The ExP Group

ACCA AAA | ExPress Notes

Advanced Audit and Assurance

SBL SBR AFM APM ATX AAA

BT MA FA LW PM TX FR AA FM

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Contents

"Hello"

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Thank you for downloading a copy of these ExPress notes and I hope you find them useful for your studies.

We provide these ExPress notes free of charge to individual students as part of our CSR initiatives. The notes are designed to help students assimilate and understand the most important areas for the exam as quickly as possible.

A word of warning though in that they have not been designed to cover everything in the syllabus so you should only use these notes for either an overview of the key areas before you start your main studies or as part of your final revision in the run up to your exams.

Importantly though, we want you to be successful in your exams so good luck with your studies and please do let us know how you get on.

All the best,

Steve

About The ExP Group

We were born with one passion, with one aim, with one desire. To use technology the way it should be used. To use technology to open up education, and in particular financial education, to whoever needs it regardless of their income, wealth, race, sex, religion or location.

We wanted to use technology to empower individuals to develop themselves through financial expertise, organisations to improve their performance through enhanced human capital and ultimately communities and families to benefit as a result.

We're on target and since our birth we have had the privilege of working with and learning from inspirational individuals and organisations from all 4 corners of the world in countries as varied as the UK in the north, Singapore in the east, South Africa in the south and the Cayman Islands in the west.

We're only part way through our journey but we're doing better than we expected. The best is yet to come though,

Education + Technology = Ethical Empowerment.

Thank you for being part of our story.

01 Assurance Engagements

The Big Picture

This is the Advanced Audit and Assurance paper. Clearly, therefore you are required to have some knowledge of assurance engagements other than audit engagements which are of course themselves examples of assurance engagements.

You also have to be prepared to contrast assurance with non-assurance engagements.

Key Terminology – Assurance Engagement

The IAASB has provided us with the following definition of an assurance engagement:

"An engagement in which a practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria."

Engagement Framework

The IAASB framework distinguishes between assurance engagements and non-assurance engagements.

Assurance engagements are broken down into:

1. Assurance engagements on historical financial information, which are then sub-divided into:
   (a) Reasonable assurance engagements e.g. statutory audit; and
   (b) Limited assurance engagements e.g. voluntary audit.
2. Assurance engagements on other information such as reviews of
   - VFM audits
   - Key Performance Indicators (KPI)
   - Internal control and systems
   - Due diligence assignments
   - Prospective Financial Information

Non-assurance engagements are indicated as including:

- Agreed upon procedures
- Compilation work

Reasonable assurance engagements on historic financial information

This would be a statutory audit with the work involved needing to be conducted in accordance with ISAs.

Auditor will give an opinion designed to increase the level of confidence for prospective users of the audited financial statements, with moderate to high assurance normally being provided.

Limited assurance engagements on historic financial information

This is more and more being seen as a possible alternative to the statutory audit. As an example, in the UK there have been discussions for the introduction of 'mini' audits for companies falling below the audit exemption threshold.

Whilst there is currently no statutory requirement for such 'mini audit', a significant and increasing number of companies are requesting limited assurance engagements, on an entirely voluntary basis.

Unlike reasonable assurance engagements, where 'positive assurance' may be given, with limited assurance engagements **only** 'negative assurance' is provided.

A limited assurance engagement involves more limited procedures than are required for a full statutory audit. In effect, no opinion is offered on the information, although some assurance is provided as to its reasonableness, with typical wording being as follows:

"Based on our review, nothing has come to our attention that the accompanying financial statements contain material misstatement."

Key Knowledge – Assurance Engagements Other than Audits or Reviews of Historical Information

The work involved in such engagements and the approach required, may be similar in many respects to an audit engagement, albeit the context is different.

ISAE 3000 provides guidance to practitioners for such engagements, the summarised requirements for which are as follows:

1. Ethical requirements – practitioners should comply with ethical requirements such as ACCA's Code of Ethics and Conduct
2. Quality control – the practitioner should implement quality control procedures that are applicable to the individual engagement.
3. Engagement – the terms of the engagement should be recorded in an engagement letter, and the practitioner should agree on the terms of engagement with the engaging party.

4. Planning and obtaining evidence – the practitioner should plan the engagement so that it will be performed effectively, and should consider materiality and assurance engagement risk, and sufficient appropriate evidence should be obtained on which to base the conclusion.
5. Reporting – the assurance report should be in writing and should contain a clear expression of the practitioner's conclusion about the subject matter information.

Key Knowledge – Value For Money (VFM) Reviews

VFM involves consideration of the three Es:

1. Economy
2. Efficiency
3. Effectiveness

In many countries such reviews originated in the public sector and in relation to other 'not-for-profit' organisations, where alternative measurements of performance (in the absence of profit) had to be developed in order to assess the relative success or otherwise of the organisation. VFM reviews may also of course be requested by commercial companies as well.

The vast majority of the knowledge required for this type of engagement is regarded by the AAA examiner as assumed knowledge from your AA studies.

Key Knowledge – Key Performance Indicators

KPIs may be seen as a set of measurements which focus on those aspects of an organisation's performance that are most critical for its continued success.

Many companies, frequently in response to shareholder expectations, now publish details of their KPIs in their annual report. Such KPIs can perhaps be seen as falling into one of two main categories:

1. Financial – e.g. accounting ratios based upon the financial statements
2. Non-financial – e.g. company targets on social and environmental issues

Assurance approach to KPIs will require careful consideration of:

- The definition of the KPI
- The calculation method
- The purpose of the reporting
- Nature of evidence available and source of underlying data

Possible problems facing the assurance provider will include:

- Lack of precise definitions
- Lack of established systems for the capture and recording of KPI data
- Susceptibility of KPIs to manipulation

Key Knowledge – Due Diligence Assignments

There is very little guidance on this type of engagement.

In an examination situation any question may be in the context of a group audit question, as in practice such task is often commissioned by the potential buyer of a company.

The potential buyer will be seeking to discover information about the target company and gain some assurance as to its reliability.

The assurance provider's procedures are often restricted to making use of analytical review techniques and enquiry as they attempt to verify the management representations made by the target company.

The practitioner may also sometimes be asked to offer practical recommendations regarding the acquisition process.

02 Audit Reports

The Big Picture

The one thing all statutory audits of limited liability companies have in common is that at the end of the day an independent auditor has to issue a report to the shareholders as the owners of the company.

The auditors must report their opinion in respect of two main issues:

1. Whether the financial statements give a 'true and fair view' (or present fairly in all material respects) the company's financial position and performance, and

2. Whether the financial statements have been 'properly prepared' in accordance with any relevant professional recommendations and/or statutory provisions.

This is not of course a new topic, as you should previously have studied this area in the AA paper. At the AAA paper stage, it is almost certain that any questions that you get in this area will be practical in nature, with few marks, if any, going for pure knowledge.

Given that the examiner has stated in the past about a concern in the auditing paper with testing candidates' accounting knowledge, you must anticipate that scenarios will include accounting treatments whose acceptability or otherwise you will have to be prepared to discuss.

The examiner has stated the acknowledgement of the importance of this syllabus area, but students should not assume that there will necessarily always be a question in this area.

Having said that, experience to date shows that there is a good chance that you will be faced with such a question in your sitting and this must be seen as a high priority area.

Key Terminology

ISA 700 The Auditors Report on Financial Statements identifies the key elements of the auditor's report:

1. Title
2. Addressee
3. Auditor's Opinion
4. Basis for Opinion
5. Key Audit Matters (for listed companies only)
6. Other Information
7. Responsibilities of Management and Those Charged with Governance
8. Auditor's Responsibilities for the Audit of the Financial Statements
9. Report on Other Legal and Regulatory Requirements
10. Name of the engagement partner
11. Signature
12. Auditor's address
13. Date of report

Modified Audit Reports

The standard audit report may be modified, such modification may or may not result in the auditors giving a qualified opinion. It is important to remember that modification of the audit report will only be required if there is some material issue.

With a practical type of question always make sure that you use any information available in the scenario to help you assess materiality in a sensible way, vague references to the fact that you would 'consider materiality' will NOT impress the examiner.

For example, let us say you are given the information that a company's profit before tax (PBT) is \$1,000,000 and that the company has failed to make provision for a known bad debt of \$150,000. State the obvious by saying that at 15% of PBT the bad debt is material, in that a standard benchmark would be to consider an item impacting on PBT as being material if it is in the range of 5% to 10% of such PBT.

It is also important when assessing materiality to remember that this must be considered so far as the user and not the preparer of financial statements is concerned. A useful working definition of materiality may be taken as,

'transactions and other events are likely to be seen as material in the context of a company's financial statements if their omission, misstatement, obscurement, or non-disclosure would matter to a proper understanding of such financial statements on the part of a potential user.'

Modified audit report with unqualified opinion

Sometimes there may be matters relating to the financial statements which, whilst fully and adequately disclosed within the financial statements, the auditor considers worthy of bringing to the particular attention of users.

The auditor achieves this by including in the audit report an additional paragraph known as an 'emphasis of matter' paragraph. This paragraph will be 'self-contained' and will NOT otherwise impact on the standard wording of an unmodified report.

An emphasis of matter paragraph should be positioned AFTER the basis for opinion paragraph

Past examiners' reports have indicated that many candidates have been unclear as to how and when to make proper use of an emphasis of matter paragraph. It is important, therefore, that you are totally happy with this aspect of audit reports.

An example of where the use of such paragraph would be appropriate includes where the financial statements have been prepared on a going concern basis, but this is dependent upon some significant uncertainty which is fully and adequately disclosed in the notes to the financial statements.

Modified audit report with qualified opinion

According to ISA 700, there are two main circumstances which might give rise to the auditors deciding that is necessary for them to qualify their audit opinion:

1. Limitation on scope which arises where the auditor has been unable to carry out some audit work which normally they would have expected to perform and/or where the circumstances are such that audit evidence which the auditor would normally expect to be available for some reason does not exist (the auditor is unable to obtain sufficient appropriate evidence).

2. Disagreement exists between the auditors and client management in relation to some aspect of the financial statements (the financial statements are materially misstated).

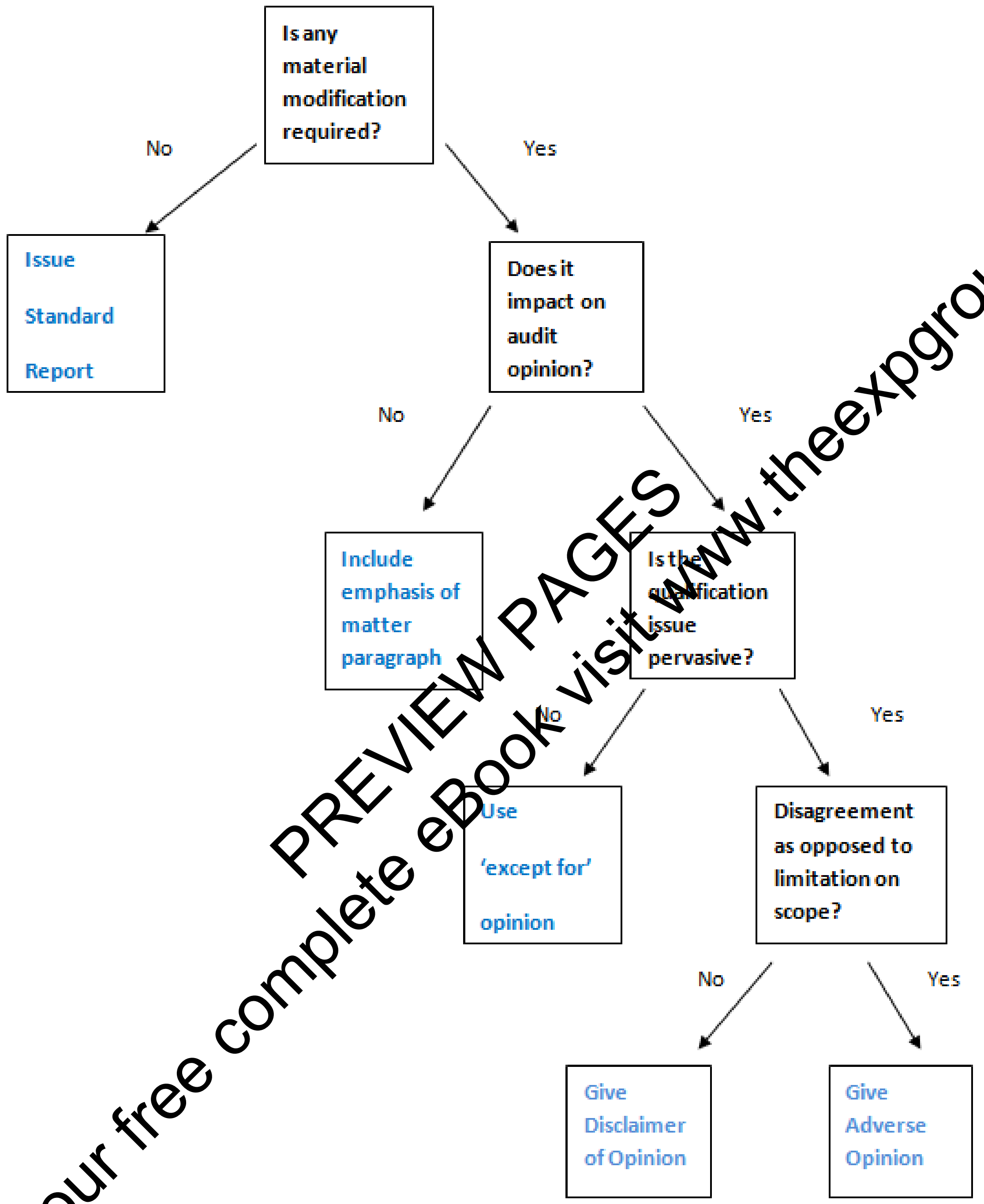
The type of qualified opinion to be given will depend not just on the circumstances as indicated above, but also on how serious the limitation on scope or disagreement is namely is it:

1. Material but not pervasive, that is to say that the limitation on scope or disagreement is confined to one particular aspect of the financial statements, such that the auditor is able to say that 'except for' this matter the financial statements give 'a true and fair view etc.'.

2. Material and pervasive, that is to say that the nature of the limitation on scope or disagreement is such that it will impact on the overall view given by the financial statements. In such situation if it is caused by limitation on scope, the auditor should give a Disclaimer of Opinion, whereas if it is because of disagreement, they should give an Adverse Opinion.

The circumstances giving rise to a qualified audit opinion should be described in a separate paragraph. Wherever possible, the auditor should quantify the qualification circumstances as this should make it easier for the reader to appreciate its significance.

Key Knowledge – Summary Diagram of Approach to Practical Audit Report Questions



03 Audit Risk

The Big Picture

Consideration of risk is to a large extent assumed knowledge, as you will have first come across this topic in your AA paper.

However, it may be some time since you passed AA and it is very important to revisit this topic as it has a good chance of featuring in the AAA examination questions.

At the professional stage, it is unlikely that you will get many, if any, marks simply for providing definitions but you must have a good working knowledge and understanding of key terms in order to be able to properly assess the risks in a given scenario and perhaps explain why they are risks.

An auditor must, as part of his assessment of a client's internal control systems, consider the risks to which the client's business is exposed and the extent to which there may be some material misstatement in the client's financial statements as a consequence of not identifying and managing such risks in an appropriate manner.

Consideration of risk is as an integral part of a modern-day audit.

Key Terminology

AUDIT RISK is very simply the overall risk that the auditor gives an inappropriate audit opinion in his report.

E.g. if an auditor gave an unqualified opinion, when in fact the company was not a going concern, then shareholders and others placing reliance on this report in making economic decisions relating to their dealings with the company might suffer financial loss.

Audit risk is seen as being made up of 3 elements:

AUDIT RISK = INHERENT RISK x CONTROL RISK x DETECTION RISK