AUSTRALIAN AUDITING STANDARDS

FACT SHEET FOR MANAGEMENT, DIRECTORS AND AUDIT COMMITTEE MEMBERS

ASA 200 Objective and General Principles Governing an Audit of a Financial Report

OBJECTIVE

ASA 200 *Objective and General Principles Governing an Audit of a Financial Report* prescribes for auditors the mandatory requirement to obtain reasonable assurance as to whether the financial report, taken as a whole, is free from material misstatement. This is a prerequisite to the auditor achieving the mandatory objective of the audit; expressing an opinion as to whether the financial report is prepared, in all material respects, in accordance with an applicable financial reporting framework (auditor's opinion). ASA 200 also provides explanatory guidance that may be extremely useful to those charged with governance in carrying out their roles. This fact sheet emphasises particularly the clarification of the roles of the auditor and of those charged with governance contained in ASA 200.

APPLICATION

Financial reporting periods commencing on or after 1 July 2006.

RESPONSIBILITY FOR THE FINANCIAL REPORT

ASA 200 emphasises that the responsibility for the preparation and presentation of the financial report in accordance with the applicable financial reporting framework is that of those charged with governance of the entity, even if they delegate that responsibility to management. The audit of the financial report does not relieve management or those charged with governance of their responsibilities. Further, the Standard goes on to explain that those charged with governance are responsible for identifying the financial reporting framework to be used in the preparation and presentation of the financial report. Those charged with governance are responsible also for preparing and presenting the financial report in accordance with that applicable financial reporting framework. This responsibility includes: (i) designing, implementing and maintaining internal control relevant to the preparation and presentation of a financial report that is free from material misstatement, whether due to fraud or error; (ii) selecting and applying appropriate accounting policies; and (iii) making accounting estimates that are reasonable in the circumstances.

THE ROLE OF THE AUDITOR

ASA 200 explains that in achieving the objective of expressing the auditor's opinion the auditor is required first to have obtained reasonable assurance in relation to whether the financial report, taken as a whole, is free from material misstatement, whether due to fraud or error.

Reasonable assurance

ASA 200 explains that the concept of reasonable assurance relates to the accumulation of the audit evidence necessary for the auditor to conclude that there are no material misstatements in the financial report taken as a whole. Reasonable assurance relates to the whole audit process. The ASA goes on to explain that an auditor cannot obtain absolute assurance because there are inherent limitations in an audit that affect the auditor's ability to detect material misstatements. These limitations result from factors such as the use of testing; the inherent limitations of internal control; and the fact that most audit evidence is persuasive rather than conclusive. Further, ASA 200 points out that the work undertaken by the auditor to form an audit opinion is permeated by judgement.

Professional judgement

Professional judgement permeates the auditor's work. ASA 200 explains that it emanates from characteristics such as the auditor's expertise, experience, knowledge and training. Professional judgement involves the auditor considering a number of factors which may influence decision making regarding the planning, performance and reporting aspects of the audit. Such factors may include audit objectives, the nature of the subject matter(s) subject to audit, expectations, practicality, sufficiency and appropriateness of audit evidence, reliability of information and alternative audit tools and techniques. When exercising professional judgement, it is important for the auditor to maintain independence, objectivity, and an attitude of professional scepticism.

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Professional scepticism

In adopting an attitude of professional scepticism, ASA 200 explains that the auditor makes critical assessments, with a questioning mind, of the validity of audit evidence obtained and is alert to evidence that contradicts or brings into question the reliability of documents, responses to enquiries, and other information obtained from management and those charged with governance. This attitude is necessary throughout the audit process, ASA 200 explains, for the auditor to reduce the risk of overlooking unusual circumstances, of over generalising when drawing conclusions, and of using faulty assumptions in determining the nature, timing and extent of the audit procedures and evaluating the results obtained from the procedures.

An audit is not a guarantee

Professional judgement and scepticism are required particularly when gathering audit evidence, for example, in deciding the nature, timing and extent of audit procedures; and drawing conclusions based on the audit evidence gathered, for example, assessing the reasonableness of the estimates made by management and those charged with governance in preparing the financial report. Hence the limitations of the audit process itself and the exercise of professional judgement and scepticism mean that an audit is not a guarantee that the financial report is free from material misstatement, because absolute assurance is not attainable. Further, ASA 200 explains that an audit opinion does not assure the future viability of the entity nor the efficiency or effectiveness with which management and those charged with governance have conducted its affairs.

The role of risk and materiality in the auditor's judgement

Management and those charged with governance are responsible for identifying business risks and responding to them. However, it is important to understand that not all risks relate to the preparation of the financial report. The auditor is concerned with risks that may affect the financial report. ASA 200 explains that the auditor needs to reduce audit risk, the risk of expressing an inappropriate audit opinion when the financial report is materially misstated, by designing and performing audit procedures to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base an audit opinion. ASA 200 explains that the auditor is concerned with material misstatements, and is not responsible for the detection of misstatements that are not material to the financial report taken as a whole. The auditor needs to consider whether the effect of identified uncorrected misstatements, both individually and in aggregate, is material to the financial report taken as a whole. That is, materiality and audit risk are interrelated. The auditor needs to consider the risk of material misstatement at two levels: the overall financial report level and the assertion level for: (a) classes of transactions; (b) account balances; and (c) disclosures and the related assertions. Assertions in this context refer to the implicit assertions in any financial report that transactions and events depicted occurred within the relevant reporting period, that reported assets, obligations and equity exist and are valued appropriately, and that the required disclosures have been made.

Risk of material misstatement at the overall financial report level

ASA 200 explains that this risk refers to the risk of material misstatement that relates pervasively to the financial report as a whole and potentially affects many assertions. Risk of this nature often relates to the entity's control environment. This overall risk represents circumstances that increase the risk that there could be material misstatements in any number of different assertions and may be especially relevant to the risk of material misstatement arising from fraud.

Risk of material misstatement at the assertion level

ASA 200 explains terminology used by auditors when assessing the risk of material misstatement at the assertion level. "Inherent risk" is the susceptibility of an assertion to a misstatement that could be material, either individually or when aggregated with other misstatements, assuming that there are no related controls. "Control risk" is the risk that a misstatement that could occur in an assertion and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity's internal control. Inherent risk and control risk are the entity's risks; they exist independently of the audit of the financial report. ASA 200 explains that consideration of the risk of material misstatement at the classes of transactions, account balances and disclosures level assists the auditor directly in determining the nature, timing, and extent of further audit procedures at the assertion level.

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