

Course: Financial Audit

Lecture 3: Auditor's Services

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Introduction

Overview of Lecture 2

Auditor Services Overview

- Auditor services involve a broad spectrum of professional tasks performed by auditing firms for their clients. These services primarily consist of assurance engagements, which aim to enhance the reliability of information shared by an organization.
- These services are governed by engagement standards that have been carefully established by the International Auditing and Assurance Standards Board (IAASB).
- However, it's important to make a distinction between assurance engagements and other types of services provided by auditing firms.

Foundation of Auditor Services

- The foundation of auditor service standards is built on two critical components that underpin every aspect of the auditing process: the IFAC Code of Ethics and the International Standards on Quality Control (ISQC).
- The IFAC Code of Ethics, established by the International Federation of Accountants (IFAC), serves as a guiding beacon for all auditors. It lays out a set of ethical principles, such as independence, objectivity, confidentiality, and professional behavior, that auditors must adhere to while conducting engagements.
- International Standards on Quality Control (ISQC) are a set of standards issued by the IAASB that ensure auditing firms maintain a consistent and high-quality approach to their engagements.

Engagement Standards Framework

- The Engagement Standards Framework is a structured set of guidelines that auditors use to conduct various types of engagements. These standards are divided into two primary frameworks to accommodate different engagement needs:
 - International Framework for Assurance Engagements
 - Related Services Framework
- Under these two frameworks, the IAASB has established several distinct standards, each tailored to specific types of engagements:
 - International Standards on Auditing (ISAs)
 - International Standards on Review Engagements (ISREs)
 - International Standards on Assurance Engagements (ISAEs)
 - International Standards on Related Services (ISRs)

Engagement Standards Framework

- ISA 100, titled "Audits and Reviews of Historical Financial Information," serves as a foundational document outlining the fundamental concepts applicable to audits, reviews, and special engagements concerning historical financial data.
- The detailed audit standards, which provide specific requirements and procedures for auditors, are found in the ISA 200-799 series.
- For specialized engagements involving historical financial information, such as those related to specific industries or unique circumstances, standards are provided in the ISA 800-899 series.
- The ISREs 2000-2699 series specifically caters to review engagements, ensuring that auditors apply consistent and appropriate procedures when providing limited assurance on financial information.

Engagement Standards Framework

- International Standards on Assurance Engagements (ISAE) 3000R, titled "Assurance Engagements on Subject Matters Other than Historical Financial Information," offers guidance for assurance engagements that extend beyond the traditional financial statement audit.
- The standards under ISAE are divided into two parts:
 - ISAEs 3000-3399
 - ISAEs 3400-3599
- Due to the absence of specific IAASB standards for assurance engagements involving social, environmental, and economic subject matters, auditors often refer to other widely accepted frameworks, such as the Global Reporting Initiative (GRI).

Assurance vs Non-assurance

- Not all engagements performed by auditors are assurance engagements. Several types of engagements do not provide formal assurance and hence do not fall within the assurance engagement framework:
 - Related Services Engagement (ISRs)
 - Tax Returns and Consulting Engagements

Guidance and Practical

- The IAASB's standards are not limited to rules and procedures; they also include practical guidance that helps auditors effectively apply these standards in various situations.
- The International Auditing Practice Statements (IAPSs) are interpretive documents that provide additional clarification on ISAs, helping auditors understand and properly implement audit requirements during engagements.
- International Assurance Engagement Practice Statements (IAEPSs) provide interpretive guidance on the application of ISAEs.
- International Related Services Practice Statements (IRSPSs) offer similar assistance for ISRSs.

Assurance Engagements

- Assurance engagements are specifically designed to enhance the credibility of information that is relevant to the needs of intended users, such as shareholders, regulatory bodies, or other stakeholders.
- The subject matter of these engagements can be financial, or related to operational processes and systems.
- The key objective of assurance engagements is to provide an independent evaluation, resulting in an assurance report.

Assurance Engagements

- The International Framework for Assurance Engagements outlines five fundamental elements that are essential in every assurance engagement:
 1. A Three-Party Relationship
 2. Subject Matter
 3. Suitable Criteria
 4. Evidence
 5. An Assurance Report

Assurance Engagements

- Assurance reports come in two forms, depending on the level of assurance being provided:
 - Positive Assurance: This type of report is used for high-level engagements, such as audits, and provides reasonable assurance
 - Negative Assurance: Typically used for reviews, this type of report provides limited assurance.

Assurance Engagements

- The criteria serve as the benchmark for evaluating or measuring the subject matter in assurance engagements. They must meet the following characteristics to be considered suitable:
 - Relevant:
 - Complete
 - Reliable
 - Neutral
 - Understandable

Assurance Engagements

- The procedures for gathering evidence in assurance engagements are similar to those used in audits. The quantity and quality of evidence depend on several factors:
 - Characteristics of the subject matter: Whether the subject is historical or prospective can affect how much and what kind of evidence is required.
 - Availability of documentation and the timing of the practitioner's appointment: These elements can significantly influence the practitioner's ability to collect sufficient evidence.

Assurance Engagements

- The conclusion in an assurance report indicates whether, based on the evidence gathered, the subject matter meets the established criteria. The form of the conclusion depends on the type of assurance engagement.
 - Positive conclusions
 - Negative conclusions

Assurance Engagements

- Assurance engagements involve three key activities: planning, gathering evidence, and reporting findings. The extent to which these activities are conducted depends on the nature of the engagement and the level of assurance being provided.
- Engagements involving historical financial information require detailed planning and extensive evidence collection to reduce assurance risk to an acceptable level.
- Other types of assurance engagements, such as those related to sustainability reports or internal controls, also require adequate planning and evidence gathering but may not be as intensive.

Assurance Engagements

- During the planning phase, auditors need to thoroughly understand the subject matter and the overall context of the engagement. This understanding helps in assessing various risks that may arise.
- Any significant findings that could impact the assurance report must be carefully documented.
- These records are essential, not only to support the assurance report but also to demonstrate adherence to International Standards on Assurance Engagements (ISAEs).

Assurance Reports

- The assurance report must be formally documented, presenting a clear conclusion on the subject matter. While International Standards on Assurance Engagements 3000R provide guidance, they do not prescribe a standard reporting format.
- Assurance reports generally include certain essential elements like the title, the intended recipient (addressee), the date of the report, and the practitioner's signature along with the specific location.
- The title should clearly indicate that this is an independent assurance report. The addressee identifies the stakeholders or intended users of the report.

Assurance Reports

- Within the body of the report, the subject matter must be described in detail.
- The subject matter's characteristics could be qualitative or quantitative, objective or subjective, or it may cover historical or prospective elements.
- The auditor should also discuss any limitations inherent in the evaluation process, such as measurement inaccuracies.

Assurance Reports

- Evidence used in the assurance engagement is assessed using specific criteria. These criteria may either be widely recognized (like the International Financial Reporting Standards for financial statements) or specially developed to suit the needs of specific users.
- If customized criteria are used, the assurance report should explicitly state that it is intended only for the identified users and specific purposes.

Assurance Reports

- To ensure that users comprehend the conclusion reached by the practitioner, the report must include details regarding the criteria used, the measurement methods employed, and any important interpretations made during the assessment.
- The practitioner's conclusion can be presented in various forms—positive, negative, or reserved. In cases involving an audit of financial statements or internal control systems (like Sarbanes-Oxley engagements), the conclusion is generally positive.

Assurance Reports

- For reviews, conclusions are expressed in negative form. Negative assurance communicates that no issues were found without providing absolute assurance.
- If the subject matter does not entirely meet the criteria or if sufficient evidence could not be obtained, the practitioner must clearly state these reservations in the conclusion.
- Auditors must communicate any significant issues identified during the assurance engagement to those in governance, such as the audit committee.

Assurance Reports

- If an assurance engagement is reclassified to a non-assurance engagement or shifted from an audit-level to a review-level engagement, the auditor must ensure that there is a reasonable basis for the change, such as a shift in user requirements or a misunderstanding regarding the nature of the original engagement.
- Assurance engagements involving historical financial data can take the form of audits, reviews, or examinations for specific purposes.
- The goal of a review is to enable the auditor to state whether there is anything that suggests the financial statements are not prepared correctly, based on limited procedures like inquiry and analytical assessments.

Assurance Reports

- The evidence gathered for a financial statement review primarily includes inquiries and analytical procedures. Inspections of records are limited, and corroborating evidence is generally not collected, unlike in audits.
- A review report includes elements like the title, addressee, introductory paragraph, scope paragraph, negative assurance statement, report date, and auditor's signature.
- The conclusion of a review report can be unqualified, qualified, or adverse.
- Auditors may conduct audits of specific financial statement components or provide opinions on compliance with contractual requirements.

Assurance Reports

- Summarized financial statements present highlights of a company's financial position, intended for users who need only a general overview.
- Financial statements may also be prepared using criteria that differ from conventional standards, known as OCBA.
- An auditor may also be asked to report on compliance with specific agreements, such as loan covenants.

ISAE 3000R

- The International Standard on Assurance Engagements (ISAE) 3000R serves as a guiding framework for professional accountants conducting assurance engagements involving subjects other than historical financial data.
- The scope of these engagements involves two key components:
 - General Topics Related to Assurance Engagements (ISAE 3000–3399)
 - Subject-Specific Standards (ISAE 3400–3699)

ISAE 3000R

- There are no additional specialized standards beyond the fundamental framework provided by ISAE 3000 to address all non-historical subjects.
- The International Auditing and Assurance Standards Board (IAASB) will develop new standards as the demand arises.

Assurance Standards

- Assurance services extend beyond audits of historical financial information to encompass different categories of subject matter. Each type of engagement is tailored to provide credibility to the data presented, with varying standards and approaches depending on the nature of the information involved:
 - Prospective Financial Information:: This involves financial data relating to future events, such as budgets, forecasts, or financial projections.
 - Non-Financial Information: Assurance engagements can be performed on non-financial data such as sustainability, environmental impacts, and governance practices.

Assurance Standards

- **System and Processes:** Assurance engagements can also focus on the evaluation of systems and processes within an organization.
- **Behavioral Aspects:** Assurance can also be provided on behavioral aspects of a company, such as adherence to human resources policies, corporate ethical conduct, or regulatory compliance.

Assurance Engagements

- For assurance engagements that go beyond historical financial audits, practitioners must consider additional factors and adapt their approach accordingly:
 - Client Acceptance and Engagement Risk: Before accepting an engagement, practitioners must evaluate the appropriateness of the client. This includes assessing the potential risks involved and whether the engagement's scope fits within the firm's expertise.

Assurance Engagements

- **Understanding the Subject Matter:** The practitioner needs a deep understanding of the subject matter, which often requires specialized knowledge. The nature of the subject matter determines the criteria to be used in the assessment.
- **Tailored Assurance Reports:** Assurance reports for non-financial engagements must be tailored to reflect the specific nature of the engagement. The report must clearly communicate the criteria, procedures, and conclusions in a manner that is understandable to the intended users.
- **Reporting and Materiality:** Materiality in assurance engagements beyond financial information can be more complex to define.

Prospective Financial Information

- "Prospective financial information" refers to data developed using assumptions regarding future events. It can take two main forms:
 - Forecast
 - Projection
- Reports examining prospective financial information can vary widely, depending on their purpose:
 - Prospectus
 - Annual Report
 - Lender's Reports

SOX & PCAOB

- The Sarbanes-Oxley Act (SOX) of 2002 requires that public companies in the USA ensure their CEOs and CFOs certify the effectiveness of internal control over financial reporting.
- The US Public Company Accounting Oversight Board (PCAOB) has established Audit Standard #2 to implement SOX's requirements, obligating public accounting firms to clearly describe the scope and findings of their internal control audits.

Sustainability Reporting

- The assurance of sustainability reports related to financial, environmental, and social issues is growing rapidly, partly due to legal requirements for environmental disclosures in certain countries.
- The economic, environmental, and social dimensions of sustainability are often reported following the Global Reporting Initiative (GRI) guidelines, focusing on:
 - Economic Dimension
 - Environmental Dimension
 - Social Dimension

Sustainability Reporting

- The GRI guidelines encourage reporting across five sections: Vision and Strategy, Profile, Governance Structure and Management Systems, GRI Content Index, and Performance Indicators.

Assurance vs Related Services

- Not every engagement undertaken by auditors qualifies as an assurance engagement. Related Service Engagements—governed by International Standards on Related Services (ISRS)—include:
 - Agreed-upon Procedures (ISRS 4400)
 - Compilation Engagements (ISRS 4410)

Assurance vs Related Services

- Assurance engagements that do not involve historical financial information are distinct from traditional audits. They require specialized considerations, particularly regarding the nature of subject matter and the uncertainties involved. Assurance practices, as they evolve, also encompass sustainability dimensions, adapting to growing societal demands for transparency and accountability across economic, environmental, and social domains.

Conclusion

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Closing

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Reference (reading material):

- Principles of Auditing: an Introduction to International Standards on Auditing, 3rd Edition, Hayes, Wallage, and Gortemaker, Pearson Education Limited, 2014