MODULE 2

The auditor's responsibilities

The auditing standards

Structure of the standards as a whole

- 100s – Preamble and ethical requirements
- 200s – Auditor's responsibilities related to the audit
- 300s – Planning the audit
- 400s – Evaluating misstatements found during the audit
- 500s – Gathering audit evidence
- 600s – Special topics – group audits, internal auditors & experts
- 700s – Reporting

How to read an auditing standard

CONTENTS

The standards are our textbook

- Read the standards relevant to the week
  - Start with the Requirements
  - For clarification – the Explanatory Material
  - For even more clarification – the Standards Explained videos

What are the auditor’s and management’s responsibilities on an audit?

Objective of Conducting an Audit

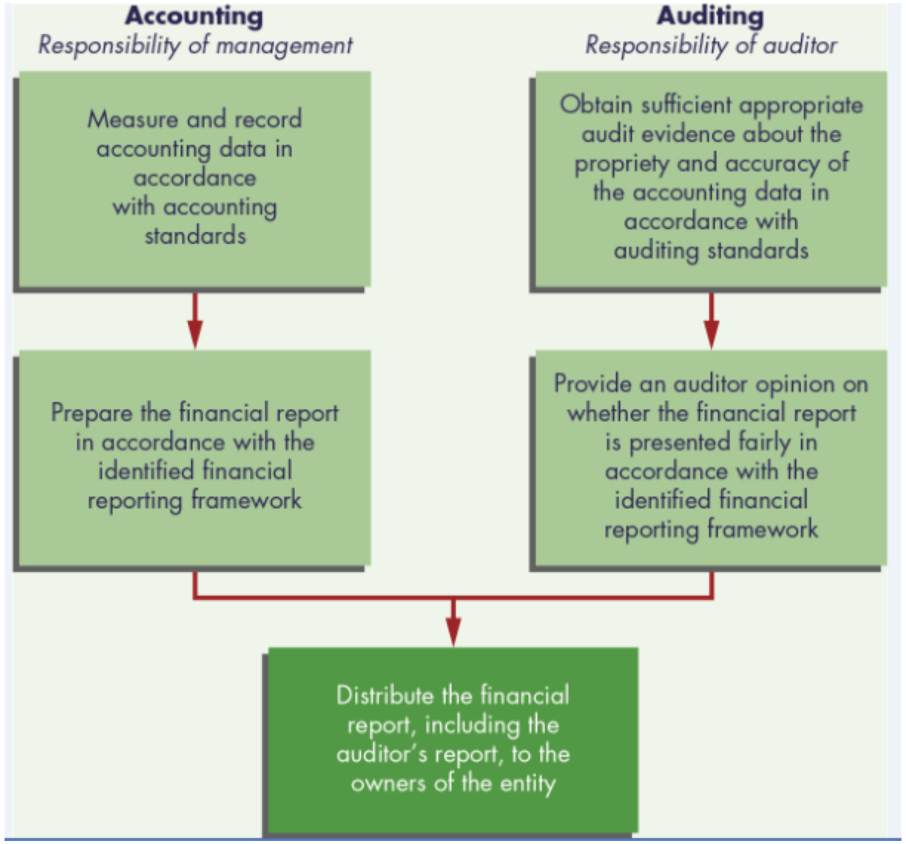
- ASA 200.3 states:

An Audit of a Financial Report

3. The purpose of an audit is to enhance the degree of confidence of intended users in the financial report. This is achieved by the expression of an opinion by the auditor on whether the financial report is prepared, in all material respects, in accordance with an applicable financial reporting framework. In the case of most general purpose frameworks, that opinion is on whether the financial report is presented fairly, in all material respects, or gives a true and fair view in accordance with the framework. An audit conducted in accordance with Australian Auditing Standards and relevant ethical requirements enables the auditor to form that opinion. (Ref: Para. A3)

- To form a judgment on the financial report, the auditor must look behind the financial report to the accounting data.
- Therefore there is a close relationship between Accounting and Auditing.

Accounting vs. Auditing



Auditor’s Responsibilities

- ASA 200.11 states:

Overall Objectives of the Auditor

11. In conducting an audit of a financial report, the overall objectives of the auditor are:

    (a) To obtain reasonable assurance about whether the financial report as a whole is free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial report is prepared, in all material respects, in accordance with an applicable financial reporting framework; and

    (b) To report on the financial report, and communicate as required by the Australian Auditing Standards, in accordance with the auditor’s findings.

To do a high-quality audit – we must

Professional Scepticism

15. The auditor shall plan and perform an audit with professional scepticism recognising that circumstances may exist that cause the financial report to be materially misstated. (Ref: Para. A20-A24)

Professional Judgement

16. The auditor shall exercise professional judgement in planning and performing an audit of a financial report. (Ref: Para. A25-A29)

Sufficient Appropriate Audit Evidence and Audit Risk

17. To obtain reasonable assurance, the auditor shall obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion. (Ref: Para. A30-A54)

Management's responsibilities

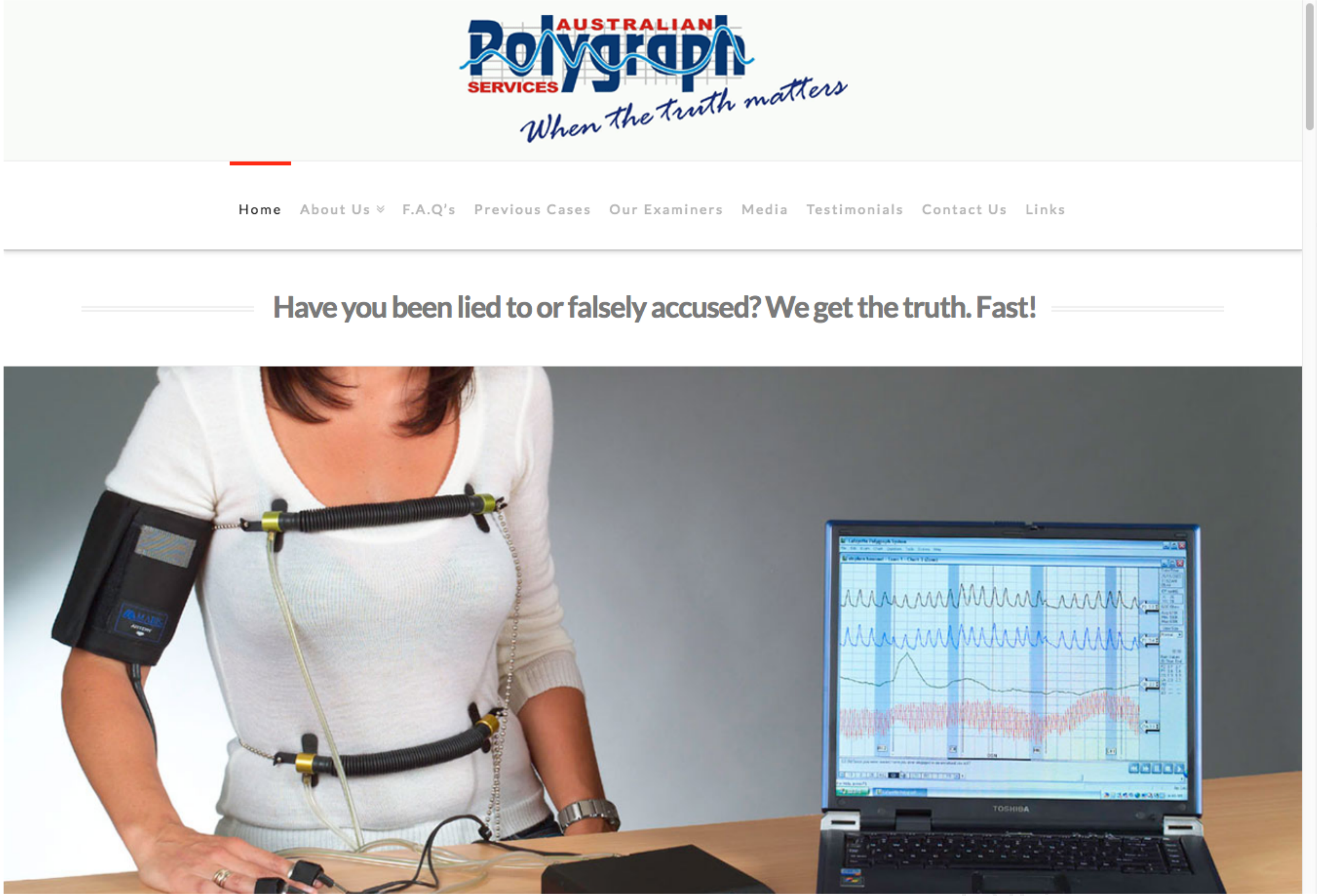
- ASA 200 has something to say about this too

4. The financial report subject to audit is that of the entity, prepared by management of the entity with oversight from those charged with governance. Australian Auditing Standards do not impose responsibilities on management or those charged with governance and do not override laws and regulations that govern their responsibilities. However, an audit in accordance with Australian Auditing Standards is conducted on the premise that management and, where appropriate, those charged with governance have acknowledged certain responsibilities that are fundamental to the conduct of the audit. The audit of the financial report does not relieve management or those charged with governance of their responsibilities. (Ref: Para. A4-A13)

- Management must prepare the financial statements in accordance with the applicable financial reporting framework – in Australia that is mostly ______________

How do we know if management are telling the truth?

The role of assertions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Previous Cases
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Testimonials
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Have you been lied to or falsely accused? We get the truth. Fast!
TOSHIBA

What should the auditor do?

- They must gather evidence to support their opinion about whether the financial statements are free from material misstatement.
- But how? With what guidance?

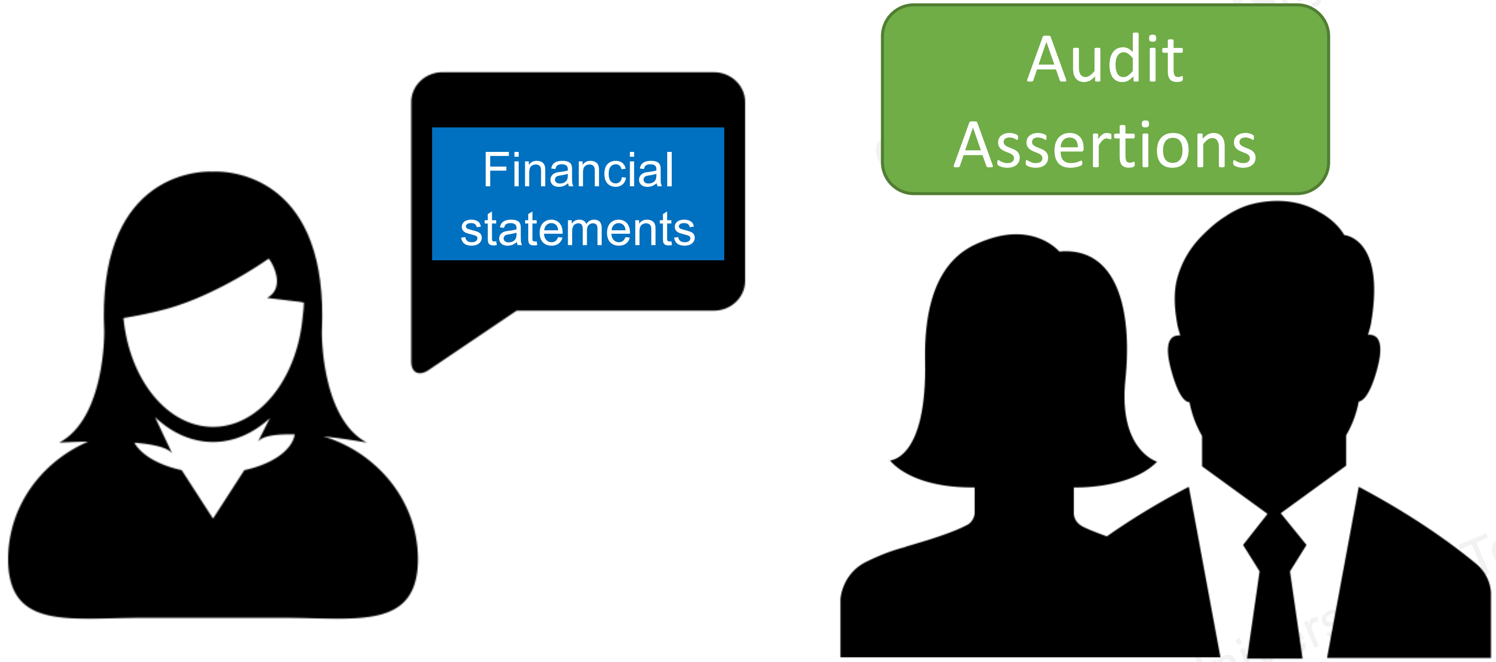
Kanye to Taylor: I'mma let you finish…

Image credit: Getty Images

Assertions explained

How do we measure whether the financial report is true?

- Assertions – statement you make that you believe is true



Client management

Created by Wilson Joseph from Noun Project

Audit team

Created by Gregor Cresnar from Noun Project

ASA 315 states the following

- 12. For the purposes of this Auditing Standard, the following terms have the meanings attributed below:
  - (a) Assertions – Representations, explicit or otherwise, with respect to the recognition, measurement, presentation and disclosure of information in the financial report which are inherent in management representing that the financial report is prepared in accordance with the applicable financial reporting framework. Assertions are used by the auditor to consider the different types of potential misstatements that may occur when identifying, assessing and responding to the risks of material misstatement. (Ref: Para. A1)

Why use assertions?

- In identifying and assessing the risks of material misstatement, the auditor uses assertions to consider the different types of potential misstatements that may occur.
    - ASA315.A188
- They provide an objective measure of “truth”
- 2 categories of assertions
    - classes of transactions and events, and related disclosures, for the period under audit
    - account balances, and related disclosures, at the period end

Classes of transactions and events – ASA315.A190(a)

- (i) Occurrence—transactions and events that have been recorded or disclosed have occurred, and such transactions and events pertain to the entity.
- (ii) Completeness—all transactions and events that should have been recorded have been recorded, and all related disclosures that should have been included in the financial report have been included.
- (iii) Accuracy—amounts and other data relating to recorded transactions and events have been recorded appropriately, and related disclosures have been appropriately measured and described.
- (iv) Cut-off—transactions and events have been recorded in the correct accounting period.
- (v) Classification—transactions and events have been recorded in the proper accounts.
- (vi) Presentation—transactions and events are appropriately aggregated or disaggregated and clearly described, and related disclosures are relevant and understandable in the context of the requirements of the applicable financial reporting framework.

Balances – ASA315.A190(b)

- (i) Existence—assets, liabilities and equity interests exist.
- (ii) Rights and obligations—the entity holds or controls the rights to assets, and liabilities are the obligations of the entity.
- (iii) Completeness—all assets, liabilities and equity interests that should have been recorded have been recorded, and all related disclosures that should have been included in the financial report have been included.
- (iv) Accuracy, valuation and allocation—assets, liabilities and equity interests have been included in the financial report at appropriate amounts and any resulting valuation or allocation adjustments have been appropriately recorded, and related disclosures have been appropriately measured and described.
- (v) Classification—assets, liabilities and equity interests have been recorded in the proper accounts.
- (vi) Presentation—assets, liabilities and equity interests are appropriately aggregated or disaggregated and clearly described, and related disclosures are relevant and understandable in the context of the requirements of the applicable financial reporting framework.

Compare and contrasting the assertions

Transactions

(i) Occurrence

(ii) Completeness

(iii) Accuracy

(iv) Cut-off

(v) Classification

(vi) Presentation

Balances

- (i) Existence
- (ii) Rights and obligations
- (iii) Completeness
- (iv) Accuracy, valuation and allocation
- (v) Classification
- (vi) Presentation

Audit Risk Model

What is the risk in conducting an audit?

- Audit risk = Giving the wrong opinion
  - Eg – unmodified opinion, when there are material errors present
  - Eg – modified opinion, when everything is actually ok

- ASA200.2 “Audit risk is a function of the risks of material misstatements and detection risk”

Audit Risk = ROMMs × Detection Risk

How do we know where to look for misstatements?

- They could be anywhere (or everywhere)
- Q: Where do misstatements come from?
- A: They arise from areas of greater risk

- The auditor must identify Risks of Material Misstatement (ROMMs) (ASA200.4)

Where to ROMMs come from?

- ASA200.4 states the following:
  - Inherent risk is described as the susceptibility of an assertion about a class of transaction, account balance or disclosure to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls.

  - Control risk is described as the risk that a misstatement that could occur in an assertion about a class of transaction, account balance or disclosure and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity's system of internal control.

What is Detection Risk?

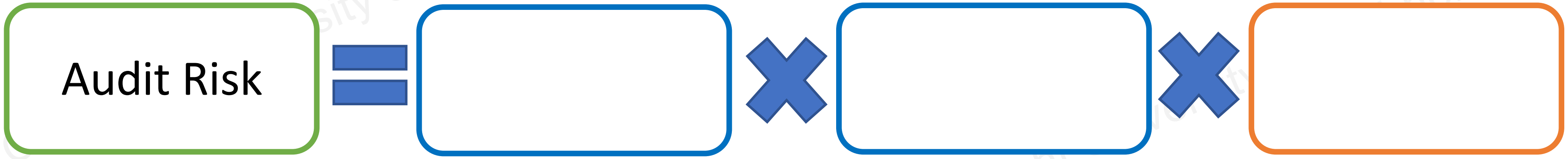
- Detection risk means the risk that the procedures performed by the auditor to reduce audit risk to an acceptably low level will not detect a misstatement that exists and that could be material, either individually or when aggregated with other misstatements. ASA200.13(e)

Another way of explaining the components

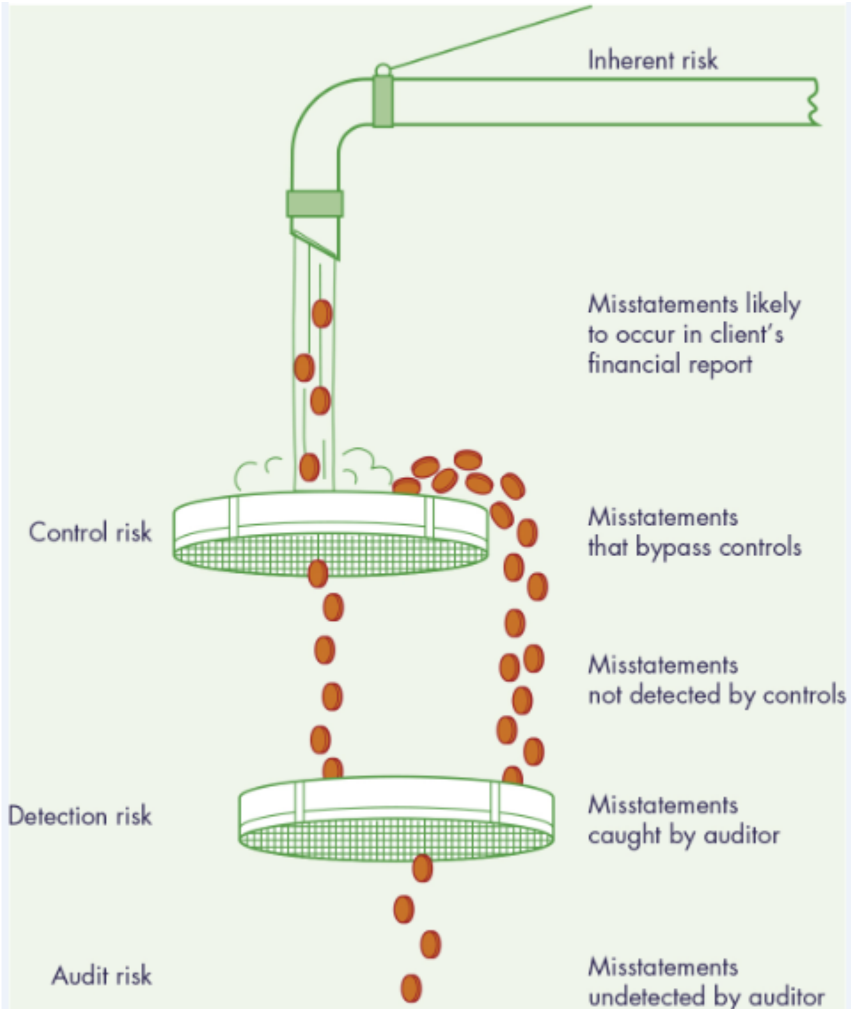
- **Inherent Risk (IR):** Susceptibility of an account or assertion to **material misstatement** given inherent and environmental characteristics, before considering the effectiveness of internal controls within the entity.
- **Control Risk (CR):** Risk that the **internal controls** within the entity will not be effective in preventing or detecting material misstatements.
- **Detection Risk (DR):** Risk that the **audit procedures** will NOT detect material misstatements which do, in fact, exist.

UTS

How is this helpful to the auditor?



Audit Risk



Inherent risk
Misstatements likely to occur in client's financial report
Control risk
Misstatements that bypass controls
Misstatements not detected by controls
Detection risk
Misstatements caught by auditor
Audit risk
Misstatements undetected by auditor

How we actually use the AR model

Interrelationship of the components of audit risk

Detection risk matrix				
		Assessment of control risk		
		High	Medium	Low
Assessment of inherent risk	High	Low	Low	Medium
	Medium	Low	Medium	High
	Low	Medium	High	High

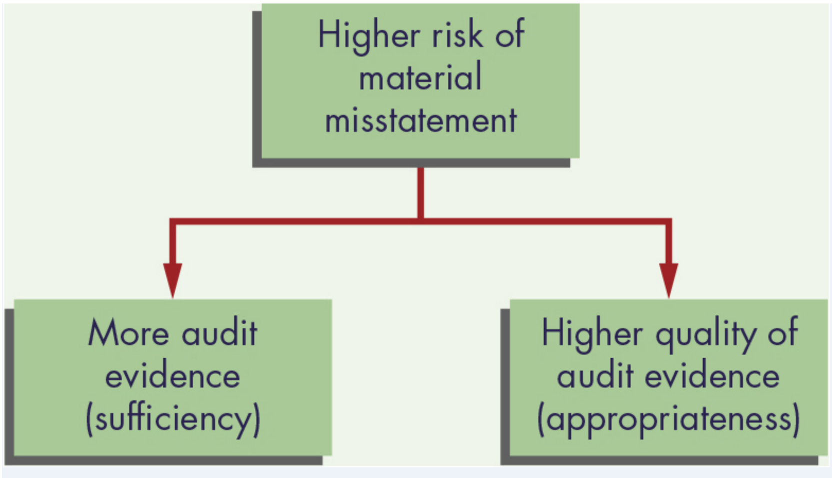
UTS

What can the auditor do to minimise audit risk?

- Inherent risk
- Control risk
- Detection risk
  - How the auditor conducts the audit
  - Audit strategy
  - Gathering evidence
  - Quality control

Impact of Increased Risk of Misstatement on Audit Plans

- **Risk Assessment** is very important as it determines the **Audit Plan/Strategy**. An audit focuses **more effort** (time and resources) on those accounts/areas that are at **greater risk of material misstatement**, and less time and resources expended on auditing accounts at low risk of material misstatement.



The audit risk model in action

Imagine a major supermarket chain

- Inherent risks
- Control risks

- What would the audit partner set as the Audit Risk?

- What does our AR model tell us?

Detection risk matrix				
		Assessment of control risk		
		High	Medium	Low
Assessment of inherent risk	High	Low	Low	Medium
	Medium	Low	Medium	High
	Low	Medium	High	High