

1. Introduction to the audit function

1.1 Financial reporting

- Financial statements are prepared by management
- Most shareholders (especially owners) have no way of checking that they present a true & fair view of the company
- This gives rise to **agency costs**

1.1.1 Assurance

- Agency costs can be reduced by having an independent 3rd party provide assurance as to whether the financial statements are true & fair
- **3rd party** conducts procedures to determine the truth & fairness of the financial statements
- 3rd party issues an opinion on their truth & fairness

5 Key elements of assurance engagements

- 3 party relationship involving a practitioner (ASIC registered auditor), responsible party (management director declaration) & intended users
- Appropriate subject matter (all 5 reports)
- Suitable criteria (Accounting standard, Corp. Act 2001)
- Sufficient appropriate evidence
- Written assurance report in a form appropriate to a reasonable or limited assurance engagement

Absolute assurance

- Can **never be provided** because of:
 - Nature of accounting (valuation issues; accounting policy choice & judgments; contingent items)
 - Time & cost of evidence collection & evaluation

Reasonable assurance

- High but not absolute level of assurance
- Conclusion is expressed in a **positive form**

- The financial statements are true & fair view
- Provided by an audit engagement
- Opinion is expressed in an audit report

Limited assurance

- Lower level of assurance than reasonable assurance
 - **Actual level of assurance depends on nature of the procedures carried out**
- Conclusion is expressed in a negative form
 - Nothing has come to our attention to suggest that the financial statements are not true & fair view
 - say **nothing is counter-attention** = doesn't say it's good/bad
 - where the reviewer provides a conclusion to the users of the financial statements as to whether they do not present a true and fair view, and are in accordance with accounting standards
- Provided by a review engagement

1.1.2 Auditing

Financial statement audits

- Carried out by an independent auditor or audit firm
- Auditor is appointed by shareholders at the AGM (in theory) but by the board of directors (in practice)
- Audit opinion expressed via an auditor's report included in the annual report
- Auditor's sole responsibility is to express an opinion
- Auditor has no right to change any aspect of the financial statements
- Auditor determines if the financial statements:
 - Comply with accounting standards
 - Present a true & fair view
 - Are free of material errors in dollar amounts & disclosures
- **Material errors** arise from:
 - Legitimate errors

- Deliberate misstatement (fraud)
- Errors in accounting judgments
- If errors are found:
 - Auditor asks management to make changes
 - If they won't, the audit changes the audit report (here is what it is => possible impact includes.....)
- Types of audit opinions:
 - Unqualified: if there is nothing wrong
 - Qualified: if the statements contain material errors

Company audits

- Audits of general purpose financial statements

1.2 Legal requirement for an audit

- Company, registered scheme or disclosing entity must have their financial report audited in accordance with Division 3 & obtain an auditor's report
 - Corp. Act 2001 **s301(1)**
 - **s307A** - Accounting Standard

Auditing standards

Australian Auditing Standards(ASA)

- Detailed rules about how to conduct an audit
- ASAs are legally enforceable set by the AUASB(s307A)
- Compliance monitored by ASIC

ASA 101.9

Mandatory component

- (i) Application
- (ii) Operative Date
- (iii) Objectives
- (iv) Definition
- (v) Requirement

ASA 101.10

Explanatory content must be included in the headings ii