

# Key Audit Process

# Are You Aware That

- ▶ The auditing standards are not designed to put the auditor in the front line, auditors should be the third line of defense
- ▶ The auditor can not assume the roles and responsibilities that are the responsibilities of management
- ▶ Audit risk is cumulative, if the first step risk assessment is high, you could not expect that the audit risk will be low
- ▶ The auditing standards are risk-based audit, not the volume-based audit

# Essential Terms

- ▶ Material Misstatement – a misstatement in the FS which would effect a decision of the reasonable users
- ▶ Audit Risk – the risk that the auditor will conclude after conducting an audit that FS are fairly stated and issued an unqualified audit opinion when , in fact, they are materially misstated
- ▶ Analytical Review Procedure – use of comparison and relationships to assess whether account balances are reasonable

# Essential Terms

- ▶ Management Assertion – representations by management about classes of transactions and related account balances, and presentation and disclosures in the FS
- ▶ Assertions comprise of – Exist, Complete, Valuation, Accuracy, Rights and Obligations, Classification, and Cutoff
- ▶ Relevant Assertions – assertions that have a meaningful bearing on whether an account is fairly stated and used to assess the RMM and the design and performance of audit procedures

# Relevant Assertions for:

## Transaction

Complete

Accuracy

Cutoff

Classification

## Account Balance

Complete

Exist

Right and obligation

Valuation

## Disclosure

Complete

Accuracy

Right and obligation

Valuation

# Essential Terms

- ▶ Substantive Test of Transactions – audit procedures testing for monetary misstatements to determine whether the related assertions have been satisfied for each class of transactions
- ▶ Test of Control – audit procedures to test the effectiveness of control
- ▶ Test of Details of Balances – audit procedures testing for monetary misstatement to determine whether the related assertions have been satisfied for each significant account balances

# Essential Terms

- ▶ Appropriate Audit Evidence – a measure of quality of evidence, appropriate evidence must be relevant and reliable in meeting audit objectives for classes of transactions, account balances, and disclosure
- ▶ Audit Documentation – the record of auditing procedures applied, evidence obtained, and conclusions reached by the auditor
- ▶ Audit Procedures – detailed instruction for the collection of audit evidence

# Essential Terms

- ▶ Audit Program – list of audit procedures for an audit area or an entire audit, audit program includes audit procedures and may also include sample size, items to select, and timing of the test (What to audit, How to audit When to audit)
- ▶ Appropriateness and Sufficiency of Evidence – the degree to which the auditor is convinced that the evidence supports the audit opinion
- ▶ Audit Strategy – overall approach to the audit that considers the nature of the client, ROSM, and other factors such as locations and past effectiveness of control

# Essential Terms

- ▶ Inherent Risk – a measure of the auditor's assessment of the likelihood that there are material misstatement before considering the effectiveness of internal control
- ▶ Control Risk – a measure of the auditor's assessment of the likelihood that misstatements exceeding a tolerable amount will not be prevented or detected by the client's internal control
- ▶ Materiality – the magnitude of the omission or misstatement of accounting information that makes it probable that the judgment of a reasonable person on the information would have been changed

# Essential Terms

- ▶ RMM – the combination of inherent risk and control risk (IR X CR)
- ▶ Entity-level Control – Controls that have a pervasive effect on the entity's system of internal control
- ▶ Internal Control – a process designed to provide reasonable assurance regarding the achievement of management's in the following categories: (1) reliability of financial reporting (2) effectiveness and efficiency of operations (3) compliance with laws and regulations

# Essential Terms

- ▶ Material Weakness – a significant deficiency in internal control that results in a reasonable possibility that a MM of the FS will not be prevented or detected
- ▶ Significant Deficiency – control deficiency exist that is less severe than a material weakness but important enough to merit attention by those responsible for oversight of the financial reporting
- ▶ Significant Risk – risks the auditor believes require special audit consideration

# Essential Terms

- ▶ Those Charged with Governance – TCWG are the persons with responsibility for overseeing the strategic direction of the entity including overseeing the financial reporting and disclosure process
- ▶ Walkthrough – the tracing of selected transactions through the accounting system to determine that controls are in place
- ▶ Professional Skepticism – an attitude of the auditor that neither assumes management is dishonest nor assume unquestioned honesty

# Essential Terms

- ▶ Audit Tests – 4 categories of audit tests are (1) test of control (2) substantive test of transaction (3) analytical review procedures (4) test of details of balance

# Commonly Used Audit Procedures for Testing Balance and Transaction

- ▶ Observation
- ▶ Physical examination
- ▶ Inquiries
- ▶ Confirmation
- ▶ Computation
- ▶ Vouching of transactions
- ▶ Analytical procedure
- ▶ Examination of documents
- ▶ Reprocessing transaction or posting

# Minimum Contents of Audit Documentation

- ▶ Evidence of planning and audit program
- ▶ Client's trial balance and audit adjustments
- ▶ Copy of internal control documents
- ▶ Memo describing audit approach and reasoning process in support of account balances
- ▶ Results of analytical procedures and test of records
- ▶ Analysis of account balances

# Audit Program should be helpful in:

- ▶ Organizing and distributing audit work
- ▶ Monitoring the audit process and progress
- ▶ Recording the audited work to be performed
- ▶ Reviewing the completeness of procedures performed

# Summary of Audit Process

- ▶ Phase 1- Plan and design an audit approach
- ▶ Phase 2- Test of controls and test of transactions
- ▶ Phase 3- Perform analytical procedures and test of balances
- ▶ Phase 4- Complete the audit

# Phase 1 Plan and design an audit approach

- ▶ Accept client and perform initial planning
- ▶ Understand client's business and industry
- ▶ Assess business risk
- ▶ Perform preliminary analytical procedures
- ▶ Set materiality and assess acceptable audit risk and inherent risk
- ▶ Understand internal control and assess control risk
- ▶ Assess fraud risk
- ▶ Develop overall audit plan and audit program

# Phase 2 Test of controls and test of transactions

- ▶ Perform test of control
- ▶ Perform test of transactions
- ▶ Assess risk of material misstatements

# Phase 3 Analytical review and tests of balances

- ▶ Perform analytical review procedures
- ▶ Perform tests of key items
- ▶ Perform additional tests of details of balances

# Phase 4 Complete the audit

- ▶ Perform additional tests of presentation and disclosures
- ▶ Evaluate final evidence
- ▶ Evaluate results
- ▶ Issue audit report

# Reminding

- ▶ Well-managed company will have a comprehensive risk management or internal control process in place.
- ▶ Auditors should start by evaluating the comprehensive and effectiveness of that process
- ▶ External auditor focused on control over financial processing. However, as FS evolve to portray the economics of company efforts, it is important that the external auditors also have to understand more about organizational risks

# Enterprise Risk Management or Internal Control

- ▶ Management should have an ERM process in place to address significant risks
- ▶ The auditor should gain an understanding of ERM to assist in developing expectation of potential misstatements

# Enterprise Risk Management or Internal Control

- ▶ To understand the process in place, the auditor will normally use the following techniques:
- ▶ Develop an understanding of the process
- ▶ Review approach use by IA
- ▶ Interview management about their understanding of risk and the relationship of risk and strategies
- ▶ Review company policies and procedures for addressing risks
- ▶ Review prior year's work to determine the actions
- ▶ Review risk management document

# Materiality

- ▶ Materiality has both qualitative and quantitative dimension. An auditor must understand who the potential users are and the type of judgments made by them when relying on FS
- ▶ A simple guideline for SME audit is to set overall materiality at 1 % of total assets or revenue. But any guidance is just that, it is only starting point that should be adjusted for qualitative condition

# To be Careful About Materiality

- ▶ The auditors should be careful about:
  - ▶ (1) Offsetting material misstatement and not making adjustment because the net effect may not be material
  - ▶ (2) Overlook swinging in accounting transaction by looking in one direction one year and not considering the opposite direction in the other year
  - ▶ (3) Passing adjustments that may not be considered material, if the amount is not material, why would management object to adjust it

# Audit Risk Model: Inherent Risk Control Risk and Detection Risk

- ▶ This model have limitation:
- ▶ (1) Inherent risk is difficult to assess, some transactions are more susceptible to error than the others
- ▶ (2) The model treats each component as separate and independent when in fact they are not
- ▶ (3) Audit technology is not developed that each component can be accurately assessed