

Importance of generally accepted auditing standards (gaas) assignment



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GAS are divided into three categories such as the general standards, the standards of fieldwork and standards of reporting. Auditors can render reports of the financial statements audited in four ways. The report can either be a qualified opinion, unqualified opinion, adverse opinion and disclaimer of opinion. Auditors who considered the report to be free from any material defect can render a report of unqualified opinion and a disclaimer is issued if the auditor will not be able to render a report on the basis of want of sufficient information.

Independence and impartiality are character traits that auditors must nurture and the materiality of an audit finding has an inverse relationship with audit risk. A business entity has the need to prepare financial statements that will truly reflect its economic performance within a business cycle. The financial statement will serve as proof on how the entity fared, on whether or not it was able to gain a profit or suffered a loss while conducting its daily business operation.

The prepared financial statements will show the financial position, the comprehensive income, the cash flows and the changes in equity of the company. Failure to reflect an accurate report will have dire consequences not only to the business organization but also to the other stakeholders. Thus, business entities have to accurately report its economic standing and it is the role of the auditors to render an audit that will accurately show the financial standing of the company with the aid of Generally Accepted Auditing Standards.

The government had imposed rules and regulations as well as guidelines on how these financial statements are made. This is to prevent companies from misstating their financial reports especially if it has the intention to mislead the public and its stakeholders on its true economic standing. To further safeguard the stakeholders who are relying on the business entity reported uncial statements, the government is requiring that these financial reports be audited by external auditors who will check the reasonableness of its accuracy.

These auditors must remain independent and objective in conducting the audit to prevent the stakeholders from thinking otherwise. There are also rules and guidelines that auditors follow in conducting the audit. The Generally Accepted Auditing Standards (GAS) contains the necessary guidelines that will aid auditors in conducting an audit that will truly reflect the true financial standing of a business entity. Background

The Generally Accepted Auditing Standards (GAS) was developed by the American Institute of Certified Public Accountants when it has the authority to oversee and provide guidelines in the conduct of Certified Public Accountants in the Accounting and Audit Profession. “ The Auditing Standards Board of the CPA developed ten generally accepted auditing standards for the audit of financial statements that serves as a foundation for all other standards, including those that have been adopted by the PEPCO.

Because the standards are conceptual in nature, an understanding of them provides a foundation to better understand other tankards. The said

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standards are developed into three categories such as the general standards which apply to the auditor and the audit firm, fieldwork standards which apply to the conduct of the audit and the last is the reporting standards which are applicable to communicating the auditor's opinion. Irritating, Chewier, & Karl 2008) Despite the fact that the CPA has been impliedly stripped off of its authority in providing guidelines and rules for auditors and accountants to abide by yet, the standard it had developed continues to be in effect since the guidelines revived serves as a foundation for the creation of further measures that safeguards Auditors have an important role in the business world. They are primarily in charge with checking the accuracy of the financial statements reported by business entities.

These business entities are required to record, interpret and report every business transaction that has a corresponding effect on the accompany economic standing. The whole business process of every business entity or organization are done or made in accordance with the Generally Accepted Accounting Principles. GAP) However, there are instances that business entities do not accurately follow the rules and guidelines provided in the GAP.

Some entities are doing it without the intention to defraud others but there are also others who delineate from the standards provided with the intention to mislead others into believing that the company is performing well or has enough assets to pay all of its liabilities despite the opposite fact. To prevent the instances mentioned above from happening, auditors are required to obtain and evaluate data from the business entities to check for any irregularities. The auditor is required to render a report whether or not there

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are is an irregularity or a misstatement in the financial statements reported by the company.

There are a number of ways that an auditor will render his audit report based on the audit findings found. These are four types of audit report, namely, Clean or Unqualified Report, Qualified Report, Adverse or Negative Report and Disclaimer of Opinion. “ A clean report is when an auditor gives an opinion on the various matters without any qualification or reservations... However, it should be pointed out that the auditor is not a guarantor or an insurer. If he gives a clean report, it does not mean that it is completely accurate...

A qualified report is when auditor gives an opinion subject to certain reservations. The said report can be used only when the auditor believes that the overall financial statements are not fairly stated... An auditor can make an adverse or negative report when there is a reasonable ground for him to form an opinion that the accounts and financial statements taken as a whole, do not present a true and fair view of the financial position and the working results of the company. If the auditor wishes to give an adverse report, he should disclose all material reasons.

A disclaimer of opinion is when an auditor, for want of sufficient information, is unable to form an opinion as to the fairness of the financial statements. ” (Kumar & Sahara 2006, p. 329-335) Through the GAS, all auditors are required to render a report stating that the financial statements of a business entity are free from any material misstatements. These material

misstatements are either caused by fraud or error committed by the company to hide its true and financial standing.

The materiality of the said error varies from one business entity to another which depends on the nature of the business and the audit risk involve. “

When landing an audit, the auditor considers what would make the financial information materially misstated. The auditor’s preliminary assessment of materiality, related to specific account balances and classes of transactions, helps the auditor decide such questions as what items to examine and whether to use sampling and analytical procedures...

There is an inverse relationship between materiality and the degree of audit risk, that is, the higher the materiality level, the lower the audit risk and vice of an audit procedure to use before conducting an audit. It is the role of the auditors to check on the reliability of the financial statements ported by a business entity. However, the auditors are not required to render a report stating that the financial statements reported by the company are absolutely and accurately reported in all its material intents and purposes.

The GAS provides that the auditor’s role is to obtain a reasonable assurance on the fairness of the financial statements reported by an entity. The GAS provides 10 standards which not only serves as a guide but also serve as a safeguard of the auditor from any liability in instances that it was not able to uncover fraud or misstatement of the company’s financial statement while conducting the audit. There are ten standards that comprises the Generally Accepted Auditing standards that serves as the criteria to evaluate the quality of the auditor’s performance.

The first three standards are known to be the General Standards which are personal in nature as they relate to qualities that the auditor brings to the assignment: (a) Training: The auditor must have adequate technical training and proficiency to perform and audit. (b) Independence: The auditor must maintain independence in mental attitude in all matters relating to the audit and (c) Due professional care- The auditor must exercise due professional care in the performance of the audit and the preparation of the report.

Auditors gather evidence that will serve as the foundation for the auditor's conclusion. The Standards of Fieldwork are (a).

Planning and Supervision- The auditor must adequately plan the work and must properly supervise any assistants. " (b) Internal Control- " The auditor must obtain sufficient understanding of the entity and its environment, including its internal control, to assess the risk of material misstatement of the financial statements whether due to fraud or error, and o design the nature, timing and extent of further audit procedures. (C) Evidence- " The Auditor must obtain sufficient appropriate evidence by performing audit procedures to afford a reasonable basis for an opinion regarding the financial statements under audit. The reporting standards will say something about the language that is required in the auditor's report: (a) GAP- The auditor must state in the auditor's report whether the financial statements are presented in accordance with generally accepted accounting principles. (GAP). (b) Consistency- The auditor must identify in the auditor's report those circumstances in which such principles have not been consistently observed in the current period in relation to the preceding period. (c)

Disclosure- When the auditor determines that informative disclosures are not

reasonably adequate, the auditor must so state in the auditor's report. D) Opinion- The auditor must either express an opinion regarding the financial statements, taken as a whole or state that an opinion cannot be expressed, in the auditor's report. When the auditor cannot express an overall opinion, the auditor should state the reasons therefore in the auditor's report. In all cases where an auditor's name is associated with financial statements, the auditor should clearly indicate the character of the auditor's work, if any, and the degree of responsibility the auditor is taking, in the auditor's report. "

(Trick 2010, p. 9-20) the fact that it reflects the financial standing and performance of a business entity. The stakeholders will be able to assess the risk of the said entity by simply looking at the financial statements reported. The misstatements of the financial reports might mislead investors to invest in a company that is on the verge of collapsing or is not worth the risk. There are many other potential users of corporate financial reports- e. G. Financial Journalists writing about individual companies. All, however, have a stake in the company-some directly (e. G. Warehouses, lenders, creditors and employees) and other more indirectly (e. G. Government departments, analysts, and journalists.) (Lee 2007 p. 14) " The financial statements are provided to third parties who have invested or might invest in the company, lend the organization resources, or who otherwise have a vested interest in the organization. Auditors gather evidence to determine whether the financial statements are fairly presented in accordance to GAP and prepare an independent opinion that is in turn shared with third-party users, management, and the board of directors. Irritating, Chewier & Johnston) The government, banks, investors and other interested parties wants to know the know the accuracy of the financial report so that it can evaluate the financial

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statement of an entity for various reasons. The government needs to have the accurate financial statement for tax purposes while the banks and investors need it to know the viability of the business and on whether or not it is worth the risk. Third parties are relying on the auditors to provide them with an accurate finding on the financial standing of a company.

However, the auditors are not required to report absolute accurateness of its reports. The GAS provides that auditors will have to render its findings with reasonable assurance which is the reason that guidelines are provided to ensure that all areas are covered and the possibility that there is fraud that will be discovered during the conduct of the audit. The said fraud can be discovered whether the audit is random or routinely conducted. It is expected that stakeholders has a high expectation on auditors.

Some are expecting auditors to detect any fraudulent activity of the company which will affect the integrity of the financial reports but it will not always be the case for there are instances that fraudulent activities are not detected due to the complexity of the fraud perpetuated in which the auditor may not be familiar on how it works. Auditors are more concerned with the material misstatements that the company may have made rather than in unearthing or discovering a fraud which is the reason why the auditors have the tendency to overlook fraudulent activities during the audit of uncial statements.

An audit is a systematic process of obtaining and evaluating evidence of an economic actions to determine its accurateness which is then reported to interested users. “ Financial statement auditing, in its broadest context, is

the process of attesting to assertions about economic actions and events. It is therefore frequently referred to as an attestation service. Attestation is a three-part process: gathering, evidence about assertions, evaluating that evidence against the objective criteria and communicating the conclusion reached. (Irritating, Chewier & Johnston) According to the book and as stated above, an audit is a three way process in standing of the client. The evidence obtained will be evaluated using the financial statements provided by the entity. The auditor will make the necessary evaluation on whether or not the financial reports was made in accordance with the generally accepted accounting standards provided. The gathering of data and the evaluating of evidence is done in an objective manner to ensure the accuracy of the audit of such reports.

The findings of the auditors are usually communicated to users who are interested on the economic standing of an entity. The auditors will observe the professional standards provided in the GAS. An audit has three basic components which include, (a) the process of auditing is to gather and evaluate evidence to test assertions, (2) the audit process is systematic and (3) when auditors provide reports to third parties, it is important that the auditor be independent of the entity audit and the audit process is unbiased.

To assert the reasonable accuracy off financial statement, the auditor must make some necessary procedures to ensure that it truly reflects the financial standing of the company. If the assets reflected in the balance sheet are fairly valued at the lower of cost or market, the auditor has to gather objective evidence to test such assertions. The management has to make an assertion if necessary that it is implementing an internal control system that <https://assignbuster.com/importance-of-generally-accepted-auditing-standards-gaas-assignment/>

prevents the misstatement of its financial reports and that there is a remote likelihood that a misstatement occurs.

An auditor has to examine the soundness of the internal control system of the company as a sound basis for management's conclusion. Objectivity, independence and impartial are some of the traits that auditors must have and observe while conducting an audit. This is to prevent the possibility that the audit was conducted with a bias towards the company audited.

Stakeholders will lose confidence on the financial reports audited if the independence of the auditor is compromised for the reason that the said reports may not be able to reflect the true standing of the company.

To prevent these scenarios from happening, auditors must abide by the standards provided by the GAS to ensure that the auditors' independence will remain intact. Auditors must have the necessary competency to be able to conduct an audit of a business entity. They are professionals who undergo the necessary training and took the necessary exam that will qualify them to conduct an audit. For individuals who want to audit public companies, they have to register themselves or their audit firm to Public Accounting Oversight Board (PEPCO). The PEPCO is a nonprofit corporation established by Congress to oversee the audit of public companies in order to protect the interests of investors and further the public interest in the preparation of informative, accurate and independent audit reports. The PEPCO also oversees the audits of broker-dealers, including compliance reports filed pursuant to federal securities laws, to promote investor protection," (bayous. Org) It is the Sarbanes-Oxley Act (SOX) that created the said organization and it is subject to Securities and Exchange Commission (SEC) inspection. The PEPCO <https://assignbuster.com/importance-of-generally-accepted-auditing-standards-gaas-assignment/>

has the authority to issue auditing standards for the auditor of public companies in the United States. It has shown that it will recognize other auditing standards either retroactively or as they arise. To date, they have adopted the existing CPA standards as a starting auditing standards. (Irritating, Chewier,& Karl 2008) This harmonistic will be beneficial to those who are in the auditing profession considering the fact that this century had ushered in globalization. Entities, including auditors should embrace these changes not only internally but externally as well.

The inspection and registration requirements should have been accomplished by the auditor before he can start practicing the audit profession. Auditors should have enough knowledge of the professional standards, laws, rules and regulations that govern the said profession. Before an auditor began to conduct an audit off business entity, he just have enough understanding and background of the clients' industry, business, financial reporting process, corporate governance and internal controls implemented. This is to ensure that the auditor will come up with a sound auditing procedure that will work for the company.

A sound auditing procedure will enable the auditor to detect any fraud or irregularities that the company or any of its employees may have employ in conducting its business. An audit procedure may work on one entity and may not work on some other which basically depends on how the culprit manipulate material transactions. Auditors must show diligence and competence in their willingness to discover and report material misstatements that the business entity might have incurred. For auditors

who want to audit private companies, the CPA was once the governing body that oversees the audit.

However, because of the anomalies that happen in some big companies such as that of Enron and Andersen, Congress had passed the SOX that empowered the PEPCO to set auditing standards and rules. “ With the passage of SOX and the creation of the PEPCO, the era has ended in which the accounting profession, primarily the CPA, controlled auditing practices through the process of professional self-regulation with oversight by the SEC. The CPA still exists but it is no longer the important or influential organization it once was.

The Private Company Practice Division still exists, and the CPA still provides guidance and sets standards for private sector entities that are not explicitly regulated by the PEPCO. ” (Quick, Turtle & Willingness, 2008, p. 250) It is the management’s responsibility to manage the organization, safeguard the assets entrusted to it and prepare the financial statements that truly reflect its economic standing. The economic standing is the result of the financial activities of the company which is the result of its day to day transaction.

The auditor on the other hand, will check for any misstatements with reasonable accurateness. But they may also be liable in instances that they are neglecting the duty that is entrusted to them or if they fail to report accurately the financial reports of the company for failure to conduct an audit based on the GAS. To ensure the integrity of the audit, auditors need to have the expertise, is independent of the management and third of parties

and is able to provide an objective opinion of the fairness of the financial statements reported.

The failure of the auditor to maintain the criteria provided above has dire consequences to the auditor and to the auditing firm itself. In fact there are actual events that transpired in which the auditor was penalized together with the business entity for the formers failure to maintain its independence in conducting an audit and for its failure to example of such incident is what had transpired that caused the collapse of Enron. The company's downfall was also the cause of the auditing firm's dissolution in the audit world.

It is the management who will seek the engagement of an auditor or of an auditing firm to conduct the audit of their financial statements. The audit engagement can last for one fiscal period or it can be for a long time in which the management will pay retainers fee to the auditing firm. Despite the existence of the second scenario, auditors and audit firms are expected to maintain their independence in conducting the audit. The company must not be able to influence the audit firm's objective gathering and evaluating of evidence to determine if there are any material misstatements in the financial audit.

The company may be able to infinite with the reasonable accuracy of the financial statements reported but they are not the only stakeholder who need such reports which is the reason that the independence and integrity of the audit has to be maintained. In instances that a company retains the services of the auditor for a long term engagement, the auditors have to

ensure that they maintain their independence despite the familiarity that comes with constant communication.

This is to prevent scenarios that occur between Enron and Arthur Andersen in which the independence of the auditor is compromised when the latter acted as its auditor as well as its consultant. “ Less than 30% of the fees that Andersen received from Enron came from auditing, with the balance of fees coming from consulting. Andersen acted as Enron’s external and its internal auditor. Andersen’s work as a consultant raises several questions.... Let it appears that Andersen’s audit team, when faced with accounting issues, chose to ignore them, acquiesced in silence to unsound accounting, or embraced accounting schemes as an advocate for its client. (Cunningham, 2006) At the conclusion of an audit, the auditor will communicate the audit results to the management and to the other interested parties. To minimize or prevent misunderstanding in sending out the communication, the auditor follows a prescribed format with a clear outline of the nature of the work performed as well as the conclusion reached by the auditors. The communication may have followed a standard outline but it comes with a big responsibility. The GAS provides the outline as well as the responsibility.

The audit report rendered by auditors should truly reflect the reasonable accurateness of the financial report considering that there are third parties who are relying on its materiality and truthfulness. A financial statement audit results in an audit report directed to the audit committee, shareholders, and/or the board of directors of the client organization. The report delineates the responsibilities of both management and the auditor, summarizes the audit process, and express the auditor’s opinion on the

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financial statements. (Irritating, Chewier,& Karl 2008) For auditors who audit public companies, they must ensure that the financial statements audited is in adherence to PEPCO standards implemented. The Securities and Exchange Commission oversees the PEPCO and is requiring these impasses to adhere to the standards provided. For private companies, auditors Certified Public (CPA) Auditing Standards Board. In conducting an audit, there are instances that auditors not only find misstatements in the company's financial misstatements. There are also instances that illegal acts perpetuated by the management can be unearthed.

But an auditor has to be careful in dealing with these events especially if the said incident does not have a material effect on the financial standing of company. There are responsibilities that auditor's must abide by if an illegal act is detected. The PEPCO n its website, provided AU Section, 317. " The term illegal acts, for purposes of this section, refers to violations of laws or governmental regulations. Illegal acts by clients are acts attributable to the entity whose financial statements are under audit or acts by management or employees acting on behalf of the entity.

Illegal acts by clients do not include personal misconduct by the entity personnel unrelated to their business activities. " (bayous. Org) In instances that the auditor has enough evidence to consider the client's activity is an illegal act, he or she may seek advice of an informed expert that is qualified to reactive law or there is a need to await final determination by a court of law. The auditor's proficiency is in accounting and audit, thus, the need to seek a legal expert to handle such incident.

The quantitative and the qualitative materiality of the act must also be considered by the auditor especially if there is a reasonable possibility that it may lead to a contingent liability or a material loss of revenue for the company. The auditor needs to evaluate and determine further if it need to disclose the illegal acts of the client in its financial statement. But if the illegal act has a attention effect on the entity operation and if material revenue or earnings are derived from the said transaction then there is a need to disclose the said acts.

If the said illegal acts create significant unusual risks associated with material revenue or earning, such as loss of a significant business relationship, disclosure will also be considered which will depend on the discretion of the auditor. " If the auditor is precluded by the client from obtaining sufficient appropriate evidential matter to evaluate whether an illegal act that could be material to the financial statements has, r is likely to have, occurred, the auditor generally should disclaim an opinion on the financial statements..

The auditor may be unable to determine whether an act is illegal or not because of limitation imposed by the circumstances rather than by the client or because of uncertainty associated with interpretation of applicable laws or regulations or surrounding facts. In these circumstances, the auditor should consider the effect on his report. " (bayous. Org) The ethical conduct and behavior of an auditor is vital to his or her audit function. The need to audit the financial statement of a company sprung from the need of an independent and competent person to monitor and evaluate the contractual arrangements made by such company.

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The lack of independence and competency of the auditor will render the audit as unreliable and thus, has no value at all. Ethics and professionalism are character traits that an auditor should maintain. Conclusion The Generally Accepted Auditing Standards contains the guidelines that auditors must abide in conducting an audit with reasonable accuracy. Auditors are not misstatement with absolute accuracy. There are instances that an auditor may overlook the fraudulent activities perpetrated by the members of the staff of a many despite the application of due diligence in conducting the audit.

However, auditors have been held in high regard by the stakeholders of an entity, thus, it must be able to maintain its independence and objectivity while conducting an audit. This is to ensure that stakeholders will continue to rely on the financial reports of the organization. The GAS is composed of 10 standards which are divided into three such as the (a) the General Standards, (B) The standards of fieldwork and (c) the standards of reporting. These are the GAS standards in which all auditors must abide during the conduct of an audit.