

Auditing stages

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The aim of this discussion is to explain how an auditor goes about the process of auditing financial statements and presents the five basic stages that the auditor performed during the financial statement audit at Maryward Primary School in Kwekwe for the year ending 31 December 2012. In order to be in a position to fulfil auditing responsibility to report on the client's annual financial statements, the auditor followed a series of procedures and activities as required by the auditing profession.

The auditor applied the following audit stages: pre-engagement activities, planning, test of controls, substantive procedures, completion and reporting. Puttick et al (2012: 102) defines an audit according to Section 1 of APA as ... the examination of, in accordance with prescribed or applicable auditing standards: a) financial statements with the objective of expressing an opinion as to their fairness or compliance with the identified financial reporting framework and any statutory requirements.

Pre-engagement activities There are five pre-engagement activities and considerations. The auditor at this stage performed a new client investigation in order to accept the new appointment as a way of managing conflicts and threats to the auditor. Assessments of any threats to the independence of the auditor was done as an audit engagement should not be accepted where the auditor's independence is compromised.

The other assessment done was the business risk faced in order to avoid the risk of association with a client whose integrity is questionable and particularly where motivation exists to misstate disclosures in financial information or indulge in illegal business and fraudulent reporting practices as it likely to render the auditor's business risk unacceptable. The factors

considered during the investigation included business reputation of Maryward Primary School. An assessment of the complication of the audit assignment and the estimated time, required to finish the work was done.

An engagement letter was prepared to provide the clearest record of the terms of the engagement. ISA 210 provides the contents of an engagement letter to be sent to the client to help prevent misunderstandings with respect to the engagement. Also, SAS 140 requires that an auditor should agree with the client the terms of the engagement to be undertaken and the terms should be written therefore the letter of engagement will be required whenever a new auditor appointment is accepted.

The main constituent features of a typical letter of engagement are: responsibility of directors and auditors, the scope of the audit, other services, fees, Applicable law (Zimbabwe) and agreement of terms. The auditor accepted the engagement for the audit of the financial statements after the conclusion that the reporting framework was acceptable. There was an agreement between the auditor and Maryward Primary School, both parties agreed to meet when changes arise and when the auditor considers the appropriateness of the matter to do so.

In preparation for the audit, the auditor had a tour to Maryward Primary School after the opening meeting with the client. Russell (2012: 69) states that " a tour of the area to be audited is permissible and often times highly desirable. An auditor may tour this area as part of a pre-audit visit to review documents before or after the opening meeting. " Travel plans were made and a team of three people was identified and sent to the audit area.

Planning

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According to Puttick et al (2012) the auditor first considers materiality at the planning stage of the audit. The auditor made a judgement of materiality in order to plan the audit in such a way that sufficient evidence is gathered to draw up a conclusion. Planning materiality was based on the end of year financial statements and budgets. According to Millichamp (2002) materiality is material if its omission/misstatement could influence the economic decisions taken on the basis of the financial statements.

The auditor also considered inherent risk as it has a direct impact on the nature, timing and extent of procedures the auditor plans to perform to gather sufficient appropriate audit evidence in response to the assessed risk of material misstatement. " Inherent risk" as per ISA 400 is " the susceptibility of an account balance or class of transactions to misstatements that could be material, individually or when aggregated with misstatements in other balances or classes, assuming that there are no related internal controls".

The auditor assessed audit risk and inherent risk as it is an essential part of audit planning to help in determining the quality and quantity of evidence gathered and the staff that needed to be assigned to the particular audit. The auditor also obtained an understanding of the business and its environment in order to assess the risk of material misstatement. ISA 310 requires a reasonable understanding of the client's business and industry. The nature of the client's business and industry affects the client business risk and the risk of material misstatements in the financial statements.

The auditor used the knowledge of these risks to determine the appropriate amount of audit evidence gathered. The auditor through experience is aware

of the exposure to problems resulting from the auditor's failure to understand comprehensively the nature of transactions in the client's business. The understanding helped the auditor to evaluate the design and implementation of specific controls that could stop or discover and rectify material misstatements at the assertions level. Control risk is the probability that the client's internal control system will fail to notice material misstatements.

Audit risk is the risk that the auditor will unknowingly express inappropriate opinion on the financial statements. Inherent and control risk are the business's risks that exist independently of the audit of financial statements, whereas detection risk is a function of the effectiveness of an audit procedure and its application by the auditor. Puttick et al (2012) quotes the ISA 200 definition of detection risk: "detection risk is the risk that the auditor will not detect a misstatement that exists in an assertion that could be material, individually or when aggregated with misstatements".

The auditor inquired into the detailed working papers, inspected legal documents and minutes of meetings of the accounting system and its related controls from the management and personnel of the client. A description of the system was recorded and confirmed that the record is an accurate description of the system and a preliminary evaluation of the internal controls was made. Audit planning involves developing an overall strategy for performing the audit.

ISA 300 "audit strategy" describes in simple terms how audit is to be carried out and the "audit plan" details the exact procedures to be carried out to implement the strategy and complete the audit. During planning the auditor established an understanding with the client as to the nature of services to

be provided and the responsibilities of each party through the engagement letter. The auditor developed an overall audit strategy, an audit plan and audit program and documented in the working papers each significant business cycle that is, revenue, expenditure, fixed assets, payroll and accounting.

Planning continued throughout the entire audit as the auditor accumulated sufficient appropriate audit evidence to support the audit opinion. Performing tests of control and Substantive procedures One of the most important of all the audit stages is the process of testing the internal controls. The aim of tests controls is to obtain evidence that controls on which audit reliance is intended, worked out throughout the period of the financial year under audit. The tests of controls indicated that internal controls are operating effectively; the planned audit approach was not to be changed.

These processes and procedures were used to ensure that proper approvals are in place before payment is made or transactions entered in the system. The auditor used the primary method of internal control testing to randomly select transactions and checked the source documentation. The random selection from a representative sample revealed that controls are strong, so there was no point for increasing the sample size. A substantive procedure is the actual process of collecting physical evidence of transactions and verifying the value posted to a specific account is supported by actual documents.

This aspect of the audit is the most time consuming and is very detailed work. Gray (2008) propounds that at this stage conclusion made by the auditor must be supported by in each case by carefully evaluated evidence <https://assignbuster.com/auditing-stages/>

that the transactions are completely and accurately recorded. As auditors cannot rely completely on management assertion of completeness, the search for unrecorded expenses and liabilities was designed to yield audit evidence of liabilities that were not recorded in the reporting period. A material error or fraud in the inventory has a pervasive effect on the financial statement.

Auditing standards requires that the auditor should observe the inventory taking and make test control. Physical inventory at year end was counted when the auditor was present to observe and perform the dual direction testing to gather evidence for the existence and completeness assertions. This involved the performance of substantive procedures the nature, timing and extent of which responded appropriately to the assessed risk of misstatement at the assertions level to achieve a level of detection risk that will result in an acceptable level of audit risk relating to assertions within financial statements.

Evaluating and concluding The final stage of auditing process involves evaluating and drawing conclusions on the fair presentation of the financial information and the drafting of the audit report. During this stage the auditor considers the sufficiency of the evidence gathered in support of financial statement assertions. Assertions are the representations of management that are represented in financial statements, for, example, that fixed assets reflected in financial statements exist and are owned by the entity and are fairly valued.

ISA 500R: identifies assertions under three categories namely: assertions about classes of transactions and events for the period under audit,
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assertions about account balances at the period end and assertions about presentation and disclosure. The auditor decided on the fair presentation of assertions and evaluated the differences between amounts included in the financial information and amounts supported by audit evidence.

The audit differences represent uncorrected material misstatements in the financial statements. The auditor evaluated the effect of uncorrected material misstatements on the audit and the effect of uncorrected misstatements on the financial statements and tested whether the financial statements as a whole are free of material misstatement. The auditor evaluated the effect of such misstatements on audit opinion. For this purpose, the auditor established a final estimate of materiality.

After consideration of all evidence, the auditor concluded that financial statements were not significantly materially misstated and management was not requested to make appropriate adjustments. The completion stage of the audit is the final stage during which the engagement team and partner responsible for the audit perform finishing procedures, evaluate the sufficiency and appropriateness of audit evidence gathered during the audit and findings in respect of significant risks identified, including fraud risk, in order to form the audit opinion on financial statements.

During completion procedures, the auditor reviewed the financial statements on an overall basis performing a final analytical review on period end financial information. The reading of supplementary and other relevant information and resolution of the impact of any significant matters arising were considered. Update inquiries on specific aspects for example, fraud, laws, regulations and evaluation of the results of audit procedures for all

significant findings. Written representations from management acknowledging its responsibility for the design and implementation of internal controls to prevent and detect error were obtained. Reporting The last stage of the audit is finalization. This is the creation of a report to management that summarizes all the procedures used to conduct the audit, the result of the various processes, and supporting documentation. Gray (2008) states that “ at this stage the auditor summarizes evidence on systems and other aspects seen to be of interest to management and sends a formal report of comments and recommendations”.

After completion of fieldwork and analysis the auditor presented the first draft of findings and recommendations to the client during the exit meeting. Paragraphs 27, 32, and 35b of ISA 700 indicate that the description in the auditor’s report can refer either to the preparation and fair presentation of the financial statements or the preparation of financial statements that give a true and fair view.

True in the sense that the auditor’s information given was factual and conforms to reality and not false, in addition the information conforms to the required standards and law and that the accounts of Maryward Primary School had been correctly extracted from the books and records. Fair in the sense that information given is free from discrimination and bias and in compliance with the expected standards and rules and that the accounts of the client reflect the substance of the business’s underlying transactions.