

KnowledgeEquity – Advanced Audit & Assurance - FAQs

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Module 1 - FAQs

How can I access CPA's guide on Companies Limited by Guarantee and Incorporated Associations?

The CPA guide relating to Companies limited by Guarantee and Incorporated Associations: Reporting and Auditing/Review Obligations, referred to on Page 51 of the Study guide can be accessed through the below link:

<https://www.cpaaustralia.com.au/-/media/project/cpa/corporate/documents/tools-and-resources/audit-assurance/incorporated-associations.pdf?rev=69d58acab8214c289b96c5cb1d81370b>

Why are the definitions of the threats to fundamental principles of the Code on page 14 different from those under the Westerways Case Study Activity on page 66?

The definitions are consistent even though the wordings used is different.

As an example, page 14 states that 'advocacy threat may occur when an auditor is asked to promote or represent their client in some particular way. This could happen when a client asks the auditor to promote their shares on the stock exchange, argue their client's position on a proposed accounting disclosure or represent them in a court case. The auditor's objectivity may be impaired. Further, the auditor's independence of mind and in appearance could be compromised'

The definition under the Westerways Case Study defines the advocacy as 'the loss of its objectivity through development of a 'pro-client' state of mind'.

The definitions are consistent as both refer to promoting or advocating for the client.

Page 55 of the Study guide states that only Australian auditing standards (ASAs) have the 'force of the law' and goes on to highlight the standards included under ASAs. Why is this list different from the ASA standards highlighted under the Australian Auditing and Assurance Standards Board?

The standards highlighted on page 55 have all been developed by the Australian Assurance Standards Board. For a more detailed breakdown you can refer to the below link for the different categories of standards developed by this board.

<https://auasb.gov.au/standards-guidance/auasb-standards/auditing-standards/>

For the purposes of the exam, you should apply the information/categorisation provided by the Study guide.

I was under the impression that an auditor cannot issue an absolute assurance. Why is it then that it can be issued if 100% of the population is tested?

An assurance practitioner can provide absolute assurance if 100% of the population is tested except where this relates to the audit or review of historical financial information where the highest level of assurance that can be provided is a reasonable assurance.

As an example, assume the assurance practitioner is engaged to confirm whether all ships recorded in the company's accounting system actually exist. If the assurance practitioner physically sights all ships and confirms they exist, then the practitioner can issue an absolute assurance.

Note that in reality assurance practitioners are unlikely to issue absolute assurance even when 100% of the population is tested due to the limitation of assurance procedures and inherent limitations of internal controls. There are 'reflection' tasks in the study guide where you are asked to think what your own opinion is on a particular issue. There is no correct answer, and no solutions are provided. You may find it helpful to discuss these questions in a study group.

I am confused about the relationship between the treasurer and the Department of Finance that is stated on page 52 of the Study guide. Can you please provide more clarity on this?

The Treasurer is the minister responsible for financial and economic matters. The Treasurer implements his role through the Department of the Treasury. The Department of Finance also works closely with the Department of the Treasury on specified financial matters.

Module 2 – FAQs

How do inherent risk, control risk and detection risk impact audit risk?

(See 'Audit risk', page 74)

Assurance engagement risk is the risk that the practitioner reports that the subject matter information is fairly presented, when in fact it is materially misstated. In other words, it is the risk that the practitioner's conclusion is wrong. When an audit is undertaken, this is referred to as audit risk.

Engagement risk (audit risk) is a function of inherent risk, control risk and detection risk.

Inherent risk is defined as the susceptibility of the subject matter information to a material misstatement and is therefore determined by the underlying subject matter. For example, in the case of a financial statement audit of a business, inherent risk is determined by the riskiness of both the business and the economic environment. As an example, for a diamond mining business, inherent risk relating to inventory (diamonds) will likely be considered to be high due to susceptibility of the diamonds to theft.

Normally, it would be expected that higher inherent risk exists for small as opposed to large businesses, and during periods of recession as opposed to periods of economic growth. Many considerations affect the assessment of inherent risk.

Control risk is defined as the risk that a material misstatement will not be prevented, or detected and corrected, by the internal control system. A well-designed and implemented control system can reduce control risk, but some level of control risk always exists because of the limitations of control systems. For example, an important control over cash is the bank reconciliation, so if a bank reconciliation is not properly performed, control risk increases. That is, the risk that the bank account will be misstated, and that the control system will fail to prevent the error, or fail to detect and correct the error, is increased.

Detection risk is the risk that the assurance practitioner's evidence-gathering procedures will not detect a material misstatement. Detection risk is affected by the quantity, reliability and relevance of evidence. For example, assume that to determine the existence of the inventory, an auditor counts 10 items of inventory. Detection risk would be reduced if the practitioner were to increase the sample size for testing to 20 items.

Risk of material misstatement is a function of inherent risk and control risk.

Audit risk arises from a combination of material misstatement and detection risk. Therefore, audit risk can also be simplified as:

Engagement risk (audit risk) is a function of the risk of material misstatement and detection risk.

To ensure audit risk is kept at an acceptable level (depending on the level of assurance required, i.e. audit versus review), the auditor will need to adjust the level of their audit procedures accordingly.

For example, if the inherent risk and control risk are high, meaning the risk of material misstatement is high, the auditor will need to ensure the detection risk is low to compensate for the high risk of material misstatement. Therefore, the auditor is expected to increase the level of audit testing/procedures to reduce the detection risk.

What is the distinction between 'Financial statement level' and 'Assertion level' risks?

(See 'Audit risk', page 74)

Financial statement level:

Risk of material misstatement at the financial statement level are risks that relate pervasively to the financial statements as a whole and potentially affect multiple assertions. These risks are not necessarily identifiable with specific assertions at the class of transaction, account balance or disclosure level. Rather, they represent circumstances that may increase the risks of material misstatement at the assertion level—for example, through management override of internal controls. Financial statement risks may be especially relevant to the auditor's consideration of the risks of material misstatement arising from fraud.

Assertion level:

Risks of material misstatement at the assertion level are risks that apply to specific classes of transaction, account balances or disclosures. Considering these risks directly assists auditors to determine the nature, timing and extent of further audit procedures to obtain sufficient appropriate audit evidence.

What is the difference between the 'occurrence' and 'existence' audit assertions?

(See 'Financial statement assertions', page 98)

Occurrence relates to the 'assertions about classes of transactions and events, and related disclosures, for the period under audit' (ISA 315). Meaning, have the transactions and events that have been recorded or disclosed occurred, and do such transactions and events pertain to the entity?

Example of an occurrence issue: It was recognised that some sales were being recorded before they were shipped.

Whereas existence relates to the 'assertions about account balances, and related disclosures, at the period end'. Meaning, do the assets, liabilities and equity interests really exist?

Example of an existence issue: During the physical count, the client's employees mistakenly counted some items twice.

Please help me understand what is meant by assertion level and financial statement level?

Financial statement level relates to the whole of the financial statements. As an example, the risk of material misstatement at the financial statement level refers to risks that affect many account balances/ classes of transactions and potentially affecting many assertions.

As an example, if it is discovered that the accounting system is compromised or not well integrated to other systems and is resulting in errors, this will be considered to be a risk of material misstatement at the financial statement level. This is because the auditor will likely be concerned that the financial statements as a whole may be materially misstated.

Assertions on the other hand are representations by management i.e., what they are directly or indirectly saying by including account balances, classes of transactions or disclosures in the financial statements.

As an example, if the financial statements include the account balance 'Property plant and Equipment (PPE) with a net book value of \$40,000' under non-current assets, management is essentially stating that the business owns the PPE (which is the assertion 'rights and obligations'), that the PPE exists (which is the assertion 'existence') and that the amount of \$40,000 is correct (which is the assertion 'accuracy, valuation and allocation').

I have noted that relevant period under ISA 570 is different from the one under ASA 570. Which is correct?

ISA 570 defines the relevant period, which defines the foreseeable future for the purposes of going concern, as covering 12 months from the date of the financial statements. ASA 570 however defines it as 12 months after the auditor's current report date.

In Australia, auditors are required to comply with the requirements of ASA 570 which means that the relevant period is defined as 12 months from the date of the auditor's current report.

Module 3 – FAQs

Why is the answer (assertion being tested) to Question 3.11 (b) in the Study guide ‘completeness’ and not ‘cut off’?

(See ‘Test of transactions and account balances, page 200)

The cut off test is designed to assess two assertions:

- a. Completeness: Transactions that occurred relating to the period have been recorded in the year. It tests whether the account balance/class of transaction is understated.
- b. Occurrence: All transactions recorded in the year occurred in the financial year. It tests whether the account balance/class of transaction is overstated.

Both of these have to be performed for it to be referred to as a cut off test.

Regarding Q3.11 (b), the auditor only reviewed whether invoices recorded after the period (post 30 June 20x9) relate to the current period (30 June 20x9). This meets the definition of a completeness test.

What is the difference between analytical procedures performed in the planning phase and substantive analytical procedures which are done when performing the audit?

Analytical procedures performed in the planning phase are done as part of the auditor’s initial risk assessment process. They are designed to highlight areas where the risk of material misstatement is high.

Substantive analytical procedures are however utilised to gather audit evidence and, in most cases, when the auditor has concluded that the controls of the organisation can be relied upon. Substantive analytical procedures reduce the level of test of details required to be performed.

Why is the risk of material misstatement due to fraud presumed in revenue recognition?

This is because revenue recognition is highly susceptible to fraud and can be manipulated to achieve management’s objectives. As an example, management can overstate revenue by intentionally recognising revenue that has not yet been earned.

Module 4 – FAQs

Does a material uncertainty mean that the company is not a going concern? If not, at what point does the organisation cease being a going concern?

The existence of a material uncertainty does not necessarily mean that the company is not a going concern. It however indicates that there are conditions or events that threaten the going concern of the business. It is important to note that going concern refers to the company's ability to continue operating in the foreseeable future.

The auditor will only conclude that the going concern assumption is not appropriate if it is clear that the organisation will not continue operating in the foreseeable future usually 12 months from the date of the auditor's report. An example of such a situation would be where there has been a change of law which makes the company's operations illegal and management have no other alternative plans to keep the business operating.

Can an emphasis of matter paragraph (EOM) be used where a modified audit opinion has been issued?

Yes, but the matter discussed under EOM should not have resulted in the modification of the audit opinion. As an example, the auditor may issue a modified audit opinion due to a material misstatement relating to inventory, but the auditor may discuss a litigation issue under the EOM paragraph. The litigation issue in this case has not resulted in the modification of the audit opinion.

What happens when a matter can be categorised as both a key audit matter (KAM) and can be discussed under the EOM paragraph? Where should the auditor discuss the issue?

If a matter qualifies as both a KAM and an EOM that is, it required significant auditor attention and is also fundamental to users of the financial statements, the matter shall be discussed under KAM. KAM therefore takes precedence over EOM.

For Question 4.3 (3a), I don't understand why the financial statements should be revised when the debtor collapsed subsequent to year end. Isn't this a subsequent event that relates to the next financial period?

While it is true that the debtor became bankrupt a few months after year end, it points to events that existed at the balance sheet date as the debtor must have been facing financial difficulties at the time. This therefore means that the valuation of debtors at year end was overstated. This is the reason why the auditor will request management to amend the financial statements.

Module 5 – FAQs

Future oriented information may contain both forecasts and projections. What audit opinion is provided in such a case?

The assurance practitioner ordinarily provides a moderate level of assurance on the reasonableness of management's best estimate assumptions (note that a reasonable assurance can also be issued on the reasonableness of management's assumption if there is sufficient evidence to support this conclusion). The assurance practitioner can only provide a moderate level of assurance on the reasonableness of management's assumption. If an opinion is issued on the full report then the opinion provided will be limited assurance.

Why is effectiveness the most important element of performance auditing?

This is the element that confirms whether the purpose for which the program, activity or organisation was set up has been achieved. As an example, the objective of a health program may be to reduce the number of smokers in Australia by 30%. The program will only be considered effective if the level of smoking actually reduces by that percentage. The project will therefore be considered to have failed if this objective is not met despite the fact that financial and other resources may have been utilised in the most economical and efficient manner.