

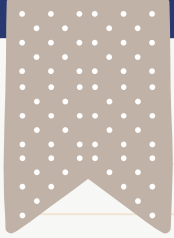


Auditing

Chapter 1: PRINCIPLES OF AUDITING & ASSURANCE SERVICES



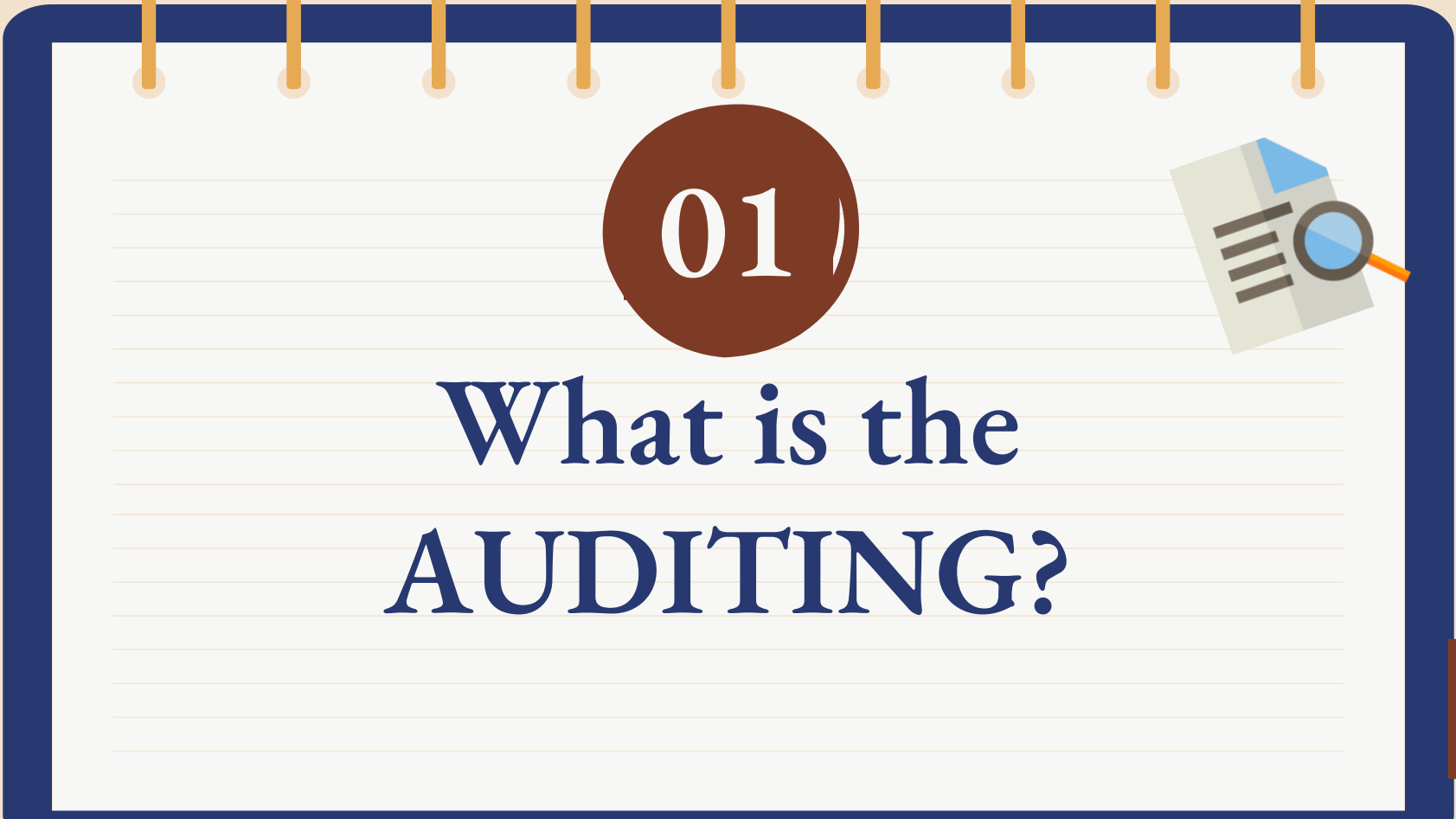
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Objectives



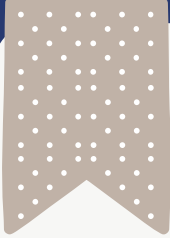
- ✓ *Information risks*
- ✓ *The Demand for audit*
- ✓ *What is the AUDITING?*
- ✓ *Analysis of audit definition*
- ✓ *Accounting VS Auditing*
- ✓ *Assurance ,Attestation Vs Non Assurance Services*
- ✓ *Audit Approaches*
- ✓ *Internal Vs External Audit*
- ✓ *Types of Auditors*
- ✓ *The objectives of financial statement audit*
- ✓ *The Importance of an audit of financial statements*



01



What is the AUDITING?



Information risks: The Demand for audit



- All businesses make a countless number of decisions each and every day. Decisions to purchase or sell goods or services, lend money, enter into employment agreements, or buy or sell investments depend in large part on the quality of useful information. These decisions affect business risk, the chance a company takes that customers will buy from competitors, that product lines will become obsolete, that taxes will increase, that government contracts will be lost, or that employees will go on strike. In other words, *business risk is the risk that an entity will fail to meet its objectives. If the company fails to meet its objectives enough times, the company may ultimately fail.*

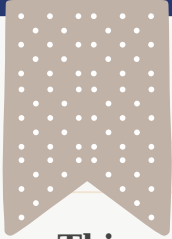


Information risks: The Demand for audit



- A further complication in effective decision making is the presence of information risk.

Information risk is the probability that the information circulated by a company will be false or misleading. Decision makers usually obtain their information from companies or organizations with which they want to conduct business, to provide loans, or to buy or sell stock. Because the primary source of information is the target company itself, an incentive exists for that company's management to make their business or service appear to be better than it actually is, to put their best foot forward. As a result, preparers and issuers of financial information (directors, managers, accountants, and other people employed in a business) might benefit by giving false, misleading, or overly optimistic information.



The Demand for audit



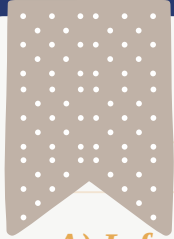
- This potential conflict of interest between information providers and users, along with financial statement frauds. Thus, they depend on information professionals to serve as independent and objective intermediaries who will lend credibility to the information. This lending of credibility to information is known as providing *assurance*.
- When the assurance is provided for specific assertions made by management, we refer to the assurance provided as *attestation*. When the assertions are embodied in a company's financial statements, we refer to the attestation as *auditing*. More specifically, when their work is completed, the auditors supply an opinion as to whether the financial statements and related footnotes are presented fairly in all material respects



What is the AUDITING?



- ✓ Auditing is the accumulation and evaluation of evidence about information to determine and report on the degree of correspondence between the information and established criteria.
- ✓ Auditing is: “A systematic process of objectively obtaining and evaluating evidence regarding assertions about economic actions and events to ascertain the degree of correspondence between those assertions and established criteria and communicating the results to interested” .

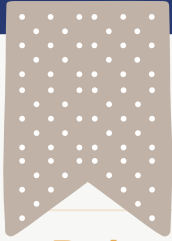


Analysis of audit definition



A) Information & Established Criteria:

- To do an audit, there must be information in a verifiable form and some standards (**criteria**) by which the auditor can evaluate the information. Information can and does take many forms .
- The criteria for evaluating information also vary depending on the information being audited.
 - When audit the F.S criteria may be **GAAP** or **IFRS**
 - When audit internal over control reporting criteria is **COSO**

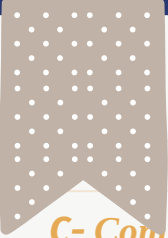


Analysis of audit definition



B- Accumulating and Evaluating Evidence:

- Evidence is any information used by the auditor to determine whether the information being audited is stated in accordance with the established criteria. Evidence takes many different forms, including:
 1. Electronic and documentary data about transactions
 2. Written and electronic communication with outsiders
 3. Observations by the auditor
 4. Oral testimony of the auditee (client)
- To satisfy the purpose of the audit, auditors must obtain a sufficient quality and volume of evidence. Auditors must determine the types and amount of evidence necessary and evaluate whether the information corresponds to the established criteria.

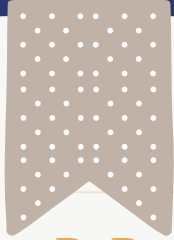


Analysis of audit definition



C- Competent, Independent Person:

- The auditor must be **qualified** to understand the criteria used and must be competent to know the types and amount of evidence to accumulate to reach the proper conclusion after examining the evidence. The auditor must also have an independent mental attitude. The competence of those performing the audit is of little value if they are biased in the accumulation and evaluation of evidence.
- Auditors strive to maintain a high level of independence to keep the confidence of users relying on their reports. Auditors reporting on company financial statements are often called independent auditors. Even though such auditors are paid fees by the company, they are normally sufficiently independent to conduct audits that can be relied on by users. Even internal auditors—those employed by the companies they audit—usually report directly to top management and the board of directors, keeping the auditors independent of the operating units they audit.



Analysis of audit definition



D- Report:

- ❑ *The final stage in the auditing process* is preparing the audit report, which communicates the auditor's findings to users. Reports differ in nature, but all must inform readers of the degree of correspondence between the information audited and established criteria. Reports also differ in form and can vary from the highly technical type usually associated with financial statement audits to a simple oral report in the case of an operational audit of a small department's effectiveness.

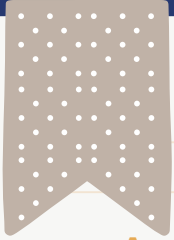
Criterion	Accounting	Auditing
Definition	Accounting is the process of systematically recording , measuring, and communicating information about financial transactions.	An audit is an independent examination and expression of an opinion on the financial statements of an enterprise
Timing	Accountancy work is conducted continuously with daily recording of financial transactions	Auditing work is generally, conducted at the end of the year after the preparation of final financial statements
Objective	To show the financial position, profitability and performance of an organization.	To add credibility to the financial statements of an organization
Governed By	Accounting standards	Standards on auditing
Performed by	Accountant	Auditor
Criterion	Accounting	Auditing

Start	Starts where book-keeping ends	Starts where financial accounting ends.
Period	Concentrates on the current financial transactions and	Concentrates on the past financial statements
Coverage	All transactions, records and statements having financial implications	Final financial statements and records.
Status	Carried out by an internal employee	Carried out by an external person or independent agency
Appointment	By the management	By the shareholders
Outputs	Financial statements e.g. Income Statement, Balance Sheet, Cash Flow Statement, etc.	External Audit Report



02

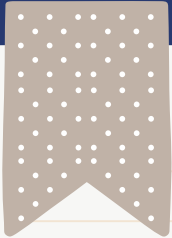
Assurance ,Attestation Vs Non Assurance Services



Assurance



- **An assurance service is an independent professional service that improves the quality of information for decision makers.**
- Such services are valued because the assurance provider is independent and perceived as being unbiased with respect to the information examined. Individuals who are responsible for making business decisions seek assurance services to help improve the reliability and relevance of the information used as the basis for their decisions.

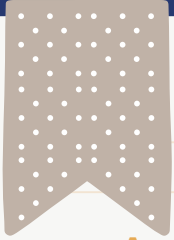


Assurance



The major elements of assurance are:

- 1) **Independence:** CPAs want to preserve their attestation and audit reputations and competitive advantages by preserving integrity and objectivity when performing assurance services.
- 2) **Professional services** :is defined as a professional service as long as it involves some element of judgment based on education and experience.
- 3) **Improving the quality of information:** For assurance services, improving the quality of information refers not to the information itself but to how the information is used in a decision-making context..
- 4) **For decision makers** :Assurance services can enhance quality by assuring users about the reliability and relevance of information They are the consumers of assurance services. The decision makers are the beneficiaries of the assurance services. Depending upon the assignment, decision makers may be a very small, targeted group (e.g., managers of a database) or a large targeted group (e.g., potential investors interested in a mutual fund manager's performance).



Assurance



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Assurance

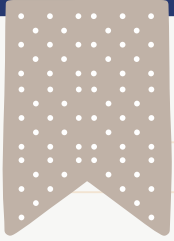
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graph TD; A[Assurance] --> B[Attestation Service]; A --> C[Non-attestation service other assurance service];
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"Report"

Attestation Service

"No Report"

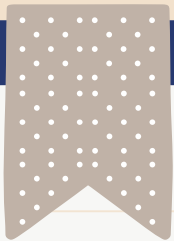
**Non-attestation service
other assurance service**



Attestation



An attestation service is a type of assurance service in which the CPA firm issues a **report** about the reliability of an assertion that is made by another party. Attestation services fall into **9 categories.**

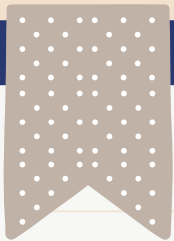


Attestation



1. **Audit of Historical Financial Statements.** In an audit of historical financial statements, management asserts that the statements are fairly stated in accordance with applicable U.S. or international accounting standards. An audit of these statements is a form of attestation service in which the auditor issues a written report expressing an opinion about whether the financial statements are fairly stated in accordance with the applicable accounting standards. These audits are the most common assurance service provided by CPA firms.”External auditor”

Those assertions can be classified into the following categories:



Attestation



1. **Existence or occurrence**—Assets or liabilities of the company exist at a given date, and recorded transactions have occurred during a given period.
2. **Completeness**—All transactions and accounts that should be presented in the financial statements are so included.
3. **Valuation or allocation**—Asset, liability, equity, revenue, and expense components have been included in the financial statements at appropriate amounts.
4. **Rights and obligations**—The company holds or controls rights to the assets, and liabilities are obligations of the company at a given date.
5. **Presentation and disclosure**—The components of the financial statements are properly classified, described, and disclosed.

EXHIBIT 1.6 Management Assertions and Their Relationship to the Financial Statements

STATEMENT OF FINANCIAL CONDITION APOLLO SHOES INC. in thousands

As of December 31

	2014	2013
Assets		
Cash	\$3,245	\$3,509
Accounts Receivable (Net of Allowances of \$1,263 and 210, respectively) (Note 3)	15,148	2,738
Inventory (Note 4)	15,813	13,823
Prepaid Expenses	951	352
Current Assets	\$35,157	\$20,422
Property, Plant, and Equipment (Note 5)	1,174	300
Less Accumulated Depreciation	(164)	(311)
	\$1,010	\$269
Investments (Note 6)	613	613
Other Assets	14	0
Total Assets	\$36,794	\$21,304
Liabilities and Shareholders' Equity		
Accounts Payable and Accrued Expenses	\$4,675	\$3,556
Short-Term Liabilities (Note 7)	10,000	0
Current Liabilities	\$14,675	\$3,556
Long-Term Debt (Note 7)	0	0
Total Liabilities	\$14,675	\$3,556
Common Stock	8,106	8,106
Additional Paid-in Capital	7,743	7,743
Retained Earnings	6,271	1,900
Total Shareholders' Equity	\$22,119	\$17,748
Total Liabilities and Shareholders' Equity	\$36,794	\$21,304

The accompanying notes are an integral part of the consolidated financial statements.

Occurrence—Did these sales transactions really take place?

Completeness—Are all the expenses included? Are they recorded in the correct period?

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS APOLLO SHOES, INC.

1. Summary of Significant Accounting Policies

Business activity The Company develops and markets technologically superior podiatric athletic products under various trademarks, including SIREN, SPOTLIGHT, and SPEAKERSHOE.

Marketable Securities Investments are valued using the market value method for investments of less than 20%, and by the equity method for investments greater than 20% but less than 50%.

Cash equivalents Cash equivalents are defined as highly liquid investments with original maturities of three months or less at date of purchase.

Inventory valuation Inventories are stated at the lower of First-in, First-out (FIFO) or market.

Property and equipment and depreciation Property and equipment are stated at cost. The Company uses the straight-line method of depreciation for all additions to property, plant, and equipment.

Intangibles Intangibles are amortized on the straight-line method over periods benefited.

Net Sales Sales for 2014 and 2013 are presented net of sales returns and allowances of \$4.5 million, and \$0.9 million, respectively, and net of warranty expenses of \$ 1.1 million, and \$0.9 million, respectively.

Income taxes Deferred income taxes are provided for the tax effects of timing differences in reporting the results of operations for financial statements and income tax purposes, and relate principally to valuation reserves for accounts receivable and inventory, accelerated depreciation and unearned compensation.

Net income per common share Net income per common share is computed based on the weighted average number of common and common equivalent shares outstanding for the period.

Reclassification Certain amounts have been reclassified to conform to the 2013 presentation.

2. Significant Customers

Approximately 15%, and 11% of sales are to one customer for years ended December 31, 2014 and 2013, respectively.

Existence—Does this cash really exist?

Rights and Obligations—Does the company really own this inventory?

Valuation or Allocation—Are these investments properly valued?

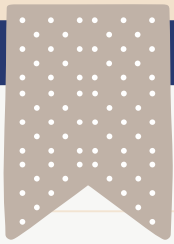
STATEMENTS OF INCOME APOLLO SHOES INC. in thousands (except per share data)

For year ended December 31,

	2014	2013
Net Sales (Note 2)	\$240,575	\$236,299
Cost of Sales	<u>\$141,569</u>	<u>\$120,880</u>
Gross Profit	\$99,006	\$115,419
Selling, General and Administrative Expenses	\$71,998	\$61,949
Interest Expense (Note 7)	\$875	0
Other Expense (Income)	<u>(\$204)</u>	<u>(\$1,210)</u>
Earnings from Continuing Operations Before Taxes	\$26,337	\$54,680
Income Tax Expense (Note 10)	<u>\$10,271</u>	<u>\$21,694</u>
Earnings from Continuing Operations Discontinued Operations, Net of tax benefit	\$16,066	\$33,046
Extraordinary Item, Net of tax benefit (Note 11)	<u>(\$11,695)</u>	<u>(\$31,301)</u>
Net Income	<u>\$14,771</u>	<u>\$1,785</u>
Earnings Per Common Share		
From Continuing Operations	\$1.98	\$4.08
Other	<u>(\$1.44)</u>	<u>(\$3.86)</u>
Net Income	<u>\$0.54</u>	<u>\$0.22</u>
Weighted shares of common stock outstanding	<u>8,106</u>	<u>8,106</u>

The accompanying notes are an integral part of the consolidated financial statements.

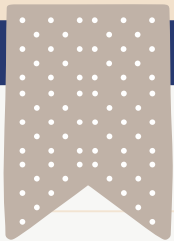
Presentation and Disclosure—Are these disclosures understandable? Has everything been disclosed that should be?



Attestation



2) “Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Tread way Commission (widely known as COSO)”. This evaluation, which is integrated with the audit of the financial statements, increases user confidence future financial reporting, because effective internal controls reduce the likelihood of future misstatements in the financial statements. “Done by External auditor”

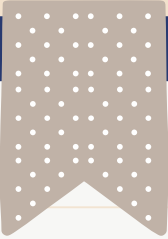


Attestation



3) Review of Historical Financial Statements For a review of historical financial statements, management asserts that the statements are fairly stated in accordance with accounting standards, the same as for audits. “J”**

- But this type of services provides a lower level of assurance for reviews of financial statements compared to a high level for audits, therefore less evidence is needed. A review is often adequate to meet financial statement users’ needs. It can be provided by the CPA firm at a much lower fee than an audit because less evidence is needed. Many nonpublic companies use this attestation option to provide limited assurance on their financial statements without incurring the cost of an audit. **“Done by External auditor”**

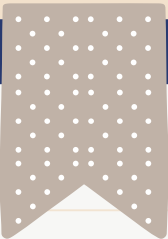


Attestation



4) Information systems audit:

information systems audit is “the process of collecting and evaluating evidence to determine whether a computer system safeguards assets, maintains data integrity, allows organizational goals to be achieved effectively and uses resources efficiently” This kind of audit involves an investigation of the controls over software development, data processing, and access to computer systems. The aim is to spot any issues that could impair the ability of IT systems to provide accurate information to users, and to ensure that unauthorized parties do not have access to the data. .”Done by Internal or External auditor”



Attestation

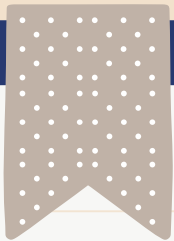


4) Information systems audit:

Examples of information systems audit:

Web Trust services. this service provide assurance to users of Web sites through the CPA's electronic *Web Trust seal displayed on the Web site. This seal* assures the user that the Web site owner has met established criteria related to business practices, transaction integrity, and information processes.

- **SysTrust services.** *attestation* service to evaluate and test system reliability in areas such as security and data integrity. **Whereas the WebTrust assurance service is primarily designed to provide assurance to third-party users of a Web site, SysTrust services might be done by CPAs to provide assurance to management, the board of directors, or third parties about the reliability of information systems used to generate real-time information**

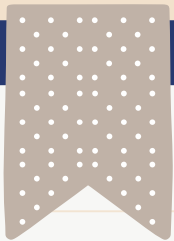


Attestation



5- Operational Audit:

This is a detailed and an efficient examination of the goals, planning processes, procedures, and results of the operations of a business. It investigates a specific unit of an organization for the purpose of measuring its performance. The Operational Audit may be conducted by internal auditor or external auditor . The intended result is an evaluation of operations, likely with recommendations for improvement. .”Done by Internal auditor or External auditor”



Attestation

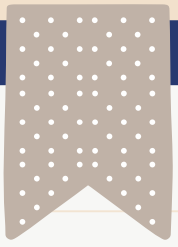


6- Compliance audit:

Compliance audit is an examination of the policies and procedures of an entity or department, in order to determine whether it is in compliance with specific policies, procedures, laws, rules, or regulations set out by some higher authority. This audit is most commonly used in regulated industries or educational institutions. "Done by Internal auditor or External auditor"

7 -Tax Audit: -

It means audit for tax purpose. It is an analysis of the tax returns submitted by an individual or business entity, to see if the tax information and any resulting income tax payment is valid. These audits are usually targeted at returns that result in excessively low tax payments, to see if an additional assessment can be made." Done by Internal revenue agent"



Attestation

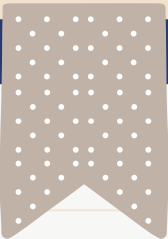


8- Social Audit:

It is a systematic investigation and evaluation of a business enterprise's social performance as distinguished from its economic performance. Social audit is performed to know and evaluate the corporate social performance or social contribution of a business organization.”Done by External auditor”

9- Government Audit: -

This term refers to the audit of accounts of government departments and offices, government companies and statutory or public corporations.”Done by Government Accountability officer”



Non Assurance Services



Numerous other services that generally fall outside the scope of assurance services. Three specific examples are:

1. Accounting and bookkeeping services
2. Tax services
3. Management consulting services

Most accounting and bookkeeping services, tax services, and management consulting services fall outside the scope of assurance services, although there is some common area of overlap between consulting and assurance services. While the primary purpose of an assurance service is to improve the quality of information, the primary purpose of a management consulting engagement is to generate a recommendation to management.

Relationship between Assurance , Attestation & Audit

ABLE 1-2

Relationships among Auditing, Attest, and Assurance Services

<i>Service</i>	<i>Value Added to Information Reported on</i>	<i>Definition of Service</i>
Auditing	Reliability Credibility	A report on an examination of a client's financial statements (and for a public client, the entity's system of internal control over financial reporting)
Attest	Reliability Credibility	A report on subject matter, or an assertion about subject matter, that is the responsibility of another party
Assurance	Reliability Credibility	Professional services that improve the quality of information, or its context, for decision makers

Audit Approaches:

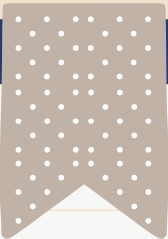


A- Continuous Audit:

Continuous Audit means Examination and verification of a firm's financial transactions, accounts and their supporting documents, continuously throughout the year . It carried out daily or on fixed interval basis.

B- Final Audit:

Final audit is commenced when all account has been closed and final financial statements are been prepared. In this kind of audit where the entity audited only once in a year and the audit of financial statements is made in one visit.



Audit Approaches:



C- Complete-Full Audit: -

Complete audit is a type of audit under which all the records , books of accounts and financial statements are audited .

D- Partial Audit: -

A partial audit is a type of audit that is conducted considering the particular area .In this kind of audit, audit of the whole account is not conducted. Only the audit of the particular area where the owner thinks it is essential to conduct an audit will be conducted. Normally, business transaction is concerned with cash, debtor, creditor etc.

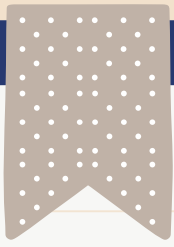
Internal Vs External Audit

Internal audit

Internal audit means a continuous and systematic investigation of the accounting, financial and other operations of a concern by **specially assigned staff in the organization** . Entities are recently increasingly contracting with independent public accounting firms or other outside professionals to perform internal audit traditionally conducted by internal auditors. These method are frequently referred to as “internal audit outsourcing,”

External audit

External audit is a critical investigation of the representation of the published financial statements , it is compulsory for all company's which are listed in the stock exchange. This audit conducted by independent qualified person.

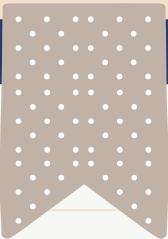


Types of Auditors



A- Internal Auditor:

- Many large companies and organizations maintain an **internal auditing staff** where large part of their work consists of **operational audits** , in addition, they may conduct compliance audits , and a number of them have expertise in evaluating computer systems. They take a holistic view of their organization's governance, risk, and control systems (in other words, **they interested primarily non-financial information**).
- An internal auditor ***must be independent of the department heads and other executives whose work he audits*** . To maintain independence from other business functions, the internal auditors must typically reports directly to the board of director or the audit committee of the board of directors. Internal auditors, however, can never be independent in the same sense as the external auditors because they are employees of the company they are auditing .

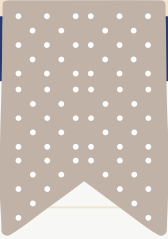


External Auditor (Certified Public Accountant “CPA”):



B- External Auditor:

- The external auditor are a public accountant who perform audits, reviews, and other work for their clients. External auditors are appointed by the shareholders of a company, although this usually comes through discussion with directors. An external auditor is independent of all clients, and so is in a good position to make an investigation and evaluation of the financial statements and systems of internal controls of those clients.
- An external auditor's opinion are highly valued by members of the investment community , creditors, and other parts who need an independent appraisal of the financial statements of organizations.
- External auditors are certified by a governing body, Most countries have strong professional accountant organizations which may also influence who becomes an auditor

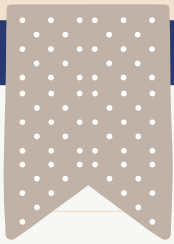


External Auditor (Certified Public Accountant “CPA”):



B- External Auditor:

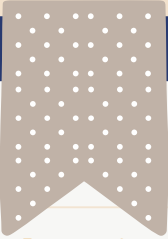
- for example in the United States is **the American Institute of Certified Public Accountants(AICPA) for private companies audits or Public Company Accounting Oversight Board(PACOB) for public listed companies audits**. As certified public accountants, external auditors have proven that they have a certain minimum level of training and experience, and have passed a lengthy examination. These auditors must also fulfill periodic continuing professional education requirements in order to keep their certifications current . (E)**



External Auditor (Certified Public Accountant “CPA”):



“While the internal and external auditor functions are complementary and may need to work closely together, their purposes and areas of focus differ. Internal auditor take a total view of his organization’s governance, risk, and control systems (in other words, primarily nonfinancial information), while external auditor is concerned with fairness of financial statements”

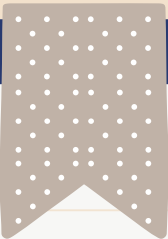


Relationship between External & Internal Auditor:



There is a strengthened relationship between the external and internal auditors in the following aspects:

- An internal auditor's existence and work may affect the nature, timing, and extent of audit procedures.
- External auditor may use internal auditor to provide direct assistance in performing the audit. With the knowledge of the internal auditor, the external auditor can obtain additional insights into the entity . In this case the external auditor must assess internal auditor competence (education, expérience, Professional certification, etc.) and objectivity (organizational status within the company).



The objectives of financial statement audit:

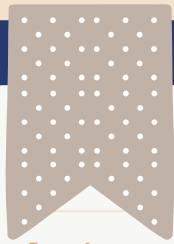


1-Main Objective:

The Primary objective of an audit of financial statements is to **enable the external auditor to express an opinion whether the financial statement** of the entity have been prepared , in all material respects, in accordance with International Financial Reporting Standards (IFRSs). External auditor has to check financial statements keeping the main object in his mind.

2- Secondary Objective:

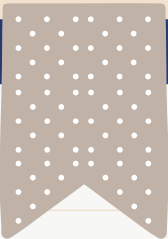
The secondary objective of an audit of financial statements is to **detect and prevent errors and frauds in the books of accounts**. While the external auditor carrying out the process of audit, he may come across certain errors and frauds. But detection of fraud or errors is not the primary objective of the audit. They are come under the secondary objectives of audit.



The Importance of an audit of financial statements

The importance of an audit of financial statements is determined by providing service for multiple parties who used the audited financial statements in making decisions, and examples of these parties are as follows:

(1) Investors: The external audit of financial statements assures the shareholders that the affairs of their company are smoothly and their investment is safe. The shareholders of a company can value their shares on the basis of audited accounts. And investors depend on the audited financial statements when they take any decision related to their savings and their investments in order to gain the highest return possible.

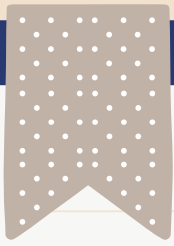


The Importance of an audit of financial statements



2) Management:

The external audit of financial statements clarifies the impact of effective management, where it depends upon the development plans, monitoring and evaluation of the performance of the management. The external audit of financial statements could help improve management's integrity especially when the result of the audit proves the financial statements present fairly, in all material respects, the financial position of the Company and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSS) that the financial statements are true and fair view.



The Importance of an audit of financial statements

(3) Employees:

The external audit of financial statements safeguards the interests of the Employees and is helpful in the settlement of claim for higher wages and bonus.

(4) Lenders:

Such as banks prefer to depend on audit financial statement while taking a decisions to apply for credit facilities and loans to the business concern.

(5) Government bodies:

based on audit financial statement for including planning, control and taxation, pricing, and the report of subsidies to some industries. e.g., Tax authorities

THANKS!

Ali Salah



Auditing

Professional standard (CPA Profession)



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Regulation of the Public Accounting Profession



Public Companies

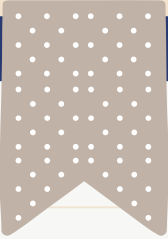
Public Company Accounting Oversight Board (PCAOB):

- Registration of public accounting firms that audit public companies.
- Establish or adopt auditing, quality control, ethics, independence standards relating to audit reports for public companies.
- Conduct inspections of public company practice of registered public accounting firms.

Nonpublic Companies

AICPA & State Boards of Accountancy

- Peer review for nonpublic practice segments of all CPA firms



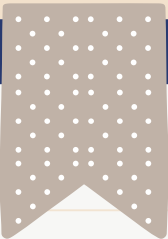
Sarbanes-Oxley act and public company accounting oversight board



- **Sarbanes-Oxley Act of 2002—Established the Public Company Accounting Oversight Board (PCAOB).**
- This Act is considered by many observers to be the most important legislation affecting the auditing profession since the 1930s.
- The provisions of the Act apply to publicly held companies and their audit firms.
- **PCAOB—Provides oversight for auditors of public companies and assess their compliance with the rules of the PCAOB and the SEC including:**
 - a. **Establishing auditing, attestation, and quality control standards for public company audits.**
 - b. **Performing inspections of audit engagements and quality controls.**

Sarbanes-Oxley act and public company accounting oversight board





PCAOB



- **Composed of 5 members – only two may be CPAs**
- **Members appointed by SEC and may serve no more than two five-year terms**
- **All accounting firms that audit SEC registrants must register with PCAOB**
- **Pledge to cooperate with PCAOB inquiries**
- **PCAOB can impose monetary damages, suspend firms, or make referrals to Justice Department**



PCAOB Inspections



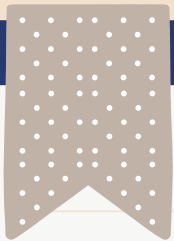
- Conducted by PCAOB staff.

Focus

- Primarily evaluating performance of sample of individual audit and review engagements; a risk based approach to selection engagements.
- Selected quality control and management issues only. This differs from a peer review.

Report

- Written report to SEC, part of which is made public



Peer Reviews



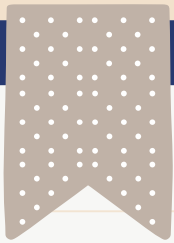
- **Members of AICPA. Conducted by CPAs or other CPA firms.**
- **Two types of peer reviews**

System review

- **Study of CPA firms' system of quality control**
- **Select sample of firms' engagements and examine related working paper files**

Engagement review

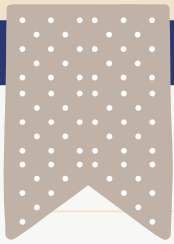
- **Sample of CPA work including reports to evaluate appropriateness**
- **Less in scope than system review**
- **Report: pass, pass with deficiencies, or fail**



Securities and exchange commission (SEC)



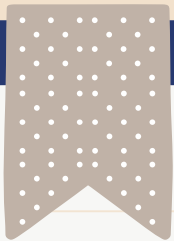
1. **The Securities Exchange Commission (SEC)**—A federal government agency that assists in providing investors with reliable information upon which to make investing decisions.
2. **The Securities Act of 1933**—Requires most companies planning to issue new securities to the public to submit a registration statement to the SEC for approval.
3. **The Securities Exchange Act of 1934**—Provides additional protection for investors by requiring public companies to file detailed annual reports with the commission.
4. **The Securities Acts of 1933 and 1934**—Require financial statements and the opinion of an independent public accountant as part of the registration statement and subsequent reports.



Securities and exchange commission (SEC)



1. providing investors with reliable information.
2. submit a registration statement to the SEC for approval.
3. detailed annual reports with the commission.
4. Require financial statements and the opinion of an independent public accountant.



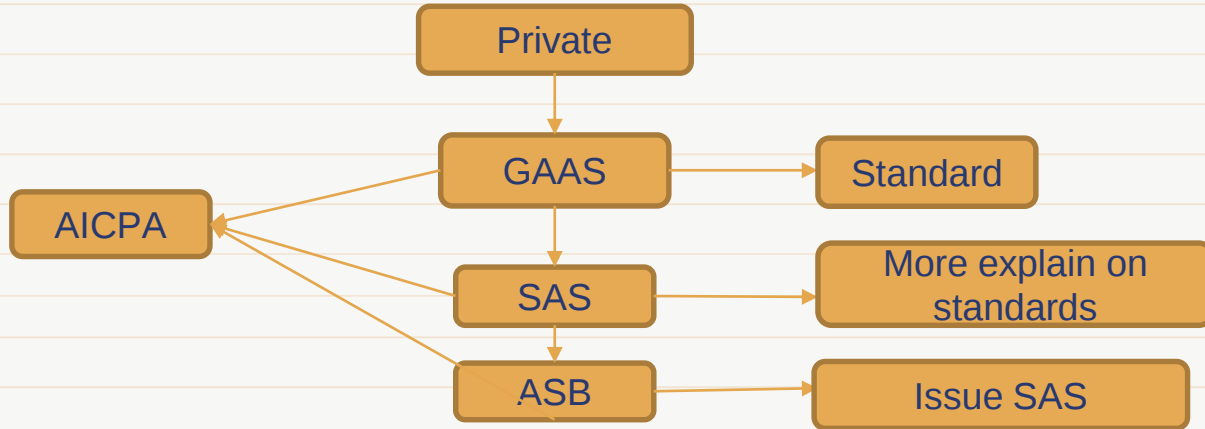
Securities and exchange commission (SEC)

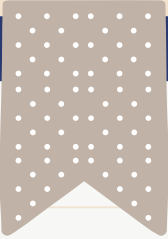


Several reports required by the SEC are of interest to auditors:

1. **Form S-1**—"S" forms must be completed prior to issuing new securities to the public
2. **Form 8-K**—report significant events of interest to investors
3. **Form 10-K**—annual report with detailed financial information, including audited financial statements
4. **Form 10-Q**—quarterly report containing certain financial information and auditor reviews of financial statements

American Institute of Certified Public Accountants AICPA





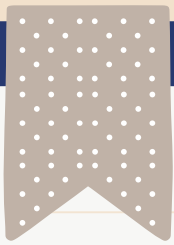
American Institute of Certified Public Accountants AICPA



- CPAs are licensed by the state in which they practice, but significant influence is exerted by their professional organization, the American Institute of Certified Public Accountants (AICPA).
- Membership in the AICPA is restricted to CPAs. Membership is voluntary, so not all CPAs are members, but it is the largest professional association for CPAs in the United States.

The AICPA sets standards and rules that all members and other practicing CPAs must follow in four major areas:

1. Auditing standards
2. Compilation and review standards
3. Other attestation standards
4. Code of Professional Conduct

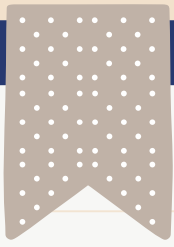


American Institute of Certified Public Accountants AICPA



Establishing Standards and Rules:

1. The Auditing Standards Board (ASB) of the AICPA issues auditing standards, called Statements on Auditing Standards (SASs), which apply to all audit engagements not covered by PCAOB standards
2. The Accounting and Review Services Committee issues Statements on Standards for Accounting and Review Services (SSARS) that apply to preparation, compilation, and review services
3. Statements on Standards for Attestation Engagements apply to assurance on nonfinancial information.
4. The AICPA Professional Ethics Executive Committee sets rules of conduct that CPAs are required to meet.



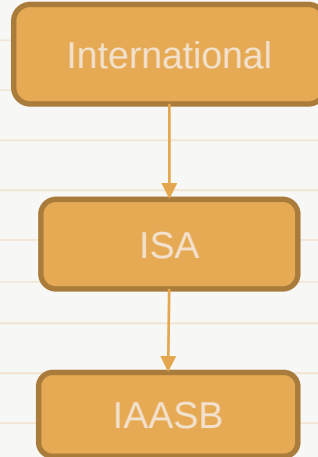
American Institute of Certified Public Accountants AICPA

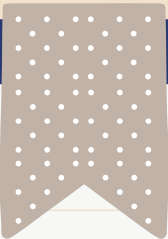


Other AICPA Functions:

1. The AICPA writes and grades the CPA Exam.
2. The AICPA supports its own research staff and provides grants to others for research.
3. The AICPA publishes the *Journal of Accountancy*, industry audit guides, and periodic updates to the Codification of Statements on Auditing Standards and the Code of Professional Conduct.

International and U.S. Auditing Standards



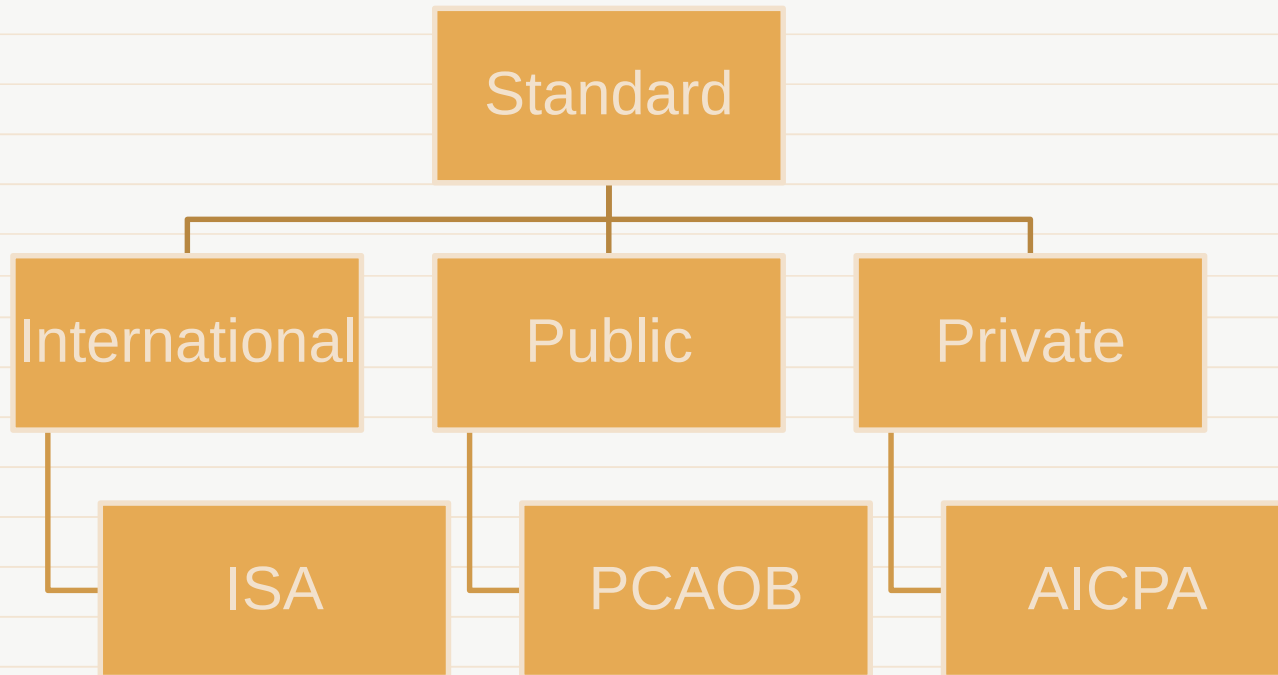


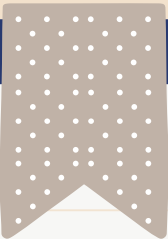
International and U.S. Auditing Standards



- **International Standards on Auditing (ISAs)** are issued by the International Auditing and Assurance Standards Board (IAASB) of the International Federation of Accountants (IFAC).
- **IFAC** is a worldwide organization for the accountancy profession.
- **IAASB** works to improve **uniformity** of auditing practices throughout the world.

Three Sets of auditing standard





Authority of Organizations



Public Company Accounting Oversight Board

- Auditing, Attestation, Quality Control, Independence, Ethical Standards for audits of public companies
- Registers and regulates auditors of public companies
-

American Institute of Certified Public Accountants

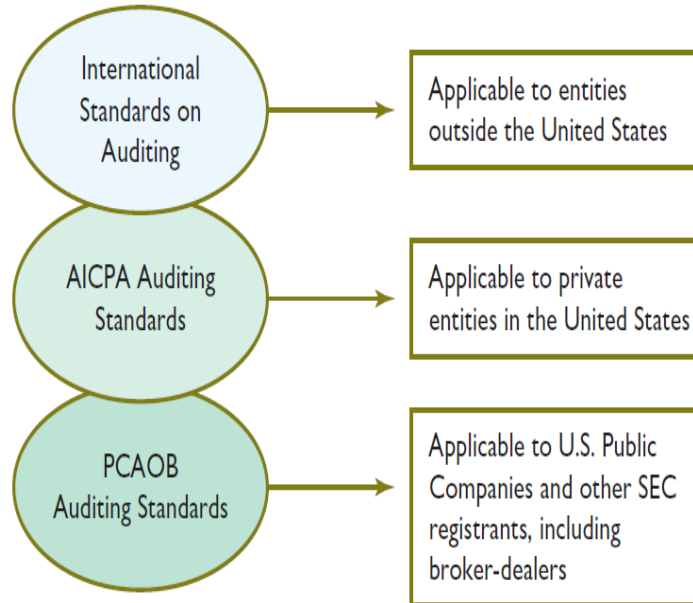
- Auditing, Attestation, Quality Control, Independence, Ethical, Accounting and Review Standards for engagements involving nonpublic companies
- Coordinates peer review programs for firms nonpublic attest practice

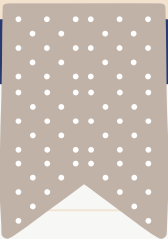
State Boards of Accountancy

- License CPAs and CPA firms to practice in their jurisdictions

FIGURE 2-1

Relation of U.S. and International Auditing Standards

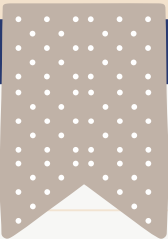




ISA



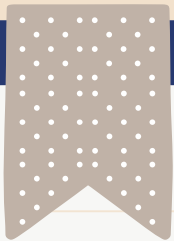
1. ISAs do not override a country's regulations governing audit practices.
2. Most countries, including the United States, base their auditing standards on ISAs, modified as appropriate for each country's regulatory environment.
3. The Auditing Standards Board in the United States has revised its audit standards to converge with international standards.



AICPA Auditing Standards



1. Auditing standards for private companies and other entities in the United States are established by the Auditing Standards Board (ASB) of the AICPA.
2. These standards are called Statements of Auditing Standards (SASs). The AICPA standards are also referred to as generally accepted auditing standards (GAAS).
3. Prior to passage of the Sarbanes-Oxley Act, the ASB established auditing standards for private and public companies. Now the PCAOB has responsibility for auditing standards for public companies and brokers and dealers registered with the SEC.



PCAOB Standards



1. Initially, the PCAOB adopted existing auditing standards established by the ASB as interim standards.
2. The PCAOB considers international standards when developing new standards.
3. PCAOB standards apply only to the audits of U.S. public companies and brokers and dealers registered with the SEC.

Organization of U.S. Auditing Standards



- The ASB issued a Preface to the Codification of Auditing Standards containing the “Principles Underlying an Audit in Accordance with Generally Accepted Auditing Standards” (the principles).
- The principles provide a framework for the two objectives of conducting an audit of financial statements:
 1. Obtain **reasonable assurance** about whether the financial statements as a whole are **free from material misstatement**, whether due to fraud or error; and
 2. Report on the financial statements, and communicate as required by GAAS, in accordance with the auditor’s findings.

Organization of U.S. Auditing Standards



The principles are not requirements and do not carry authority, but they provide structure for the Codification. The structure is organized around the following principles:

1. Purpose of an audit (Purpose)
2. Personal responsibilities of the auditor (Responsibilities)
3. Auditor actions in performing the audit (Performance)
4. Reporting (Reporting)

These principles are summarized in Figure 2-2.

FIGURE 2-2

AICPA Principles Underlying an Audit

Principles in AICPA Auditing Standards

Purpose of an Audit

- Provide an opinion about the financial statements

Responsibilities

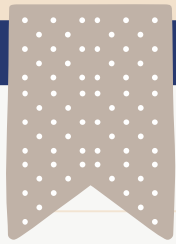
- Possess appropriate competence and capabilities
- Comply with ethical requirements
- Maintain professional skepticism and exercise professional judgment

Performance

- Obtain reasonable assurance about whether financial statements are free of material misstatement
- Plan work and supervise assistants
- Determine and apply materiality level or levels
- Identify and assess risks of material misstatement based on understanding of entity and its environment, including internal controls
- Obtain sufficient appropriate audit evidence

Reporting

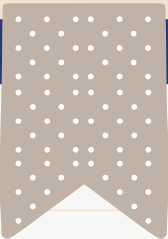
- Express opinion on financial statements in a written report
- Whether financial statements were presented fairly in accordance with financial reporting framework



AICPA Principle



1. **Purpose:** The purpose of an audit is to provide financial statement users with an opinion issued by the auditor on whether the financial statements are presented fairly, in all material respects, in accordance with applicable financial reporting framework.
2. **Responsibilities:** The auditor's responsibilities stress the importance of the qualities that the auditor should possess:
 - a. Appropriate competence and capabilities
 - b. Comply with relevant ethical requirements
 - c. Maintain *professional skepticism* and exercise *professional judgment*



AICPA Principle

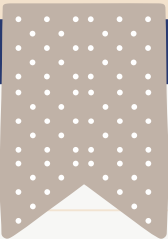


3. Performance: To obtain **reasonable assurance** that the financial statements are presented fairly, the auditor fulfills several performance responsibilities:

- a) Adequate planning and supervision
- b) Determine and apply materiality levels
- c) Assess risks of material misstatement
- d) Sufficient appropriate evidence

4. Reporting: The auditor is responsible for expressing an opinion in the form of a written report about whether the financial statements are expressed fairly, in all material respects, in accordance with the applicable financial reporting framework.

The audit report is the final step in the auditing process.



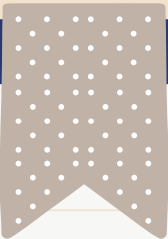
Principles versus Auditing Standards



- The **principles** underlying auditing standards are **general**.
- The **standards** (SASs issued by the AICPA and ASs issued by the PCAOB) provide **specific guidance**.

Classification of Auditing Standards

- SASs issued by the AICPA have two classification numbers: an **SAS** number identifying the order in which it was issued and an **AU-C** number indicating its location in the **Codification of Auditing Standards**.
- Auditing Standards issued by the PCAOB are also numbered consecutively as issued. The PCAOB recently reorganized their standards by topic.



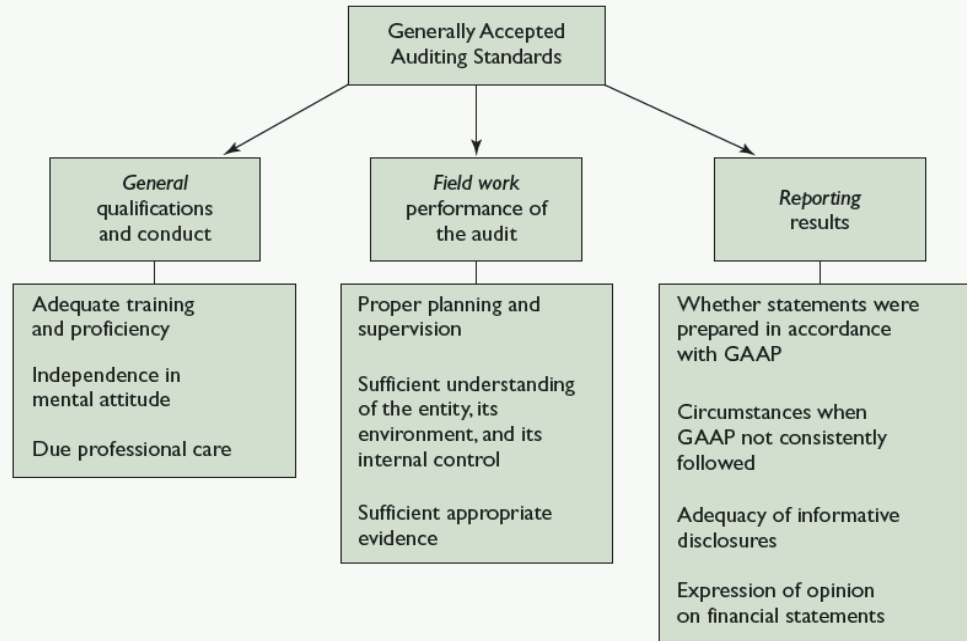
Standard of Performance

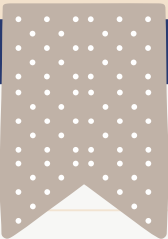


- Although auditing standards provide authoritative guidance for members of the profession, the amount of guidance is limited.
- The AICPA principles and auditing standards are minimum standards of performance. If standards seem impractical in a certain situation, the auditor may use an alternative course of action, though the burden of justifying a departure from the standards falls on the auditor.
- When auditors want more specific guidelines, they must use less authoritative sources. Materials published by the AICPA, including industry audit guides, provide assistance on specific questions.

FIGURE 2-3

Summary of Generally Accepted Auditing Standards





The Egyptian Context



- Under the Corporate Law No. 159 of 1981 and the Capital Market Authority Law No. 95 of 1992, all companies in Egypt (listed and unlisted) must prepare financial statements in accordance with Egyptian Accounting Standards, and those financial statements must be audited by a Certified Public Accountant according to the Egyptian Auditing Standards. *Joint audits* are required for banks and other financial institutions.



Financial reporting framework

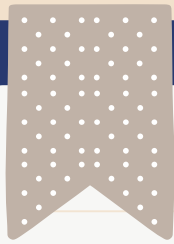


- The Minister of Investment and International Cooperation is recognized as *the accounting standard-setter* in Egypt and **has adopted Egyptian Accounting Standards (EAS) based on IFRS** since 2006. In 2019, the Minister issued Decision No. 69/2019 adopting EAS, which are based on the 2018 IFRS, for all public interest entities (PIEs).

Auditing standards



- The Ministry of investment and international Cooperation is also the **auditing standard-setter** and, in 2008, issued Decision No. 166/2008, adopting the Egyptian Standards on Auditing Review and Other Assurance Services, which are aligned with the 2015 version of International Standards on Auditing (ISA). These standards have not been updated to align with the latest version of the ISA.



Egyptian Society for Accountants and Auditors



Egyptian Society of Accountants and Auditors (ESAA), Its responsibilities include:

1. **Setting initial and continuing professional development (IPD and CPD) requirements for its members.**
2. **Promoting the EFSA Code of Ethics for its members registered with the EFSA (there are no other ethical requirements established by the ESAA for its members).**
3. **Establishing an investigative and disciplinary system for its members.**
4. **Proposing revisions to the Egyptian Accounting Standards and Egyptian Standards on Auditing Review and Other Assurance Services to the Minister of Investment and International Cooperation.**

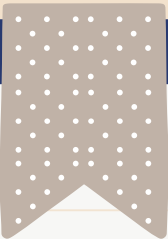


FINANCIAL REGULATORY AUTHORITY



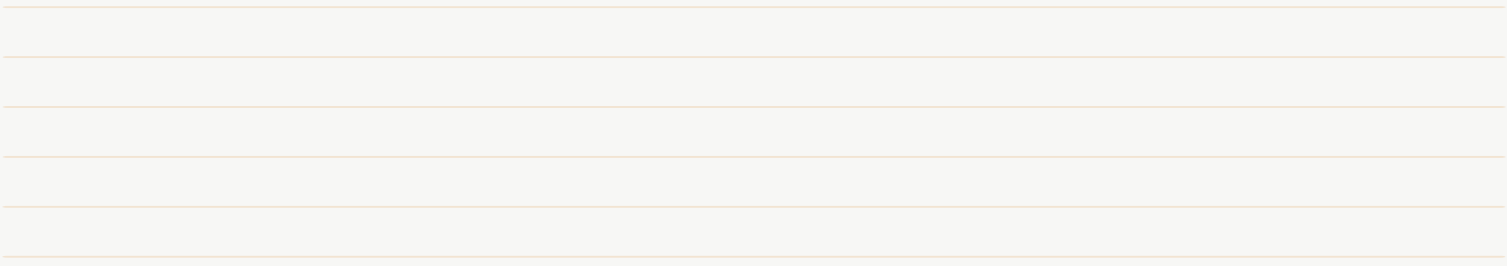
In order to audit listed companies, an auditor must be listed in the Egyptian Financial Regulatory Authority (EFRA) list of auditors. EFRA was established by Law No. 10 of 2009 to regulate listed entities and all Non-Banking Financial Institutions (NBFIs). This Law notes that the EFRA is responsible for

1. Maintaining a register of auditors who are licensed to audit listed companies and NBFIs.
2. Establishing a quality assurance review system and an investigative and discipline system for EFRA-registered auditors.
3. Setting CPD requirements for EFRA-registered auditors.
4. Establishing ethical requirements for EFRA-registered auditors.



Quality Control



- the Egyptian Financial Regulatory Authority (EFRA) established a quality assurance (QA) review system for auditors that are licensed to conduct audits of listed companies and Non-Banking Financial Institutions (NBFIs). **The EFRA created the Auditors Oversight Board (AOB).** The AOB's Audit Inspection Department inspects auditors.
- 

THANKS!

Ali Salah

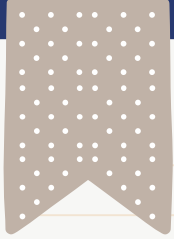


Auditing

Chpater2: Audit Reports



<https://youtu.be/-G9hK1N5I6Q>



Objectives



- ✓ **Auditor's opinion**
- ✓ **Benefits of auditor's report**
- ✓ **Contents of the Auditor's Report**
- ✓ **Types of auditor's opinion:**
 - Standard Unqualified Opinion Auditor's Report
 - Qualified opinion or modified
 - Adverse opinion
 - Disclaimer opinion

Auditor's Report (output of the audit engagement)



- The external auditor's report is the main product or output of the external audit, users of financial statements rely on the external auditor's report to provide "reasonable assurance" on the company's financial statements. The external auditor will be held responsible if an incorrect external audit report is issued.
- The external auditor's report communicates the users on whether the auditee's financial statements "Subject Matter under audit" have been prepared in accordance with International Financial Reporting Standards (IFRSs). "Criteria"
- Whether they are free of material misstatement (e.g. free of important and significant errors), and whether they show a true and fair view of the operating results, financial position and cash flows of the auditee.

Auditor's Report (output of the audit engagement)



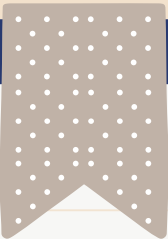
- **Reasonable assurance** = Good level of assurance but not 100%. It means CPA should provide highest level of quality .
- **Free of martial misstatement:**
- **Free of** = not include
- **Martial** = something important to decisions makers
- **immaterial** = not important to decisions makers
- **mis/statement** = something wrong in financial statement such as error or fraud



Benefits of auditor's report



- Enhanced communications between the external auditor and investors which improve trust .
- Increased user confidence in financial statements.
- Increased attention by management and financial statement preparers to the disclosures in the financial statements.
- Increased transparency ,external audit quality, and enhanced information value .
- Renewed focus of the external auditor on matters to be reported, that could result in an increase in professional skepticism.



Contents of the Auditor's Report



- 1) **Report title**
- 2) **Audit report address**
- 3) **Auditor's Opinion**
- 4) **Basis of Opinion**
- 5) **Going Concern Issues**
- 6) **Key Audit Matters**
- 7) **Management Responsibilities for the Financial Statements**
- 8) **Auditor's Responsibilities for the Audit of the Financial Statements**
- 9) **Other reporting responsibilities**
- 10) **Signature and address of CPA firm**
- 11) **Audit report date**

Contents of the Auditor's Report

1- Report title



.Auditing standards require that the report be titled and that the title include the word *independent*. For example, appropriate titles include “*independent auditor’s report*,” “*report of independent auditor*” .

.The requirement that the title include the word *independent* *conveys* to users that the audit was *unbiased* in all aspects.

Report Title

INDEPENDENT AUDITOR'S REPORT

Contents of the Auditor's Report

2- Audit report address



•The report is usually addressed to those for whom the report is prepared, including the company, its stockholders, or the board of directors.
”Interested parties/Stakeholders”

•The external auditor's report is usually addressed either to the shareholders or supervisory board or the board of directors of the entity whose financial statements have been audited.

Audit Report Address

To the Board of Directors and Stockholders
General Ring Corporation

Contents of the Auditor's Report

3- Auditor's Opinion:



- This section includes the external auditor's opinion and some elements considered absolutely necessary:
- The identification of the entity whose financial statements have been audited
- State that the financial statements have been audited
- Identifying the title of each component (the title of each statement comprising the financial statements) . "B/S-I/S-Cash flow Statement-Changes in Equity"
- A reference to notes, including a summary of significant accounting policies
- The specification of the date or period covered by each financial statement comprising the financial statements

Contents of the Auditor's Report

3- Auditor's Opinion:



- This section includes the external auditor's opinion and some elements considered absolutely necessary:

- the opinion "conclusion" The external auditor's opinion.

the external auditor's opinion is categorized into four different types as follows:

1. Unqualified Opinion or Unmodified Opinion
2. Qualified Opinion or Modified Opinion
3. Adverse Opinion
4. Disclaimer of Opinion

Contents of the Auditor's Report

3- Auditor's Opinion:



1. Unqualified Opinion or Unmodified Opinion : تقرير غير متحفظ

- Clean audit report.
- CPA does not have any comments

- *In our opinion, the accompanying financial statements present fairly, in all material respects, (or give a true and fair view of) the financial position of the Company as at December 31, 20X1, and (of) its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs)*

Contents of the Auditor's Report

3- Auditor's Opinion:



2. *Qualified Opinion or Modified* : تقرير متحفظ (المقيد)

- Clean audit report.
- CPA have comments
- *In our opinion, the accompanying financial statements present fairly, in all material respects, **Except for** (or give a true and fair view of) the financial position of the Company as at December 31, 20X1, and (of) its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs)*

Contents of the Auditor's Report

3- Auditor's Opinion:



3. *Adverse opinion* : تقرير سلبي (عكسي)

- *In our opinion, the accompanying financial statements are not present fairly, in all material respects,*

• 4. *Disclaimer of Opinion*: تقرير المراجع بالامتناع عن ابداء الرأي (الخالي من الرأي)

Contents of the Auditor's Report

4- Basis of Opinion:



- The auditor makes a statement that the audit was conducted in accordance with Standards on Auditing
- The auditor Makes a reference to the section of the external auditor's report that describes the auditor's responsibilities for complying with ISAs.
- This paragraph contains a statement that the auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit, and has fulfilled the auditor's other ethical responsibilities in accordance with these requirements.
- The external auditor state that whether the auditor believes that the external audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's opinion.

Contents of the Auditor's Report

5- Going Concern Issues:



1- Use of Going Concern Basis of Accounting Is **Inappropriate**:

If the financial statements have been prepared using the going concern basis of accounting but, in the auditor's judgment, management's use of the going concern basis of accounting in the preparation of the financial statements is inappropriate, the auditor shall express **an adverse opinion**.

2- Use of Going Concern Basis of Accounting Is **Appropriate** but a Material Uncertainty Exists Adequate Disclosure of a Material Uncertainty Is Made in the Financial Statements:

If adequate disclosure about the material uncertainty is made in the financial statements, **the auditor shall express an unqualified "unmodified" opinion and the auditor's report shall include a separate section under the heading "Material Uncertainty Related to Going Concern" or "Significant business continuity uncertainties"**

Contents of the Auditor's Report

5- Going Concern Issues:



3-Adequate Disclosure of a Material Uncertainty Is Not Made in the Financial Statements:

If adequate disclosure about the material uncertainty is not made in the financial statements, the auditor shall:

(a) Express a qualified opinion or adverse opinion.(Materiality level)

(b) In the Basis for Qualified (Adverse) Opinion section of the auditor's report, state that a material uncertainty exists that may impose significant doubt on the entity's ability to continue as a going concern and that the financial statements do not adequately disclose this matter.

Contents of the Auditor's Report

6- Key Audit Matters(KAMs):



- Key audit matters are those matters that, in auditor's professional judgment, were of most significance in his audit of the financial statements of the current period. These matters were addressed in the context of his audit of the financial statements as a whole, and in forming his opinion thereon, and the auditor do not provide a separate opinion on these matters
- The external auditor's objectives are to determine the key audit aspects and, once he has formed an opinion on the financial statements, these issues should be communicated in the external auditor's report .
- *The purpose of communicating key audit aspects is to increase the external auditor's report communication value through the transparency of the audit. The communication of key aspects provides users with additional information on those issues considered significant by the auditor.*

Contents of the Auditor's Report

7- Management Responsibilities



- The external auditor's report shall include a section with a heading ***“Responsibilities of Management for the Financial Statements.”*** *Management are responsible for:*
- 1-The ***preparation of financial statements*** that give a true and fair view in accordance with the applicable financial reporting framework ***“Criteria”***.
- 2- Maintain effective ***“internal controls”*** to enable the preparation of financial statements that are free from material misstatement.
- 3- Assessing the entity's ability to continue as ***“a going concern”*** and whether the use of the going concern basis of accounting is appropriate.

Contents of the Auditor's Report

8- Auditor's Responsibilities



The external auditor's report shall include a section with the heading "Auditor's Responsibilities for the Audit of the Financial Statements." . This section of the auditor's contains:

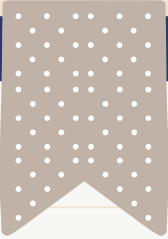
- 1- Description of what constitutes reasonable assurance
- 2- Evaluate the adequacy of the accounting policies used, the reasonableness of the estimates and the transparency of the presentations.
- 3- State that misstatements can arise from fraud or error
- 4-Obtain understanding & evaluation of internal control relevant to the audit.
- 5-Evaluate appropriateness of accounting policies and accounting estimates.
- 6-Conclude on the appropriateness of management's use of the going concern basis of accounting.
- 7-Evaluate overall presentation, structure and content of the financial statements.
- 8-Communicate with to those entrusted with governance (**BOD & AUDIT COMMITTEE**), such as, the scope audit engagement, external audit period and significant findings, including those concerning internal control deficiencies.

Contents of the Auditor's Report

9- Other reporting responsibilities



- This paragraph is introduced when the external auditor has other reporting responsibilities additional to those required by the International Standards on Auditing. (e.g. corporate law no 159 for year 1981)



Contents of the Auditor's Report

10- Signature and address of CPA firm



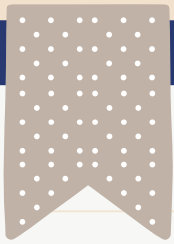
The signature identifies the CPA firm or practitioner who performed the audit. ***“Typically, the firm’s name is used because the entire CPA firm has the legal and professional responsibility to ensure that the quality of the audit meets professional standards”.*** The city and state of the audit firm should also be indicated

Contents of the Auditor's Report



11- Audit report date:

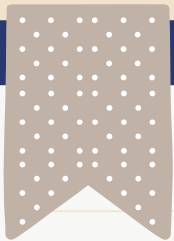
- The appropriate date for the report is the one on which the auditor completed the auditing procedures needed to obtain sufficient appropriate audit evidence.
- *This date is important to users because it indicates the last day of the auditor's responsibility for the review of significant events that occurred after the date of the financial statements.*
- In the audit report the balance sheet is dated December 31, 2019, and the audit report is dated February 15, 2020.
- This indicates that the auditor searched for material unrecorded transactions and events that occurred up to February 15, 2020



Try yourself



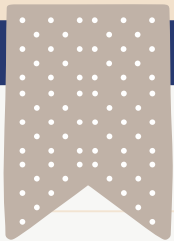
- Auditing standards require that the audit report must be titled and that the title must
 - ➔ A) include the word "independent."
 - B) indicate if the auditor is a CPA.
 - C) indicate if the auditor is a proprietorship, partnership, or corporation.
 - D) indicate the type of audit opinion issued.



Try yourself



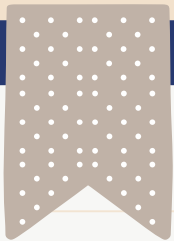
- The audit report date on a standard unmodified opinion audit report indicates
 - A) the last day of the fiscal period.
 - B) the date on which the financial statements were filed with the Securities and Exchange Commission.
 - C) the last date on which users may institute a lawsuit against either the client or the auditor.
 - ➔ D) the last day of the auditor's responsibility for the review of significant events that occurred after the date of the financial statements.



Try yourself



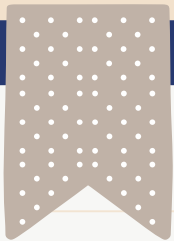
- Which of the following is **not explicitly** stated in the standard unmodified opinion audit report?
 - A) The financial statements are the responsibility of management.
 - ➔ B) The audit was conducted in accordance with generally accepted accounting principles.
 - C) The auditors believe that the audit evidence provides a reasonable basis for their opinion.
 - D) An audit includes assessing the accounting estimates used.



Try yourself



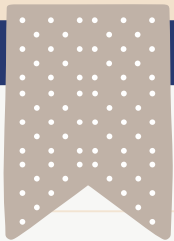
- The auditor's responsibilities section of the standard unmodified opinion audit report states that the auditor is
 - A) responsible for the financial statements and the opinion on them.
 - B) responsible for the financial statements.
 - C) exercising professional judgment throughout the audit.
 - D) expressing an opinion on the effectiveness of internal controls.



Try yourself



- If the balance sheet of a private company is dated December 31, 2018, the audit report is dated February 8, 2019, and both are released on February 15, 2019, this indicates that the auditor has searched for subsequent events that occurred up to
 - A) December 31, 2018.
 - B) January 1, 2019.
 - C) February 8, 2019.
 - D) February 15, 2019.



Try yourself



- The appropriate audit report date for a standard unmodified opinion audit report for a nonpublic entity should be
 - A) the date the financial statements are given to the Board of Directors.
 - B) the date of the financial statements.
 - C) the date the auditor completed the auditing procedures in the field.
 - D) 60 days after the date of the financial statements as required by the SEC

Reasonable Assurance not guarantee (Audit Risk)

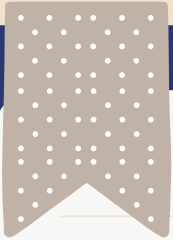


- The opinion paragraph is stated as an **opinion** rather than as a statement of **absolute fact or a guarantee**.
- The intent is to indicate that the conclusions are based on **external auditor's professional judgment**.
- The phrase "in our opinion" indicates that there may be some **information risk associated with the financial statements, even though the financial statements have been audited**.
- The terms used to express the external auditor's opinion are "**give a true and fair view**" or "**present fairly, in all material respects**"

Types of auditor's opinion



- The external auditor's opinion is categorized into four different types as under ***“Depending on Materiality Level”*** as follows:
 - - Unqualified Opinion or Unmodified Opinion
 - - Qualified Opinion or Modified Opinion
 - - Adverse Opinion
 - - Disclaimer of Opinion



Materiality Level



Three levels of materiality are used for determining the type of opinion to issue:

- a. Amounts are *immaterial*
- b. Amounts are *material but do not overshadow the financial statements as a whole*
- c. Amounts are *so material or so pervasive* that overall fairness of the statements is in question

Materiality and Types of opinion



Materiality	Significance in Terms of Reasonable Users' Decisions	Type of Opinion
Immaterial	Users' decisions are unlikely to be affected.	Unmodified
Material	Users' decisions are likely to be affected only if the information in question is important to the specific decisions being made. The effect of the misstatement(s) is not pervasive to the financial statements and the overall financial statements are presented fairly.	Qualified

Materiality and Types of opinion



Materiality	Significance in Terms of Reasonable Users' Decisions	Type of Opinion
Highly material	Most or all Users' decisions based on the financial statements are likely to be significantly affected. The effect of the misstatement(s) is pervasive to the financial statements.	Disclaimer or Adverse

Note: Lack of independence **requires a disclaimer regardless of materiality.**

Contents of the Auditor's Report

3- Auditor's Opinion:



1. Unqualified Opinion or Unmodified Opinion : تقرير غير متحفظ

- Clean audit report.
- CPA does not have any comments

- *In our opinion, the accompanying financial statements present fairly, in all material respects, (or give a true and fair view of) the financial position of the Company as at December 31, 20X1, and (of) its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs)*

Requirements to Give Unqualified Opinion In an auditor's



1. **All statements**—balance sheet, income statement, statement of changes in stockholders' equity, and statement of cash flows—are **included in the financial statements**.
2. **Sufficient appropriate evidence has been accumulated**, and the auditor has conducted the engagement in a manner that enables him or her to **conclude that the audit was performed in accordance with auditing standards**.
3. the **financial information** has been prepared using International Financial Reporting Standards (IFRSs) , **which have been consistently applied**.
4. the financial information **complies with International Financial Reporting Standards (IFRSs)**

Requirements to Give Unqualified Opinion In an auditor's



5. the view presented by the financial information as a whole is consistent with the external auditor's knowledge of the business of the entity.
6. there is adequate disclosure of all material matters relevant to the proper presentation of the financial information.
7. There are no circumstances requiring the addition of an explanatory paragraph or modification of the wording of the report.

Emphasis-of-Matter



“Explanatory Paragraph/Nonstandard Report Wording”

The unmodified opinion audit report with emphasis-of-matter paragraph or nonstandard report wording:

Meets the criteria of a complete audit with satisfactory results and financial statements that ***are fairly presented***. (IFRS or GAAP is achieved)

But the auditor believes it is important to draw the reader's attention to certain matters or the auditor is ***required to provide additional information***

Emphasis-of-Matter



“Explanatory Paragraph/Nonstandard Report Wording”

- The most important causes of the addition of an emphasis-of-matter paragraph/nonstandard report wording:
 - a) Lack of consistent application of GAAP (i.e. FIFO to LIFO or Shifting Method of Depreciation)
 - b) Auditor agrees with a departure from promulgated accounting principles (i.e. Departure from GAAP but is justified by management and accepted by the auditor)
 - c) Substantial doubt about going concern (i.e. Going Concern Issues but appropriately assessed and sufficiently disclosed by management- “E.g. Law suit against”)
 - d) Emphasis of other matters
 - e) Reports involving other auditors (i.e. Shared opinion) (*Nonstandard Report Wording*)

Emphasis-of-Matter



“Explanatory Paragraph/Nonstandard Report Wording”

Auditor may want to emphasize specific matters regarding the financial statements under certain circumstances:

- a. **Material related party transactions (i.e. Parent and Subsidiaries)**
- b. **Subsequent events (i.e. After balance sheet date and before issuing the audit report)**

INDEPENDENT AUDITOR'S REPORT

(Same paragraphs as the standard report)

Emphasis of Matter – Change in Accounting Principle

As discussed in Note 8 to the financial statements, the Company changed its method of computing depreciation in 2019. Our opinion is not modified with respect to this matter.

Added Explanatory Paragraph

DEPARTURES FROM AN UNQUALIFIED AUDIT REPORT



- **Three conditions requiring a modification to the opinion:**
 - The scope of the audit has been restricted (i.e. When the external auditor has been unable to obtain sufficient appropriate evidence).
“scope limitation”
 - The financial statements have not been prepared in accordance with GAAP and not justified by management and accepted by the auditor (i.e. When the financial statements are not free from material misstatement) “Unjustified and unaccepted GAAP Departure”
 - The auditor is not independent

DEPARTURES FROM AN UNQUALIFIED AUDIT REPORT



In these circumstances the external auditor has to issue a modified report . There are **three types of modification**. Their use depends upon the nature and “Materiality or Significance” of the matter under consideration. They are:

- the qualified opinion
- the adverse opinion
- the disclaimer of opinion

DEPARTURES FROM AN UNQUALIFIED AUDIT REPORT



- When the external auditor modifies the opinion on the financial statements, the external auditor shall:
 - Amend the heading “Basis for Opinion” required by to “Basis for Qualified Opinion,” “Basis for Adverse Opinion,” or “Basis for Disclaimer of Opinion,” as appropriate.
- Within this section, include a description of the matter giving rise to the modification.

2- Qualified opinion or modified



- When an external auditor issues a qualified report, he must use the term “**except for**” in the opinion paragraph.
- The implication is that the external auditor is satisfied that the overall financial statements are present fairly, in all material respects, accordance with International Financial Reporting Standards (IFRSs) “except for” a specific aspect of them.

2- Qualified opinion or modified



Such an opinion is expressed when:

- There are a **lack of sufficient appropriate external audit evidences** or there are **restrictions on the scope of the external audit** that have led the external auditor to conclude that he cannot express an unqualified opinion and the external auditor concluded not to disclaim an opinion .
- The external auditor believes, on the basis of his audit, that the financial statements contain a **departure from International Financial Reporting Standards (IFRSs)** , the effect of which is **material**, and the auditor concluded not to express an adverse opinion

Next figure shows Qualified Opinion due to a Material Misstatement of the Financial Statements :

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of ABC Company [or Other Appropriate Addressee]

Report on the Audit of the Financial Statements

Qualified Opinion

We have audited the financial statements of ABC Company (the Company), which comprise the statement of financial position as at December 31, 20X1, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies. In our opinion, except for the effects of the matter described in the Basis for Qualified Opinion section of our report, the accompanying financial statements present fairly, in all material respects, (or give a true and fair view of) the financial position of the Company as at December

31, 20X1, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs).

Basis for Qualified Opinion

The Company's inventories are carried in the statement of financial position at xxx. Management has not stated the inventories at the lower of cost and net realizable value but has stated them solely at cost, which constitutes a departure from IFRSs. The Company's records indicate that, had management stated the inventories at the lower of cost and net realizable value, an amount of xxx would have been required to write the inventories down to their net realizable value. Accordingly, cost of sales would have been increased by xxx, and income tax, net income and shareholders' equity would have been reduced by xxx, xxx and xxx, respectively. We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report

We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in [jurisdiction], and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified opinion

3- *Adverse opinion*



- An adverse opinion states that the financial statements do not present fairly the financial position, results of operations, or cash flows of the entity in conformity with International Financial Reporting Standards (IFRSs).
- Such an opinion is expressed when the external auditor believes that the overall financial statements are so materially misstated or misleading that the external auditor concludes that a qualification of the report is not adequate to disclose the misleading or incomplete nature of the financial statements.
- The adverse opinion report can arise only when the external auditor has knowledge, after an adequate investigation, of the absence of conformity. This is uncommon and thus the adverse opinion is rarely used.

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of ABC Company [or Other Appropriate Addressee]

Report on the Audit of the Consolidated Financial Statements

Adverse Opinion

We have audited the consolidated financial statements of ABC Company and its subsidiaries (the Group), which comprise the consolidated statement of financial position as at December 31, 20X1, and the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies. In our opinion, because of the significance of the matter discussed in the Basis for Adverse Opinion section of our report, the accompanying consolidated financial statements do not present fairly (or do not give a true and fair view of) the consolidated financial position of the Group as at December 31, 20X1, and (of) its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs).

Basis for Adverse Opinion

As explained in Note X, the Group has not consolidated subsidiary XYZ Company that the Group acquired during 20X1 because it has not yet

been able to determine the fair values of certain of the subsidiary's material assets and liabilities at the acquisition date. This investment is therefore accounted for on a cost basis. Under IFRSs, the Company should have consolidated this subsidiary and accounted for the acquisition based on provisional amounts. Had XYZ Company been consolidated, many elements in the accompanying consolidated financial statements would have been materially affected. The effects on the consolidated financial statements of the failure to consolidate have not been determined. We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Consolidated Financial Statements section of our report. We are independent of the Group in accordance with the ethical requirements that are relevant to our audit of the consolidated financial statements in [jurisdiction], and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our adverse opinion.

4- Disclaimer opinion



- A disclaimer of opinion states that the external auditor does not express an opinion on the financial statements .It is expressed when the external auditor has been unable to satisfy himself that the overall financial statements are fairly presented accordance with International Financial Reporting Standards (IFRSs).
- This occurred when possible effect of a limitation on scope is so material and pervasive that the external auditor has not been able to obtain sufficient appropriate audit evidence to form his opinion and accordingly is unable to express an opinion on the financial statements.

4- Disclaimer opinion



- The necessity for disclaiming an opinion may arise because of a severe limitation on the scope of the audit or a non-independent relationship under the Code of Professional Conduct between the auditor and the client. Either of these situations prevents the auditor from expressing an opinion on the financial statements as a whole.
- The auditor also has the option to issue a disclaimer of opinion for a going concern problem. If unable to accumulate sufficient and appropriate evidence.
- the auditor disclaims an opinion, the auditor's report should give all of the substantive reasons for the disclaimer.

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of ABC Company [or Other
Appropriate Addressee]

Report on the Audit of the Financial Statements

Disclaimer of Opinion

We were engaged to audit the financial statements of ABC Company (the Company), which comprise the statement of financial position as at December 31, 20X1, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies. We do not express an opinion on the accompanying financial statements of the Company. Because of the significance of the matters described in the Basis for Disclaimer of Opinion section of our report, we have not been able to obtain sufficient appropriate audit evidence to

provide a basis for an audit opinion on these financial statements

Basis for Disclaimer of opinion

We were not appointed as auditors of the Company until after December 31, 20X1 and thus did not observe the counting of physical inventories at the beginning and end of the year. We were unable to satisfy ourselves by alternative means concerning the inventory quantities held at December 31, 20X0 and 20X1, which are stated in the statements of financial position at xxx and xxx, respectively. In addition, the introduction of a new computerized accounts receivable system in September 20X1 resulted in numerous errors in accounts receivable. As of the date of our report, management was still in the process of rectifying the system deficiencies and correcting the errors. We were unable to confirm or verify by alternative means accounts receivable included in the statement of financial position at a total amount of xxx as at December 31, 20X1. As a result of these matters, we were unable to determine whether any adjustments might have been found necessary in respect of recorded or unrecorded inventories and accounts receivable, and the elements making up the statement of comprehensive income, statement of changes in equity and statement of cash flows

Summary

Nature of the matter Giving Rise to the Modification	Type of opinion when "Immaterial"	Type of opinion when "Material but NOT pervasive" i.e. Material	Type of opinion When Material AND pervasive i.e. Highly Material
Financial statements are misstated "Error & Fraud"	Standard Unqualified	Qualified pinion ('...except for...')	Adverse opinion ('...do not present fairly...')
Inability to obtain sufficient appropriate audit evidence "Scope Limitation"	Standard Unqualified	Qualified pinion ('...except for...')	Disclaimer of opinion ('...we do not express an opinion...')

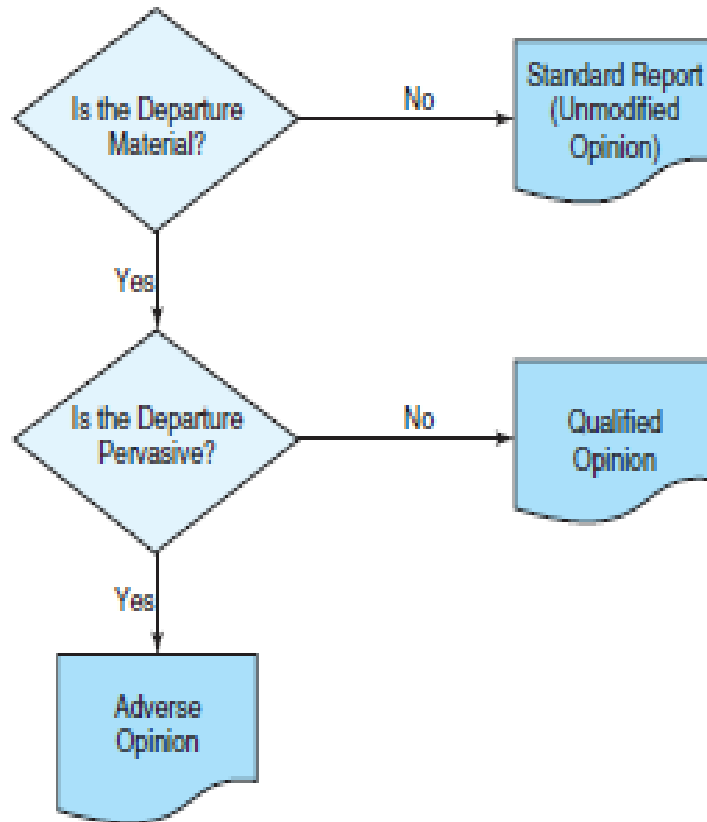
Summary

	Level of Materiality			
Condition Requiring an Unmodified Opinion Report With Nonstandard Wording or Explanatory Paragraph	Immaterial	Material		
	Accounting principles not consistently applied*	Standard unmodified opinion	Unmodified opinion with explanatory paragraph	
	Justified departure from GAAP or other accounting principle	Standard unmodified opinion	Unmodified opinion with explanatory paragraph	
	Substantial doubt about going concern†	Standard unmodified opinion	Unmodified opinion with explanatory paragraph	
	Emphasis of other matters	Standard unmodified opinion	Unmodified opinion with explanatory paragraph	
	Use of another auditor	Standard unmodified opinion	Unmodified opinion with revised wording in other report paragraphs	
	Condition Requiring a Departure From Unmodified Opinion Audit Report	Level of Materiality		
Immaterial		Material, But Not Pervasive to the Financial Statements as a Whole	So Material That Overall Fairness Is in Question	
Scope restricted by client or other conditions		Standard unmodified opinion	Qualified opinion (except for)	Disclaimer of opinion
Financial statements not prepared in accordance with GAAP‡		Standard unmodified opinion	Qualified opinion (except for)	Adverse opinion
Auditor is not independent			Disclaimer, regardless of materiality	

Summary

EXHIBIT 12.3

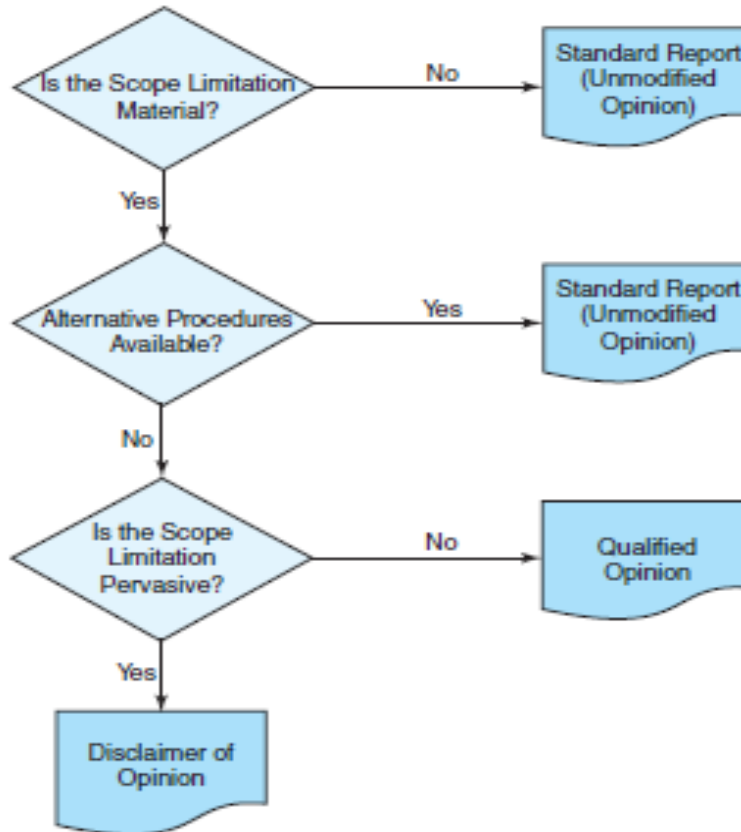
GAAP Departures



Summary

EXHIBIT 12.6

Scope Limitations



THANKS!

Ali Salah



Auditing

Audit responsibilities and objectives



https://youtu.be/toK2PMS_7W8

The objective of conducting an audit of historical financial statements



- The purpose of an audit is to:
- Provide financial statement users with an opinion by the auditor on
- Whether the financial statements are presented fairly, in all material respects, in accordance with the applicable financial accounting framework, which enhances the degree of confidence that intended users can place in the financial statements

Steps to develop audit objectives

Understand objectives and responsibilities for the audit

Divide financial statements into cycles

Know management assertions about financial statements

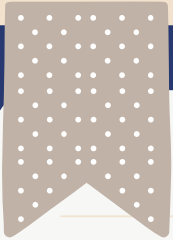
Know general audit objectives for classes of transactions, accounts, and disclosures

Know specific audit objectives for classes of transactions, accounts, and disclosures

Management's Responsibilities



- **Management's responsibility includes:**
 - a. Adopting sound **accounting policies**
 - b. Maintaining adequate **internal control**
 - c. Making fair **representations** in the financial statements
 - d. **Certifying** the quarterly and annual financial statements



Management's Responsibilities



- **Management's responsibility includes:**
 - a. Adopting sound **accounting policies**
 - b. Maintaining adequate **internal control**
 - c. Making fair **representations** in the financial statements
 - d. **Certifying** the quarterly and annual financial statements

REPORT OF MANAGEMENT

International Business Machines Corporation and Subsidiary Companies

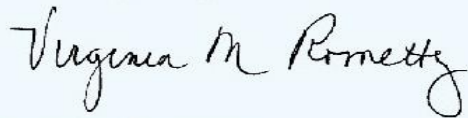
Management Responsibility for Financial Information

Responsibility for the integrity and objectivity of the financial information presented in this Annual Report rests with IBM management. The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America, applying certain estimates and judgments as required.

IBM maintains an effective internal control structure. It consists, in part, of organizational arrangements with clearly defined lines of responsibility and delegation of authority, and comprehensive systems and control procedures. An important element of the control environment is an ongoing internal audit program. Our system also contains self-monitoring mechanisms, and actions are taken to correct deficiencies as they are identified.

[third paragraph omitted]

The Audit Committee of the Board of Directors is composed solely of independent, non-management directors, and is responsible for recommending to the Board the independent registered public accounting firm to be retained for the coming year, subject to stockholder ratification. The Audit Committee meets regularly and privately with the independent registered public accounting firm, with the company's internal auditors, as well as with IBM management, to review accounting, auditing, internal control structure, and financial reporting matters.



Virginia M. Rometty
Chairman, President and Chief Executive Officer
February 27, 2018



James J. Kavanaugh
Senior Vice President and Chief Financial Officer,
February 27, 2018

Auditor's responsibility



- The overall objectives of the auditor are to:
 - a. Obtain **reasonable assurance** about whether the financial statements as a whole are **free from material misstatement**, whether due to fraud or error, thereby enabling the auditor to
 - b. Express an **opinion** on whether the financial statements are **presented fairly**, in all material respects, in accordance with an applicable financial reporting framework

Auditor's responsibility



- The overall **objectives** of the auditor are to:
 - a. **Report** on the financial statements, and communicate as required by auditing standards, in accordance with the auditor's findings
- Auditor are also **responsible** to:
 - a. Detect material unintentional **mistakes**
 - b. Detect material **fraud**
 - c. Consider **laws and regulations** relevant to the client

Auditor's responsibilities for Errors and Fraud

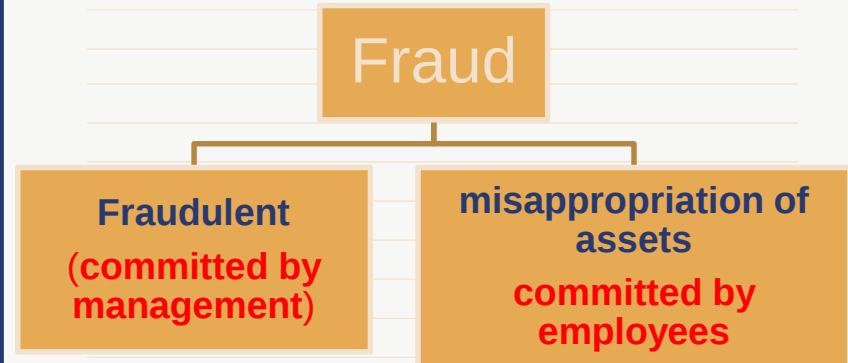
Errors

versus

Fraud

An error is an unintentional misstatement of the financial statements, whereas fraud is intentional.

For fraud, there is a distinction between misappropriation of assets, usually committed by employees, and fraudulent financial reporting, usually committed by management.



Auditor's responsibilities for Errors and Fraud

Errors

versus

Fraud

Auditor's Responsibilities for Detecting Material Errors:

Auditors spend a great portion of their time planning and performing audits to detect unintentional errors made by management and employees.

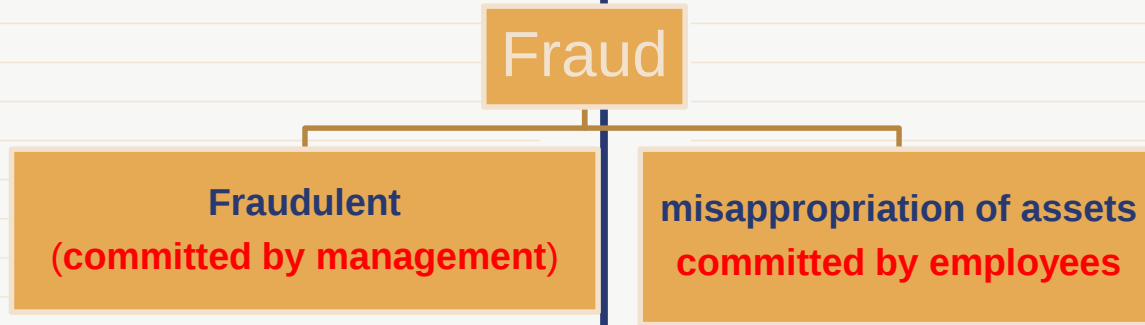
Auditor's Responsibilities for Detecting Material Fraud:

Auditing standards make no distinction between the auditor's responsibilities for detecting errors versus fraud.

However, the standards do recognize that fraud is more difficult to detect because those who are committing the fraud attempt to conceal the fraud.

Auditor's responsibilities for Errors and Fraud

Fraud versus Misappropriation of Assets

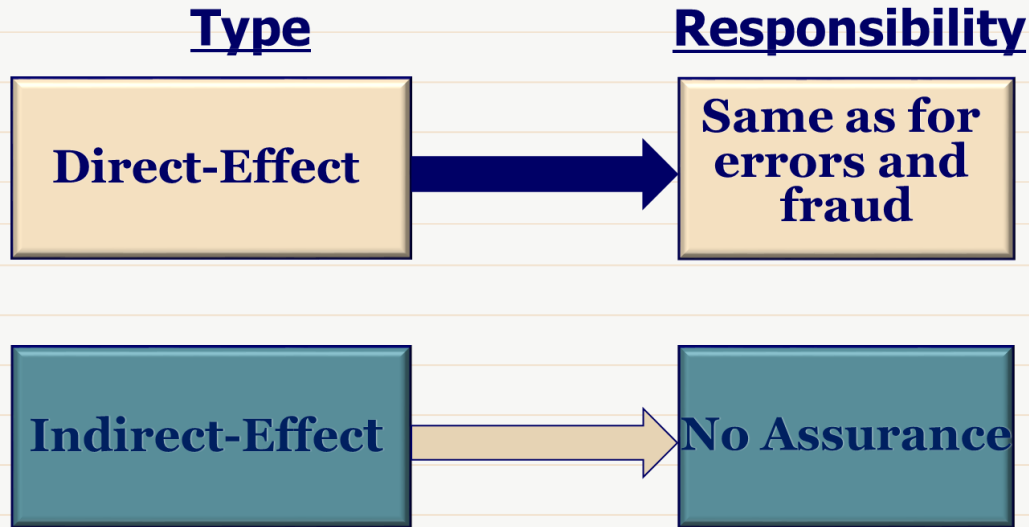


Fraudulent Financial Reporting versus Misappropriation of Assets:

Both are harmful to financial statement users.

- **Fraudulent** financial statements present users with incorrect financial information that is used for decision making.
- **Misappropriation of assets** is harmful to creditors, stockholders, and others because the assets have been taken from their rightful owners, the company.

Auditor's Responsibilities for Detecting and reporting Illegal Acts



Auditor's Responsibilities for Detecting and reporting Illegal Acts



Audit Procedures When Illegal Act Is Identified or Suspected:

- The auditor should obtain an understanding of the situation and discuss the matter with management at a level above those involved.
- Auditors should obtain sufficient evidence regarding material amounts that are directly affected by laws and regulations.
- Laws such as those relating to taxes and pensions usually have a direct effect on the amounts or disclosures in the financial statements, and therefore require the auditor's attention.

Reporting Identified or Suspected Illegal Act:

- Unless the matter is inconsequential, the auditor should communicate with those charged with governance of matters of noncompliance.

The need to maintain Professional skepticism



Aspects of Professional Skepticism: Two primary components: A questioning mindset and a critical assessment of audit evidence.

Elements of Professional Skepticism:

Questioning mindset—"trust but verify"—a disposition to inquiry with some sense of doubt.

Suspension of judgment—withholding judgment until appropriate evidence is obtained.

Search for knowledge—a desire to investigate beyond the obvious, with a desire to corroborate.

Interpersonal understanding—recognition that people's motivations and perceptions can lead them to provide biased or misleading information.

Autonomy—the self-direction, moral independence, and conviction to decide for oneself, rather than accepting the claims of others.

Self-esteem—the self-confidence to resist persuasion and to challenge assumptions or conclusions.

THANKS!

Ali Salah



Auditing

Management Assertions and Audit objectives



https://youtu.be/p_X-jjdjpZQ

Setting Audit Objectives



Generally, the most efficient and effective way to conduct audits is to obtain some combination of assurance for each class of **transactions** and for the **ending balance** in the related accounts

• **Audit objectives include:**

a. **Transaction-related** audit objectives

b. **Balance-related** audit objectives

Steps to develop audit objectives

Understand objectives and responsibilities for the audit

Divide financial statements into cycles

Know management assertions about financial statements

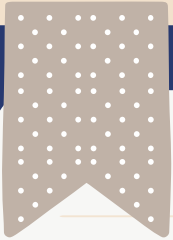
Know general audit objectives for classes of transactions, accounts, and disclosures

Know specific audit objectives for classes of transactions, accounts, and disclosures

Management Assertions



- **Management assertions are implied or expressed representations by management about:**
 - a. **Classes of transactions and the related accounts and disclosures in the financial statements and**
 - b. **They are directly related to the financial reporting framework used by the company**
 - c. **Assertions by management are directly related to the financial reporting framework (U.S. GAAP or IFRS) that forms the criteria that management uses to record and disclose accounting information in financial statements.**
 - d. **Management assertions lead to the audit objectives. Therefore, auditors must have a thorough understanding of management assertions to perform quality audits.**



PCAOB Assertions



- **The PCAOB describes five categories of management assertions:**
 - a. **Existence or occurrence**
 - b. **Completeness**
 - c. **Valuation or allocation**
 - d. **Rights and obligations**
 - e. **Presentation and disclosure**

International and AICPA Assertions



- International auditing standards and AICPA auditing standards further divide management assertions into two categories:
 - a. Assertions about **classes of transactions** and events and related disclosures
 - b. Assertions about **account balances** and related disclosures

PCAOB Assertions



1. Existence or occurrence: all transaction or balances in journal and posting in ledger is real, happen and exist. Mang. Should provide this assertion
2. Completeness: all transaction is recorded in journal and posting in ledger and apply the all accounting cycle for it. Assume journal include 50 transaction....., Mang. Should provide this assertion
3. Valuation or allocation: when record transaction this transaction has value also when prepare F.S with value or amount. The problem here is how to know this value is correct? Mang. Should provide assertion to prove this balance is correct. 'Confirm all values are correct'

PCAOB Assertions



1. Rights and obligation:

Rights is very linked to assets

Obligation is very linked to liabilities

-this mean when mang. Presented asset in f.s this asset should own by mang. And has rights over assets

-for example this not allowed to mang. To present assets 'building / land/ A/R' and not have rights over assets.

-obligation is mang. Presented liabilities this obligation should happened.

1. Presentation and disclosure

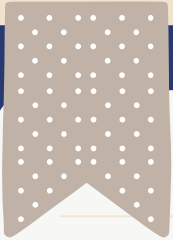
PCAOB Assertions



Management Provide assertion about transaction and balance.

The question how CPA test, verify this assertion?

The answer is: apply audit objectives



General transactions-related audit objectives



1. Occurrence—Recorded transactions exist
2. Completeness—Existing transactions are recorded
3. Accuracy—Recorded transactions are stated at the correct amounts
4. Posting and summarization—Transactions are included in the master files and are correctly summarized.
5. Classification—Transactions are properly classified
6. Timing—Transactions are recorded on the correct dates
7. Rights and obligations

Management Assertions related to transactions	General transaction related audit objective	Specific transaction related audit objectives related to sales
. Existence or occurrence	Occurrence audit objective	Recorded sales are for shipments made nonfictions customers
Completeness	Completeness audit objective-	Existing sales transactions are recorded. All sales disclosures required by GAAP are included in financial statements
Valuation or allocation	Accuracy audit objective	Recorded sales are for the amount of goods shipped and correctly billed and recorded. Sales –related disclosures in footnotes are accurately measured and described.
	Posting and Summarization-audit objective	Sales transaction are properly included in the master file and are correctly summarized
	Classification audit objective	Sales transactions are properly classified
	Timing audit objective	Sales transactions are recorded at correct dates.
Presentation and disclosure	Presentation audit objective	Sales revenue is properly aggregated and related disclosures in the financial statements are relevant and understandable

Balance-related audit objectives



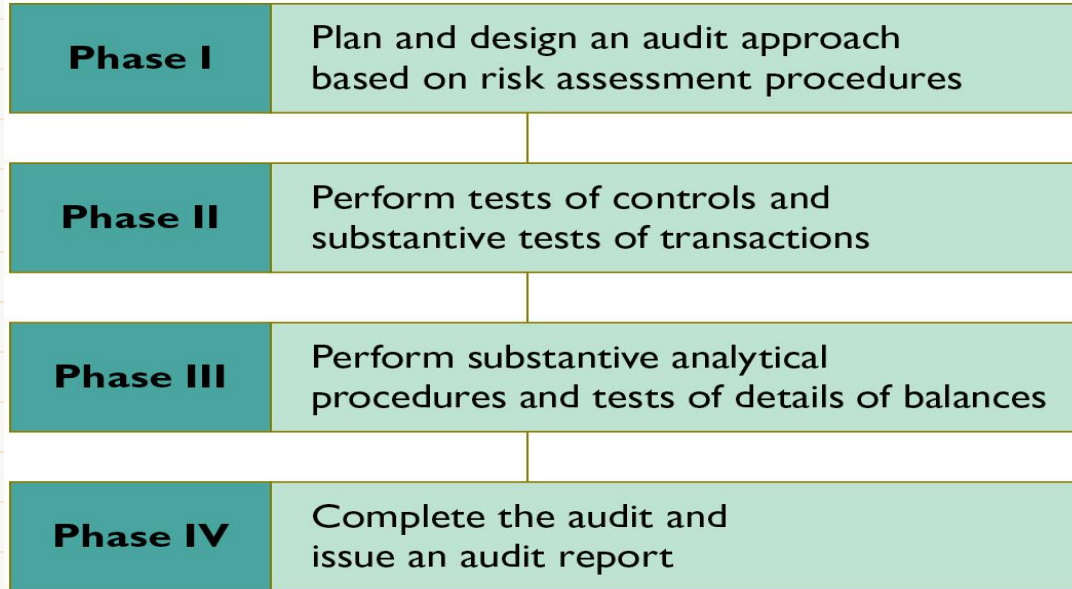
1. **Existence**—amounts included exist
2. **Completeness**—existing amounts are included
3. **Accuracy**—amounts included are correct
4. **Classification**—amounts in the client's listing are properly classified
5. **Cut-off**—transactions near the balance sheet date are recorded in the proper period
6. **Detail Tie-In**—details in the account balance agree with related master file amounts, foot to the total in the account balance, and agree with the total in the general ledger
7. **Realizable Value**—assets are included at the amounts estimated to be realized
8. **Rights and Obligations**

Management Assertions related to the balances	General Balance related audit objective	Specific Balance related audit objectives related to inventory
. Existence or occurrence	Existence audit objective	All recorded inventory exists at the balance sheet date
Completeness	Completeness audit objective	All existing inventory has been counted and included in inventory summary. All inventory disclosures required by accounting standards are included in the financial statements.
Valuation or allocation	Accuracy audit objective	Inventory quantities on client perpetual records agree with items physically on hand. Prices used to value inventories are materially correct. Inventory footnote disclosures are appropriately measured and described.
	Cutoff audit objective	Sales cutoff at year ended is proper. Purchase at year ended is proper.
	-Detail tie-in audit objective	Total inventory items agree with general ledger.
	Realizable value audit objective-	Inventory has been written down where net realizable value is impaired.
	Classification audit objective	Inventory items are properly classified as raw material, work in process, finished goods.
Rights and obligations	Rights and obligations audit objective	The company has title to all inventory items listed. Inventories are not pledge as collateral.
Presentation and disclosure	Presentation audit objective	Inventory is [properly aggregated and costing method is clearly described in the financial statements

How Audit Objectives Are Met



- Auditors follow the four phases of the audit process to ensure that all required audit objectives are both specified and met:



THANKS!

Ali Salah



Auditing

Audit Evidence



<https://youtu.be/DFazaCb5kNc>

OBJECTIVE 1
**Contrast audit evidence with evidence
used by other professions.**



NATURE OF EVIDENCE

- **Evidence** was defined as any *information used by the auditor* to determine whether the information being audited is stated in accordance with the established criteria.
- The information varies greatly in the extent to which it persuades the auditor whether financial statements are fairly stated.
- Evidence includes information that is highly persuasive, such as the auditor's count of marketable securities, and less persuasive information, such as responses to questions of client employees.

OBJECTIVE 2

Identify the four audit evidence decisions that are needed to create an audit program.



AUDIT EVIDENCE DECISIONS

The auditor must make **four major decisions** regarding what evidence to gather and how much to accumulate:

1. Which audit procedures to use?

An **audit procedure** is the detailed instruction that explains the audit evidence to be obtained during the audit. For example, the audit procedure for the verification of cash disbursements is to Examine the cash disbursements journal in the accounting system and compare the payee, name, amount, and date with online information provided by the bank about checks and electronic transfers processed for the account.

AUDIT EVIDENCE DECISIONS (CONT.)

2. What sample size to select for a given procedure?

Once an audit procedure is selected, auditors can vary the sample size from one to all the items in the population being tested. In an audit procedure to verify cash disbursements,

suppose 6,600 checks and electronic transfers are recorded in the cash disbursements journal. The auditor might select a sample size of 50 disbursements for comparison with the cash disbursements journal.

AUDIT EVIDENCE DECISIONS (CONT.)

3. Which items to select from the population?

After determining the sample size for an audit procedure, the auditor must decide which items in the population to test. If the auditor decides,

for example, to select 50 disbursements from a population of 6,600 for comparison with the cash disbursements journal, several different methods can be used to select the specific items to be examined. The auditor can

- (1) select a week and examine the first 50 transactions,
- (2) select the 50 disbursements with the largest amounts,
- (3) select the items randomly, or
- (4) select those transactions that the auditor thinks are most likely to be in error. Or, a combination of these methods can be used.

AUDIT EVIDENCE DECISIONS (CONT.)

4. When to perform the procedures?

The timing decision is affected by when the client needs the audit to be completed.

In the audit of financial statements, the client normally wants the audit completed one to three months after year-end.

The SEC currently requires that all public companies file audited financial statements with the SEC within 60 to 90 days of the company's fiscal year-end, depending on the company's size.

However, timing is also influenced by when the auditor believes the audit evidence will be most effective and when audit staff is available.

For example, auditors often prefer to do counts of inventory as close to the balance sheet date as possible.

AUDIT EVIDENCE DECISIONS (CONT.)

The list of audit procedures for an audit area or an entire audit is called an **audit program**.

The audit program always includes a list of

- the audit procedures, and it usually includes -sample sizes, -items to select, and the -timing of the tests.

Audit engagement software assists the auditor in selecting the procedures to be performed and other evidence decisions, based on identified risks and other audit planning decisions.

Normally, there is an audit program, including several audit procedures, for each component of the audit. Therefore, there will be an audit program for accounts receivable, one for sales, and so on.

OBJECTIVE 3
**Specify the characteristics that
determine the persuasiveness of
evidence.**



PERSUASIVENESS OF EVIDENCE

*** Audit standards require that the auditor accumulate sufficient appropriate evidence to support the opinion issued.**

- **The two determinants of the persuasiveness of evidence are appropriateness and sufficiency.**

1. Appropriateness of evidence is a measure of the quality of evidence, meaning its relevance and reliability in meeting audit objectives for classes of transactions, account balances, and related disclosures.

Appropriateness of evidence depends on:

- **Relevance of evidence**
- **Reliability of evidence**

PERSUASIVENESS OF EVIDENCE (CONT.)

- * **Relevance of evidence** means that the evidence must pertain to or be relevant to the audit objective that is being tested.
- * **Reliability of evidence** refers to the degree to which evidence is believable or worthy of trust. Reliability depends on the following characteristics:

PERSUASIVENESS OF EVIDENCE (CONT.)

RELIABILITY OF EVIDENCE

1. Independence of provider

- Evidence obtained from a source outside the entity is more reliable than that obtained from within. Communications from banks, attorneys, or customers is generally considered more reliable than answers obtained from inquiries of the client.

2. Effectiveness of client's internal controls

- When a client's internal controls are effective, evidence obtained is more reliable than when they are not effective.

PERSUASIVENESS OF EVIDENCE (CONT.)

RELIABILITY OF EVIDENCE

3. Auditor's direct knowledge

- Evidence obtained directly by the auditor through physical examination, observation, recalculation, and inspection is more reliable than information obtained indirectly.

4. Qualifications of individuals providing the information

Although the source of information is independent, the evidence will not be reliable unless the individual providing it is qualified to do so.

For example, examining an inventory of diamonds by an auditor not trained to distinguish between diamonds and cubic zirconia is not reliable evidence for the existence of diamonds.



PERSUASIVENESS OF EVIDENCE (CONT.)

RELIABILITY OF EVIDENCE

5. Degree of objectivity

- Objective evidence is more reliable than evidence that requires considerable judgment to determine whether it is correct. Examples of objective evidence include confirmation of accounts receivable and bank balances and the physical count of securities and cash. Examples of subjective evidence include a letter written by a client's attorney discussing the likely outcome of outstanding lawsuits against the client.

6. Timeliness

- Evidence is usually more reliable for balance sheet accounts when it is obtained as close to the balance sheet date as possible.
- For income statement accounts, evidence is more reliable if there is a sample from the entire period under audit, such as a random sample of sales transactions for the entire year, rather than from only a part of the period.

PERSUASIVENESS OF EVIDENCE (CONT.)

2- Sufficiency of evidence refers to the quantity of evidence obtained.

*** The sample size that is considered sufficient is affected by two factors:**

- The auditor's expectation of misstatements**
- The effectiveness of the client's internal controls**

*** In making decisions about audit evidence, both persuasiveness and cost must be considered. The auditor's goal is to obtain a sufficient amount of appropriate evidence at the lowest possible total cost.**

OBJECTIVE 4
**Identify and apply the eight types of
evidence used in auditing.**



TYPES OF AUDIT EVIDENCE

Every audit procedure obtains one or more of the following types of evidence:

- 1. Physical examination**
- 2. Confirmation**
- 3. Inspection**
- 4. Analytical procedures**
- 5. Inquiries of the client**
- 6. Recalculation**
- 7. Reperformance**
- 8. Observation**

TYPES OF AUDIT EVIDENCE (CONT.)

1. Physical Examination—The inspection or count of a tangible asset by the auditor.

- This type of evidence is most often associated with inventory and cash, but it is also applicable to the verification of securities, notes receivable, and tangible fixed assets.
- Physical examination is a direct means of verifying that an asset actually exists (existence objective) and is considered one of the most reliable and useful types of audit evidence. However, physical examination is not sufficient evidence to verify that existing assets are owned by the client
- (rights and obligations' objective), and proper valuation for financial statement purposes usually cannot be determined by physical examination (accuracy and realizable value objectives). Inv.

TYPES OF AUDIT EVIDENCE (CONT.)

2. Confirmation—The receipt of a direct written response from a third party verifying the accuracy of information that was requested by the auditor.

- * The response may be in paper form or electronic or other medium, such as the auditor's direct access to information held by the third party.
- * Because confirmations come from third-party sources instead of the client, they are a highly regarded and often used type of evidence. However, confirmations are relatively costly to obtain and may cause some inconvenience to those asked to supply them. Therefore, they are not used in every instance in which they are applicable.

* Limitations of confirmation :

Confirmation as a type of evidence could have some limitations include the following :

- – Confirmation from debtors may provide audit evidence for existence and right and obligation assertions, but not for valuation, The external auditor should be alert of the possibility that the customer may sign the confirmation without verification form the books.
- – Confirmation from creditors may not be effective verify completeness assertion
- – Confirmation request should be directed to appropriate individual
- – Certain parties may not provide objective or unbiased response to a confirmation request
- – The external auditor should also consider the respondent's competence, knowledge, ability and willingness to respond to confirmation request
- – The external auditor should be alert whether there are any indications that the confirmation received may not be reliable. The reliability of response should be considered and external audit procedures should be performed to dispel any concern. The external auditor may choose to verify the source and contents of a response in a telephone call to the purported sender.

TYPES OF AUDIT EVIDENCE (CONT.)

3. Inspection—The auditor's examination of the client's documents and records to substantiate the information in the financial statements.

- **Documents can be internal or external**

* An **internal document** has been prepared and used within the client's organization and is retained without ever going to an outside party. Internal documents include duplicate sales invoices, employees' time reports, and inventory receiving reports.

- An **external document** has been handled by someone outside the client's organization who is a party to the transaction being documented, but that is either currently held by the client or readily accessible.
- In some cases, external documents originate outside the client's organization and end up in the hands of the client. Examples of external documents include vendors' invoices, cancelled notes payable, and insurance policies.

TYPES OF AUDIT EVIDENCE (CONT.)

- When auditors use documentation to support recorded transactions or amounts, the process is often called **vouching**.
- To vouch recorded acquisition transactions, the auditor might, for example, verify entries in the acquisitions journal by examining supporting vendors' invoices and receiving reports and thereby satisfy the occurrence objective.
- If the auditor traces from receiving reports to the acquisitions journal to satisfy the completeness objective, this latter process is called **tracing**.

TYPES OF AUDIT EVIDENCE (CONT.)

4. Analytical Procedures—The evaluation of financial information through analysis of plausible relationships among financial and nonfinancial data and are required during planning and completion phases of all audits (For example, an auditor may compare the gross margin percent in the current year with the preceding year's gross margin).

*** Purposes of analytical procedures include:**

- **Understand the Client's Industry and Business**

- Auditors must obtain knowledge about a client's industry and business as a part of planning an audit. By conducting analytical procedures in which the current year's unaudited information is compared with prior years' audited information or industry data, changes are highlighted.

TYPES OF AUDIT EVIDENCE (CONT.)

- **Assess the Entity's Ability to Continue as a Going Concern**

- Analytical procedures are often a useful indicator for determining whether the client company has financial problems.

- **Indicate the Presence of Possible Misstatements in the Financial Statements**

- Significant unexpected differences between the current year's unaudited financial data and other data used in comparisons are commonly called **unusual fluctuations**.

- **Provide Evidence Supporting an Account Balance**

- In many cases, an analytical procedure can be used to provide evidence supporting recorded account balances.

*** Limitations of Analytical procedures :**

Analytical procedures as type of evidence have some limitations including the following :

- – When information produced by the organization is used by the external auditor to perform analytical procedures, the external auditor should be alert about completeness and accuracy of the information.
- – Reliance should not be placed on analytical procedures only in case of material accounts.
- – The external auditor should be alert that analytical procedures may identify relationships as expected, when, in fact, a material misstatement may exist.
- – Analytical procedures are usable only when the accuracy with which expected results may be predicted. For example, analytical procedures are not appropriate in comparing 'research and development or advertising expenses from one period to another.
- – A comparison with budget is not appropriate if budgets are not attainable but have been set as goals to be achieved.

TYPES OF AUDIT EVIDENCE (CONT.)

5. Inquiry—Obtaining written or oral information from the client in response to auditor questions. (Usually not considered conclusive because It is not from an independent source).

* Inquiry as a type of evidence has some **limitations** including considering integrity and specialization of management regarding responses received, Response from attached parties are not as strong evidence as responses from independent third party , Inquiry alone does not provide adequate audit evidence to detect a material misstatement and Also, inquiry alone is not adequate for performing test of controls.

6. Recalculation—Rechecking a sample of calculations made by the client

* Rechecking client calculations consists of testing the client's arithmetical accuracy and includes such procedures as extending sales invoices and inventory, adding journals and subsidiary records, and checking the calculation of depreciation expense and prepaid expenses.

TYPES OF AUDIT EVIDENCE (CONT.)

7. Reperformance—The auditor's test of client accounting procedures or controls that were originally done as part of the entity's accounting and internal control system.

8. Observation—Watching a process or procedure being performed by others

- The auditor may tour the plant to obtain a general impression of the client's facilities, or watch individuals perform accounting tasks to determine whether the person assigned a responsibility is performing it properly.
- **Limitations** of observation include being limited to the point in which the observation takes place and the external auditor should be alert that the act of being observed may affect how the process is performed.

TYPES OF AUDIT EVIDENCE (CONT.)

Cost of Types of Evidence:

- **Most expensive:**
 - Physical examination
 - Confirmation
- **Moderately costly:**
 - Inspection
 - Analytical procedures
 - Repperformance
- **Least expensive:**
 - Observation
 - Inquiries of the client
 - Recalculation

OBJECTIVE 5
**Understand the purposes of audit
documentation.**

AUDIT DOCUMENTATION

- **Audit documentation** is the record of the audit procedures performed, relevant audit evidence, and conclusions the auditor reached.
 - **Purposes of audit documentation:**
 - **A basis for planning the audit**
- * If the auditor is to plan an audit adequately, the necessary reference information must be available in the audit files. The files may include such diverse planning information as descriptive information about internal control, a time budget for individual audit areas, the audit program, and the results of the preceding year's audit.

AUDIT DOCUMENTATION (CONT.)

- **A record of the evidence accumulated and the results of the tests**

- * Audit documentation is the primary means of documenting that an adequate audit was conducted in accordance with auditing standards.

- * Audit documentation should identify the items tested, any significant audit findings or issues, actions taken to address them, and the basis for the conclusions reached.

- **Data for determining the proper type of audit report**

- * Audit documentation provides an important source of information to assist the auditor in deciding whether sufficient appropriate evidence was accumulated to justify the audit report in a given set of circumstances.

AUDIT DOCUMENTATION (CONT.)

- **A basis for review by supervisors and partners**

* The audit files are the primary frame of reference used by supervisory personnel to review the work of assistants.

- **Ownership of audit files:**

* Audit documentation prepared during the engagement, including schedules prepared by the client for the auditor, is the *property of the auditor*. The only time anyone else, including the client, has a legal right to examine the files is when they are subpoenaed by a court as legal evidence or when they are examined by approved peer reviewers or regulatory inspectors.

AUDIT DOCUMENTATION (CONT.)

- **Confidentiality of audit files:**

* A member in public practice shall not disclose any confidential client information without the specific consent of the client.

- **Requirements for retention of audit documentation:**

* Auditing standards require that records for audits of private companies be retained for a minimum of five years. The Sarbanes–Oxley Act requires auditors of public companies to prepare and maintain audit files and other information related to any audit report in sufficient detail to support the auditor’s conclusions, for a period of not less than seven years.

OBJECTIVE 6

Prepare organized audit documentation.

AUDIT DOCUMENTATION (CONT.)

* The type of audit documentation and the way it is arranged in the files is logical although firms may vary in their approaches.

Permanent Files: Contain data of a historical or continuing nature. These provide a convenient source of information that is used from year to year as:

- Copies of company documents such as articles of incorporation, bylaws, bond indentures, and long-term contracts
- Analyses of accounts from previous years that have continuing importance
- Information related to understanding internal controls and assessing control risk
- Results of analytical procedures from prior years' audits for comparison

AUDIT DOCUMENTATION (CONT.)

Current Files: Includes all documentation for the current year audit including:

- **Audit Program**
- **Working Trial Balance**
- **Adjusting Entries—Auditors propose adjusting entries for material misstatements.**
- **Supporting Schedules—Major types include the following:**
 - **Analysis**
 - **Trial balance or list**
 - **Reconciliation of amounts**
 - **Substantive analytical procedures**
 - **Summary of procedures**
 - **Examination of supporting documentation**
 - **Informational**
 - **Outside documentation**

REVIEW QUESTIONS

- **A- Choose questions**

1) Which of the following is an accurate statement regarding audit evidence?

- A) Responses to the auditor's questions by client employees is considered highly persuasive evidence.
- B) Audit evidence should provide an absolute level of assurance.
- C) The auditor uses evidence to determine whether the statements are fairly presented.
- D) All evidence must be highly persuasive.

- Answer: C

2) A(n) _____ is the detailed instruction that explains the audit evidence to be obtained during the audit.

- A) audit objective
- B) audit procedure
- C) audit assertion
- D) audit program

- Answer: B

3) Which of the following is **not** one of the four decisions about what evidence to gather and how much of it to accumulate?

- A) which audit procedures to use
- B) which accounts must agree to the general ledger
- C) when to perform the procedures
- D) what sample size to select for a given procedure

- Answer: B

4) Which of the following is **not** a characteristic of the reliability of evidence?

- A) effectiveness of client internal controls
- B) education of auditor
- C) independence of information provider
- D) timeliness

- Answer: B

5) Appropriateness of evidence is a measure of the

- A) quantity of evidence.
- B) quality of evidence.
- C) sufficiency of evidence.
- D) meaning of evidence.

- Answer: B

6) Which of the following is a correct statement regarding audit evidence?

- A) A large sample of evidence provided by an independent party is always considered persuasive evidence.
- B) A small sample of only one or two pieces of highly appropriate evidence is always considered persuasive evidence.
- C) The auditor must obtain a sufficient amount of relevant and reliable evidence to form an opinion on the fairness of the financial statements.
- D) Evidence is usually more reliable for balance sheet accounts when it is obtained within six months of the balance sheet date.

- Answer: C

7) Evidence is usually more persuasive for balance sheet accounts when it is obtained

A) as close to the balance sheet date as possible.

B) only from transactions occurring on the balance sheet date.

C) from various times throughout the client's year.

D) from the time period when transactions in that account were most numerous during the fiscal period.

- Answer: A

8) Calculating the gross margin for the current audit year as a percent of sales and comparing it with previous years is what type of evidence?

A) physical examination

B) analytical procedures

C) observation

D) inquiry

- Answer: B

9) When the auditor uses tracing as an audit procedure for tests of transactions, she is primarily concerned with which audit objective?

- A) occurrence
- B) completeness
- C) cutoff
- D) classification

- Answer: B

10) When the auditor uses the audit procedure vouching she is primarily concerned with which of the following audit objectives when testing classes of transactions?

- A) occurrence
- B) completeness
- C) authorization
- D) classification

- Answer: A

11) "Physical examination" is the inspection or count by the auditor of items such as

A) cash, inventory, and payroll timecards.

B) cash, inventory, canceled checks, and sales documents.

C) cash, inventory, canceled checks, and tangible fixed assets.

D) cash, inventory, securities, notes receivable, and tangible fixed assets.

- Answer: D

12) _____ generally provide the most reliable evidence.

A) Confirmations

B) Recalculations

C) Reperformances

D) Observations

- Answer: A

13) _____ is the auditor's examination of the client's documents and records to substantiate that the information is included in the financial statements.

- A) Inspection
- B) Recalculation
- C) Observation
- D) Verification

- Answer: A

14) Which of the following best describes one of the primary objectives of audit documentation?

- A) defend against claims of a deficient audit
- B) provide a basis for reviewing the work of subordinates
- C) provide reasonable assurance that the audit was conducted in accordance with auditing standards
- D) provide additional support of recorded amounts to the client

- Answer: C

- **B- True or false questions**

1) All evidence must have the same level of persuasiveness.

- Answer: FALSE

2) The relevance of audit evidence depends on the audit objective being tested.

- Answer: TRUE

3) Inquiries of the client are usually sufficient to provide appropriate evidence to satisfy an audit objective.

- Answer: FALSE

4) Confirmations are among the most expensive type of evidence to obtain.

- Answer: TRUE

5) When analytical procedures reveal unusual fluctuations in an account balance, the auditor will probably perform fewer tests of details for that account and increase the tests of controls related to the account.

- Answer: FALSE

6) Auditor judgment is the primary determinant in determining the amount of evidence gathered.

- Answer: TRUE

7) Analytical procedures must be used in the planning and completion phases of the audit.

- Answer: TRUE

8) Inspection consists of looking at a process or procedure being performed by others.

- Answer: FALSE

9) Auditing standards require that records for audits of private companies be retained for a minimum of seven years.

- Answer: FALSE

10) Audit documents are the joint property of the auditor and the audit client.

- Answer: FALSE