid losses

Nature of Auditing

- **Auditing:** accumulation and evaluation of evidence about info to determine and report on the degree of correspondence between the info (FS) and established criteria (AASB)
- **Information and established criteria:**
 - Info must be in verifiable form and standards the audit can evaluate against
 - Objective (financial statements, tax returns) and subjective (IT, operations) forms
- **Accumulating and evaluating evidence:**
 - Evidence: determine whether info being audited is stated in accordance with criteria
- **Competent (skills), independent (objective) person:**
 - Auditor must be qualified to understand the applicable criteria and competent to know the types/amounts of evidence required to reach a conclusion
 - Independent auditors: public accountants/firms that perform audits of commercial and non commercial financial entities (attests to the results of accounting, other operations and data)
- **Reporting:**
 - Audit report: communication of audit findings to users
 - Inform about the correspondence between info and established criteria

Distinction between Auditing and Accounting

- **Accounting:** recording, classifying and summarising of economic events in a logical manner for the purpose of providing financial info for decision making
 - Quantitative info, Know AASB
- **Auditing:** determine whether recorded info properly reflects the economic events
 - Accumulate and interpret evidence
 - Determine proper audit procedures, Decide the number and types of items to test
 - Evaluate results

Types of Audits

- **Financial statement audits:** audit conducted to determine whether the overall financial statements of an entity are stated in accordance with specified criteria (AASB)
- **Performance/operational audits:** review of any part of the organisation's procedures and methods for the purpose of evaluating efficiency and effectiveness
 - Make recommendations for improvement – organisational goals
 - Subjective, different forms, not limited to accounting, no established criteria
- **Compliance audits:** determine whether the client is following specific procedures, rules or regulations set by a higher authority (e.g. tax) - Reported to management rather than external users

Types of Auditors

- **Public accounting firms:** entity that has obtained registration as a company auditor in accordance with the provision of the Corporations Act 2001
- **Officers serving the Auditor General:** auditor serving a Federal or State Auditor General reports to and is responsible solely to parliament
- **Tax auditors:** auditors who work for the ATO and conduct examinations of tax returns (compliance)
- **Internal auditors:** auditors employed by a company to audit the company's board of directors and management (Performance and compliance audits, lack independence, but independent from function)

Example 1

Firm: Coca Cola

Firm Type: Manufacturing

Account Name: Inventory

Assertion from ASA 500	Occurrence Existence	Accuracy Valuation	Completeness	Cut off Rights and Obligations	Classification Allocation	Presentation and Disclosure
Audit Procedure						
Inspection of Physical Assets or Documents	Stocktake: sample of inventory items from the inventory records and check back there is stock in the warehouse	Stocktake: sample of inventory items from the inventory records and check back there is stock in the warehouse Inspect obsolete or old stock	Part of tracing to inspect documents	Who owns raw materials?	Inspect chart of accounts during tracing and vouching	Review financial statement disclosures – inventory is disclosed properly
Observation	Observe client staff doing the stocktake	Observe obsolete or old stock	Can you observe inventory that you don't recognise from tracing	x	x	x
Recalculation	x	Re-perform product costing calculations – ABC, plant wide	x	x	x	x
Analytical Procedure	Compare raw material usage – standard vs actual production	Compare raw material usage – standard vs actual production	Compare raw material usage – standard vs actual production	x	x	x
Enquiries of Personnel	Talk to personnel for any discrepancy	Talk to personnel about product costing methods		Talk to personnel or production manager	Talk to personnel about chart of accounts	Talk to personnel about accounting policy choices – FIFO, LIFO, weighted average
Confirmation	x	x		Send a	x	x

				positive confirmation to suppliers		
Tracing	x	Raw materials → value of inventory	Select a sample of inventory and trace to the accounting records		Check journal entry uses correct current account codes	AASB → financial report
Vouching	Start with inventory records and match it back to actual inventory	Value of inventory → raw materials	x		Check journal entry uses correct current account codes	Financial report → AASB

Example 2

Firm: Qantas

Firm Type: Service

Account Name: PPE – Aircraft

- Existence: Vouch a sample of aircraft and physical inspect, Match identifiers
- Valuation: Select a sample of aircraft and check the valuation by recalculation, Check depreciation by examining depreciation methods, salvage value and useful life, New aircrafts: check all appropriate costs including in value
- Completeness: Analytical analysis of costs to determine if they represent the correct number of planes, Reconcile plane costs to individual aircrafts
- R&O: For a sample of plans, obtain proof of ownership (sale contract, registration), For lease aircrafts, inspect contract to determine the lease type, For finance leases, assets + liabilities reported, For operating leases, expenses reported

Example 3

Firm: Athletes Foot

Firm Type: Retailer

Account Name: Sales

- Occurrence: Vouch sales journal entries to sales receipts/credit card/EFT slip, No packing slips and there is no deliveries, Compare inventory movement to sales records
- Accuracy: Recalculate a sample of sales, reconciling prices from the receipt to master price list
- Completeness: Trace a sample of sales from cash register records to journal entries
- Classification: Select a sample of journal entries, check account used are correct based on the Athletes Foot's chart of accounts
- Cut-off: Block select sales two days prior and after EOFY, Ensure goods taken by customers by year end (laybys)