Auditing and Assurance Services Notes

Unit 200535

Prescribed text: Gay, G & Simnett, R 2012, Auditing and assurance services in Australia, 5th edn, McGraw-Hill.

2014

Auditing and Assurance Services

Week 2

1. ASSURANCE

What is assurance and what are the different types and levels of assurance?

Five elements:

Three-parties relationships, subject matter, suitable criteria, sufficient appropriate evidence, written assurance report

Types	**Levels**	**Expression of opinion**
Financial report audits (which is the focus of this unit!)	Absolute (100%) (Not possible with a financial statement audit)	
Audit engagements	Reasonable	Positive expression of opinion
Review engagements	Limited	Negative expression of opinion
Agree-upon procedures engagements	No assurance	A report of factual findings (no assurance or opinion)

2. ROLES OF PREPARERS & AUDITORS

What are the different responsibilities of report preparers and auditors?

Preparers – financial reports to be:	**Auditors – to exercise**:
Relevant	Professional scepticism
Reliable	Professional judgement
Comparable (take the same approach as last year)	
True and fair	

- Professional scepticism: is an attitude that includes a questioning mind, being alert to conditions that may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence (ASA 200.15)
- Professional judgment: involves the application of relevant training, knowledge and experience in making informed decisions about the courses of action that are appropriate in the circumstances of the assurance engagement (ASA 200.16)

3. AUDIT DEMAND

Why is there a demand for assurance services?

Demand due to:	**Theoretically explained by**:
Competing incentives	Agency theory
Need for reliability (main reason)	Information hypothesis
Report Complexity (makes it easier to interpret)	Insurance hypothesis
Remoteness of users	

- Agency theory: is where investors are the principals in a relationship, who entrust the managers with their resources, who act as their agents or stewards of the resources. This gives rise to a demand for assurance to ensure that the agents have acted in the interests of the principals. Also known as the stewardship hypothesis.

- Information hypothesis: posits that the demand for auditing is a result of investors wanting reliable information that can be used effectively in decision-making, unlike agency theory the emphasis is not so much on the agent as on the reliability of information.

- Insurance hypothesis: a view that posits that managers and professional participants are in financial activities seek to use and auditor as a means of insurance- that is, as a means of shifting financial responsibility if any losses are expected from litigation.

4. AUDIT EXPECTATION GAP

What is the audit expectation gap and how can it be reduced?

The expectation gap is what auditors will deliver and what audit can deliver.

There is a common expectation that an audit report provides full assurance, however auditors are limited in what they do, as they only use samples to audit, thus auditors have to exercise professional judgment.

Three components: reasonableness gap, deficient performance gap, and deficient standards gap

Users might think an audit guarantees that:	**Audits are limited by**:
Everything has been checked No fraud exists	Time and cost restricts the amount of work that can be performed
Entity won't fail	Sampling is used, so not 100% verification
It is a good investment	Judgement is required

- ***Reasonableness gap***: the gap between what society expects auditors to achieve and what they can reasonably be expected to accomplish.
- ***Deficient performance gap***: the gap between the expected standard of performance of auditor's existing duties and auditor's perceived performance as expected and perceived by society.

- ***Deficient standards gap***: the gap between the duties that can be reasonably be expected of auditors and auditor's existing duties as defined by law and professional promulgations.

Expectation Gap reduced by:

Auditors – performing at expected level, peer reviews, improved standards, clearer reporting

The Public – improved education

5. QUALITY CONTROL

What are commonly used quality control procedures by audit firms?

Quality control procedures are essential to ensure that auditors meet their responsibilities to the clients, other users and regulators.

Ethics: personnel at all levels in the firm should adhere to the principles of integrity, objectivity, independence, confidentiality and professional behaviour.

Employment: the firm should employ personnel with the necessary technical skills and professional competence to enable them to meet their responsibilities.

Assignment of personnel: audit work should be assigned to personnel who have the required technical training and proficiency.

Supervision: direction, supervision and review ensure that delegation policies are adhered to, that assistants understand audit directions, that the work is being carried out in accordance with the specified program and that any questions raised have been appropriately dealt with.

Guidance and assistance: consultation should occur within or outside the audit firm with those people who have the appropriate expertise.

Client evaluation: prospective and ongoing clients should be evaluated when a making a decision to accept or retain a client. Independence and ability to serve the client should be considered.

Monitoring: the adequacy and effectiveness of quality control procedures need to be continually monitored.

Internal review: in-house procedures designed to ensure that office policies adhered to with regard to control over the quality of work and auditor independence.

Auditor rotation: periodic rotation of auditors on engagements with other auditors from the firm brings fresh views to the audits, aid professional scepticism and promote independence.

Peer reviews: independent periodic review of the quality of an auditor's audit procedures by other firms of public accountants.

Continuing professional development: members of professional accounting firms are required to undertake a certain amount of professional development. This requirement to maintain and update their knowledge will expand as the environment within which they operate continues to change.

6.KEY REGULATION OF THE AUDIT FUNCTION

What audit regulation exists?

FRC-oversees accounting standard setting and auditing standard setting

AUASB – sets auditing standards

APESB – sets ethical and professional standards

ASIC – enforces corporations law

Week 3

<u>KEY QUESTIONS OF THE WEEK</u>:

<u>1. PROFESSIONAL ETHICS</u>

<u>What are the fundamental principles of professional ethics?</u>

APES110, sec 100.5 for accountants generally:

Integrity: auditor should act with consistency. It imposes an obligation on the auditor to be straightforward and honest in all professional and business relationships and requires fair dealing and truthfulness.

Objectivity: auditor must be fair and without bias, conflict of interest or the undue influence of others to override their objectivity.

Competence & due care: auditor has duty to attain and maintain their level of professional competence and should undertake work they can expect to complete with professional competence. Must also maintain a level of professional competence through continuing professional development.

Confidentiality: auditor should respect the confidentiality of information obtained during the course of their work and should not disclose such information to a third party without authority.

Professional behaviour: auditor should comply with the relevant legislation and conduct themselves in a manner consistent with the good reputation of their profession and refrain from any conduct that could bring discredit to it.

Virtues of an auditor: the distinguishing mark of the audit profession is its acceptance of the responsibility to act in the public interest.

<u>2. AUDITOR INDEPENDENCE</u>

<u>Why is auditor independence critical to the audit function, and how is it achieved?</u>

Independence is one of the fundamental ethical virtues or principles required for an assurance engagement by APES 110.

The main reason for auditor independence is the need for credibility.

Auditor independence is strengthened through amendments to the Corporations Act 2001 and the APES 110

<u>Legislative requirements: Corporations Act 2001</u>

- ***Independence declaration***: s307C
- ***Conflict of interest***: s324CA must ensure that no conflict of interest exists and that if so must ensure that conflict of interest ceases to exist. S324CD situations where conflict of interest exists.
- ***Former auditors***: s324CI member of audit firm cannot become director, company secretary or senior manager of audit client until after 2 years ceasing to be with the audit firm (two year cooling off period)
- ***Rotation of audit partners***: s324DA if an audit partner plays a significant role in an audit for 5 successive years they cannot do so for at least another 2 years. Where involvement is not in consecutive years audit partner cannot play a significant role for more than 5 out of 7 successive years.
- ***Non-audit services***: s300(11B) the boards of all listed companies must provide a statement identifying all non-audit services provided by the audit firm, fee for each service and how provision of service did not impair independence.

Ethical requirements: APES 110 (s290)

The ethical principle is the reasonable person test outlined in APES 110

- ***Perceived independence***: "independence in appearance", and is the belief of financial report users that actual independence been achieved.
- ***Actual independence***: "independence of mind" and is the achievement of actual freedom from bias, personal interest, prior commitment to an interest or susceptibility of undue influence or pressure. Three factors that contribute to an independent mind are:

1) integrity
2) objectivity
3) strength of character

Threats to independence – APES 110 (s200)

- ***Self-interest threats***; the possibility that the firm or individuals within it could benefit from a financial interest in or conflict with an assurance client.
- ***Self-review threats***; the possibility that the firm or individuals within it would have to revaluate their own work to form a judgment.
- ***Advocacy threats***; situations where the firm or individuals within it could promote the audit clients point of view in a manner that compromises objectivity.
- ***Familiarity threats***; the possibility that the firm or individuals within it have become too sympathetic to the client's interests.
- ***Intimidation threats***; the possibility that the firm or individuals within it may be deterred from acting objectively by threats from the client concerning dismissal, litigation or fees.

Implement safeguards to limit threats – APES 110 (s200)

- ***Safeguards created by the profession, legislation or regulation****;* such as education, professional standards, monitoring and disciplinary processes and inspections and review.