Auditing and Assurance:
The Profession and Regulation

The Framework for Assurance Engagements and the types of Assurance Engagements

- In order for users to be able to judge the performance of the responsible party, they may ask the responsible party to provide them with a report of how the resources under their care have been used.
  - However, it is recognised that the report by the responsible party is potentially bias, as they may have incentive to prepare a report that reflects their performance well.
  - Before the report is made available to the user, the credibility of it is enhanced by having someone who is independent and expert examine the *underlying subject matter* to ensure that it is prepared in accordance with *suitable criteria*, and provide an assurance report.
- The *Framework for Assurance Engagements* by the AUASB covers both audits and reviews of historical financial information and all other assurance engagements.
- An **assurance engagement** is 'an engagement in which a practitioner aims to obtain sufficient appropriate evidence in order to express an conclusion designed to enhance the degree of confidence of the intended users other than the responsible part about the outcome of the measurement or evaluation of an underlying subject matter against criteria'.
  - They provide *assurance* that in their *opinion*, the financial statements are true and fair, relevant, and are faithful representations, and are prepared in according with the AASBs.
- The five elements of an assurance engagement are identified (in para 6 of the framework):
  - Three-party relationship:
    - Assurance practitioner (auditor): undertaking the assurance engagement
    - Responsible party: person responsible for underlying subject matter.
    - Intended users: the addresses of the report.
  - Underlying subject matter: what is being audited – e.g. financial reports.
  - Criteria: standards or benchmarks used to evaluate the underlying subject matter.
  - Sufficient appropriate evidence: considers materiality and relevance.
  - A written assurance report: a written conclusion providing assurance about the underlying subject matter.
- Assurance providers must:
  - Be independent: users derive value from the knowledge that the assurance provider has no interest in the information other than to enhance its credibility.
  - Have expertise: about reporting mechanism and about assurance.
  - Exercise **professional judgement**: the application of relevant training, knowledge and experience in making informed decisions.
  - Apply **professional scepticism**: 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.
- Types of assurance engagements:

- A **reasonable assurance engagement** (an audit) provides a *reasonable* level of assurance by providing of a *positive* expression of opinion to enhance the credibility of an assertion about an accountability matter.
    - E.g. ‘in our opinion the financial reports are a true and fair representation … and free from material error’
  - A **limited assurance engagement** provides a *limited* level of assurance through the expression of a negative expression of opinion.
    - The level of assurance is lower than an audit.
    - E.g. ‘we have not found anything to suggest that there is a material error’.
  - An **agreed-upon procedures engagement** is where the auditor reports their findings but does not provide assurance.
- An **attestation engagement** is where the responsible party prepares a report and the auditor audits the report. They evaluate the underlying subject matter in accordance with suitable criteria to provide a *reasonable level of assurance*. A **direct engagement** is where the auditor themselves prepare the report.

Auditing – Definition and Fundamental Principles

- *Assurance* covers the range of underlying subject matter information, both financial and non-financial, while the term *audit* is used to refer to a subset of assurance engagements, where the subject matter is financial information prepared in accordance with an applicable financial reporting framework.
- **Auditing** is a systematic process of objectively obtaining and evaluating evidence regarding assertions about economic actions and events to ascertain the degree of correspondence between those assertions and established criteria and communicating the results to interested users.
  - The purpose is to enhance the *degree of confidence* in intended users that the financial statements are ‘true and fair’ and produced in accordance with the applicable accounting standards.
  - It is a systematic and objective process in which evidence is obtained and evaluated in order to support assertions or representations with the intention to communicate the results of the process.
- The **fundamental principles** are a basic framework of auditing principles underlying the audit process that guides the development of auditing as a discipline. They encompass the high ideals of professional conduct and the essential qualities underpinning every audit. They should:
  - Underpin the objectives of an audit and help drive the conduct of the auditor.
  - Be easily understand by both auditors and other readers.
  - Be universally applicable to all audits.
  - Entrench the expectations that auditors are expected to accept and abide by.
- The auditor is required to comply with relevant ethical requirements relating to audits:
  - *Integrity*: straightforward and honest.
  - *Objectivity*: not allow prejudices, bias, conflicts of interest or undue influence.
  - *Professional competence and due care*: duty to maintain knowledge and skill.
  - *Confidentiality*: respect confidentiality and not disclose to third parties.
  - *Professional behaviour*: comply with relevant laws and regulations.
- Fundamental principles underlying the objective of an audit: knowledge, responsibility, quality control, rigour and scepticism, professional judgement, evidence, documentation, communication, association, and reporting.

Attributes of Accounting Information and the Demand for Assurance

- The functions served by financial reporting comprise economic decision making, control and accountability. The potential users include current and potential investors, creditors, employees and their representatives, customers, the government and the public.
- The *fundamental characteristics* of financial information include:
  - *Relevance*: the information must be capable of making a difference in the decision making of report users.
  - *Faithful representation*: the extent to which the information presented represents without bias or undue error. It should be complete, neutral, and free from error.
- The *enhancing characteristics* of financial information are:
  - *Comparability* – can be compared with other entities and with the same entity over time.
  - *Verifiability* – different knowledgeable and independent observers could reach consensus that it is a faithful representation.
  - *Understandability* – classifying, characterising and presenting information clearly and concisely.
  - *Timeliness* – having information available in a timely fashion (and information is current).
- Demand for assurance:
  - Users of assurance service require some assurance as to the quality of information in terms of those attributes. The role of auditing is especially important for the fundamental characteristics.
  - The need for the independent financial report audit arises because of:
    - 1) Agency theory:
      - Investors (as principals) entrust resources to managers (agents). However, a potential conflict of interest arises as managers may have an incentive to present biased information o convey information about their performance. An audit attempts to reduce this bias.
    - 2) Information hypothesis:
      - Investors require information to make an assessment of expected returns and risks associated with their investment.
    - 3) Insurance hypothesis:
      - Preparers of financial reports want to be “indemnified” against wrong doing.
- Benefits of assurance:
  - Increased relevant and reliability of the assured information means that providers of capital (shareholders and debt holders) will be able to invest in an entity with greater confidence as a result of reduced information risk.
  - Financial analysts can make more accurate and informed recommendations.
  - The assurance provider may provide recommendations by the assurance provider to improve the efficiency and effectiveness of operations.
  - The audit may provide a positive influence on the behaviour of people whose activities are being assured.