## Contents

<table>
<thead>
<tr>
<th>Chapter</th>
<th>Title</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chapter 1</td>
<td>Introduction to assurance</td>
<td>1</td>
</tr>
<tr>
<td>Chapter 2</td>
<td>Rules and regulation</td>
<td>17</td>
</tr>
<tr>
<td>Chapter 3</td>
<td>Corporate governance</td>
<td>29</td>
</tr>
<tr>
<td>Chapter 4</td>
<td>Ethics and acceptance</td>
<td>59</td>
</tr>
<tr>
<td>Chapter 5</td>
<td>Risk</td>
<td>101</td>
</tr>
<tr>
<td>Chapter 6</td>
<td>Planning</td>
<td>135</td>
</tr>
<tr>
<td>Chapter 7</td>
<td>Evidence</td>
<td>173</td>
</tr>
<tr>
<td>Chapter 8</td>
<td>Systems and controls</td>
<td>223</td>
</tr>
<tr>
<td>Chapter 9</td>
<td>Internal audit</td>
<td>287</td>
</tr>
<tr>
<td>Chapter 10</td>
<td>Procedures</td>
<td>307</td>
</tr>
<tr>
<td>Chapter 11</td>
<td>Completion and review</td>
<td>377</td>
</tr>
<tr>
<td>Chapter 12</td>
<td>Reporting</td>
<td>419</td>
</tr>
<tr>
<td>Chapter 13</td>
<td>Summary of key ISAs</td>
<td>465</td>
</tr>
<tr>
<td>Chapter 14</td>
<td>Financial reporting revision</td>
<td>481</td>
</tr>
<tr>
<td>Chapter 15</td>
<td>Questions and Answers</td>
<td>491</td>
</tr>
<tr>
<td>Chapter 16</td>
<td>References</td>
<td>547</td>
</tr>
<tr>
<td>Index</td>
<td></td>
<td>I.1</td>
</tr>
</tbody>
</table>
Introduction

This document references IFRS® Standards and IAS® Standards, which are authored by the International Accounting Standards Board (the Board), and published in the 2018 IFRS Standards Red Book.
How to use the materials

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

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

1. Detailed study guide and syllabus objectives
2. Description of the examination
3. Study skills and revision guidance
4. Study text
5. Question practice

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

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

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

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

- The content for each topic area commences with a brief explanation or definition to put the topic into context before covering the topic in detail. You should follow your studying of the content with a review of the illustration/s. These are worked examples which will help you to understand better how to apply the content for the topic.

- Test your understanding sections provide an opportunity to assess your understanding of the key topics by applying what you have learned to short questions. Answers can be found at the back of each chapter.

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

- Question practice is provided at the back of each text.
Quality and accuracy are of the utmost importance to us so if you spot an error in any of our products, please send an email to mykaplanreporting@kaplan.com with full details, or follow the link to the feedback form in MyKaplan. Our Quality Coordinator will work with our technical team to verify the error and take action to ensure it is corrected in future editions.

**Icon Explanations**

- **Supplementary reading** – These sections will help to provide a deeper understanding of core areas. The supplementary reading is **NOT** optional reading. It is vital to provide you with the breadth of knowledge you will need to address the wide range of topics within your syllabus that could feature in an exam question. **Reference to this text is vital when self-studying.**

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

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

- **New** – Identifies topics that are brand new in exams that build on from earlier exams.

- **Test your understanding** – Exercises for you to complete to ensure that you have understood the topics just learned.

- **Illustration** – Worked examples help you understand the core content better.

- **Tricky topic** – When reviewing these areas care should be taken and all illustrations and Test your understanding exercises should be completed to ensure that the topic is understood.

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

- **Footsteps** – Helpful tutor tips.

**References to ISA paragraph numbers are for copyright purposes only. Students are not required to learn this level of detail.**
On-line subscribers

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

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

1. On-line reference ware: reproduces your Study Text on-line, giving you anytime, anywhere access.
2. On-line testing: provides you with additional on-line objective testing so you can practice what you have learned further.
3. On-line performance management: immediate access to your on-line testing results. Review your performance by key topics and chart your achievement through the course relative to your peer group.

Syllabus for September 2019 to June 2020

Syllabus background

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

Objectives of the syllabus

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

- Audit framework and regulation.
- Planning and risk assessment.
- Internal control.
- Audit evidence.
- Review and reporting.

ACCA Performance Objectives

In order to become a member of the ACCA, as a trainee accountant you will need to demonstrate that you have achieved nine performance objectives. Performance objectives are indicators of effective performance and set the minimum standard of work that trainees are expected to achieve and demonstrate in the workplace. They are divided into key areas of knowledge which are closely linked to the exam syllabus.

There are five Essential performance objectives and a choice of fifteen Technical performance objectives which are divided into five areas.

The performance objectives which link to this exam are:

1. Ethics and professionalism (Essential)
2. Governance risk and control (Essential)
3. Prepare for and plan the audit process (Technical)
4. Collect and evaluate evidence for an audit (Technical)
5. Review and report on the findings of an audit (Technical)

The following link provides an in depth insight into all of the performance objectives:

Progression

There are two elements of progression that we can measure: first how quickly students move through individual topics within a subject; and second how quickly they move from one course to the next. We know that there is an optimum for both, but it can vary from subject to subject and from student to student. However, using data and our experience of student performance over many years, we can make some generalisations.

A fixed period of study set out at the start of a course with key milestones is important. This can be within a subject, for example ‘I will finish this topic by 30 June’, or for overall achievement, such as ‘I want to be qualified by the end of next year’.

Your qualification is cumulative, as earlier papers provide a foundation for your subsequent studies, so do not allow there to be too big a gap between one subject and another. We know that exams encourage techniques that lead to some degree of short term retention, the result being that you will simply forget much of what you have already learned unless it is refreshed (look up Ebbinghaus Forgetting Curve for more details on this). This makes it more difficult as you move from one subject to another: not only will you have to learn the new subject, you will also have to relearn all the underpinning knowledge as well. This is very inefficient and slows down your overall progression which makes it more likely you may not succeed at all.

In addition, delaying your studies slows your path to qualification which can have negative impacts on your career, postponing the opportunity to apply for higher level positions and therefore higher pay.

You can use the following diagram showing the whole structure of your qualification to help you keep track of your progress.
The Examination

Examination format
The syllabus is assessed by computer-based examination (CBE).

The CBE will contain 100 marks of exam content that needs to be completed within 3 hours. Prior to the start of the exam candidates are given an extra 10 minutes to read the exam instructions.

All questions are compulsory. The exam will contain both computational and discursive elements.

Some questions will adopt a scenario/case study approach.

Section A
Section A of the exam comprises three 10 mark case-based questions. Each case has five objective test questions worth 2 marks each.

There are no dependencies between the individual questions. Therefore, if you get one question wrong, it will not affect your ability to get the others correct.

OT questions in section A will be of varying styles as follows:

- Multiple choice – where you are required to choose one answer from a list of options provided by clicking on the appropriate ‘radio button’.
- Multiple response – where you are required to select more than one response from the options provided by clicking on the appropriate tick boxes. The question will specify how many answers need to be selected, but the system won’t stop you from selecting more answers than this.
- Fill in the blank – where you are required to type an answer into a box (usually numerical, but may be text). Any specific rounding requirements will be displayed.
- Drag and drop – where you are required to drag an answer and drop it into place. Some questions could involve matching more than one answer to a response area and some questions may have more answer choices than response areas, which means not all available answer choices need to be used.
- Drop down list – where you are required to select one answer from a drop down list. Some questions may contain more than one drop down list and an answer has to be selected from each one.
- Hot spot – where you are required to select one point on an image as your answer. When the cursor is hovered over the image, it will display as an ‘X’. To answer, place the X on the appropriate point on the diagram.
- Hot area – these are similar to hot spot questions, but instead of selecting a specific point, you are required to select one or more areas in an image.
Section B

Section B of the exam comprises one 30 mark question and two 20 mark questions.

This section of the exam will predominantly examine one or more aspects of audit and assurance from planning and risk assessment, internal control or audit evidence, although topics from other syllabus areas may also be included.

Examination tips

Be sure you understand how to use the software before you start the exam. If in doubt, ask the assessment centre staff to explain it to you.

Questions are displayed on the screen and answers are entered using keyboard and mouse.

We recommend that 10 minutes should be spent reviewing the format and content of the requirements so that you understand what you need to do. Pay particular attention to section B, where questions will be based on longer scenarios than the 2 mark OT cases in section A.

Read each question carefully.

- Divide the time you spend on questions in proportion to the marks on offer.
- One suggestion for this examination is to allocate 1.8 minutes to each mark available (180 minutes/100 marks), so a 20 mark question should be completed in approximately 36 minutes.

Section A

You should begin by reading the OT questions that relate to the case, so that when you read through the information for the first time, you know what it is that you are required to do.

Once you have read through the information, you should first answer any of the OT questions that can be quickly answered. You should then attempt the other OT questions utilising the remaining time for that case.

If you don’t know the answer, eliminate those options you know are incorrect and see if the answer becomes more obvious. After you have eliminated the options that you know to be wrong, if you are still unsure, guess.

Answer every question.

Each OT question is worth two marks. Therefore you have 18 minutes (1.8 minutes per mark) to answer the five OT questions relating to each case. It is likely that all of the cases will take the same length of time to answer, although some of the OT questions within a case may be quicker than other OT questions within that same case.

Work steadily. Rushing leads to careless mistakes and the OT questions are designed to include answers which result from careless mistakes.

Section A questions can be found at the end of each chapter.
Section B

The constructed response questions in section B will require a written response rather than being OT questions. Therefore, different techniques need to be used to score well.

Unless you know exactly how to answer the question, spend some time planning your answer. Stick to the question and tailor your answer to what you are asked. Pay particular attention to the verbs in the question e.g. 'Describe', 'State', 'Explain'.

If you get completely stuck with a question leave it and return to it later.

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

When answering the constructed response questions, be concise. DO NOT write an essay.

Make sure that each point is clearly identifiable by leaving a line space between each of your points.

Some questions ask you to present your answer in the form of a report or letter. Use the correct format as there are easy marks to gain here for presentation.

Section B style questions can be found in most chapters and also in Chapter 15.

All sections

Don’t skip parts of the syllabus. The AA syllabus has 18 different questions so the examination can cover a very broad selection of the syllabus each sitting.

Spend time learning definitions.

Practice plenty of questions to improve your ability to apply the techniques.

Spend the last few minutes reading through your answers and making any additions or corrections.

Don’t panic if you realise you've answered a question incorrectly. Try to remain calm, continue to apply examination technique and answer all questions required within the time available.

ACCA support

For additional support with your studies please also refer to the ACCA Global website.
Introduction to assurance

Chapter learning objectives

This chapter covers syllabus areas:

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

Detailed syllabus objectives are provided in the introduction section of the textbook.

One of the PER performance objectives (PO4) is governance risk and control. You contribute to effective governance in your area. You evaluate, monitor and implement risk management procedures, complying with the spirit and the letter of policies, laws and regulations. Working through this chapter should help you understand how to demonstrate that objective.
1 What is assurance?

An assurance engagement is: ‘An engagement in which a practitioner obtains sufficient appropriate evidence in order to express a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria.’

[International Framework for Assurance Engagements, 10]

Giving assurance means offering an opinion about specific information so the users of that information are able to make confident decisions knowing that the risk of the information being 'incorrect' is reduced.
There are **five elements of an assurance engagement**: 

<table>
<thead>
<tr>
<th>Element</th>
<th>Explanation</th>
<th>In relation to an audit</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Three party involvement</td>
<td>Practitioner (the reviewer of the subject matter who provides the assurance)</td>
<td>Auditor</td>
</tr>
<tr>
<td></td>
<td>Intended users (of the information)</td>
<td>Shareholders</td>
</tr>
<tr>
<td></td>
<td>Responsible party (those responsible for preparing the subject matter)</td>
<td>Directors</td>
</tr>
<tr>
<td>(ii) Appropriate subject matter</td>
<td>The information subject to examination by the practitioner</td>
<td>Financial statements</td>
</tr>
<tr>
<td>(iii) Suitable criteria</td>
<td>The subject matter is evaluated against the suitable criteria</td>
<td>Financial reporting framework</td>
</tr>
<tr>
<td>(iv) Sufficient appropriate evidence</td>
<td>Sufficient appropriate evidence is needed to provide a basis for the opinion/conclusion</td>
<td>Sufficient appropriate evidence is obtained by performing audit procedures</td>
</tr>
<tr>
<td>(v) Written assurance report in an appropriate form</td>
<td>The output of the assurance engagement expressing a conclusion/opinion about the subject matter</td>
<td>Independent auditor’s report providing an opinion as to whether the financial statements give a true and fair view</td>
</tr>
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[International Framework for Assurance Engagements]

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### Illustration 1 – Buying a house

Consider someone who is buying a house. There is a risk that someone pays a large sum of money to purchase a structurally unsafe property which needs further expenditure to make it habitable. To reduce this risk, it is normal for house buyers (the users) to pay a property surveyor (the practitioner) to perform a structural assessment of the house (the subject matter). The surveyor would then report back (written report) to the house buyer identifying any structural deficiencies (measured against building regulations/best practice and other criteria). With this information the potential buyer can then make their decision whether or not to buy the house with the confidence that they know its structural condition. In this example, the responsible party is the current house owner, and the evidence would largely be obtained through visual inspection of the property.
Assurance engagements

Examples of assurance engagements include:

- Audit of financial statements
- Review of financial statements
- Systems reliability reports
- Verification of social and environmental information
- Review of internal controls
- Value for money audit in public sector organisations.

General principles the assurance provider must follow when performing such engagements include:

- Comply with ethical requirements.
- Apply professional scepticism and judgment.
- Perform acceptance and continuance procedures to ensure only work of acceptable risk is accepted.
- Agree the terms of engagement.
- Comply with quality control requirements (ISQC 1).
- Plan and perform the engagement effectively.
- Obtain sufficient appropriate evidence.
- Consider the effect of subsequent events on the subject matter.
- Form a conclusion expressing either reasonable or limited assurance as appropriate.
- The evidence should be documented to provide a record of the basis for the assurance report.

Types of assurance engagement

Two types of assurance engagement are permitted:

- Reasonable
- Limited.
Reasonable assurance engagements

The practitioner:

Gathers **sufficient appropriate evidence** to be able to draw **reasonable conclusions**

Concludes that the subject matter **conforms in all material respects** with identified suitable criteria

Gives a **positively worded assurance opinion**

Gives a **high level** of assurance (confidence)

Performs very thorough procedures to obtain sufficient appropriate evidence – tests of controls and substantive procedures

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

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

Therefore:

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

Limited assurance engagement

The practitioner:

Gathers **sufficient appropriate evidence** to be able to draw **limited conclusions**

Concludes that the subject matter, with respect to identified suitable criteria, is **plausible in the circumstances**

Gives a **negatively worded assurance conclusion**

Gives a **moderate or lower level** of assurance than that of an audit

Performs significantly fewer procedures – mainly enquiries and analytical procedures

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

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

Purpose of an external audit engagement

ISA 200 Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing states the purpose of an external audit engagement is to ‘enhance the degree of confidence of intended users in financial statements.’

This is achieved by the auditor expressing an opinion on whether the financial statements:

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

[ISA 200, 3]

The financial reporting framework to be applied will vary from country to country. In Audit & Assurance, it is assumed that International Financial Reporting Standards are the basis for preparing the financial statements.

True and fair

- **True**: factually correct information which conforms with accounting standards and relevant legislation, and agrees with the underlying records.
- **Fair**: clear, impartial and unbiased information which reflects the commercial substance of the transactions of the entity.

Objectives of the auditor

The objectives of an auditor are to:

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

[ISA 200, 11]
Need for external audit

- Shareholders provide the finance for a company and may or may not be involved in the day to day running of the company.

- Directors manage the company on behalf of the shareholders in order to achieve the objectives of that company (normally the maximisation of shareholder wealth).

- The directors must prepare financial statements to provide information on performance and financial position to the shareholders.

- The directors have various incentives to manipulate the financial statements and show a different level of performance.

- Hence the need for an independent review of the financial statements to ensure they give a true and fair view – the external audit.

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

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

Benefits of an audit

- Higher quality information which is more reliable improving the reputation of the market.

- Independent scrutiny and verification may be valuable to management.

- Reduces the risk of management bias, fraud and error by acting as a deterrent. An audit may also detect bias, fraud and error.

- Enhances the credibility of the financial statements, e.g. for tax authorities or lenders.

- Deficiencies in the internal control system may be highlighted by the auditor.
Expectation gap

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

Examples of the expectation gap

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

Limitations of an audit

- Financial statements include subjective estimates and other judgmental matters.
- Internal controls may be relied on which have their own inherent limitations.
- Representations from management may have to be relied upon as the only source of evidence in some areas.
- Evidence is often persuasive not conclusive.
- Do not test all transactions and balances. Auditors test on a sample basis.

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

Limitations of an audit

- Nature of financial reporting – financial statement amounts are affected by management judgment and therefore subject to bias.
- Nature of audit procedures – information provided by the client may be incomplete or falsified documents may be provided.
- Timeliness of financial reporting – the relevance of information diminishes over time and the auditor cannot investigate every matter exhaustively.

[ISA 200, A48 – A50]
3 Review engagements

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

Purpose and objective of a review engagement

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

The procedures will mainly focus on analytical procedures and enquiries of management. In particular, no tests of controls will be performed.

As only limited assurance is being expressed, the work does not need to be as in depth as for an audit.

The objective of a review of financial statements is to enable an auditor to state whether, on the basis of procedures which do not provide all the evidence required in an audit, anything has come to the auditor’s attention that causes the auditor to believe that the financial statements are not prepared in accordance with the applicable financial reporting framework.
Incorporation and the separation of ownership and control

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

Incorporation has the following implications:

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

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

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

This conflict led to the legal requirement for financial statements to be produced by directors to allow the shareholders to assess the performance of management.

Accountability, agency and stewardship

**Key definitions:**

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

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

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

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

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

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

Examples of stakeholders groups

Stakeholder groups with an interest in the financial statements

- Shareholders can decide whether to alter their shareholdings.
- Employees may be able to judge whether they think their levels of pay are adequate compared to the directors. They may also be interested in the results of the company as this may impact their employment decisions.
- Those charged with governance can see whether they think management have struck the right balance between their own need for reward (remuneration, share options, etc) and the needs of other stakeholders.
- Customers can make judgments about whether the company has sufficient financial strength (i.e. liquidity) to justify future trading.
- Suppliers and lenders can assess financial stability before giving credit.
- The government can decide whether the right amounts of tax have been paid and whether the company appears to be compliant with the relevant laws and regulations.
Test your understanding 1
List and explain the elements of an assurance engagement.  

(5 marks)

Test your understanding 2
Explain the term ‘limited assurance’ in the context of an examination of a company’s cash flow forecast and explain how this differs from the assurance provided by an external audit.  

(5 marks)

Test your understanding 3
Your firm has been approached to perform the external audit of Perth Co. Perth Co has grown over the last two years and has now reached the audit threshold. As this is the first year the company has required an audit, the directors are unsure about the purpose of the audit. They have been informed that an audit need not be as inconvenient or intrusive as they expect it to be as there are additional benefits that may arise from having an audit. The directors have indicated that they expect your firm to detect every fraud and error in their accounting records so that when they need to apply for finance to help them grow further, they can use the audited financial statements to support the loan application and this should make it easier to get the loan.

(1) What level of assurance will be provided by the independent auditor’s report?
   A Absolute
   B Reasonable
   C Moderate
   D Limited

(2) Which of the following is NOT one of the five elements of an assurance engagement?
   A Subject matter
   B Suitable criteria
   C Assurance file
   D Written report
(3) **Which of the following is NOT a benefit of an audit?**

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

(4) **Which of the following statements is false?**

A. The auditor will express an opinion as to whether the financial statements give a true and fair view  
B. The auditor must obtain sufficient appropriate evidence to be able to form an audit opinion  
C. If the financial statements are found to contain material misstatements a negative audit opinion will be given  
D. An audit may not detect all fraud and error in the financial statements

(5) **Which of the following are examples of the expectation gap?**

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

A. (i), (ii) and (iii)  
B. (i), (ii) and (iv)  
C. (i) and (ii) only  
D. (ii) and (iii) only
4 Chapter summary

Assurance engagements

Levels of assurance
- Reasonable
- Limited

Elements
- External audit
- Review engagements
- True and fair
- Nothing has come to our attention

Benefits

Limitations

Expectations gap

1. Three parties
2. Subject matter
3. Suitable criteria
4. Sufficient appropriate evidence
5. Written report
Test your understanding answers

Test your understanding 1

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

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

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

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

(5) An assurance report contains the opinion that is given by the practitioner to the intended user.

Test your understanding 2

<table>
<thead>
<tr>
<th>Limited Assurance</th>
<th>Assurance provided by an external audit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Limited assurance is a moderate level of assurance.</td>
<td>An audit provides reasonable assurance, which is a high level.</td>
</tr>
<tr>
<td>The objective of a limited assurance engagement is to obtain sufficient appropriate evidence that the cash flow forecast is plausible in the circumstances i.e. prepared on the basis of reasonable assumptions.</td>
<td>The objective of an audit is to obtain sufficient appropriate evidence that the financial statements conform in all material respects with the relevant financial reporting framework.</td>
</tr>
</tbody>
</table>
A limited assurance report provides a negative conclusion. The practitioner will state that nothing has come to their attention which indicates that the assumptions used to prepare the cash flow forecast are not reasonable.

The assurance is therefore given on the absence of any indication to the contrary.

More evidence will need to be obtained to provide reasonable assurance, and a wider range of procedures performed, including tests of controls.

With limited assurance, limited procedures are performed. In the context of a forecast, procedures will be limited as the transactions and events haven't occurred yet.

More evidence will need to be obtained to provide reasonable assurance, and a wider range of procedures performed, including tests of controls.

A forecast relates to the future, which is inherently uncertain, and therefore it would not be possible to obtain assurance that it is free from material misstatement.

Financial statements relate to the past, and so the auditor should be able to obtain sufficient appropriate evidence.

Less reliance can therefore be placed on the forecast than the financial statements.

### Test your understanding 3

| (1) | B | Reasonable assurance is given in an independent auditor’s report. |
| (2) | C | Assurance file. |
| (3) | D | Sampling provides a limitation of the audit process, not a benefit. |
| (4) | C | A negative conclusion is used for limited assurance engagements. |
| (5) | A | The auditor cannot confirm the accuracy of the financial statements as they contain estimates and judgments of management. The company may not be a going concern and the financial statements may correctly reflect this resulting in an unmodified audit opinion. The auditor does not test all transactions. |