



Financial Audit

Thursday, 18 August 2016



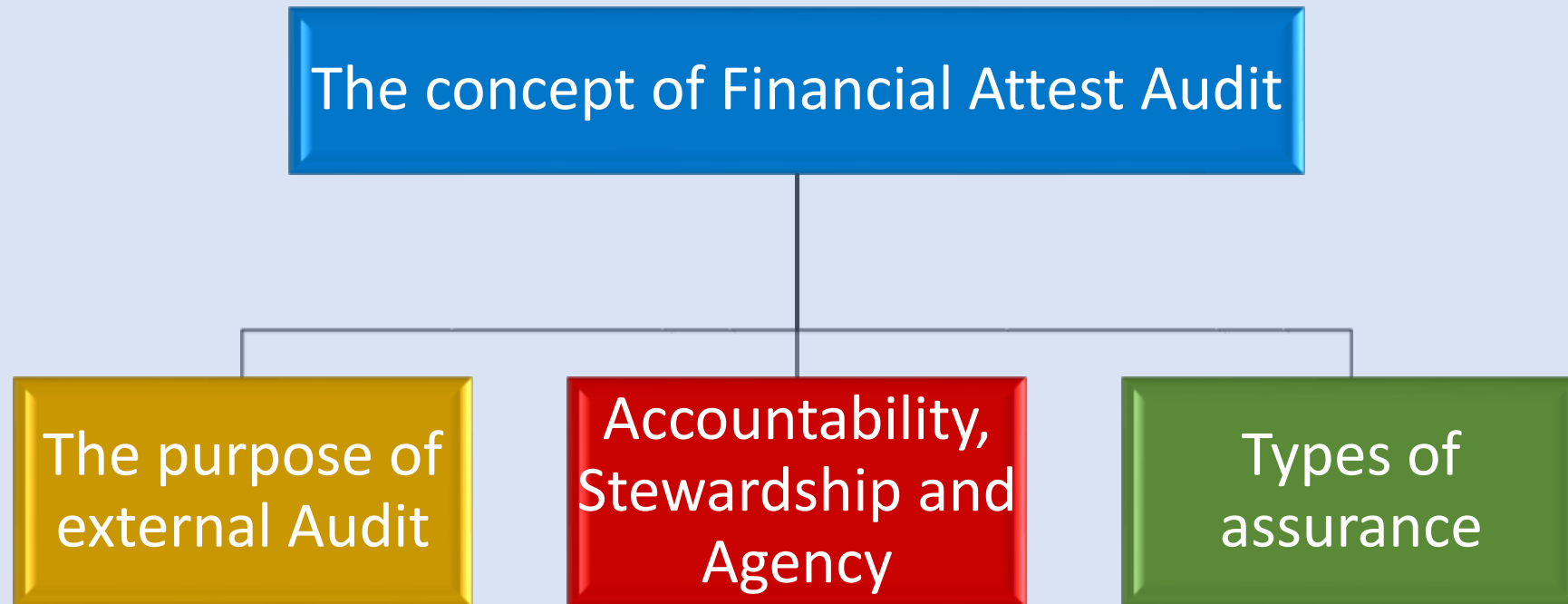
What is Financial Attest Audit?

Financial Attest Audit is primarily concerned with expression of an opinion on a set of financial statements . These are designed to reduce the possibility of a material misstatement in a financial statement and , therefore, assure credibility to such statements.



Nature of Financial Attest Audit

- Examination and evaluation of financial records and expression of opinions on financial statements.
- Audit of financial statements and transactions including an evaluation of compliance with applicable statutes and regulations which affects the accuracy and completeness of financial records.
- Audit of internal control and internal audit functions that assists in safeguarding the assets and resources and assure the accuracy and completeness of financial records.





Assurance and Reports

Communication to different
Stakeholders

Concepts in reporting:

Materiality

True and Fair

Reasonable assurance

Levels of assurance



Why External Certification Audit

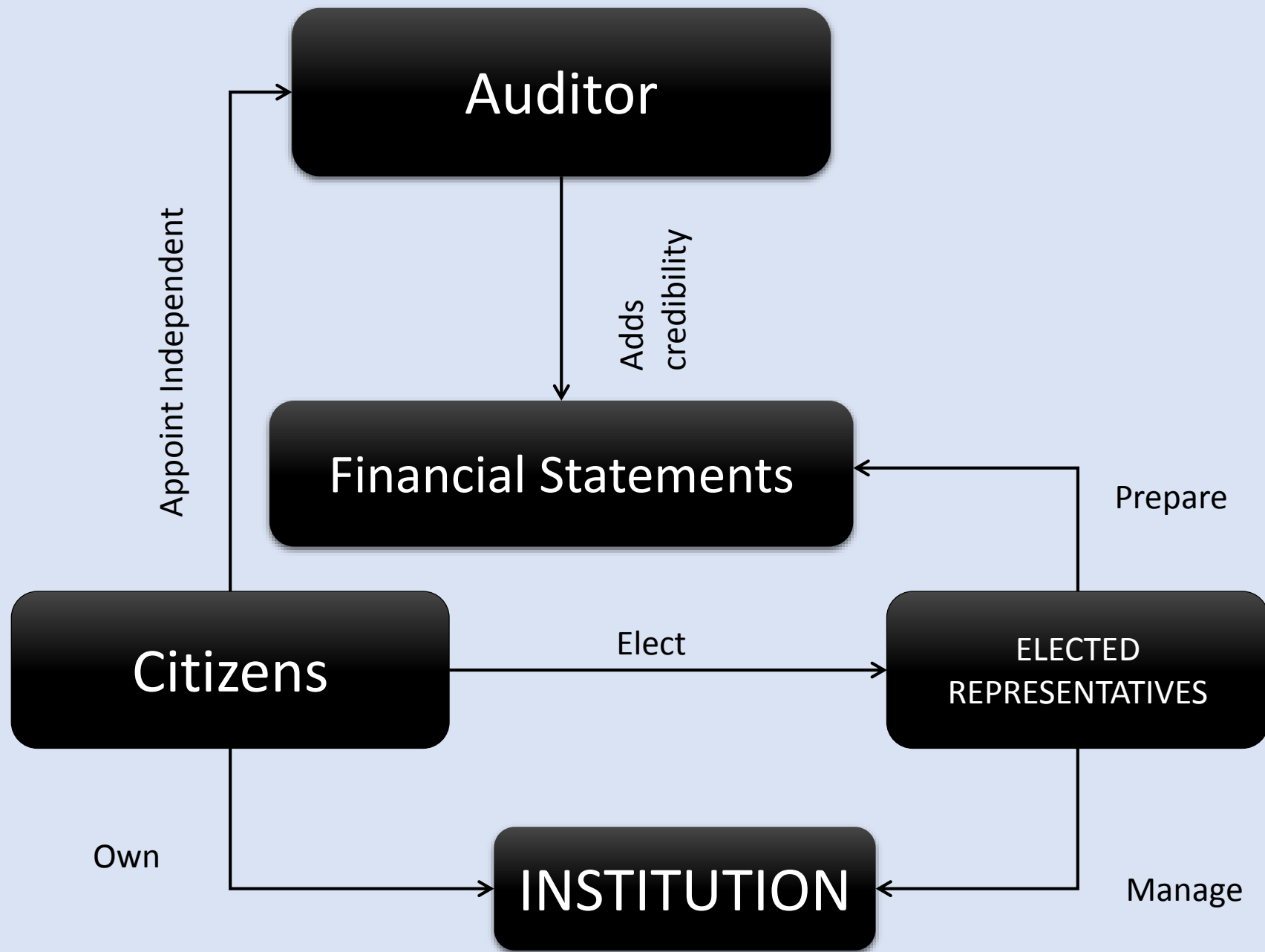
“Independent examination and expression of opinion on the financial statements of an entity”

The primary role of an external certification audit is to report on the truth and fairness of the financial statements of an entity .

- Auditor gives an opinion on whether the financial statements:

Have been prepared in accordance with an acceptable financial reporting framework.

Comply with any specific statutory requirement.

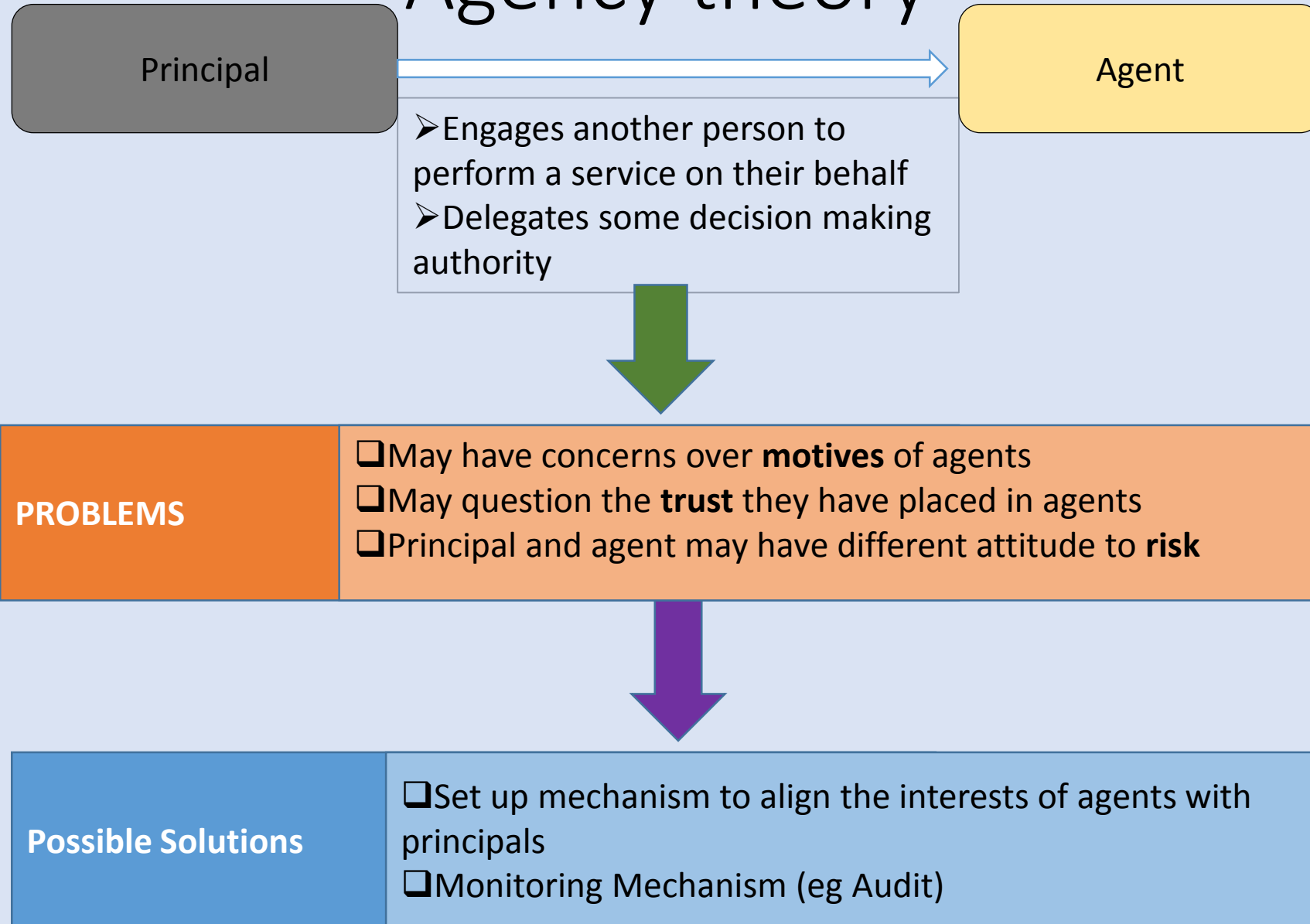




The elected representatives are required to account for the **stewardship** of the assets placed under their control. They achieve this by preparing financial statements which are presented to the people.

The auditor's opinion enhances the credibility of the financial statements by providing **reasonable assurance** from an independent source that financial statements taken as a whole are free from material misstatement.

Agency theory





What is “true and fair”

Fair suggests that the financial statements are factually correct and have been prepared according to applicable reporting framework and they do not contain any material misstatements that may mislead the users. Misstatements may result from material errors or omissions of transactions & balances in the financial statements.

True implies that the financial statements present the information faithfully without any element of bias and they reflect the economic substance of transactions rather than just their legal form.



What is “reasonable assurance”

No Auditor can give 100% assurance. The highest level of assurance given, as in the case of certification audit , is described as reasonable assurance.

‘Reasonable assurance is less than absolute assurance. Reducing assurance engagement risk to zero is very rarely attainable or cost beneficial as a result of factors such as :

Use of selective testing.

The inherent limitations of internal control.

The fact that much of the evidence is persuasive rather than conclusive.

The use of judgment in gathering and evaluating evidence and forming conclusions based on that evidence.



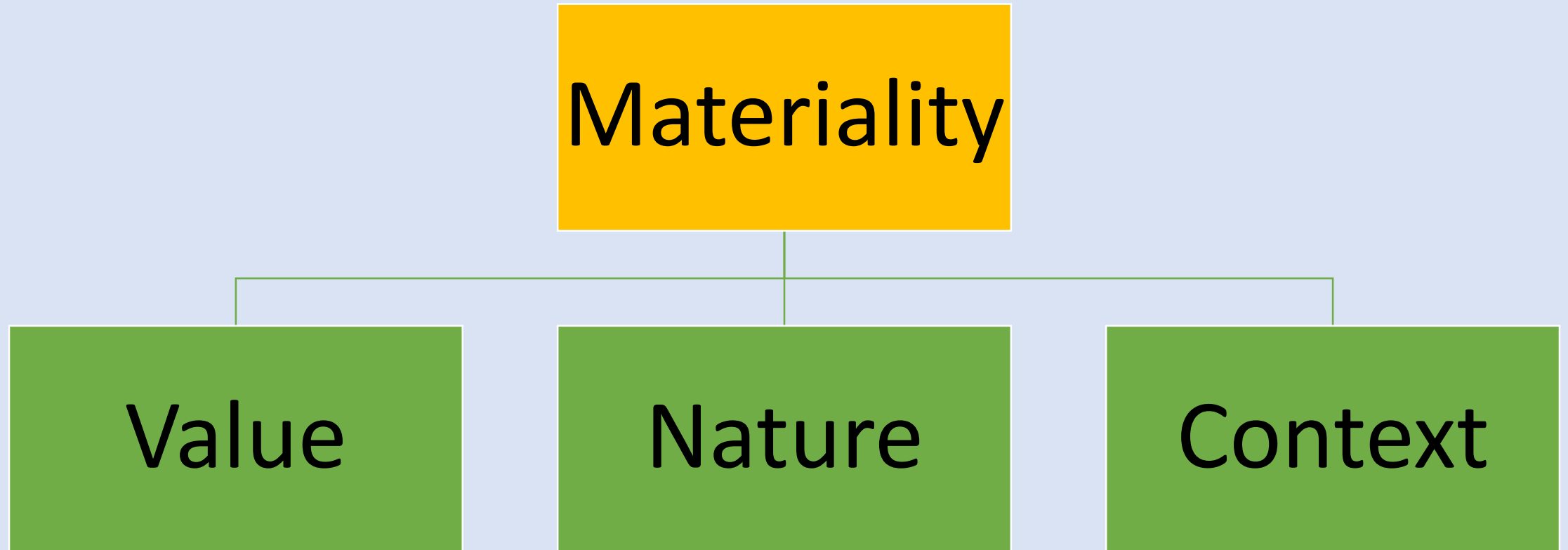
What is “materiality”

The objective of certification audit is to enable the auditor to express an opinion on whether the financial statements are prepared in all material respects, with an identified financial reporting framework

Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements

Materiality therefore relates to the significance of transactions, balances and errors contained in the financial statements. Materiality defines the threshold or cut-off point after which financial information becomes relevant to the decision making needs of the users. Information contained in the financial statements must therefore be complete in all material respects in order for them to present a true and fair view of the affairs of the entity.

Materiality





Materiality is also linked closely to other accounting concepts and principles:

Relevance: Material information influences the economic decisions of the users and is therefore relevant to their needs.

Reliability: Omission or misstatement of an important piece of information impairs users' ability to make correct decisions taken on the basis of financial statements thereby affecting the reliability of information.

Completeness: Information contained in the financial statements must be complete in all material respects in order to present a true and fair view of the affairs of the entity.



Reporting different levels of Assurance

POSITIVE EXPRESSION

- 'In our opinion internal control is effective, in all material respects, based on XYZ criteria.'

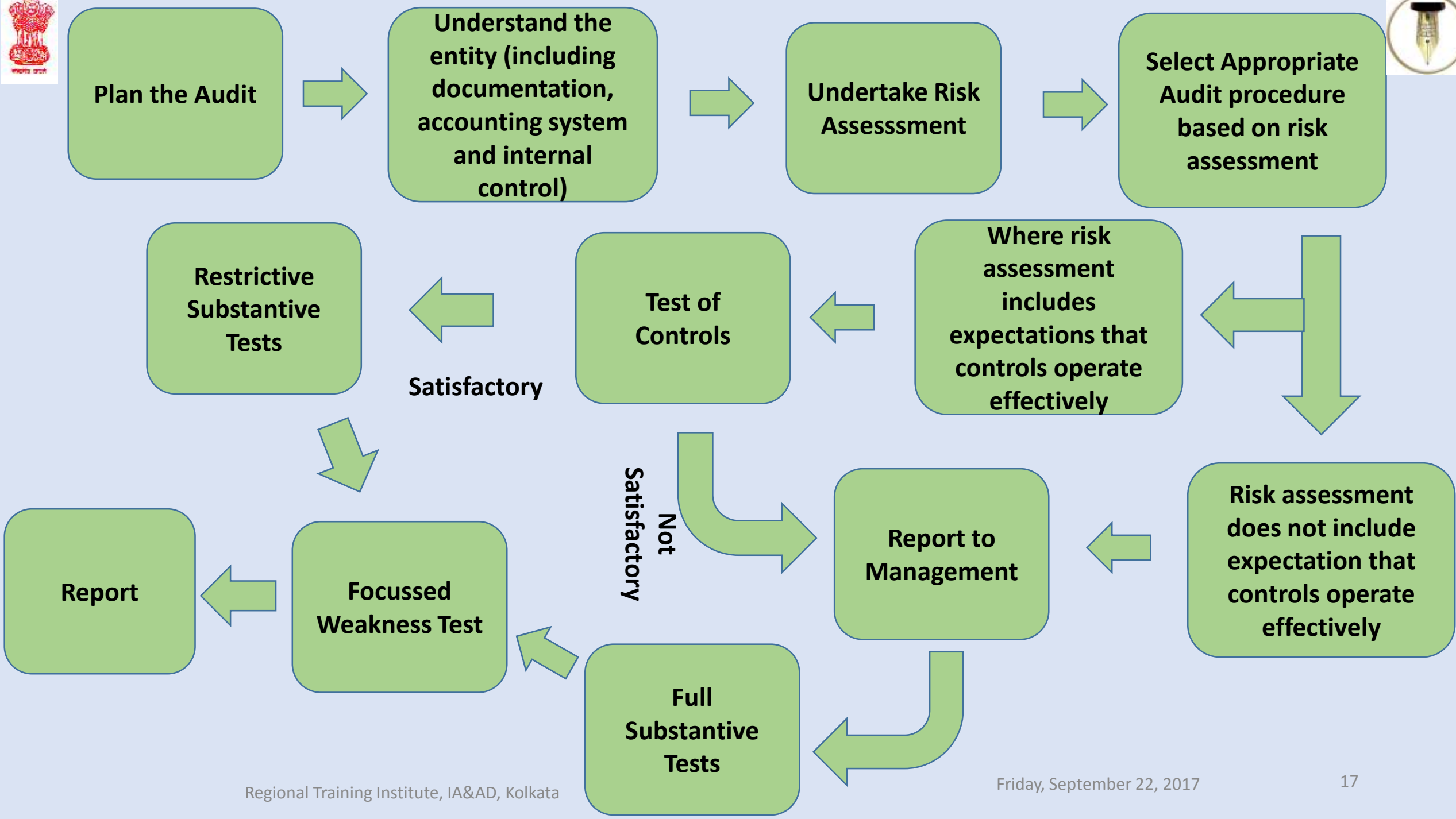
NEGATIVE EXPRESSION

- 'Based on our work described in this report, nothing has come to our attention that causes us to believe that internal control is not effective, in all material respects, based on XYZ criteria.'

Management's assertions

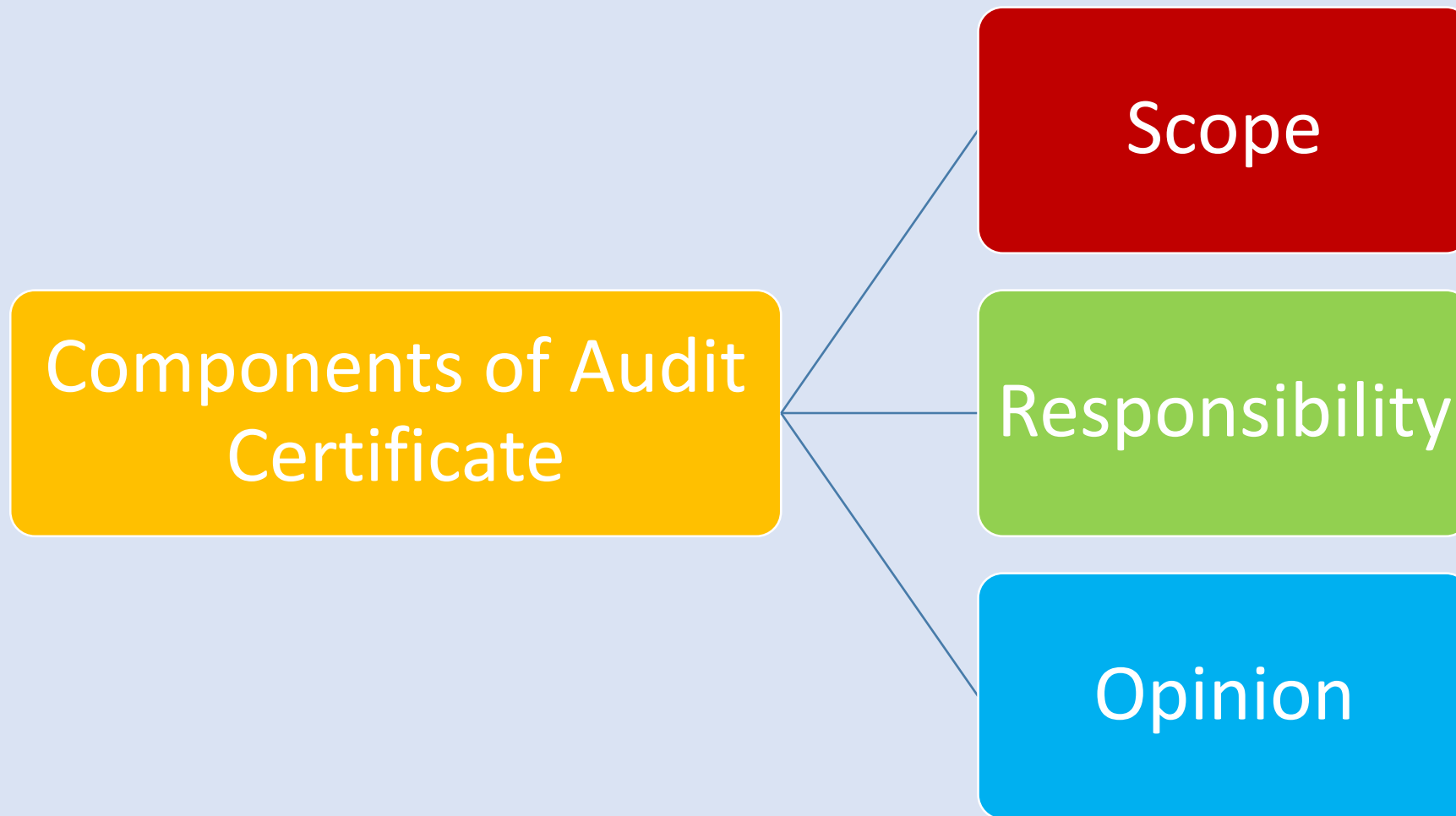
There are 5 general assertions that Management make in their financial statements:

- ✓ Completeness
- ✓ Existence
- ✓ Valuation
- ✓ Ownership and
- ✓ Disclosure





Audit Certificate





Scope

The paragraph on scope should identify the financial statements, the legislation or other authority providing for the audit and the auditing standards or practices followed in conducting audit.



Responsibility Statements

Management's Responsibility:

The paragraph usually elaborates that it was Management's responsibility to prepare and present the financial statements in accordance with the Accounting Framework and that this responsibility includes to design, implementation and maintenance of an internal control system to enable preparation of a financial statement that is 'true and fair'.



Auditor's Responsibility

Paragraph that usually elaborates that Auditor's responsibility is to:

- To express an opinion on the financial statements based on its audit.
- That the audit is carried out in terms of the applicable auditing framework.
- That audit is planned to obtain reasonable assurance that the financial statements are free from material misstatements.



Audit opinion





Unqualified Opinion

If the auditor comes to the conclusion that the accounts / financial statements are **reasonably reliable**, he gives an unqualified opinion. The meaning of reasonably reliable shall be considered in relation to the materiality of errors noticed.

An unqualified opinion is given when the auditor is satisfied in all material respects that :

- ☐ The financial statements have been prepared using acceptable accounting basis and policies which have been consistently applied; and
- ☐ The statements comply with statutory requirements and relevant regulations.



Qualified Opinion

When there is **uncertainty** or **disagreement** in regard to certain items in the accounts / financial statements that are material but not fundamental to the understanding of the accounts, a qualified opinion would be given.

Uncertainty may arise in either of the following situations :-

- ❖ The auditor is unable to obtain all the information and explanations. The non-availability of the connected accounting records may be cause or the auditor might have been prevented from carrying out the necessary audit process to test the accuracy of material figures in the accounts.
- ❖ The auditor cannot reach an objective conclusion as to the outcome of a situation. For example, here may be doubts about the performance of long-term contracts or the result of a legal action, which would have material financial consequences.



Qualified Opinion

Disagreement may arise as regards inclusion or exclusion of certain items in the accounts by the entity :

- ☐ The figures in accounts may not be based on the appropriate accounting principles or policies.
- ☐ The auditor may disagree with the facts or amounts in the accounts.
- ☐ The auditor may disagree with the way the entity has disclosed facts or accounts.
- ☐ The entity may have failed to comply with legislation or other regulations.



Disclaimer

Where the auditor is unable to arrive at an opinion because of uncertainty or restriction on scope of audit that is so fundamental that an opinion which is qualified in certain aspects would not be adequate, a disclaimer is given. The wording of the disclaimer opinion makes it clear that an opinion cannot be given, mentioning clearly and concisely all matters of uncertainty.

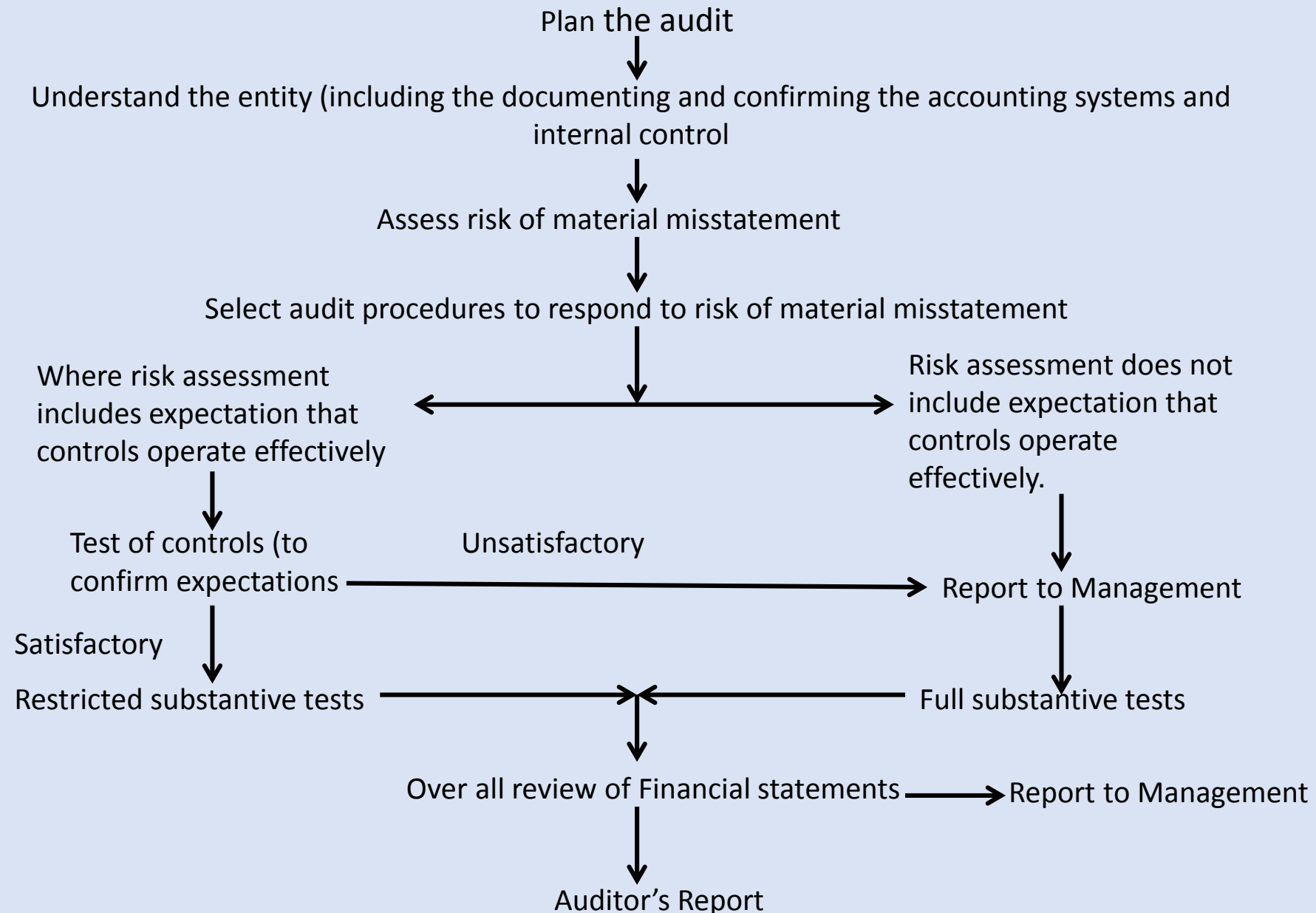


Adverse opinion

Where disagreement on the validity and truthfulness of the accounts / financial statements is so fundamental that even a qualified certificate in certain respects is found to be unjustified, an adverse opinion is given.



Stages of certification audit





Summary

- ❖ The purpose of certification audit is to promote confidence and trust in financial information.
- ❖ The object of certification audit is to produce an opinion in the form of a report.
- ❖ Reasonable assurance is usually reported in terms of positive expression.
- ❖ Limited assurance is usually reported in terms of negative expression.



Difference with other Audits

- ❖ Not an comment on propriety.
- ❖ Usually not a comment on compliance other than accounting framework and statutory acts.
- ❖ Usually not an comment on economy, efficiency, effectiveness, equity or ethics.
- ❖ No IR or DP etc, but end product is Audit certificate.



Audit techniques and audit evidence

Techniques

Evidence

Audit Findings

Audit Report



Audit techniques

to gather sufficient, competent, relevant, useful evidence

Inspection

Observation

External
Confirmation

Re-calculation

Re-Performance

Inquiry

Sampling

Analytical
Procedures



Inspection



- ❖ Inspection involves examining records or documents, whether internal or external, in paper form, electronic form, or other media, or a physical examination of an asset. An example of inspection used as a test of controls is inspection of records for evidence of authorization.
- ❖ Some documents represent direct audit evidence of the existence of an asset. Inspection of such documents may not necessarily provide audit evidence about ownership or value. In addition, inspecting an executed contract may provide audit evidence relevant to the entity's application of policies.
- ❖ Inspection of tangible assets may provide reliable audit evidence with respect to their existence, but not necessarily about the entity's rights and obligations or the valuation of the assets. Inspection of individual inventory items may accompany the observation of inventory counting.



Observation

- ❖ Observation consists of looking at a process or procedure being performed by others, for example, the auditor's observation of inventory counting by the entity's personnel, or of the performance of control activities.
- ❖ Observation provides audit evidence about the performance of a process or procedure, but is limited to the point in time at which the observation takes place, and by the fact that the act of being observed may affect how the process or procedure is performed.



External Confirmation

An external confirmation represents audit evidence obtained by the auditor as a direct written response to the auditor from a third party (the confirming party), in paper form, or by electronic or other medium. External confirmation procedures frequently are relevant when addressing assertions associated with certain account balances and their elements.

However, external confirmations need not be restricted to account balances only. For example, the auditor may request confirmation of the terms of agreements or transactions an entity has with third parties; the confirmation request may be designed to ask if any modifications have been made to the agreement and, if so, what the relevant details are. External confirmation procedures also are used to obtain audit evidence about the absence of certain conditions.



Re-calculation and Re-performance

- ❖ Re-calculation consists of checking the mathematical accuracy of documents or records.
Recalculation may be performed manually or electronically.
- ❖ Re-performance involves the auditor's independent execution of procedures or controls that were originally performed as part of the entity's internal control



Inquiry



- ❖ Inquiry consists of seeking information of knowledgeable persons, both financial and non-financial, within the entity or outside the entity. Inquiry is used extensively throughout the audit in addition to other audit procedures. Inquiries may range from formal written inquiries to informal oral inquiries. Evaluating responses to inquiries is an integral part of the inquiry process.
- ❖ Responses to inquiries may provide the auditor with information not previously possessed or with corroborative audit evidence. Alternatively, responses might provide information that differs significantly from other information that the auditor has obtained, for example, information regarding the possibility of management override of controls. In some cases, responses to inquiries provide a basis for the auditor to modify or perform additional audit procedures.



Inquiry



- ❖ Although corroboration of evidence obtained through inquiry is often of particular importance, in the case of inquiries about management intent, the information available to support management's intent may be limited. In these cases, understanding management's past history of carrying out its stated intentions, management's stated reasons for choosing a particular course of action, and management's ability to pursue a specific course of action may provide relevant information to corroborate the evidence obtained through inquiry.
- ❖ In respect of some matters, the auditor may consider it necessary to obtain written representations from management and, where appropriate, those charged with governance to confirm responses to oral inquiries.



Analytical procedures

Analytical procedures consist of evaluations of financial information through analysis of plausible relationships among both financial and non-financial data. Analytical procedures also encompass such investigation as is necessary of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount.

Sampling

The application of audit procedures to less than 100% of items within a population of audit relevance such that all sampling units have a chance of selection in order to provide the auditor with a reasonable basis on which to draw conclusions about the entire population.



AUDIT EVIDENCE

Audit evidence is necessary to support the auditor's opinion and report. It is cumulative in nature and is primarily obtained from audit procedures performed during the course of the audit. It may, however, also include information obtained from other sources such as previous audits.



AUDIT EVIDENCE: Relevance

Relevance deals with the logical connection with, or bearing upon, the purpose of the audit procedure and, where appropriate, the assertion under consideration. The relevance of information to be used as audit evidence may be affected by the direction of testing. For example, if the purpose of an audit procedure is to test for overstatement in the existence or valuation of accounts payable, testing the recorded accounts payable may be a relevant audit procedure. On the other hand, when testing for understatement in the existence or valuation of accounts payable, testing the recorded accounts payable would not be relevant, but testing such information as subsequent disbursements, unpaid invoices, suppliers' statements, and unmatched receiving reports may be relevant.



AUDIT EVIDENCE: Relevance

A given set of audit procedures may provide audit evidence that is relevant to certain assertions, but not others. For example, inspection of documents related to the collection of receivables after the period end may provide audit evidence regarding existence and valuation, but not necessarily cut off. Similarly, obtaining audit evidence regarding a particular assertion, for example, the existence of inventory, is not a substitute for obtaining audit evidence regarding another assertion, for example, the valuation of that inventory. On the other hand, audit evidence from different sources or of a different nature may often be relevant to the same assertion.



AUDIT EVIDENCE: Reliability

The reliability of information to be used as audit evidence, and therefore of the audit evidence itself, is influenced by its source and its nature, and the circumstances under which it is obtained, including the controls over its preparation and maintenance where relevant.

Therefore, generalizations about the reliability of various kinds of audit evidence are subject to important exceptions. Even when information to be used as audit evidence is obtained from sources external to the entity, circumstances may exist that could affect its reliability. For example, information obtained from an independent external source may not be reliable if the source is not knowledgeable, or a management's expert may lack objectivity.



AUDIT EVIDENCE: Reliability

- ❖ The reliability of audit evidence is increased when it is obtained from independent sources outside the entity.
- ❖ The reliability of audit evidence that is generated internally is increased when the related controls, including those over its preparation and maintenance, imposed by the entity are effective.
- ❖ Audit evidence obtained directly by the auditor (for example, observation of the application of a control) is more reliable than audit evidence obtained indirectly or by inference (for example, inquiry about the application of a control).



AUDIT EVIDENCE: Reliability

- ❖ Audit evidence in documentary form, whether paper, electronic, or other medium, is more reliable than evidence obtained orally (for example, a contemporaneously written record of a meeting is more reliable than a subsequent oral representation of the matters discussed).
- ❖ Audit evidence provided by original documents is more reliable than audit evidence provided by photocopies or facsimiles, or documents that have been filmed, digitized or otherwise transformed into electronic form, the reliability of which may depend on the controls over their preparation and maintenance.



Attributes of Audit Evidence

- **Relevance:** The evidence must be relevant and related to audit conclusion.
- **Objectivity:** Objective evidence is usually more persuasive than subjective. This is achieved when two or more auditors, working independently, are very likely to arrive at same result.
- **Timeliness:** Timely evidence is typically more persuasive than evidence produced after a delay.
- **Authoritativeness:** Authoritative evidence is more persuasive than non authoritative evidence.
- **Direct:** Direct evidence is more persuasive.
- **Competent:** The evidence must be competent i.e. reliable.
- **Sufficient:** The evidence must be sufficient to support audit conclusion.