

C39AU: Auditing & Assurance

Introduction to Course

- What is an Audit?
- What is the purpose of an audit?
- Why study Auditing?
- What you will learn?
- How will you learn?
- How will your learning be assessed?
- How will you be successful?

Examples of 'Audits'

- Financial Statement Audit
- Environmental Audit
- Medical Audit
- Forensic Audit
- Technology audits
- Teaching audits
- VFM Audits
- Efficiency audit
- Health and safety audit

What is an Audit?

An audit is:

- an *investigation* or a *search for evidence*
- to enable *reasonable assurance* to be given
- on the *truth and fairness* of financial and other information
- by a person or persons *independent of the preparer and (of) persons likely to gain directly from the use of the information,*
- and the *issue of a report* on that information
- *with the intention of increasing its credibility and therefore its usefulness.*”

Gray & Manson

ISA (UK and Ireland) 200

- The purpose of an audit is to increase the confidence of intended users in the FS...
- ..by the expression of *an opinion*...
- ..on whether the FS are prepared, *in all material respects*

ISA 200 para 7

- The ISAs require that the auditor exercise professional judgment and maintain professional scepticism throughout the planning and performance of the audit and, among other things:
- Identify and assess risks of material misstatement..
- Obtaining sufficient appropriate audit evidence about whether material misstatements exist....
- Form an opinion on the FS based on conclusions drawn from the evidence obtained.

Justifications for Audit

- Agency Theory
- Information Hypothesis
- Insurance Hypothesis

Agency theory basic ideas

- Both the owners (principals) of organisation and the managers (agents) employed to manage it on their behalf try to maximise their own wealth.
- As a result principals need a monitoring mechanism in the form of a financial report.
- Agents are likely to favour the preparation of a financial report as the principals will otherwise be unwilling to believe that they are telling the truth.
- Agents recognise that, for the owners to believe the financial report is valid, it will need to be verified by a party (the auditor) independent of both principals and agents.
- Agency theory suggests that the appointment of professional external auditors will be preferred as this is the most cost-effective of monitoring devices.
- A particular problem is that the auditor may also be regarded as a wealth maximiser, raising possible doubts about the value of the audit report, but agency theory suggests that the auditors will provide a true report to maintain their reputation.

Information & Insurance Hypotheses

- An insurance policy over the accuracy of the accounts

Reasonable Assurance

- The auditor does not guarantee that the accounts are 100% correct.
- The auditor provides a 'reasonable assurance'.

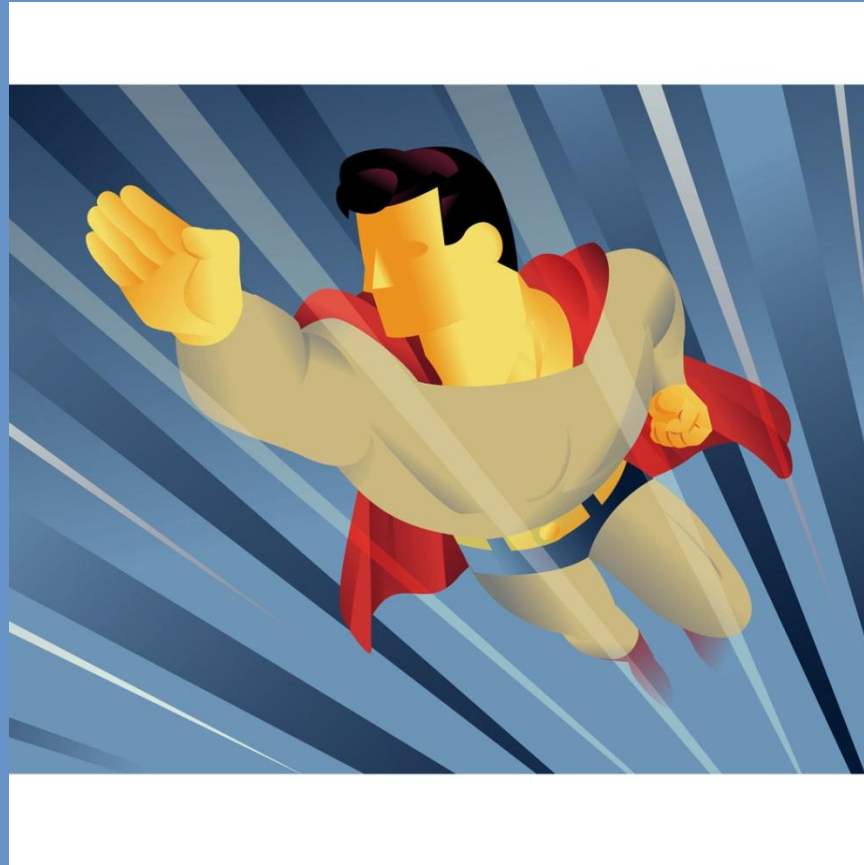
Truth & Fairness

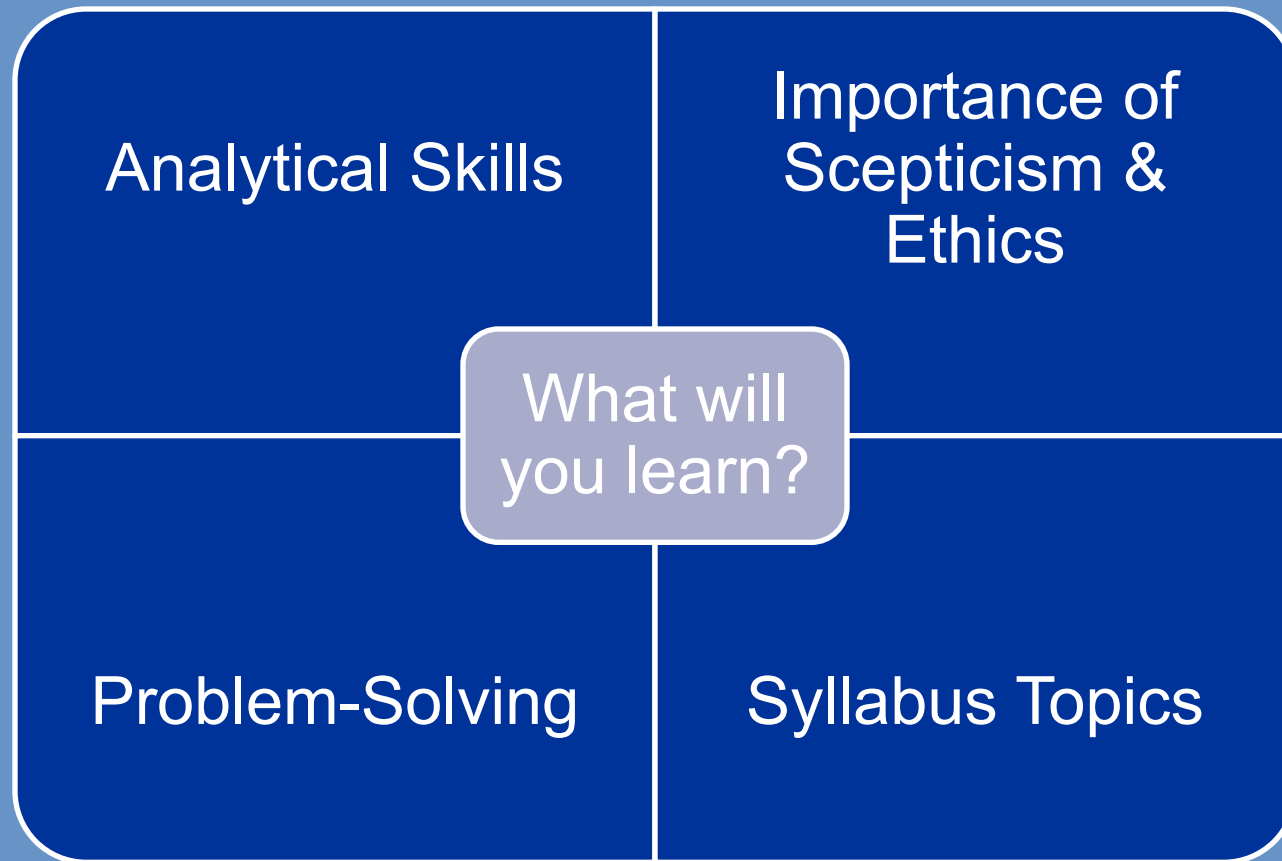
- Stated in the auditor's opinion that the financial statements are 'true and fair'.

Audit Process

- Preliminary Stages (Client acceptance & Planning)
- Systems work and transaction testing
- Preparation for final work
- Final Work

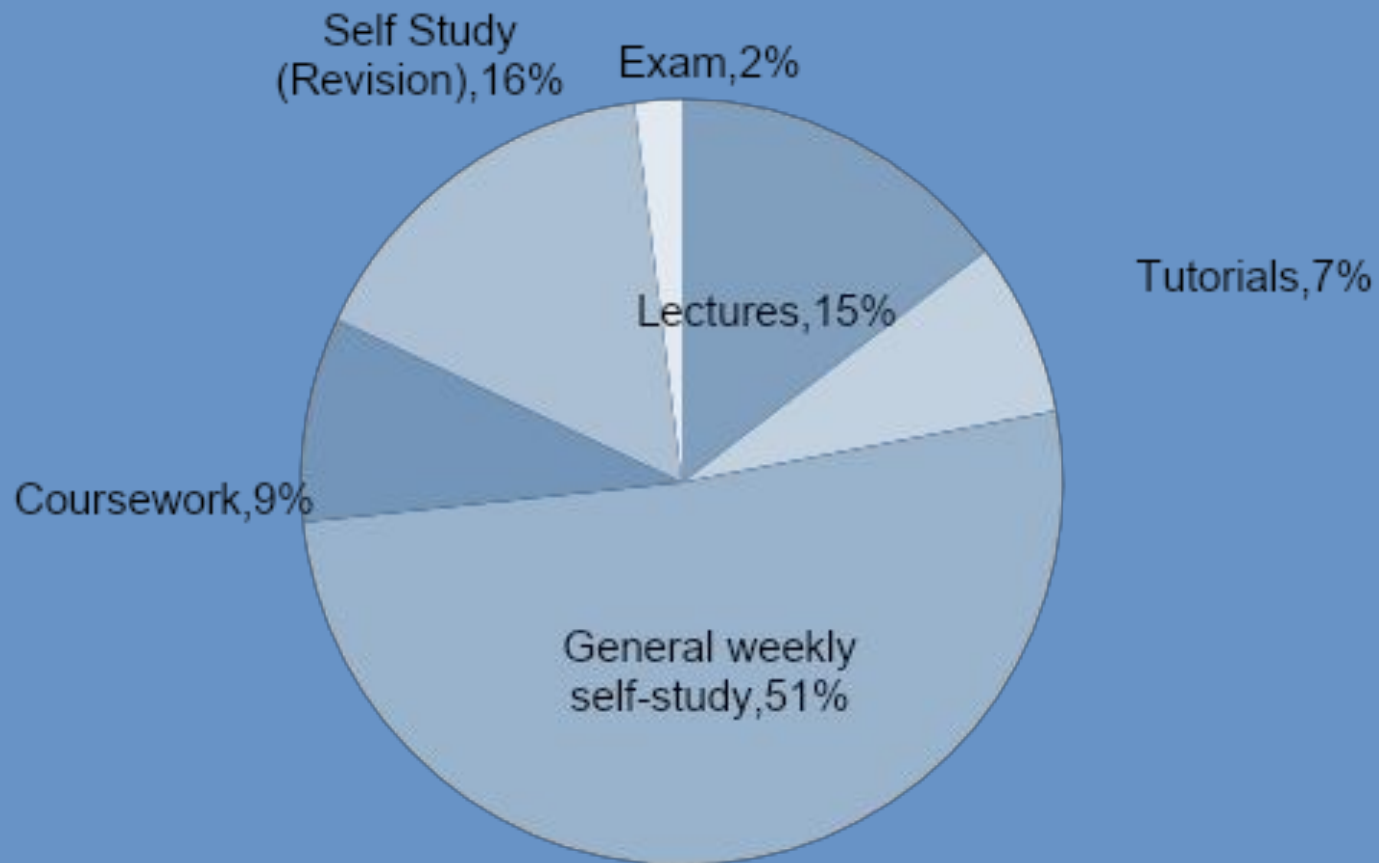
Why Study Auditing?



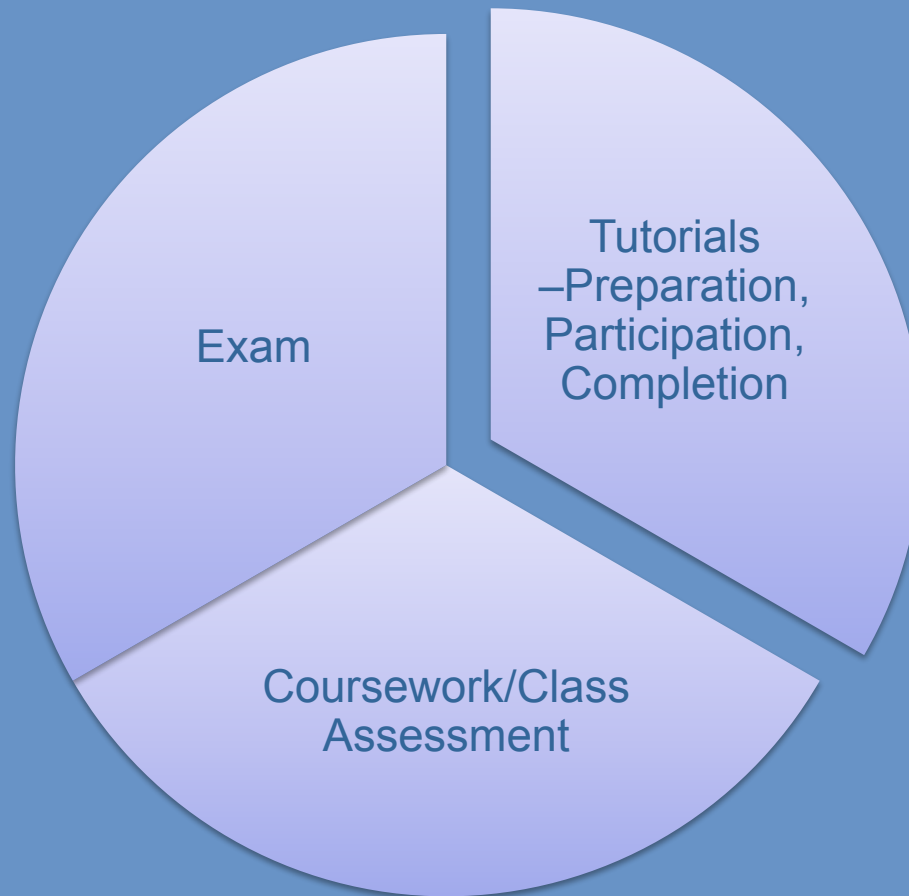




How will you spend your time?



Assessment



My Role



Practical Issues

- Sign up for tutorial groups
- Start thinking about Coursework

Company

Carries Out Business

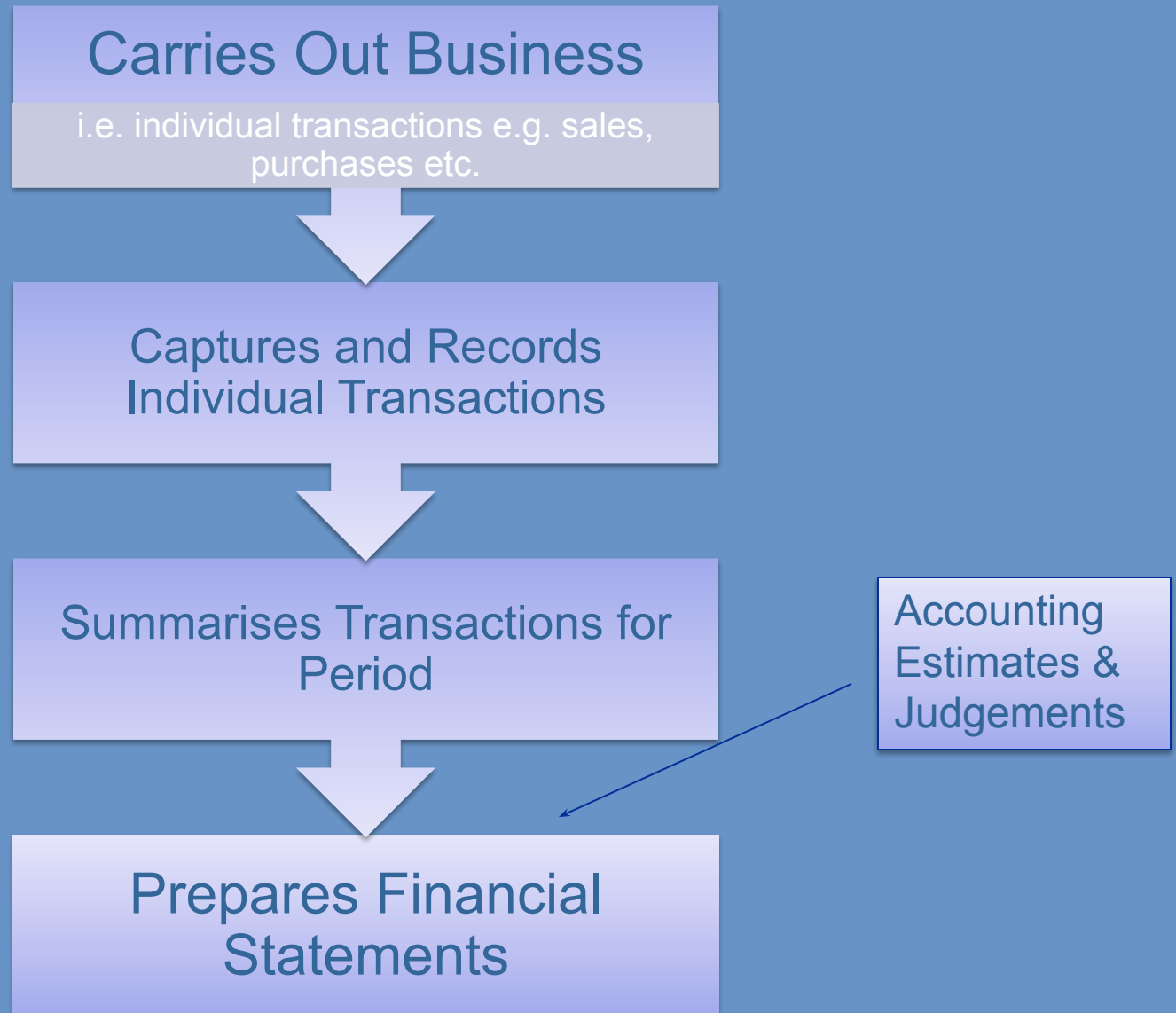
i.e. individual transactions e.g. sales,
purchases etc.

**Captures and Records
Individual Transactions**

**Summarises Transactions for
Period**

**Prepares Financial
Statements**

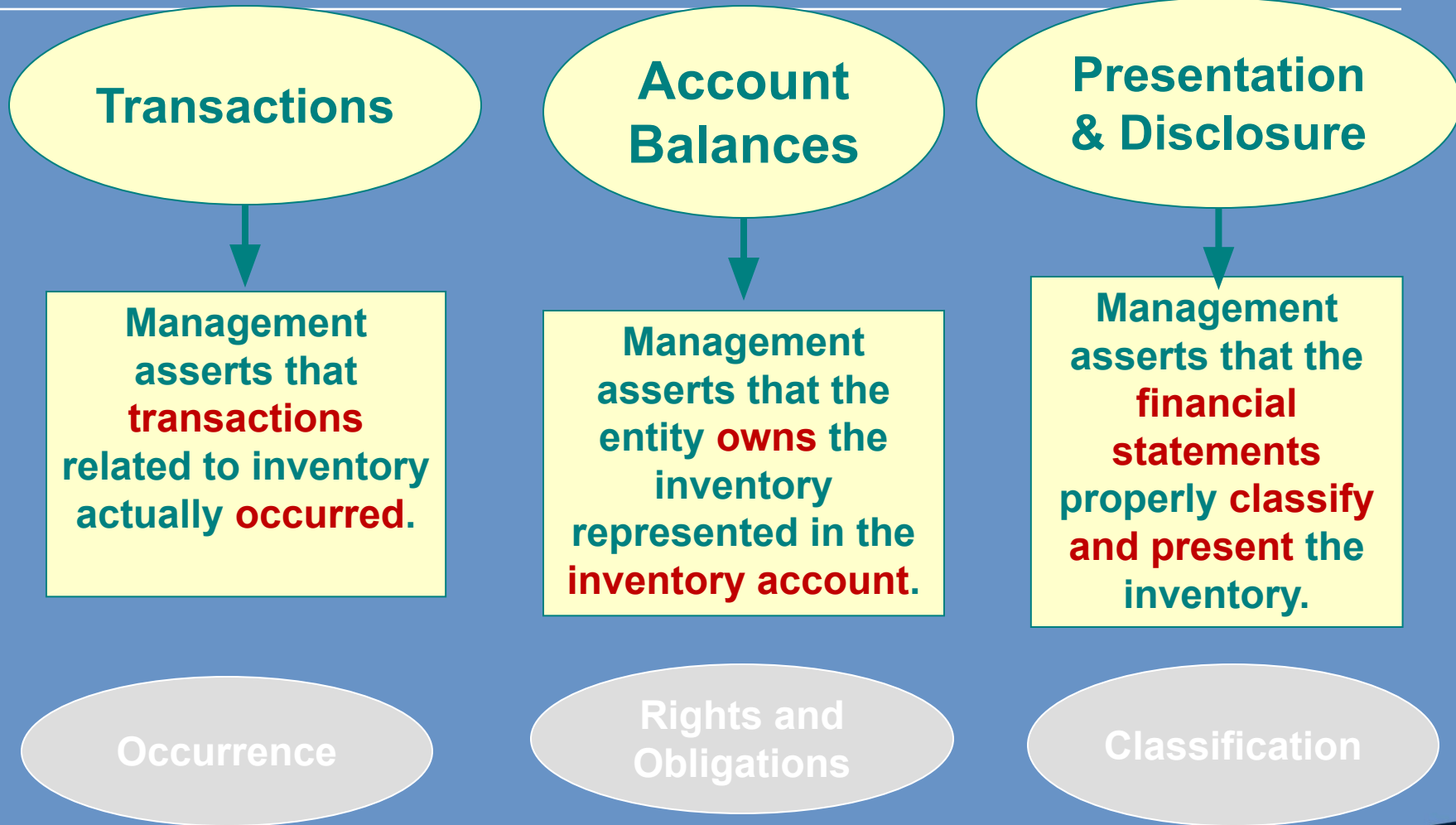
Accounting
Estimates &
Judgements



Assertions in Financial Statements

- Financial Statements issued by management contain explicit and implicit assertions
e.g. Inventory (Stock) shown at £4 billion
- What assertions are being made?

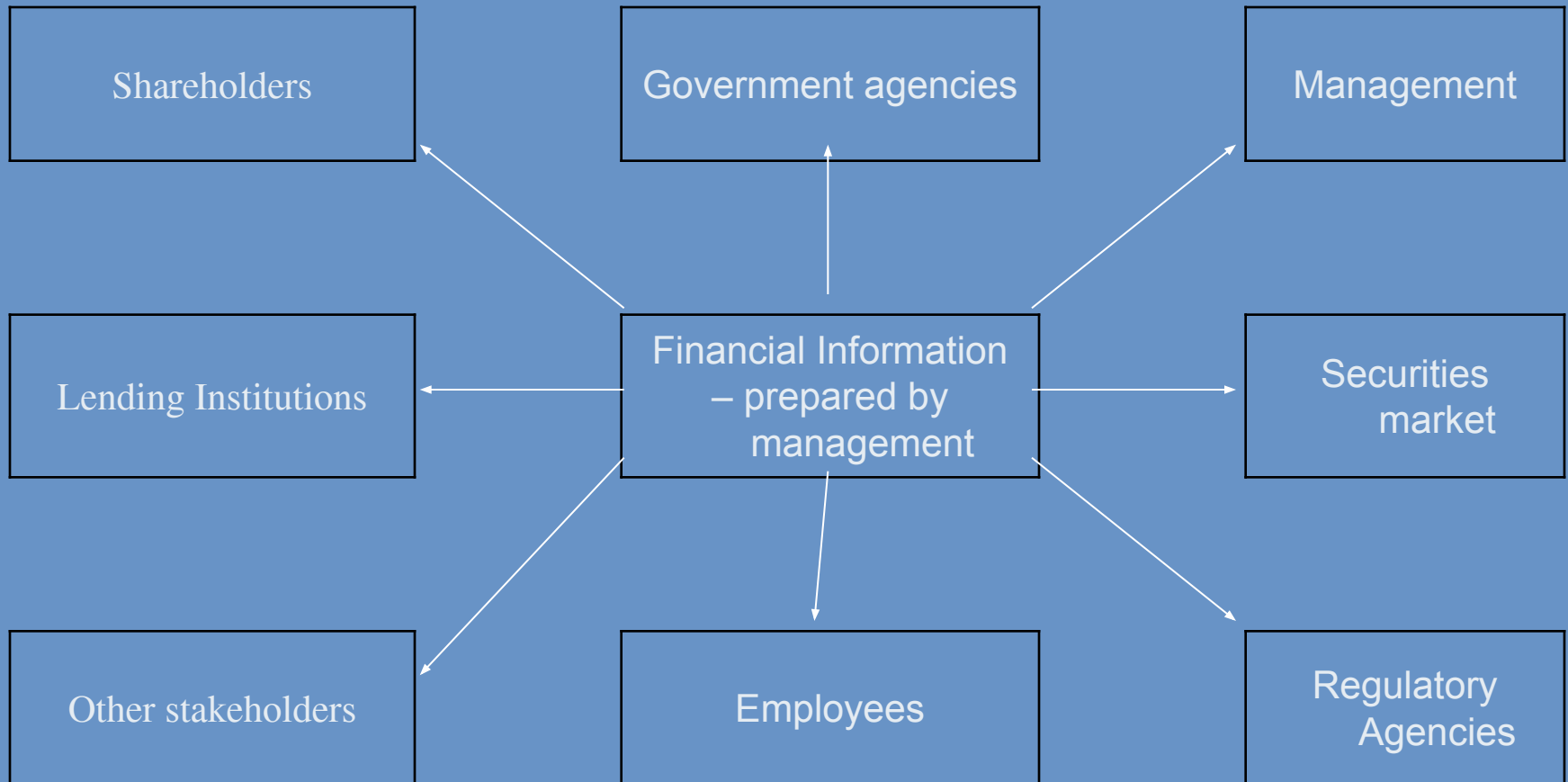
Management Assertions: E.g. with Inventory



Management Assertions

- Assertions are **about**:
 - Classes of transactions and events
 - Account balances
 - Presentation & disclosure
- Key assertions are:
 - **Completeness**
 - **Existence/Occurrence**
 - **Accuracy**
 - **Valuation**
 - **Ownership/Rights & Obligations**
 - **Presentation – Classification & Understandability**
 - **Also: Cut Off & Authorisation**

Users of financial information



Why need audit?

Conflict of Interest

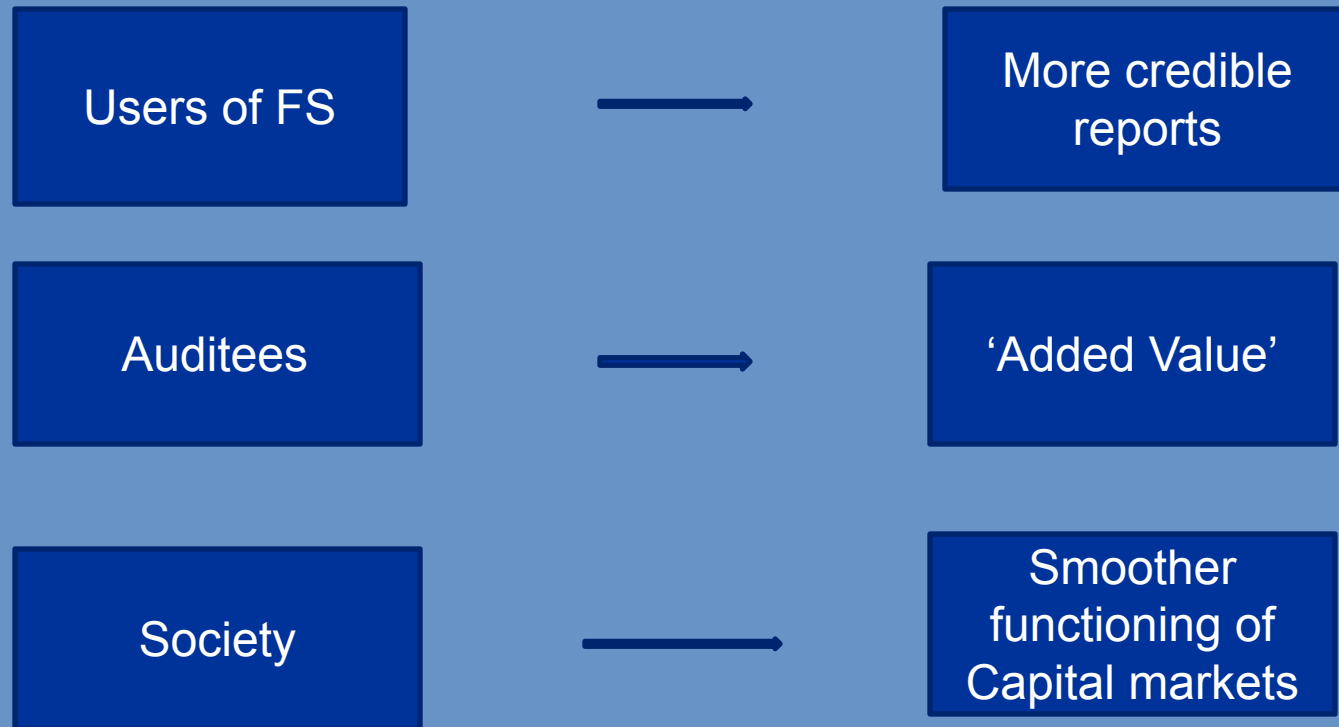
Remoteness

Complexity

Public Trust

Public Interest

Beneficiaries of external audit of FS



Accounting vs Auditing

Accounting

creative process of

- constructing financial statements
- (through identifying, organising, summarising and communicating information about economic events)

Auditing

evaluative process

- collecting and evaluating audit evidence,
- drawing conclusions and
- communicating opinion based on conclusions



Overall Objectives of the Auditor

- To obtain
- Reasonable Assurance
- About whether the FS as a whole
- Are free from Material Misstatement
- Whether due to Fraud or Error
- Enabling expression of opinion on
- Whether the FS are prepared
- In all material respects
- In accordance with an applicable FR framework
- Report on the FS and communicate as required by the ISAs (UK & I) in accordance with findings

Key Audit Terms

- Fill in the Blanks
- Ask for explanations of any words you don't understand
- You need to learn the key elements of these definitions

Postulates of Auditing

- FS and Financial data are verifiable;
- Existence of a satisfactory system of internal control eliminates probability of irregularities;
- Consistent application of GAAP results in fair presentation of financial position and results;
- When examining financial data for purpose of expressing an independent opinion thereon, auditor acts exclusively in capacity of an auditor.
- Professional status of independent auditor imposes commensurate professional obligations.

Before next lecture

- Read back over the notes and your notes
- Look at the annual accounts for any big household name company
- Look at auditors report and find what's been audited
- Look at financial statements and think about how figures have been arrived at
- Will be looking at extracts from accounts in first tutorial so will be building on this