

Assurance Services & Audit – 22522

Lecture One – Demand for Audit and Assurance Services (Chp 1)

Assurance Services

Definition – Independent professional services that improve the quality of information for decision makers.

- It is an extra opinion to provide more comfort.

Note: key word – Independent & Unbiased with respect to the information examined.

- These services provide satisfaction as to reliability and relevance of provided information.
- Can be performed by public accountants or a variety of other professionals.
- Various levels (reasonable, limited) depending on the nature and extent of procedures and evidence.
- Growth continues given the demand for real-time (not always possible) and forward-looking information.

Assurance services provided by firms other than public accountants include;

- Television and Radio ratings
- Several non-for-profit organisations (such as Choice – which test products)
- Lottery accountants

Attestation Services

Definition – Type of assurance service in which the public accounting firm issues a written communication (opinion) that expresses a conclusion about the reliability of a written assertion/statement of another party (something that the company/client thinks is true).

3 types of Attestation Services

➤ Audit of historical financial statements

- A form of attestation service in which the auditor issues a written report expressing an opinion about whether the financial statements are in material conformity with accounting standards (AASB).
- Audits are the predominant form of assurance performed by public accounting firms.
- External users who rely on financial statements to make business decisions use the auditor's report as an indication of the statement's reliability.

Publicly traded companies are required to have audits under the Corporations Act 2001.

Even without legislation, some companies audit their financial statements to provide assurance to their investors.

➤ Review of historical financial statements

- Known as a 'mini-audit'.
- Provides a moderate (limited) amount of assurance on the financial statements.
- Many companies want to provide assurance on their financial statements without incurring the cost of an audit.

Note:

- Audit means to provide reasonable assurance.
- Review means to provide limited assurance

Audits and Reviews link specifically to the financial statements only.

➤ Other Attestation Services

- Must involve written assertions on an accountability matter.
- These seek independent assurances about other types of information.
- Attest to the information in an entity's forecasted financial statements, which are used to obtain finance.

Other Assurance Services

Most of the assurance services that accountants provide don't meet the formal definition of attestation services.

- These services must still be independent and must provide assurance about information used by decision makers, but;
- Differs in that the public accountant may not be required to issue a written report, and the assurance doesn't have to be about the reliability of another party's written assertion about compliance with specific criteria.

In other assurance engagements, the assurance is about the reliability and relevance of information, which may or may not have been asserted by another party.

Note: there is greater competition for public accountants performing other assurance services – audits and many types of attestation services are limited by regulation to licensed public accountants, but the market for other forms of assurance is open to other competitors.

➤ Assurance Services on information technology;

- WebTrust services
- SysTrust services

The greater demand for other assurance services is partly due to the growth of the internet and electronic commerce.

- Concerns over privacy and security of information.

WebTrust Services – Public accounting firms that are licensed to perform this service provide assurance to website users through the electronic 'WebTrust seal' affixed to the website. This seal ensures the user that the website has met established criteria relating to business practices.

SysTrust Services – SysTrust is an attest-type engagement to evaluate and test system reliability in areas such as security and date integrity.

➤ Assurance Services on other types of information;

- Business Performance measurement services – Gives more information to users to evaluate the business performance. Done through a balanced scorecard.

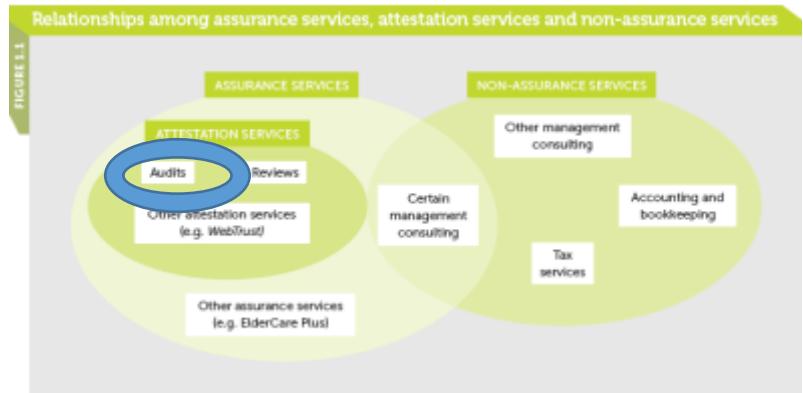
Using a balanced scorecard, the board of directors and managers defines an entity's strategic objectives and goals and then assess the entity's success in achieving these goals, by implementing performance measurement systems.

- ElderCare Plus – The emerging trend of an aging population offers public accountants an opportunity to provide assurances to these elderly individuals and their families that care is being provided at an acceptable level.

Non-assurance Services

- Accounting and bookkeeping services
- Tax services
- Other Management consulting services

Note: Some overlap exists between management consulting and assurance services.



- The primary purpose of a management consulting engagement is to generate a recommendation to management, whereas;
- The primary purpose of an assurance services engagement is to improve the quality of information.

Economic Demand for Auditing

The ability to issue opinions on financial statements is restricted to registered auditors.

Information Risk – The risk (possibility) that information on which a business decision is based is inaccurate.

Auditing can have a significant effect on information risk.

- The reduction of information risk can have a significant effect on the borrower's ability to obtain capital at a reasonable cost.

Auditors wont be able to remove all information risk as some information is not even disclosed to them, and therefore have no idea about it.

Causes of Information Risk

- Remoteness of information
 - Risk to shareholders
- Biases and motives of the provider
 - If information is provided by someone whose goals are inconsistent with those of the decision maker, the information may be biased in favour of the provider.
 - Agency Problem (Management and Shareholders)
- Voluminous Data
 - As organisations become larger, so does the volume of their exchange transactions.
 - This increases the likelihood that improperly recorded information will be included in the records – perhaps buried in a large amount of other information.
 - Too much information/data to go through – problem.
- Complex exchange transactions
 - Become more complex over the last few years and therefore more difficult to record properly.
 - Partly due to globalisation (Foreign Exchange FX Transactions).

Reducing Information Risk

Three main ways;

- User (shareholder) verifies information

- The user may go to the business premises to examine records and obtain information about the reliability of the statements.
 - It may be impractical, but some users perform their own verification.
- User shares information risk with management
- A difficulty with sharing information risk with management is that users may not be able to collect on losses.
- Audited financial statements are provided
- Most common way for users to obtain reliable information.
 - The audited information is then used in the decision-making process on the assumption that it is reasonably complete, accurate and unbiased.

Nature of Auditing

Auditing – is the accumulation (gathering) and evaluation (checking) of evidence (relevant documents) about information (financial statements) to determine and report on the degree of correspondence (correctness) between the information and established criteria (Accounting standards).

Auditing should be performed by a competent, independent person.

- Information and established criteria;
 - Information must be in a verifiable form and some standards (criteria) the auditor can evaluate the information against.
 - The criteria for evaluating information also vary depending on the information being audited.
- Accumulating and evaluating evidence;
 - Sufficient quality and volume

Evidence – is any information used by the auditors to determine whether the information being audited is stated in accordance with the established criteria.

- Competent, Independent person
 - Qualified, competent and independent
 - Qualified to understand the applicable criteria
 - Competent to know the types and amount of evidence required to reach the proper conclusion.
 - Independent mental attitude.

Independent auditors – public accountants or accounting firms that perform audits of commercial and non-commercial financial entities.

- Even though these auditors are paid a fee by the company, they are normally sufficiently independent to conduct audits that can be relied upon by users.
- Reporting;
 - Communication of the auditor's findings to users
 - Happens in the audit opinion
 - Final stage in the auditing process – preparing the audit report.

Audit report – the communication of audit findings to users.

Auditing and Accounting

Accountants	Auditors	Accountants	Auditors
Record, classify and summarise economic events for the purpose of providing financial information used in decision making	Determine whether recorded information properly reflects the economic events that occurred during the accounting period	Function of accounting is to provide certain types of quantitative information that management and others can use to make decisions.	<ul style="list-style-type: none"> • Independent/ external • Annual-basis (6-8 weeks) • Report to the board of directors <ul style="list-style-type: none"> • Accountants are <u>inside</u> the company • Work-year round

Note; Auditors gather evidence from accountants.

Types of Audits (3 types)

➤ Financial Statement audit;

Definition - The audit conducted to determine whether the overall financial statements are stated in accordance with specified criteria (usually accounting standards).

- In determining whether financial statements are fairly stated in accordance with accounting standards, the auditor performs appropriate tests to determine whether the statements contain material errors or other misstatements.
- An integrated approach to auditing considers both the risk of errors and operating controls intended to prevent errors.

➤ Performance audit (also referred to as an operational audit);

Definition - Evaluation of the efficiency and effectiveness of an organisation's operating procedures and methods.

- Eg; evaluating the efficiency and accuracy of processing payroll transactions in a newly installed computer system.
- Government organisations

➤ Compliance audit;

Definition - To determine whether the client is following specific procedures, rules or regulations set by a higher authority.

- Rules and regulations
- Differ depending on the client – eg; private business or schools.
- Results of compliance audits are typically reported to someone within the organisational unit being audited, rather than to a broad spectrum of users.
- Management is the primary group concerned, not external users.

TABLE 1.3

Examples of three types of audits

TYPE OF AUDIT	EXAMPLE	INFORMATION	ESTABLISHED CRITERIA	AVAILABLE EVIDENCE
Financial statement audit	Annual audit of Woolworths' financial statements	Woolworths' financial statements	Accounting standards	Documents, records and outside sources of evidence
Performance audit	Evaluate whether the computerised payroll processing for subsidiary H is operating efficiently and effectively	Number of payroll records processed in a month, costs of the department and number of errors made	Company standards for efficiency and effectiveness in payroll department	Error reports, payroll records and payroll processing costs
Compliance audit	Determine whether bank requirements for loan continuation have been met	Company records	Loan agreement provisions	Financial statements and calculations by the auditor

Types of Auditors

Most common types of auditors are;

- Public accounting firms
- Officers serving for the Auditor-General
- Tax Auditors
- Internal Auditors

➤ Public Accounting firms

- Responsible for auditing the published historical financial statements of all publicly traded companies, most other reasonably large companies, many smaller companies, and non-commercial organisations.
- Often called 'external auditors' or 'independent auditors' to distinguish them from internal auditors.

Public accountant – person who has obtained registration as a company auditor in accordance with the provisions of the Corporations Act 2001. Must apply to ASIC for registration.

➤ Officers serving the Auditor-General

- An auditor serving a Federal or State Auditor-General; the Auditor-General reports to and is responsible solely to Parliament.
- Government related auditors
- The primary responsibility of the audit staff is to perform the audit function for the government.
- Most of the information prepared by various government agencies is audit by the Auditor-General before being submitted to Parliament.
- Eg; Centrelink

➤ Tax auditors

- Auditors who work for the ATO (Australian Taxation Office) and conduct examinations of taxpayers' returns to determine whether they have complied with tax laws.
- These audits can be regarded as solely compliance audits.

➤ Internal Auditors

- Auditors employed by a company to audit for the company's board of directors and management.
- Responsibilities vary considerably depending on the employer.
- Involved in compliance auditing and performance auditing.