ACC3600: Auditing and Assurance

Contents

Topic 1: Introduction and overview of audit assurance

- An **assurance engagement** (or service) is defined as 'an engagement in which an assurance practitioner aims to obtain sufficient appropriate evidence in order to express a conclusion designed to enhance the degree of confidence of the **intended users** other than the **responsible party** about the outcome of the measurement or evaluation of an underlying subject matter against criteria.'

  Auditor responsibility

  Auditor also has responsibilities relating to the audit. Auditor needs to be objective.
  - Professional scepticism: maintaining independent of the entity and having a questioning mind to thoroughly investigate all evidence presented.
  - Professional judgement: use of judgement based on level of expertise, knowledge and training obtained by the auditor. Training etc.
  - Due care: being diligent, applying standards and documenting each stage of the audit process.

  Theoretical frameworks to explain audit Demand:

  The demand for audit can be explained by the following three theories:
  - **Agency theory:** Due to the remoteness of the owners from the entity, the owners have an incentive to hire an auditor to assess information provided by management.
  - **Information hypothesis:** Due to the need for reliable information, users will demand that information be audited to aid in decision making.
  - **Insurance hypothesis:** Investors demand audited financial statements to insure against potential losses. Investors can sue auditor if the auditor should have known something was wrong.
- **Limitations of an audit:**
  - There is no guarantee that the financial report is free from error or fraud. Cannot go through all transactions, only sample some to base opinion on.
  - The nature of audit procedures and processes are required to be performed within a reasonable period and at a reasonable cost (ASA 200, ISA 200).
  - Judgement is required in the process of preparation of the financial statements.

Audit expectation gap

- **Is the difference between the expectations of assurance providers and financial reports or other users.**
- Can be caused by unrealistic expectations including:
    - The auditor providing a complete assurance.
    - The auditor guaranteeing future viability of entity.
    - An unqualified opinion denotes complete accuracy.
    - The auditor will find all frauds.
- **The expectation gap can be reduced by:**
    - Auditors performing their duties appropriately
    - Undertaking peer reviews of work performed
    - Reviewing and updating auditing standards.
    - Educating the public.
    - Enhanced reporting explaining audit processes and levels of opinion auditors provide to the entity.
    - Greater attention to the risk of material fraud occurring
- **Auditors may provide varying levels of assurance when conducting assurance engagements.**

  Reasonable e.g. Financial Statement Audit – Positive
    - The auditor has conducted sufficient tests and obtained appropriate and sufficient evidence to conclude positively that the information assured is (or isn't) reliable).

  Limited e.g. Review of a company's half-year financial report – Negative
    - Auditor has done adequate work to report whether or not anything came to their attention to believe that the information that is assured is not true and fair.

  No assurance e,g, Agreed-upon procedures engagement – No Assurance Given
    - The auditor does not report an opinion – merely report on the findings and the facts of their findings. The client determines the nature, timing and extent of evidence gathered and then draws their own conclusions about these findings.

Topic 2: Ethics, legal liability and client acceptance

Fundamental principles of professional ethics

1 Integrity - Do not provide materially false or misleading statement:

2 Objectivity - Not allow personal feelings or prejudices to influence professional judgement.

3 Professional competence and due care

  - Act diligently, complete each task thoroughly, document all work, finish on a timely basis.

4. Confidentiality

   Refrain from disclosing information to people outside that is learned as a result of employment.

   Exception if legal requirement to disclose.

   Not allowed to use confidential information to their advantage or advantage of another person.

5. Professional behaviour.

   Comply with rules and regulations and do not harm reputation of the profession.

   Do not undermine reputation of, or quality of work produced by, others.

6. Independence is the **ability** to act with integrity, objectivity and with professional scepticism (questioning mind).

Improve professional scepticism through education and training to identify what is wrong.

Lack of auditor independence impacts on credibility and reliability of the financial report.

The auditor must be, and be seen to be, independent.

Independence of mind:

ability to act independently- Actual independence

ability to make a decision free from bias, personal belief and client pressures.

Independence in appearance:

belief that independence of mind has been achieved.

Perceived independence

Threats to independence:

Self-interest threat - desire to give unqualified opinion

- Can occur if the audit firm or its staff have financial interest in audit client.
- Solution: sell off shares, don't take client

Self-review threat - Can occur when the assurance team need to form an opinion on their own work or work done by others in their firm.

- Solution: Use a different team.

Advocacy threat - Can occur when an audit firm or assurance staff act, or is believed to act, on behalf of assurance client.

- Can lead to questioning of auditor's objectivity.
- Solution: Don't audit the client, or give up advocacy if that brings less money/value.

Familiarity threat - Can occur when close relationship exists or develops between assurance firm and client, or firm and client personnel.

- Assurance staff can become too sensitive to needs of client and lose objectivity.
- Solution: Change the employee.

Intimidation threat - Can occur when member of assurance team feels threatened by the client's staff or directors.

- Assurance team member unable to act objectively, fearing negative consequences.
- Solution: match staff member communicating with client member

Safeguards to independence:

- **Created by profession, legislation or regulation:**
  - quality control standards
  - code of ethics
  - legislative requirement to be independent.
- **Created by clients:**
  - corporate governance- audit committee - power to appoint independent auditors
  - policies and procedures.
- **Created by accounting firms:**
  - quality control procedures
  - client acceptance and continuance.

Client acceptance and continuance decisions

The first stage in any audit is client acceptance or continuance decision.

- Step 1: assess client integrity.
- Step 2: assess audit firm's ability to meet ethical requirements, service client.
- Step 3: prepare client engagement letter.

Client integrity - auditor should consider:

- Reputation of client, management, directors, key stakeholders.
- Client's reason for switching auditor.
- Client's attitude to risk exposure and management.
- Client's attitude to using internal controls to mitigate risk.
- Appropriateness of the client's interpretation of accounting rules.
- Client's willingness to allow auditor full access to information required to form an opinion.
- Client's attitude and willingness to pay fair amount for audit work.

Ethical requirements:

- Consider if any threats to fundamental principles arise from appointment (APES 110 s.210).
- Auditor must ensure it has sufficient staff available with required knowledge to complete audit (professional competence and due care). What if company is growing? Professional competence.
- Consider potential safeguards and remedies.
- Decline appointment if threat insurmountable.
- Have documentation in place explaining why client continuance.

Engagement letter (ASA 210; ISA 210):

- Prepared by auditor, acknowledged by client.