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Paper Introduction
How to Use the Materials

These Kaplan Publishing learning materials have been carefully designed to make your learning experience as easy as possible and to give you the best chances of success in your examinations.

The product range contains a number of features to help you in the study process. They include:

(1) Detailed study guide and syllabus objectives
(2) Description of the examination
(3) Study skills and revision guidance
(4) Complete text or study notes
(5) Question practice

The sections on the study guide, the syllabus objectives, the examination and study skills should all be read before you commence your studies. They are designed to familiarise you with the nature and content of the examination and give you tips on how to best to approach your learning.

The complete text or study notes comprises the main learning materials and gives guidance as to the importance of topics and where other related resources can be found. Each chapter includes:

- The learning objectives contained in each chapter, which have been carefully mapped to the examining body’s own syllabus learning objectives or outcomes. You should use these to check you have a clear understanding of all the topics on which you might be assessed in the examination.

- The chapter diagram provides a visual reference for the content in the chapter, giving an overview of the topics and how they link together.

- The content for each topic area commences with a brief explanation or definition to put the topic into context before covering the topic in detail. You should follow your studying of the content with a review of the illustration/s. These are worked examples which will help you to understand better how to apply the content for the topic.
• **Test your understanding** sections provide an opportunity to assess your understanding of the key topics by applying what you have learned to short questions. Answers can be found at the back of each chapter.

• **Summary diagrams** complete each chapter to show the important links between topics and the overall content of the paper. These diagrams should be used to check that you have covered and understood the core topics before moving on.

• **Question practice** is provided at the back of each text.

Quality and accuracy are of the utmost importance to us so if you spot an error in any of our products, please send an email to mykaplanreporting@kaplan.com with full details, or follow the link to the feedback form in MyKaplan.

Our Quality Co-ordinator will work with our technical team to verify the error and take action to ensure it is corrected in future editions.

**Icon Explanations**

**Definition** – Key definitions that you will need to learn from the core content.

**Key Point** – Identifies topics that are key to success and are often examined.

**New** – Identifies topics that are brand new in papers that build on, and therefore also contain, learning covered in earlier papers.

**Expandable Text** – Expandable text provides you with additional information about a topic area and may help you gain a better understanding of the core content. Essential text users can access this additional content on-line (read it where you need further guidance or skip over when you are happy with the topic)

**Test Your Understanding** – Exercises for you to complete to ensure that you have understood the topics just learned.

**Illustration** – Worked examples help you understand the core content better.
Tricky topic – When reviewing these areas care should be taken and all illustrations and test your understanding exercises should be completed to ensure that the topic is understood.

Tutorial note – Included to explain some of the technical points in more detail.

Footsteps – Helpful tutor tips.

On-line subscribers

Our on-line resources are designed to increase the flexibility of your learning materials and provide you with immediate feedback on how your studies are progressing.

If you are subscribed to our on-line resources you will find:

(1) On-line referenceware: reproduces your Complete Text on-line, giving you anytime, anywhere access.

(2) On-line testing: provides you with additional on-line objective testing so you can practice what you have learned further.

(3) On-line performance management: immediate access to your on-line testing results. Review your performance by key topics and chart your achievement through the course relative to your peer group.

Ask your local customer services staff if you are not already a subscriber and wish to join.
Syllabus for December 2015 and June 16

Paper background

The aim of ACCA Paper F8, Audit and Assurance, is to develop knowledge and understanding of the process of carrying out the assurance engagement and its application in the context of the professional regulatory framework.

Objectives of the syllabus

• Explain the concept of audit and assurance and the functions of audit, corporate governance, including ethics and professional conduct, describing the scope and distinguishing between the functions of internal and external audit.
• Demonstrate how the auditor obtains and accepts audit engagements, obtains an understanding of the entity and its environment, assesses the risk of material misstatement (whether arising from fraud or other irregularities) and plans an audit of financial statements.
• Describe and evaluate internal controls, techniques and audit tests, including IT systems to identify and communicate control risks and their potential consequences, making appropriate recommendations.
• Identify and describe the work and evidence obtained by the auditor and others required to meet the objectives of audit engagements and the application of the International Standards on Auditing.
• Explain how consideration of subsequent events and the going concern principle can inform the conclusions from audit work and are reflected in different types of audit report, written representations and the final review and report.

Core areas of the syllabus

• Audit framework and regulation.
• Planning and risk assessment.
• Internal control.
• Audit evidence.
• Review and reporting.
Syllabus objectives and chapter references

We have reproduced the ACCA’s syllabus below, showing where the objectives are explored within this book. Within the chapters, we have broken down the extensive information found in the syllabus into easily digestible and relevant sections, called Content Objectives. These correspond to the objectives at the beginning of each chapter.

Syllabus learning objective

A AUDIT FRAMEWORK AND REGULATION

1 The concept of audit and other assurance engagements

(a) Identify and describe the objective and general principles of external audit engagements. [2] Ch. 1
(b) Explain the nature and development of audit and other assurance engagements. [1] Ch. 1
(c) Discuss the concepts of accountability, stewardship and agency. [2] Ch. 1
(d) Define and provide the objectives of an assurance engagement. [1] Ch. 1
(e) Explain the five elements of an assurance engagement. [2] Ch. 1
(f) Describe the types of assurance engagement. [2] Ch. 1
(g) Explain the level of assurance provided by an external audit and other review engagements and the concept of true and fair presentation. [1] Ch. 1

2 External audits

(a) Describe the regulatory environment within which external audits take place. [1] Ch. 2
(b) Discuss the reasons and mechanisms for the regulation of auditors. [1] Ch. 2
(c) Explain the statutory regulations governing the appointment, rights, removal and resignation of auditors. [1] Ch. 2
(d) Explain the regulations governing the rights and duties of auditors. [1] Ch. 2
(e) Describe the limitations of external audits. [1] Ch. 1
(f) Explain the development and status of International Standards on Auditing (ISAs). [1] Ch. 2

(g) Explain the relationship between International Standards on Auditing and national standards. [1] Ch. 2

3 Corporate governance

(a) Discuss the objectives, relevance and importance of corporate governance. [2] Ch. 11

(b) Discuss the provisions of international codes of corporate governance (such as OECD) that are most relevant to auditors. [2] Ch. 11

(c) Describe good corporate governance requirements relating to directors' responsibilities (e.g. for risk management and internal control) and the reporting responsibilities of auditors. [2] Ch. 11

(d) Analyse the structure and roles of audit committees and discuss their benefits and limitations. [2] Ch. 11

(e) Explain the importance of internal control and risk management. [1] Ch. 11

(f) Discuss the need for auditors to communicate with those charged with governance. [2] Ch. 10

4 Professional ethics and ACCA's Code of Ethics and Conduct

(a) Define and apply the fundamental principles of professional ethics of integrity, objectivity, professional competence and due care, confidentiality and professional behaviour. [2] Ch. 3

(b) Define and apply the conceptual framework, including the threats to the fundamental principles of self-interest, self-review, advocacy, familiarity, and intimidation. [2] Ch. 3

(c) Discuss the safeguards to offset the threats to the fundamental principles. [2] Ch. 3

(d) Describe the auditor's responsibility with regard to auditor independence, conflicts of interest and confidentiality. [1] Ch. 3
5 Internal audit and governance, and the differences between external audit and internal audit

(a) Discuss the factors to be taken into account when assessing the need for internal audit. [2] Ch. 12

(b) Discuss the elements of best practice in the structure and operations of internal audit with reference to appropriate international codes of corporate governance. [2] Ch. 12

(c) Compare and contrast the role of external and internal audit. [2] Ch. 12

6 The scope of the internal audit function, outsourcing and internal audit assignments

(a) Discuss the scope of internal audit and the limitations of the internal audit function. [2] Ch. 12

(b) Explain outsourcing. [1] Ch. 12

(c) Explain the advantages and disadvantages of outsourcing the internal audit function. [1] Ch. 12

(d) Discuss the nature and purpose of internal audit assignments including value for money, IT, financial, regulatory compliance, fraud investigations and customer experience. [2] Ch. 12

(e) Discuss the nature and purpose of operational internal audit assignments. [2] Ch. 12

(f) Describe the format and content of audit review reports and make appropriate recommendations to management and those charged with governance. [2] Ch. 12

B PLANNING AND RISK ASSESSMENT

1 Obtaining and accepting audit engagements

(a) Discuss the requirements of professional ethics in relation to the acceptance of new audit engagements. [2] Ch. 3

(b) Explain the preconditions for an audit. [2] Ch. 3

(c) Explain the process by which an auditor obtains an audit engagement. [2] Ch. 3

(d) Justify the importance of engagement letters and their contents. [1] Ch. 3
2 Objective and general principles

(a) Identify the overall objectives of the auditor and the need to conduct an audit in accordance with ISAs. [2] Ch. 2 and 5

(b) Explain the need to plan and perform audits with an attitude of professional scepticism, and to exercise professional judgement. [2] Ch. 4

3 Assessing audit risks

(a) Explain the components of audit risk. [1] Ch. 4

(b) Explain the audit risks in the financial statements and explain the auditor's response to each risk. [2] Ch. 4

(c) Define and explain the concepts of materiality and performance materiality. [2] Ch. 4

(d) Explain and calculate materiality levels from financial information. [2] Ch. 4

4 Understanding the entity and its environment

(a) Explain how auditors obtain an initial understanding of the entity and its environment. [2] Ch. 4

(b) Describe and explain the nature and purpose of analytical procedures in planning. [2] Ch. 4

(c) Compute and interpret key ratios used in analytical procedures. [2] Ch. 4

5 Fraud, laws and regulations

(a) Discuss the effect of fraud and misstatements on the audit strategy and extent of audit work. [2] Ch. 5

(b) Discuss the responsibilities of internal and external auditors for the prevention and detection of fraud and error. [2] Ch. 5

(c) Explain the auditor's responsibility to consider laws and regulations. [2] Ch. 5

6 Audit planning and documentation

(a) Identify and explain the need for and importance of planning an audit. [2] Ch. 5

(b) Identify and describe the contents of the overall audit strategy and audit plan. [2] Ch. 5
(c) Explain and describe the relationship between the overall audit strategy and the audit plan. [2] Ch. 5

(d) Explain the difference between interim and final audit. [1] Ch. 5

(e) Describe the purpose of an interim audit, and the procedures likely to be adopted at this stage in the audit. [2] Ch. 5

(f) Describe the impact of the work performed during the interim audit on the final audit. [2] Ch. 5

(g) Explain the need for and the importance of audit documentation. [1] Ch. 5

(h) Describe the form and contents of working papers and supporting documentation. [2] Ch. 5

(i) Explain the procedures to ensure safe custody and retention of working papers. [1] Ch. 5

C INTERNAL CONTROL

1 Internal control systems

(a) Explain why an auditor needs to obtain an understanding of internal control relevant to the audit. [1] Ch. 6

(b) Describe and explain the five key components of internal control. [2] Ch. 7
   (i) the control environment
   (ii) the entity's risk assessment process
   (iii) the information system, including related business processes, relevant to financial reporting, and communication
   (iv) control activities relevant to the audit
   (v) monitoring of controls

2 The use and evaluation of internal control systems by auditors

(a) Explain how auditors record internal control systems including the use of, narrative notes, flowcharts, internal control questionnaires and internal control evaluation questionnaires. [2] Ch. 7

(b) Evaluate internal control components, including deficiencies and significant deficiencies in internal control. [2] Ch. 7
(c) Discuss the limitations of internal control components. [2] Ch. 7

3 Tests of controls

(a) Describe computer systems controls including general IT controls and application controls. [2] Ch. 7

(b) Describe control objectives, control procedures, activities and tests of control in relation to:
   (i) The sales system
   (ii) The purchases system
   (iii) The payroll system
   (iv) The inventory system
   (v) The cash system
   (vi) Non-current assets

4 Communication on internal control

(a) Discuss the requirements and methods of how reporting significant deficiencies in internal control are provided to management and those charged with governance. [2] Ch. 7

(b) Explain, in a format suitable for inclusion in a report to management significant deficiencies within an internal control system and provide recommendations for overcoming these deficiencies to management. [2] Ch. 7

D AUDIT EVIDENCE

1 Financial statement assertions and audit evidence

(a) Explain the assertions contained in the financial statements about. [2] Ch. 6
   (i) Classes of transactions and events
   (ii) Account balances at the period end
   (iii) Presentation and disclosure

(b) Describe audit procedures to obtain audit evidence, including inspection, observation, external confirmation, recalculation, re-performance, analytical procedures and enquiry. [2] Ch. 6

(c) Discuss the quality and quantity of audit evidence. [2] Ch. 6
(d) Discuss the relevance and reliability of audit evidence. [2] Ch. 6

2 Audit procedures

(a) Discuss substantive procedures for obtaining audit evidence. [2] Ch. 6

(b) Discuss and provide examples of how analytical procedures are used as substantive procedures. [2] Ch. 6

(c) Discuss the problems associated with the audit and review of accounting estimates. [2] Ch. 8

(d) Describe why smaller entities may have different control environments and describe the types of evidence likely to be available in smaller entities. [1] Ch. 8

(e) Discuss the difference between tests of control and substantive procedures. [2] Ch. 9

3 Audit sampling and other means of testing

(a) Define audit sampling and explain the need for sampling. [1] Ch. 6

(b) Identify and discuss the differences between statistical and non-statistical sampling. [2] Ch. 6

(c) Discuss and provide relevant examples of, the application of the basic principles of statistical sampling and other selective testing procedures. [2] Ch. 6

(d) Discuss the results of statistical sampling, including consideration of whether additional testing is required. [2] Ch. 6

4 The audit of specific items

For each of the account balances stated in this sub-capability:

Explain the audit objectives and the audit procedures in relation to:

(a) Receivables:[2] Ch. 8
   (i) direct confirmation of accounts receivable
   (ii) other evidence in relation to receivables and prepayments, and
   (iii) completeness and occurrence of sales.
5 Computer-assisted audit techniques

(a) Explain the use of computer-assisted audit techniques in the context of an audit. [1] Ch. 6

(b) Discuss and provide relevant examples of the use of test data and audit software. [2] Ch. 6
6 The work of others

(a) Discuss why auditors rely on the work of others. [2] Ch. 6

(b) Discuss the extent to which external auditors are able to rely on the work of experts, including the work of internal audit. [2] Ch. 6

(c) Explain the audit considerations relating to entities using service organisations. [2] Ch. 6

(d) Explain the extent to which reference to the work of others can be made in audit reports. [1] Ch. 6

7 Not-for-profit organisations

(a) Apply audit techniques to not-for-profit organisations. [2] Ch. 8

E REVIEW AND REPORTING

1 Subsequent events

(a) Explain the purpose of a subsequent events review. [1] Ch. 9

(b) Explain the responsibilities of auditors regarding subsequent events. [1] Ch. 9

(c) Discuss the procedures to be undertaken in performing a subsequent events review. [2] Ch. 9

2 Going concern

(a) Define and discuss the significance of the concept of going concern. [2] Ch. 9

(b) Explain the importance of and the need for going concern reviews. [2] Ch. 9

(c) Explain the respective responsibilities of auditors and management regarding going concern. [1] Ch. 9

(d) Identify and explain potential indicators that an entity is not a going concern. [2] Ch. 9

(e) Discuss the procedures to be applied in performing going concern reviews. [2] Ch. 9

(f) Discuss the disclosure requirements in relation to going concern issues. [2] Ch. 9
(g) Discuss the reporting implications of the findings of going concern reviews. [2] Ch. 9

3 Written representations

(a) Explain the purpose of and procedure for obtaining written representations. [2] Ch. 9

(b) Discuss the quality and reliability of written representations as audit evidence. [2] Ch. 9

(c) Discuss the circumstances where written representations are necessary and the matters on which representations are commonly obtained. [2] Ch. 9

4 Audit finalisation and the final review

(a) Discuss the importance of the overall review of evidence obtained. [2] Ch. 9

(b) Describe procedures an auditor should perform in conducting their overall review of financial statements. [2] Ch. 9

(c) Explain the significance of uncorrected misstatements. [1] Ch. 9

(d) Evaluate the effect of dealing with uncorrected misstatements. [2] Ch. 9

5 Audit reports

(a) Identify and describe the basic elements of the auditor's report. [1] Ch. 10

(b) Explain unmodified audit opinions in the auditor's report. [2] Ch. 10

(c) Explain modified audit opinions in the audit report. [2] Ch. 10

(d) Describe the format and content of emphasis of matter and other matter paragraphs. [2] Ch. 10

The superscript numbers in square brackets indicate the intellectual depth at which the subject area could be assessed within the examination. Level 1 (knowledge and comprehension) broadly equates with the Knowledge module, Level 2 (application and analysis) with the Skills module and Level 3 (synthesis and evaluation) to the Professional level. However, lower level skills can continue to be assessed as you progress through each module and level.
For a list of examinable documents, see the ACCA web site: (www.accaglobal.com/en/student).

The Examination

Examination format

The examination paper is structured into two sections:

Section A will contain eight 2 mark and four 1 mark objective test questions assessing the breadth of the syllabus.

Section B will contain four 10 mark questions and two 20 mark questions. Section B questions will require application of knowledge to a scenario.

You will have 15 minutes of reading and planning time plus 3 hours of writing time.

Paper-based examination tips

Spend the first few minutes of the examination reading the paper.

Section A

- Read the options available and see if you can find the right answer.
- If you are not sure what the right answer is, go through and rule out the wrong answers.
- If in doubt - guess.
- Never leave a multiple choice question unanswered!

Section B

Divide the time you spend on questions in proportion to the marks on offer. One suggestion for this examination is to allocate 1.8 minutes to each mark available, so a 10-mark question should be completed in approximately 18 minutes.

Unless you know exactly how to answer the question, spend sometime planning your answer. Stick to the question and tailor your answer to what you are asked. Pay particular attention to the verbs in the question.

Spend the last five minutes reading through your answers and making any additions or corrections.
If you **get completely stuck** with a question, leave space in your answer book and return to it later.

If you do not understand what a question is asking, state your assumptions. Even if you do not answer in precisely the way the examiner hoped, you may be given some credit, if your assumptions are reasonable.

You should do everything you can to make things easy for the marker. The marker will find it easier to identify the points you have made if your answers are legible and well spaced out.

**Written questions:** Be concise. It is better to write a little about a lot of different points than a great deal about one or two points. Make sure that each point is clearly identifiable by leaving a line space between each of your points. **DO NOT** write an essay.

**Reports, memos and other documents:** Some questions ask you to present your answer in the form of a report or a memo or other document. So use the correct format - there are easy marks to gain here. Your report should have a clear structure. It should contain a brief introduction (paraphrase the requirement), a main section (your answer to the requirement) and a conclusion (a brief summary of what you have written about and its relevance).

**Study skills and revision guidance**

This section aims to give guidance on how to study for your ACCA exams and to give ideas on how to improve your existing study techniques.

**Preparing to study**

**Set your objectives**

Before starting to study decide what you want to achieve i.e. the type of pass you wish to obtain. This will decide the level of commitment and time you need to dedicate to your studies.

**Devise a study plan**

Determine which times of the week you will study.

Split these times into sessions of at least one hour for study of new material. Any shorter periods could be used for revision or practice.
Put the times you plan to study onto a study plan for the weeks from now until the exam and set yourself targets for each period of study. In your sessions make sure you cover the course, course assignments and revision.

If you are studying for more than one paper at a time, try to vary your subjects as this can help you to keep interested and see subjects as part of wider knowledge.

When working through your course, compare your progress with your plan and, if necessary, re-plan your work (perhaps including extra sessions) or, if you are ahead, do some extra revision/practice questions.

**Effective studying**

**Active reading**

You are not expected to learn the text by rote, rather, you must understand what you are reading and be able to use it to pass the exam and develop good practice. A good technique to use is SQ3Rs – Survey, Question, Read, Recall, Review:

(1) **Survey the chapter** – look at the headings and read the introduction, summary and objectives, to get an overview of what the chapter deals with.

(2) **Question** – whilst undertaking the survey, ask yourself the questions that you hope the chapter will answer for you.

(3) **Read** through the chapter thoroughly, answering the questions and making sure you can meet the objectives. Attempt the exercises and activities in the text, and work through all the examples.

(4) **Recall** – at the end of each section and at the end of the chapter, try to recall the main ideas of the section/chapter without referring to the text. This is best done after a short break of a couple of minutes after the reading stage.

(5) **Review** – check that your recall notes are correct.

You may also find it helpful to re-read the chapter to try to see the topic(s) it deals with as a whole.
**Note-taking**

Taking notes is a useful way of learning, but do not simply copy out the text. The notes must:

- be in your own words
- be concise
- cover the key points
- be well-organised
- be modified as you study further chapters in this text or in related ones.

Trying to summarise a chapter without referring to the text can be a useful way of determining which areas you know and which you don't.

**Three ways of taking notes:**

**Summarise the key points of a chapter.**

**Make linear notes** – a list of headings, divided up with subheadings listing the key points. If you use linear notes, you can use different colours to highlight key points and keep topic areas together. Use plenty of space to make your notes easy to use.

**Try a diagrammatic form** – the most common of which is a mind-map. To make a mind-map, put the main heading in the centre of the paper and put a circle around it. Then draw short lines radiating from this to the main sub-headings, which again have circles around them. Then continue the process from the sub-headings to sub-sub-headings, advantages, disadvantages, etc.

**Highlighting and underlining**

You may find it useful to underline or highlight key points in your study text – but do be selective. You may also wish to make notes in the margins.

**Revision**

The best approach to revision is to revise the course as you work through it. Also try to leave four to six weeks before the exam for final revision. Make sure you cover the whole syllabus and pay special attention to those areas where your knowledge is weak. Here are some recommendations:
Read through the text and your notes again and condense your notes into key phrases. It may help to put key revision points onto index cards to look at when you have a few minutes to spare.

Review any assessments you have completed and look at where you lost marks – put more work into those areas where you were weak.

Practise exam standard questions under timed conditions. If you are short of time, list the points that you would cover in your answer and then read the model answer, but do try to complete at least a few questions under exam conditions.

Also practise producing answer plans and comparing them to the model answer.

If you are stuck on a topic find somebody (a tutor) to explain it to you.

Read good newspapers and professional journals, especially ACCA’s Student Accountant – this can give you an advantage in the exam.

Ensure you know the structure of the exam – how many questions and of what type you will be expected to answer. During your revision attempt all the different styles of questions you may be asked.

**Further reading**

You can find further reading and technical articles under the student section of ACCA’s website.
Introduction to assurance

Chapter learning objectives

This chapter covers syllabus areas:

• A1 - The concept of audit and other assurance engagements
• A2e - Limitations of external audits

Detailed syllabus objectives are provided in the introduction section of the text book.
1 What is assurance?

An assurance engagement is: ‘An engagement in which a practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria.’ (International Audit and Assurance Standards Board Handbook)

Giving assurance means: offering an opinion about specific information so the users of that information are able to make confident decisions knowing that the risk of the information being ‘incorrect’ is reduced.

There are five elements of an assurance engagement:

(i) the three parties involved:
   – the practitioner (i.e. the reviewer of the subject matter who provides the assurance)
   – the intended users (of the information)
   – the responsible party (i.e. those responsible for preparing the subject matter)

(ii) an appropriate subject matter

(iii) suitable criteria, against which the subject matter is evaluated/measured

(iv) sufficient appropriate evidence

(v) a written assurance report in an appropriate form.
Consider someone who is buying a house.

Most members of the public lack the technical expertise to assess the structural condition of property. There is a risk that someone pays a large sum of money to purchase a structurally unsafe property which needs further expenditure to make it useable.

To reduce this risk, it is normal for house buyers (the users) to pay a property surveyor (the practitioner) to perform a structural assessment of the house (the subject matter). The surveyor would then report back (written report) to the house buyer identifying any structural deficiencies (measured against building regulations/best practice and other criteria). With this information the potential buyer can then make their decision to buy or not to buy the house with confidence that they know the structural condition of the house.

In this example, the responsible party is the current house owner, and the evidence would largely be obtained by visually inspecting the property.

The elements of an audit engagement

The five elements of an external audit engagement

(i) The three parties involved:
   - the preparers – management/directors
   - the users – shareholders
   - the practitioner – the auditors

(ii) The subject matter: the financial statements (prepared by management).

(iii) Sufficient appropriate evidence: obtained by performing audit procedures and reviewing the financial statements.

(iv) This includes evaluating whether the FS are prepared in accordance with a relevant financial reporting framework (i.e. suitable criteria).

(v) The audit report: which is presented to the shareholders. This report summarises the auditor’s opinion as to whether the financial statements are "presented fairly" (or "true and fair").
Audit of financial statements
• Review of financial statements
• Risk assessment reviews
• Systems reliability reports
• Verification of social and environmental information (e.g. to validate an employer’s claims about being an equal opportunities employer or a company’s claims about sustainable sourcing of materials)
• Reviews of internal controls
• Value for money audit in public sector organisations.

2 Types of assurance engagement

The IAASB International Framework for Assurance Engagements permits two types of assurance engagement:

• reasonable
• limited.

Reasonable assurance engagements

In a reasonable assurance engagement, the practitioner:

• Gathers **sufficient appropriate evidence** to be able to draw reasonable conclusions.
• Concludes that the subject matter **conforms in all material respects** with identified suitable criteria.
• Gives a **positively** worded assurance opinion.
• Gives a **high** level of assurance (confidence).
• Performs very thorough procedures to obtain sufficient appropriate evidence - tests of controls and substantive procedures.

Illustration 2: Positively worded assurance opinion

In our opinion, the financial statements give a true and fair view of (or **present fairly, in all material respects**) the financial position of Murray Company as at December 31 20X4, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.
Limited assurance engagement

In a limited assurance assignment, the practitioner:

- Gathers **sufficient appropriate evidence** to be able to draw limited conclusions.
- Concludes that the subject matter, with respect to identified suitable criteria, **is plausible in the circumstances**.
- Gives a **negatively** worded assurance opinion.
- Gives a **moderate** or lower level of assurance than that of an audit.
- Performs significantly fewer procedures - mainly enquiries and analytical procedures.

*Illustration 3: Negatively worded assurance opinion*

**Nothing has come to our attention** that causes us to believe that the financial statements of Murray Company as of 31 December 20X4 are not prepared, in all material respects, in accordance with an applicable financial reporting framework.

The confidence inspired by a reasonable assurance report is designed to be greater than that inspired by a limited assurance report.

Therefore:

- there are more regulations/standards governing a reasonable assurance assignment
- the procedures carried out in a reasonable assignment will be more thorough
- the evidence gathered will need to be of a higher quality.

**3 External audit engagements**

**Objective of an external audit engagement**

The objective of an **external audit engagement** is to enable the auditor to express an opinion on whether the financial statements:

- Give a true and fair view (or present fairly in all material respects).
- Are prepared, in all material respects, in accordance with an applicable financial reporting framework.

The financial reporting framework to be applied will vary from country to country. In F8, it is assumed that International Financial Reporting Standards are the basis of preparing the financial statements.
ISA 200 Overall objectives of the independent auditor and the conduct of an audit in accordance with International Standards on Auditing states: the objectives of an auditor are to:

- Obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error.
- Express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework.
- Report on the financial statements, and communicate as required by ISAs, in accordance with the auditor's findings.

An external audit is an example of a reasonable assurance engagement.

The purpose of an audit is to enhance the degree of confidence of the intended users in the financial statements.

**Need for external audit**

- Shareholders provide the finance for a company and may or may not be involved in the day to day running of the company.
- Directors manage the company on behalf of the shareholders in order to achieve the objectives of that company (normally the maximisation of shareholder wealth).
- The directors must prepare financial statements to provide information on performance and financial position to the shareholders.
- The directors have various incentives to manipulate the financial statements and show a different level of performance.
- Hence the need for an independent review of the financial statements to ensure they give a true and fair view - the external audit.

In most developed countries, publicly quoted companies and large companies are required by law to produce annual financial statements and have them audited by an external auditor.

Companies that are not required to have a statutory audit may choose to have an external audit because the company's shareholders or other influential stakeholders want one and because of the benefits of an audit.
**Benefits of an audit**

- Improves the quality and reliability of information, giving investors faith in and improving the reputation of the market.
- Independent scrutiny and verification may be valuable to management.
- May reduce the risk of management bias, fraud and error by acting as a deterrent.
- May detect bias, fraud and error.
- Enhances the credibility of the financial statements, e.g. for tax authorities or lenders.
- Deficiencies in the internal control system may be highlighted by the auditor.

**Expectations gap**

Some users incorrectly believe that an audit provides absolute assurance; that the audit opinion is a guarantee the financial statements are 'correct'. This and other misconceptions about the role of an auditor are referred to as the 'expectations gap'.

**Examples of the expectations gap**

- A belief that auditors test all transactions and balances; they test on a sample basis.
- A belief that auditors are required to detect all fraud; auditors are required to provide reasonable assurance that the financial statements are free from material misstatement, which may be caused by fraud.
- A belief that auditors are responsible for preparing the financial statements; this is the responsibility of management.

Auditors provide reasonable assurance which is not absolute assurance. The **limitations of an audit** mean that it is not possible to provide a 100% guarantee.

**Limitations of an audit:**

- Financial statements include subjective estimates and other judgemental matters.
- Internal controls may be relied on which have their own inherent limitations.
- Representations from management may have to be relied upon as the only source of evidence in some areas.
- Evidence is often persuasive not conclusive.
- Do not test all transactions and balances. Auditors test on a sample basis.
The objective of a review of financial statements is to enable an auditor to state whether, on the basis of procedures which do not provide all the evidence required in an audit, anything has come to the auditor’s attention that causes the auditor to believe that the financial statements are not prepared in accordance with the applicable financial reporting framework (i.e. negative/limited assurance).

A review engagement is an example of a limited assurance engagement.

A company which is not legally required to have an audit may choose to have a review of their financial statements instead. The review will still provide some assurance to users but is likely to cost less and be less disruptive than an audit.

The procedures will mainly focus on analytical procedures and enquiries of management. In particular, no tests of controls will be performed. As only limited assurance is being expressed, the work does not need to be as in depth as for an audit.
Accountability, agency and stewardship

Key definitions:

**Accountability** means that people in a position of power can be held to account for their actions, i.e. they can be compelled to explain their decisions and can be criticised or punished if they have abused their position.

Accountability is central to the concept of good corporate governance – the process of ensuring that companies are well run – which we will look at in more detail in a later chapter.

**Agency** occurs when one party, the principal, employs another party, the agent, to perform a task on their behalf.

**Stewardship** is the responsibility to take good care of resources. A steward is a person entrusted with management of another person’s property, for example, when one person is paid to look after another person’s house while the owner goes abroad on holiday. The steward is accountable for the way he carries out his role.

This relationship, where one person has a duty of care towards someone else is known as a ‘**fiduciary relationship**’.

A **fiduciary relationship** is a relationship of ‘good faith’ such as that between the directors of a company and the shareholders of the company. There is a ‘separation of ownership and control’ in the sense that the shareholders own the company, while the directors make the decisions. The directors must make their decisions in the interests of the shareholders rather than in their own selfish personal interests.

Therefore:

- The directors are the stewards of the company.
- The shareholder is the principal, employing the directors (the agents) to run the company on their behalf.
- The directors are accountable to the shareholders for the way in which they run the company.
Incorporation and the separation of ownership and control

Businesses can operate through a number of different vehicles. It is common for investors in those businesses to seek the protection of limited company status. This means that whilst they could lose the funds they invest in a business they cannot be held personally responsible for satisfying the remaining corporate debts. The creation of a limited company is referred to as incorporation.

Incorporation has the following implications:

• the creation of a legal distinction between the owners of the business and the business itself;
• the opportunity for the owners/investors to detach themselves from the operation of the business; and
• the need for managers to operate the business on a daily basis.

Whilst this has provided financial protection for shareholders it does lead to one significant conflict:

• Shareholders seek to maximise their wealth through the increasing value of their shareholding. This is driven by the profitability (both current and potential) of the company.
• Directors/management seek to maximise their wealth through salary, bonuses and other employment benefits. This reduces company profitability.

This conflict led to the legal requirement for financial statements to be produced by directors to account for their stewardship of the company. These are sent to shareholders to allow them to assess the performance of management.

True and fair

• True: factual, conforms with accounting standards and relevant legislation and agrees with underlying records.
• Fair: clear, impartial and unbiased and reflects the commercial substance of the transactions of the entity.
Examples of stakeholder groups

Examples of stakeholder groups and their use of corporate information are:

- Shareholders can decide whether to alter their shareholdings.
- Employees may be able to judge whether they think their levels of pay are adequate compared to the directors and results of the company, and to enable them to make career decisions.
- Those charged with governance can see whether they think management have struck the right balance between their own need for reward (remuneration, share options, etc) and the needs of other stakeholders.
- Customers can make judgements about whether the company has sufficient financial strength (i.e. liquidity) to justify future trading.
- Suppliers and lenders can assess financial stability before giving credit.
- The government can decide whether the right amounts of tax have been paid and whether the company appears to be compliant with the relevant laws and regulations.

Test your understanding 1

Auditors are frequently required to provide assurance for a range of non-audit engagements.

**Required:**

List and explain the elements of an assurance engagement.

(5 marks)

Test your understanding 2

Explain the term ‘limited assurance’ in the context of a review of a company's cash flow forecast and explain how this differs from the assurance provided by a statutory audit.

(5 marks)
(1) Auditors aim to give absolute assurance over the accuracy of the financial statements. True or False?

A  True
B  False

(2) Which of the following is not one of the five elements of an assurance engagement?

A  Subject matter
B  Suitable criteria
C  Assurance file
D  Written report

(3) Which of the following is NOT a benefit of an audit?

A  Increased credibility of the financial statements
B  Deficiencies in controls may be identified during testing
C  Fraud may be detected during the audit
D  Sampling is used

(4) Which of the following statements is false?

A  The auditor will express an opinion as to whether the financial statements show a true and fair view
B  The audit opinion will provide reasonable assurance
C  If the financial statements are found to contain material misstatements a negative audit opinion will be given
D  An audit may not detect all fraud and error in the financial statements

(5) Which of the following are examples of the expectations gap?

(i) The audit report confirms the financial statements are accurate
(ii) An unmodified opinion means the company is a going concern
(iii) The auditor tests all transactions
(iv) The auditor can be sued for negligence if they issue an inappropriate opinion

A  i, ii, iii
B  i, ii, iv
C  i & ii only
D  ii & iii only
5 Chapter summary

Levels of assurance
- Reasonable
- Limited
- Review engagements
- True and fair
- Nothing has come to our attention

Assurance engagements

Elements
- 1. Three parties
- 2. Subject matter
- 3. Suitable criteria
- 4. Sufficient appropriate evidence
- 5. Written report

Benefits

Limitations

Expectations gap
Test your understanding answers

Test your understanding 1

(1) An assurance engagement will involve three separate parties:
   (i) the intended user who is the person who requires the assurance report
   (ii) the responsible party, which is the organisation responsible for preparing the subject matter to be reviewed and
   (iii) the practitioner (i.e. an accountant) who is the professional, who will review the subject matter and provide the assurance.

(2) A second element is a suitable subject matter. The subject matter is the data that the responsible party has prepared and which requires verification.

(3) Suitable criteria are required in an assurance engagement. The subject matter is compared to the criteria in order for it to be assessed and an opinion provided.

(4) Appropriate evidence has to be obtained by the practitioner in order to give the required level of assurance.

(5) An assurance report is the opinion that is given by the practitioner to the intended user and the responsible party.
Limited Assurance | Assurance provided by statutory audit
---|---
Limited assurance is a moderate level of assurance. | A statutory audit provides reasonable assurance, which is a high level. 
The objective of a limited assurance engagement is to obtain sufficient appropriate evidence that the cash flow forecast is plausible in the circumstances. | The objective of a statutory audit is to obtain sufficient appropriate evidence that the financial statements conform in all material respects with the relevant financial reporting framework. 
A limited assurance report provides a negative opinion. The practitioner will state that nothing has come to their attention which indicates that the cash flow forecast contains any material errors. | The statutory audit report provides a positive opinion; that is the financial statements do show a true and fair view. 
The assurance is therefore given on the absence of any indication to the contrary. |  
With limited assurance, limited procedures are performed; often only enquiry and analytical procedures. | More evidence will need to be obtained to provide reasonable assurance, and a wider range of procedures performed, including tests of controls. 
A cash flow relates to the future, which is inherently uncertain, and therefore it would not be possible to obtain assurance that it is free from material misstatement. | Financial statements relate to the past, and so the auditor should be able to obtain sufficient appropriate evidence. 
Less reliance can therefore be placed on the forecast than the financial statements, where the positive assurance was given. |
False. Only reasonable assurance can be given as all transactions are not tested.

(2) C Assurance file.

(3) D Sampling provides a limitation of the audit process, not a benefit.

(4) C A negative opinion is used for limited assurance engagements.

(5) A The auditor cannot confirm the accuracy of the financial statements as they contain estimates and judgements of management. The company may not be a going concern and the financial statements may correctly reflect this resulting in an unmodified audit opinion. The auditor does not test all transactions.