

CPA

PART II SECTION 4

AUDITING AND ASSURANCE

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STUDY TEXT

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TOPIC 1

ASSURANCE AND NON-ASSURANCE ENGAGEMENTS

DEFINITION AND OBJECTIVES

The term **assurance** refers to the expression of a conclusion that is intended to increase the confidence that users can place in a given subject matter or information. For example, an auditor's report is a conclusion that increases the confidence that users can place in a company's financial statements.

Audit engagement refers to audit performed by an auditor. It is the very first stage of an audit procedure where the client is notified by the auditor that the work pertaining to audit has been accepted by him/her and also provides clarifications with regard to the scope and purpose of audit. To be more specific, audit engagement can be referred to the written letter that the auditor uses to notify the client that he/she would be engaging in auditing services. Thus, the audit engagement procedure is basically a negotiation based on professional terms that takes place between prospective customer and a public accounting entity. This procedure is used for finding new customers and offer accounting related services to different businesses.

The auditor uses the term 'audit engagement' when the entity has to undergo the auditing procedure. This could imply varied things and therefore it is necessary that the auditor clarifies what she/he exactly means by the term. Irrespective of the definition followed by the auditor, he/she makes it a point to follow certain specific guidelines and procedure for offering the services.

Full Engagement

Audit engagement consists of several steps that basically revolve around planning, substantiation, control testing and finalization. The very first step involves providing a letter to the client reminding him about the audit. Once the client has been contacted, both the auditor and client meet with each other to determine how, why and when the auditing would take place. In addition to this, the client also needs to provide the auditor with relevant resources for conducting the procedure smoothly. Following this, the auditor carries out surveys to find out more about the organization and its controls. This is followed by testing of controls and garnering of as much detail and information as is possible. On the basis of the results and information, the auditor prepares a temporary draft and shares the same with client. Once the client has gone through the draft report, he responds to the recommendations and findings made in it. After this, the auditor prepares a final audit report and may also request the client to fill a survey form to better understand his/her performance. The audit is completed after a follow up meeting with client, which usually happens within 6 months.

Objectives of the Practitioner

A practitioner is an the individual(s) conducting the engagement (usually the engagement partner or other members of the engagement team, or, as applicable, the firm) by applying assurance skills and techniques to obtain reasonable assurance or limited assurance, as appropriate, about whether the subject matter information is free from material misstatement. In conducting an assurance engagement, the objectives of the practitioner are:

- a) To obtain either reasonable assurance or limited assurance, as appropriate, about whether the subject matter information (that is, the reported outcome of the measurement or evaluation of the underlying subject matter) is free from material misstatement;
- b) To express a conclusion regarding the outcome of the measurement or evaluation of the underlying subject matter through a written report that clearly conveys either reasonable or limited assurance and describes the basis for the conclusion; and
- c) To communicate further as required by relevant ISAEs.

In all cases when reasonable assurance or limited assurance, as appropriate, cannot be obtained and a qualified conclusion in the practitioner's assurance report is insufficient in the circumstances for purposes of reporting to the intended users, the ISAEs require that the practitioner disclaim a conclusion or withdraw (or resign) from the engagement, where withdrawal is possible under applicable laws or regulations.

NON-ASSURANCE ENGAGEMENTS

Non-assurance Engagements

If an engagement lacks the five elements of assurance engagements, it is considered non-assurance (residual definition). Examples of non-assurance engagement are the following:

1. Agreed-upon procedures
2. Compilations engagements
3. Preparation of Income tax returns where no conclusion conveying assurance is expressed
4. Management advisory services and Consulting
5. Engagement that includes rendering of professional opinions not intended to be an assurance report

Elements of Assurance Engagements

There are five elements that must all be present in order to qualify the engagement as an assurance engagement.

1. A **three-party relationship** involving a practitioner, a responsible party, and intended users;
2. An appropriate **subject matter**;

3. Sufficient appropriate **evidence**;
4. Suitable **Criteria**;
5. A written **assurance report** in the form appropriate to a reasonable assurance engagement or a limited assurance engagement.

Appropriate Subject Matter

The subject matter and the subject matter information of an assurance engagement can take many forms, such as:

- Financial performance or conditions
- Non-financial performance or conditions
- Physical characteristics
- Systems and Processes
- Behavior

An appropriate subject matter is

- Identifiable and capable of consistent evaluation or measurement against the identified criteria
- Capable of being subjected to procedures for gathering sufficient appropriate evidence to support a reasonable assurance or limited assurance conclusion, as appropriate

Sufficient Appropriate Evidence

- **Sufficiency** is the measure of the quantity of evidence
 - The quantity of evidence needed is affected by the risk of the subject matter being materially misstated.
- **Appropriateness** is the measure of the quality of evidence, that is, its relevance and reliability
 - The reliability of evidence is influenced by its source and by its nature, and is dependent on the individual circumstances under which it is obtained.
 - Generalization about the reliability of evidence – evidence is more reliable if:
 - Obtain from independent source outside the entity
 - Generated internally when the related controls are effective
 - Obtained directly by the practitioner than indirect or by inference
 - Exist in documentary form
 - Provided by original documents
- Merely obtaining more evidence **may not** compensate for its poor quality
- The auditor should consider the cost of obtaining the usefulness of the evidence.

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Suitable Criteria

The following are the characteristics of a criteria to be considered suitable:

- Relevance – contribute to conclusions that assist decision-making by the intended users.
- Completeness – the relevant factors that could affect the conclusions are not omitted. Includes benchmarks for presentation and disclosure
- Reliability – allows reasonably consistent evaluation or measurement of the subject matter including where relevant, presentation and disclosure, when used in similar circumstances by similarly qualified practitioners
- Neutrality – free from bias
- Understandability – contribute to conclusions that are clear, comprehensive, and not subject to significantly different interpretations

TYPES OF ASSURANCE ENGAGEMENTS

1. As to level of assurance:
 - i. **Reasonable Assurance** – the objective is a reduction in assurance engagement risk to an acceptably low level as the basis for a positive form of expression of a practitioner’s conclusion. (e.g., audit of historical financial statements)
 - ii. **Limited Assurance** – the objective is a reduction in assurance engagement risk to a level that is acceptable in the circumstances of the engagement, but where the risk is greater than for a reasonable assurance engagement, as the basis for a negative form of expression of the practitioner’s conclusion. (e.g., review of historical financial statements)
2. As to structure of engagement:
 - i. **Assertion-based** – the evaluation or measurement of the subject matter is performed by the responsible party, and the subject matter information is in the form of assertion to the intended users.
 - ii. **Direct Reporting** – the practitioner either directly performs the evaluation or measurement of the subject matter, or obtains a representation from the responsible party that has performed the evaluation or measurement that is not available to intended users. The subject matter information is provided to the intended users in the assurance report.

Importance of Assurance Engagements

1. Potential bias in providing information
2. Remoteness between a user and the organization
3. Complexity of the transactions, information, or processing systems
4. Investors need to manage their risk and thereby minimize financial surprises as consequences to investors, and others, of relying on inaccurate information can be quite significant.