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AUDITING/CORPORATE GOVERNANCE | BASIC/INTERMEDIATE

Video Transcription: An Overview of the Audit Process

Hello there, my name is Sumaya, and this video will be taking a big picture view of the audit process to allow you to see how all the individual sections you have or will learn about, fit into the audit process.

So, the directors of a company are responsible for compiling the annual financial statements. The directors make certain assertions or claims that all the reported amounts and disclosures in the financial statements are valid, accurate and complete. The auditors, on the other hand, are responsible for providing an audit opinion on whether the financial statements are fairly presented by the directors of the company. The audit opinion is therefore the end goal, or the objective, of performing an external audit.

Let's go through the four stages of the audit process to understand how an auditor would form an audit opinion on the financial statements presented by the directors. As we go through the four stages, I will be asking a very important question throughout the audit process – why? In other words, why do the auditors perform certain procedures at a particular point in that stage? This will assist in your understanding of the reason for the subsequent steps in that stage, and also assist in linking the audit topics together.

1. The Pre-Engagement Stage:

Now, why do auditors perform pre-engagement activities in the first stage? They want to decide whether or not to accept a new client, or continue with an existing client. The auditors need to consider whether accepting the client will be a business risk to the audit firm. At this stage, if it is a new client, the auditor does not have access to the confidential financial information of the client. The auditors will therefore have to make a decision based on the following main considerations:

The integrity of the client – is the client potentially involved in price-fixing?
This may indicate that the client does not have integrity and the auditor may consider not accepting the client. If you accepted the new client that is potentially involved in price-fixing, you will have to consider whether accepting this client will cause conflicts of interest with existing clients.

Whether they, the auditors, are independent of the client and can be objective in performing the audit.
If, for example, the auditor is married to the director of the client then it creates a threat to independence, and the auditors may not provide an objective audit opinion on the financial statements. Before the client is accepted, the auditor will question whether they have sufficient resources, skills and competence to complete the audit. If the auditor and the client agree on the terms of the audit, the auditor moves onto the planning stage of the audit.

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2. The Planning Stage

In this stage, the auditor develops an audit plan.
So, how is an audit plan developed?
Firstly, the auditors will have to update their knowledge of the client. For example, what industry does the client operate in, what legislative requirements are applicable to the client, what products or services do they provide, who are the customers and suppliers? The point is, the auditor will have to have a very good understanding of the client's business in order to develop a solid audit plan.

The auditors will also have to update their knowledge of the accounting systems and the related controls.
Why do they have to understand the entity, the accounting system and the related controls?
So that they can identify and assess the risks of material misstatement in the financial statements. The auditor will have to understand the internal control system to identify and assess the control risk and will have to understand the entity and accounting system to identify and assess inherent risks of material misstatement.

There are two levels at which RoMM needs to be identified and assessed:

1. The overall financial statement level
2. The assertion level

Now, why do the auditors assess Risk of Material Misstatement at the overall financial statement level?
Risk of Material Misstatement is assessed at the overall financial statement level as it will influence the planning materiality level. If, for example, the auditor determines that the risk of material misstatement is high, the auditor will have to lower the materiality level. This means that the auditors will have to perform more audit work in order to identify the potential misstatements in the financial statements.
The overall level assessment of Risk of Material Misstatement is also going to influence the audit strategy. The audit strategy is a high-level decision based on the overall Risk of Material Misstatement assessment. The auditor will ensure that the appropriate resources are allocated in such a way that the audit can be successfully completed. At this level, the scope, direction and timing of the audit is determined.

Now, let's understand why the auditors have to assess Risk of Material Misstatement at the assertion level.
The assessment at this level will influence the audit approach and the audit plan. The audit approach deals with the nature of the audit procedures, to be performed at the assertion level. The nature can either be substantive procedures only, or a combined audit approach, where the auditor may rely on testing the controls and performing some substantive audit procedures. The audit plan not only details with the nature of the audit procedures, but also the timing and the extent of the audit procedures to be performed.
Remember, these decisions are all documented in an audit programme. The nature, the timing and extent of the audit procedures are documented at the assertion level for each business cycle. That is the expenditure, revenue, inventory, and the finance and investment cycles.

The audit programme is simply a list of all the audit procedures the auditor will have to perform. The audit programme will be used when performing the fieldwork in the next stage – the risk response stage.

3. The Risk Response Stage

In this stage, the auditors will use the audit programme to gather sufficient and appropriate audit evidence to support the assertions that the directors have made in the financial statements. They may even use the work of internal auditors, other auditors or experts to gather audit evidence. Control deficiencies identified and any audit evidence that is gathered that does not support directors' assertions, will have to be communicated with the client as soon as possible.

4. The Evaluating and Concluding Stage

This is the last stage.
So, why do auditors have to gather sufficient and appropriate audit evidence?
To form an independent opinion on whether or not the financial statements are fairly presented.
In the final stage, the auditor will have to evaluate all the audit evidence gathered throughout the audit. The auditors will have to evaluate and perform audit procedures on the Going Concern assumption. They will also have to perform procedures on subsequent events to assess if these events have an effect on the financial statements at the reporting date.

Furthermore, the auditor will assess the unadjusted differences between the evidence the auditors gathered, and the amounts reported by management. For example, an unadjusted difference is when the auditors believe that the inventory should be reflected at R10 million, but the client reported the inventory should be at R12 million. There is a R2 million difference, but the client does not want to adjust the financial statements. This is an unadjusted difference. The auditor will have to assess all the unadjusted differences throughout the audit. The list of unadjusted differences is compared to the final materiality level. Why do auditors do that? To identify whether the unadjusted differences are material.

Why do they need to assess if the differences are material?
This assessment will influence the type of audit opinion provided; can either be an unqualified or a modified opinion. Modifications can be qualified, adverse or disclaimer of opinions.

Finally, it is important to note that governance considerations, which include King III, the company's ability to comply with legislative requirements, ethical and quality-control issues are pervasive to the entire audit process. That means that the auditor will have to consider the effects of all governance, legislative, ethical and quality-control issues throughout the audit.

This video should have provided an understanding of the link between all the audit topics.

Thank you for watching. Good day.