THOMAS ADEWUMI UNIVERSITY

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NATURE, MEANING AND EVOLUTION OF AUDITING, ASSURANCE AND INVESTIGATION

Definition of Auditing

There are different definitions of auditing:

Auditing is the process of examining the accounts or the accounting systems of an entity by an auditor.

Auditing is an examination of accounting records undertaken with a view to establish whether they correctly and completely reflect the transactions to which they relate.

Auditing is defined by the American Accounting Association (AAA) as 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 result to intended users.

OBJECTIVES OF AUDIT

A. **Primary Objective:** The primary objective of an audit of financial statements is to enable the auditor express an opinion whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. Thus, the primary objective of an audit is the expression of professional opinion as to whether or not, the financial statements examined by the auditor, for a reporting period, give a true and fair view (that is, fairly presented in all material respects).

B. **Secondary Objective:** Other objectives achieved in the course of the audit process include:

i. Detection and prevention of frauds

ii. Detection and prevention of errors

iii. Evaluation of the effectiveness and appropriateness of internal control system over financial reporting and submitting a report to management for needed improvements

iv. Evaluating and reporting on the likelihood of the business continuing as a going concern

v. Providing valuable advice to the entity audited on areas such as accounting systems, taxation matters, risk management practices and other incidental matters.

CLASSIFICATION OF AUDITS

Statutory audits – these are audits required by law. The companies Act in Nigeria makes it mandatory that companies incorporated under that Act must be audited every year. This statute also specifies the scope of the audit which cannot be restricted by the owners of the business or by their managers.

Private audits – a private audit is not required by law, it is optional. The person who engaged the auditor will usually agree the scope of work to be done with the auditor. Examples of private audits include the audit of sole traders and partnerships.

Internal audit – these are audits carried out by employees of an organization (called internal auditors) to ensure adherence and compliance to policies and controls established by the management. It is an independent appraisal function established by the management for the purpose of evaluating the organization's operations and improving the effectiveness of management controls and governance processes.

External audit – this is an audit carried out by an independent party (non-employee of the organization). It examines the operations and financial statements prepared by management and reports to owners of the organization. Examples are the statutory and private audits.

DEFINITION OF ASSURANCE

Assurance means confidence. In an assurance engagement, an 'assurance firm' is engaged by one party to give an opinion on a piece of information that has been prepared by another party. The opinion is an expression of assurance about the information that has been reviewed.

Assurance can be provided by: audit: this may be external audit, internal audit or a combination of the two review.

Assurance provided by audit :

An audit provides a high, but not absolute, level of assurance that the audited information is free from any material misstatement. This is often referred to as reasonable assurance. The assurance of an audit may be provided by external auditors or internal auditors.

Assurance provided by review

A review is a 'voluntary' investigation. In contrast to 'reasonable' level of assurance provided by an audit, a review into an aspect of the financial statements would provide only a moderate level of assurance that the information under review is free of material misstatement. A review does not provide the same amount of assurance as an audit.

LEVELS OF ASSURANCE

The degree of assurance that can be provided about the reliability of the financial statements of a company will depend on:

i. the amount of work performed in carrying out the assurance process, and

ii. the results of that work. The resulting assurance falls into one of two categories:

Reasonable Assurance – A high (but not absolute) level of assurance provided by the practitioner's conclusion expressed in a positive form. The report (conclusion)would usually be expressed in a positive form, giving a "reasonable assurance" that the subject matter conforms in all material respects, with criteria.

Limited Assurance – A moderate level of assurance provided by the practitioner's conclusion expressed in a negative form. Limited assurance is a lower level of assurance. The nature, timing and extent of procedures carried out by the practitioner would be limited compared with what is required in a reasonable assurance engagement.

INVESTIGATION

Investigation is undertaken to know the essential facts about a matter under inquiry. It is done with some special purpose of view. It may cover more than one accounting year. It is carried out on behalf of any party interested in the matter. It is wider in scope. It may be carried out beyond balance sheet. It is voluntary. It is required under certain circumstances. It may be conducted at any time in case of suspicion about any transaction.

Scope of Investigation

The following are some of the investigations commonly met with in practice.

- Investigation on behalf of an individual or firm proposing to buy a business for investment purpose.
- Investigation on behalf of a bank for credit purpose.
- Investigation for the purpose of business re-organisation and reconstruction or for merger and acquisition.
- Investigation on behalf of a business where fraud is suspected or known to have taken place etc.

INTERNATIONAL STANDARDS ON AUDITING

International Standards on Auditing (ISA) are a set of guidelines and principles established by the International Auditing and Assurance Standards Board (IAASB), a global standard-setting body for auditing and assurance services. These standards provide a framework for auditors to conduct high-quality audits of financial statements and other financial information in a consistent, reliable, and transparent manner across international borders.

INTERNATIONAL STANDARDS ON AUDITING

- ISA 200: Overall Objectives of the independent-auditor and the Conduct of an Audit in Accordance with International Standards on Auditing
- ISA 210: Agreeing to the Terms of Audit Engagements
- ISA 220: Quality Control for an Audit of Financial Statements
- ISA 230: Audit Documentation
- ISA 240: The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements
- ISA 250: Consideration of Laws and Regulations in an Audit of Financial Statements
- ISA 260: Communication with Those Charged with Governance
- ISA 265: Communicating Deficiencies in Internal Control to Those Charged with Governance and Management

- ISA 300: Planning an Audit of Financial Statements
- ISA 315: Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment
- ISA 320: Materiality in Planning and Performing an Audit
- ISA 330: The Auditor’s Responses to Assessed Risks
- ISA 402: Audit Considerations Relating to an Entity Using a Service Organization
- ISA 450: Evaluation of Misstatements Identified during the Audit

- ISA 500: Audit Evidence
- ISA 501: Audit Evidence-Specific Considerations for Selected Items
- ISA 505: External Confirmations
- ISA 510: Initial Audit Engagements-Opening Balances
- ISA 520: Analytical procedures
- ISA 530: Audit sampling
- ISA 540: Auditing accounting estimates, Including Fair Value Accounting Estimates and Related Disclosures
- ISA 550: Related Parties
- ISA 560: Subsequent event
- ISA 570: Going Concern
- ISA 580: Written Representations

- ISA 600: Special Considerations-Audits of Group Financial Statements (Including the Work of Component Auditors)
- ISA 610: Using the Work of Internal Auditors
- ISA 620: Using the Work of an Auditor's Expert
- ISA 700: Forming an Opinion and Reporting on Financial Statements
- ISA 705: Modifications to the Opinion in the Independent auditor report
- ISA 706: Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report
- ISA 710: Comparative Information-Corresponding Figures and Comparative Financial Statements
- ISA 720: The Auditor's Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements
- ISA 800: Special Considerations-Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks
- ISA 805: Special Considerations-Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement
- ISA 810: Engagements to Report on Summary Financial Statements

PUBLIC SECTOR AUDITING STANDARDS

Auditing in the public sector is an essential process to ensure the efficient and effective use of public resources and maintain the accountability and transparency of government entities. Public sector auditing standards differ from those applied in the private sector due to the unique characteristics of public sector organizations and their objectives.

Public sector auditing refers to the examination and evaluation of the financial records, operations, and performance of government entities, including national, regional, and local governments, as well as public agencies, organizations, and entities that receive public funding. The primary objective of public sector auditing is to ensure transparency, accountability, and the effective use of public resources.

PUBLIC SECTOR AUDITORS

Public sector auditors include anyone fulfilling an audit capacity and working in local, state, or federal government, or any publicly-controlled or publicly-funded agencies, enterprises, and other entities that deliver public programs, goods, or services. Public sector auditors may be internal auditors employed by government entities or external auditors appointed by legislative bodies, government agencies, or independent audit institutions. They adhere to established auditing standards, to ensure the quality, integrity, and independence of their work.

TYPES OF PUBLIC-SECTOR AUDIT

The three main types of public-sector audit are defined as follows:

Financial audit focuses on determining whether an entity's financial information is presented in accordance with the applicable financial reporting and regulatory framework. This is accomplished by obtaining sufficient and appropriate audit evidence to enable the auditor to express an opinion as to whether the financial information is free from material misstatement due to fraud or error.

Performance audit focuses on whether interventions, programmes and institutions are performing in accordance with the principles of economy, efficiency and effectiveness and whether there is room for improvement. Performance is examined against suitable criteria, and the causes of deviations from those criteria or other problems are analyzed. The aim is to answer key audit questions and to provide recommendations for improvement.

Compliance audit focuses on whether a particular subject matter is in compliance with authorities identified as criteria. Compliance auditing is performed by assessing whether activities, financial transactions and information are, in all material respects, in compliance with the authorities which govern the audited entity. These authorities may include rules, laws and regulations, budgetary resolutions, policy, established codes, agreed terms or the general principles governing sound public- sector financial management and the conduct of public officials.

GENERAL PRINCIPLES

1. Auditors should comply with the relevant ethical requirements and be independent. Ethical principles should be embodied in an auditor's professional behaviour.
2. Auditors should maintain appropriate professional behaviour by applying professional skepticism, professional judgment and due care throughout the audit. The auditor's attitude should be characterized by professional skepticism and professional judgement, which are to be applied when forming decisions about the appropriate course of action. Auditors should exercise due care to ensure that their professional behaviour is appropriate.
3. Auditors should perform the audit in accordance with professional standards on quality control.
4. Auditors should possess or have access to the necessary skills. The individuals in the audit team should collectively possess the knowledge, skills and expertise necessary to successfully complete the audit. This includes an understanding and practical experience of the type of audit being conducted, familiarity with the applicable standards and legislation, an understanding of the entity's operations and the ability and experience to exercise professional judgement.
5. Auditors should consider materiality throughout the audit process Materiality is relevant in all audits. A matter can be judged material if knowledge of it would be likely to influence the decisions of the intended users. Determining materiality is a matter of professional judgement and depends on the auditor's interpretation of the users' needs. This judgement may relate to an individual item or to a group of items taken together.

COMMON PUBLIC SECTOR AUDITING STANDARDS

1. International Standards of Supreme Audit Institutions (ISSAI)
2. Generally Accepted Government Auditing Standards (GAGAS) (United States)
3. International Standards on Auditing (ISA)
4. National Auditing Standards

PLANNING THE AUDIT

An audit plan refers to the design of an audit describing the overall audit strategy and guidelines to follow while performing the audit. It helps in the successful completion of the audit process. Planning for auditing is the initial step in an audit. It helps the auditor efficiently manage the audit by analyzing the prime focus areas, proactive problem management, and allocating responsibilities to team members.

Audit planning involves the formulation of the general strategy for an audit and sets the direction for the audit, describes the expected scope and conduct of the audit and provides guidance for the development of the audit programme. Audit planning is a continual process throughout the audit engagement.

THE KEY STEPS INVOLVED IN PLANNING AN AUDIT:

1. Understand the Client and its Environment:
2. Set Audit Objectives and Scope
3. Risk Assessment and Materiality
4. Develop an Audit Plan:
5. Communicate with Key Stakeholders
6. Documentation and Workpapers

A typical audit plan includes details on –

1. Objectives of the audit (e.g reporting to shareholders, special- purpose audit or reporting to any other party).
2. Nature and extent of other services to be performed for the client e.g taxation services.
3. Timing and scheduling of the audit work – what to do before balance sheet date, on the balance sheet date or after, including dates for cash count, observing of inventory, third party confirmations/circularization.
4. Description of the client company and its environment.
5. Work to be done by the client staff eg production/presentation of T/balance, schedules, reconciliations etc
6. Staffing requirements during the engagement.
7. Discussions among team members about significant risks.
8. Target dates for completing major segments of the engagement eg consideration of internal control, audit report, filing of tax returns etc

AUDIT RISK ASSESSMENT

Audit risk is the risk that auditors may issue an incorrect audit opinion on financial statements that are materially misstated. In other words, it's the risk that auditors may fail to detect material misstatements in the financial statements, leading to an inappropriate audit conclusion.

Audit risk assessment is a critical process that auditors undertake to identify and evaluate risks that may impact the reliability of financial statements and the effectiveness of audit procedures.

The procedure for risk assessment include:

1. Understanding the Entity and its Environment:
2. Performing Risk Assessment Procedures:
3. Assessing Materiality:
4. Evaluating Internal Controls:
5. Analyzing Risk Factors:
6. Documenting Risk Assessment:

EXECUTING THE AUDIT

Executing the audit involves implementing the audit plan developed during the planning phase to gather sufficient and appropriate audit evidence to support the auditor's opinion on the financial statements.

The key steps involved in executing the audit:

1. Performing Substantive Procedures: Conduct substantive procedures, including tests of details and substantive analytical procedures, to detect material misstatements in the financial statements.

2. Testing Internal Controls (if applicable): If the audit strategy includes reliance on internal controls, perform tests of controls to assess the design and operating effectiveness of key controls.

3. Sampling and Audit Evidence: Use sampling techniques to select items for testing when performing substantive procedures and tests of controls.

4. Documenting Audit Procedures and Findings:

- Document the audit procedures performed, including the nature, timing, and extent of procedures, as well as the audit evidence obtained and conclusions reached.

5. Communication and Coordination:

- Communicate with management and relevant stakeholders as needed throughout the audit process to address questions, obtain additional information, and provide updates on audit progress.

6. Review and Supervision:

- Review audit workpapers and documentation to ensure accuracy, completeness, and compliance with professional standards and audit policies.

AUDIT AND INVESTIGATION IN A COMPUTERIZED ENVIRONMENT

Computer-Assisted Audit Techniques

Where systems are IT based, specialized techniques of obtaining audit evidence may be required. These are known as computer-assisted audit techniques (CAATs).

CAATs can be defined as any technique that enables the auditor to use IT systems as a source of generating audit evidence. They involve the use of computer techniques by the auditor to obtain audit evidence.

Two commonly-used types of CAATs are audit software, and test data. Test data is primarily used in the testing of controls. Audit software is primarily used for substantive testing.

AUDIT SOFTWARE

Audit Software

Audit software is computer programs used by the auditor to extract information from a computer-based information system, for use in the audit. The main types of audit software include:

- interrogation programs, to access the client's files and records and extract data for auditing
- interactive software, for use in interrogation of on-line IT systems
- 'resident code' or 'embedded' software, to monitor and review transactions as they are being processed by the client's programs. This type of software is called 'embedded audit facilities'.

TEST DATA

An auditor may use test data to process a sample of transactions through the client's computer-based information system, and compare the results (output) obtained from the processing with the pre-determined results that the auditor would expect. Test data can also be used to check the controls that prevent processing of invalid data e.g. an amount, which if processed will breach customer credit limit could be entered to check the system reaction to it. Test data, thus, is used primarily for tests of control. The technique provides evidence that specific application controls are operating effectively in a given system

ADVANTAGES OF CAATS

CAATs also have many advantages (which is why many audit firms use them).

- They give auditors an ability to test the completeness and accuracy of the electronic processing itself (the computer software), rather than relying only on testing the accuracy and completeness of inputs and outputs.
- They give the auditor an ability to test a larger number of transactions in a relatively short amount of time: testing larger amounts of data reduces the overall audit risk.
- They allow the auditor to test the effectiveness of controls that are programmed into the computer software.

DISADVANTAGES OF CAATS

CAATs give the auditor the ability to audit the processing of transactions in an IT system. However, there are some disadvantages with using CAATs. They can be expensive, and the use of CAATs should be evaluated on a cost benefit basis. The costs related to the use of CAATs may include:

- purchasing or developing the programs
- keeping programs up-to-date for changes in hardware and software

training audit staff in the use of computer systems to run the CAAT

AUDIT IN A COMPUTERIZED ENVIRONMENT

1. Understanding the IT Environment: Auditors need a thorough understanding of the organization's IT infrastructure, including hardware, software, networks, and databases.
2. Risk Assessment: Identify and assess the risks associated with the use of technology, including cybersecurity risks, data integrity issues, and compliance concerns.
3. Audit Planning: Develop an audit plan tailored to the organization's IT environment, considering factors such as system complexity, data sensitivity, and regulatory requirements.
4. Data Analysis: Utilize specialized tools and techniques to analyze electronic data, such as data analytics software and computer-assisted audit techniques (CAATs), to identify patterns, anomalies, and potential areas of concern.
5. Testing Controls: Evaluate the effectiveness of IT controls, such as access controls, change management processes, and data encryption, to ensure the security and integrity of information systems.
6. Continuous Monitoring: Implement continuous monitoring mechanisms, such as intrusion detection systems and security information and event management (SIEM) tools, to detect and respond to cybersecurity threats in real-time.
7. Reporting: Communicate audit findings and recommendations to management and stakeholders in a clear and concise manner, highlighting areas of strength and weakness in the organization's IT environment.

INVESTIGATION IN A COMPUTERIZED ENVIRONMENT:

1. Incident Identification: Identify potential incidents or anomalies through monitoring systems, employee reports, or external alerts.

2. Preservation of Evidence: Ensure the preservation of digital evidence by following proper forensic procedures, including securing electronic devices and maintaining chain of custody.

3. Forensic Analysis: Conduct forensic analysis of digital evidence, including examining log files, recovering deleted files, and tracing network activity, to reconstruct events and identify perpetrators.

4. Root Cause Analysis: Determine the root cause of the incident, whether it be a cybersecurity breach, data breach, fraud, or other malicious activity, to prevent recurrence and mitigate future risks.

5. Legal and Regulatory Compliance: Ensure compliance with legal and regulatory requirements governing the handling of digital evidence, such as data privacy laws and chain of custody protocols.

6. Reporting and Remediation: Document findings and conclusions in a comprehensive investigation report, including recommendations for remediation and improvement of controls to prevent similar incidents in the future.

AUDIT REVIEW AND REPORTING

Audit review and reporting are critical steps in the audit process to communicate findings and recommendations to stakeholders. Here's a breakdown of each:

Audit Review:

1. Quality Assurance: Before finalizing the audit report, it's essential to conduct a thorough review of the audit workpapers, documentation, and evidence to ensure accuracy, completeness, and compliance with audit standards and procedures.
2. Independence and Objectivity: Reviewers should ensure that the audit was conducted with independence and objectivity, free from bias or undue influence, and in accordance with professional auditing standards.
3. Technical Review: For audits in specialized areas or involving complex technical issues, consider engaging subject matter experts to review the audit findings and conclusions to ensure technical accuracy and relevance.
4. Cross-Functional Review: In multi-disciplinary audits involving different departments or areas of the organization, conduct a cross-functional review to obtain input and feedback from stakeholders representing various perspectives and interests.
5. Risk Assessment: Review the risk assessment process and ensure that audit findings are aligned with identified risks and priorities, and that appropriate audit procedures were performed to address significant risks.
6. Documentation Review: Verify that audit documentation is comprehensive, well-organized, and adequately supports the audit findings, conclusions, and recommendations.

AUDIT REPORTING

Audit Reporting:

1. Clarity and Transparency: The audit report should be clear, concise, and written in plain language to ensure that stakeholders can easily understand the findings, conclusions, and recommendations.
2. Executive Summary: Include an executive summary at the beginning of the audit report summarizing the key findings, conclusions, and recommendations for the attention of senior management and decision-makers.
3. Scope and Objectives: Provide an overview of the audit scope, objectives, methodology, and timeframe to provide context for the audit findings.
4. Findings and Conclusions: Present the audit findings and conclusions in a structured manner, organized by audit criteria or areas of focus, and supported by evidence and analysis.
5. Recommendations: Offer practical and actionable recommendations for addressing identified weaknesses, improving controls, and mitigating risks to help management effectively respond to the audit findings.
6. Management Response: Include management's response to the audit findings and recommendations, indicating whether they agree or disagree with the findings, and outlining their planned corrective actions and timelines.
7. Distribution and Communication: Distribute the audit report to relevant stakeholders, including senior management, audit committee members, and other appropriate parties, and facilitate discussions to ensure understanding and agreement on the findings and recommendations.

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