

An audit by any other name

The word audit means many different things to different people. We look into the implications of this. As expert financial statement audit and assurance providers who work in full compliance with the International Standards on Auditing and other professional requirements we have a clear understanding of what is involved in an audit and the implications. However, we are aware that many don't have the luxury of our detailed professional understanding. Hence the following is aimed to assist improve understanding and make audit services more valuable.

A great example of good governance in action is an independent audit report on an entity's annual financial statements. It is an important part of reliable financial reporting.

What is an audit?

From an auditor's perspective an audit is a service defined by a detailed set of mandatory standards to provide a level of formal independent assurance to a defined group of people about the work of others. Most commonly audits are referred to in relation to financial matters and this work of others is summarised in a set of annual financial statements. The auditor provides an independent opinion on these financial statements which are the primary responsibility of the governing body of the entity that prepared them. The independent audit opinion provides a high but not absolute level of assurance of the fair presentation of the information presented. Also of note is that the information being audited is normally historical.

However, some users of audit services have a perception that an audit gives a 100% clean bill of health about the entity concerned, and on an on-going basis. This incorrect understanding usually seems to include such assurance as there has been no fraud, no errors, and the entity will continue to operate in the future. This is obviously a much wider, and frankly, usually impossible, level of assurance.

An independent audit certainly adds to the credibility of the financial information, but it can never remove the primary responsibility of the governing body to prepare and present information that is true and fair.

The audit expectation gap

This difference of understanding referred to above is called the "audit expectation gap". In essence it's the difference in understanding of two parties as to the true purpose of an audit and seems to have existed as long as auditing has been a profession.

Given the diversity of understanding, such a gap is serious and can sometimes be quite dangerous if users are relying on an incorrect understanding of what comfort they can take from an audit report.

What's happened to address this issue?

Sadly some parties, such as the occasional grandstanding politician calling for an audit whenever something goes wrong, or most media looking for a sensational sound-bite rather than providing an in-depth understanding only serve to reinforce such an expectations or understanding gap. Many and on-going attempts at education have been made over the years to attempt to bridge this understanding difference that leads to the expectation gap. These have come from a variety of players, but mostly from the auditing profession and the audit and assurance standard setters around the world.

In 2011 the New Zealand Government formed a standard setter in this area called the New Zealand Auditing and Assurance Standards Board (NZAuASB) being one of the two sub-boards of the External Reporting Board (XRB). This board's role is to set auditing and assurance standards for all statutorily required audits in New Zealand. In doing so they closely follow the International Audit and Assurance Standards Board as audit and assurance standards become increasingly consistent internationally.

In recent years we have seen quite a bit of activity from the standard setters in setting mandatory standards to try and force better explanations from auditors to their clients and readers of their output. This has resulted in more mandatory documentation such as increasingly detailed letters of engagement, progressively longer audit reports over the years, and accompanying letters to the governing body and management from auditors explaining features of the audit and various observations.

Audit reports

The most visible summary product of an auditor's work is the audit report.

Audit reports have changed and evolved considerably over time. Go back 30 to 40 years and you would generally see a single paragraph audit report something along the lines of "*Audited and found correct*".

However as business practices and financial statements have progressively become more complex changes have been made to audit reports to make these much more explicit regarding what is being audited, the responsibilities of various parties, what reliance can be placed on them, the basis of opinion, and the opinion itself.

This has resulted in the current audit report format which generally runs to 2 pages. While a standard format exists audit reports can also contain many differences. In a future article we will help explain some of these differences, what causes them, and their implications in more detail.



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