

Segment: Financial Reporting

Topic: Auditing Financial Statements

Table of Contents

| | |
|---|---|
| 1. Role of an Auditor | 4 |
| 2. Audit Report..... | 4 |
| 3. Generally Accepted Auditing Standards (GAAS) | 6 |
| 4. Summary | 7 |



Introduction

The users of the financial statements require a certain level of assurance about the reliability of the information contained in these statements. Public listed companies (as well as other companies) are required by law to have their financial statements audited by an independent external auditor. The purpose of the audit process is to provide reasonable assurance about whether the financial statements are prepared in accordance with GAAP, are fairly presented and are free from material misstatement.



Learning Objectives

At the end of this topic, you will be able to:

- describe the audit process
- describe the standard for the audit process, GAAS
- identify the three possible outcomes in the audit report.

1. Role of an Auditor



Fig.1: Role of an Auditor

The external auditor examines the records of the company and reviews the accounting methods and procedures used in the preparation of the financial statements. The auditor traces and verifies a company's business transactions and assesses the materiality of any misstatement. In addition, the auditor will interview key personnel and read the procedures manual to determine whether the organisation's internal accounting control system is adequate.

However, the auditor does not examine every record and transaction because the cost does not normally justify the benefit. The auditor would typically only select a sample of those records and transactions. Sampling procedures tend to follow generally accepted auditing standards.

2. Audit Report

The outcome of the audit process is an audit report. In that report, the auditor expresses an opinion about the fairness of the financial statements. It may be:

- a clean opinion
- a qualified opinion
- an adverse opinion

Clean Opinion

If the auditor believes that the financial statements (and the footnotes to these statements) are fairly presented and are free from material misstatement, he/she issues an unqualified or a clean opinion. An unqualified opinion includes wording such as, "In our opinion, the accompanying

financial statements present fairly the financial position of XYZ company at the fiscal year ending 31 December 20XX, ... in conformity with generally accepted accounting principles."

The audit report is typically included in the financial report. For an example of a clean audit report, review the auditor's report of ExxonMobil by visiting its website (<https://corporate.exxonmobil.com/en>) and follow the steps below:

1. Navigate to "Investors"
2. Click on "Investor relations"
3. Click on "SEC filings"
4. Download the latest available Form 10-K (e.g., 2019 Form 10-K) for the fiscal year and then scroll down to "Report of Independent Registered Public Accounting Firm".

Qualified Opinion

If the auditor believes that the financial statements (and the footnotes to these statements) are fairly presented overall, but that an item or certain items are not presented fairly or are not presented in accordance with GAAP, he or she may issue a qualified opinion. A qualified opinion may also be issued when the auditor believes that there is some uncertainty as to the company's ability to continue as a going concern. In general, qualified opinions are not very common. A qualified opinion might include wording such as, "In our opinion, except for the omission of... the accompanying financial statements present fairly..."

Adverse Opinion

If the auditor believes that the financial statements (and the footnotes to these statements) are not fairly presented in accordance with GAAP, he or she might issue an adverse opinion. Adverse opinions are very rare.

External auditors must be licensed before they are allowed to form an opinion about a company's financial statements. In some countries, the licensing process is carried out by the private sector, e.g., US, UK. In other countries, the government is more involved in the licensing process, e.g., Germany. The licensing process typically set education requirements, experience requirements and an examination process.

The audit industry comprises large and small audit firms. Many large audit firms typically perform the audit function for the largest global companies. The four biggest global audit firms are Deloitte Touche Tohmatsu, Ernst & Young, KPMG and Price Waterhouse Coopers. In addition to audit and assurance services, audit firms may provide other services such as tax advisory services and management advisory functions. Recently, there has been significant debate about the independence of auditors who perform non-audit services for their clients.

3. Generally Accepted Auditing Standards (GAAS)



Auditors perform their audit and assurance services in accordance with Generally Accepted Auditing Standards (GAAS). Just like GAAP, GAAS tend to vary internationally. This leads to differential objectives of the audit function.

For example, in the US, the objective of the audit function is to express an opinion on the fairness with which the financial statements presents, in all material respects, the financial position, results of operations and cash flows in conformity with GAAP in the US. In Italy, the objective of the audit function is to ensure that the financial statements give a true and fair view of the financial position and results in compliance with Italy's civil code. In Singapore, the objective of the audit function is to determine whether the accounts give a true and fair view of a company's affairs in accordance with provisions of the Companies Act of Singapore.

4. Summary

Here is a quick recap of what we have learnt so far:

- The audit process provides reasonable assurance about whether the financial statements are prepared in accordance with GAAP, are fairly presented and are free from material misstatement
- The auditors may issue a clean, qualified or adverse audit opinion.
- The audit process is carried out following GAAS.