

20th Annual ASQ Audit Division Conference

Presentation Title:

Influence of terms of an agreement with auditors on risks of users of the financial statements

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Information Level/ Audience (beginner, intermediate, advanced, all): all

Abstract:

The question of decreasing business risks is important for users of the financial statements. The existing system of an estimation of audit quality does not assume the customer's participation in this process. However, the customer has possibility to influence audit quality at the conclusion of audit agreements and to demand from auditors the coordination of the materiality level. It is important for possible proceedings.

Materiality is a limiting misstatement for the audit report to be valid. The higher the materiality level is, the less an audit risk is. But the less the materiality level is, the less risks for the user are. In order to support decision-making in evaluating the materiality level the innovative expert system "Audit" is developed and applied in Belarus. The system allows the person who is not possessing specific knowledge in audit to evaluate essential conditions of the agreement – audit risks, the materiality level, labor input and audit cost. The main benefit of applying the technology is carrying out effective negotiations at the conclusion of audit agreements.

Tutorials:

Influence of terms of an agreement with auditors on risks of users of the financial statements

An aspiration to minimize fraud and to raise an information transparency is at the heart of motivation for auditing. The issue of audit quality and risks limitation is actual for users of the financial statements. Audit quality assurance is carried out at all its stages according to the American and International standards of Audit. Controllers estimate the auditors' documentation and system of their internal

control. It is difficult to recognize such approach as effective for users. The problem is that the user of the financial statements cannot independently estimate audit quality at the moment when audit report is issued. Negative consequences of poor-quality audit will appear later.

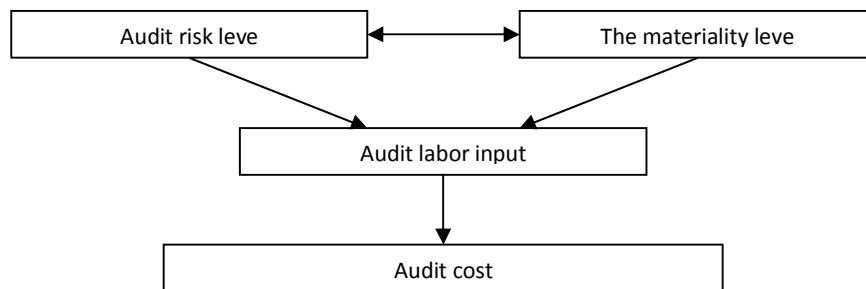
At the same time the customer has possibility to influence audit quality at the moment of the conclusion of agreements with auditors. But the knowledge of some auditor standards is necessary for it. Auditors are obliged to open how audit cost is formed during agreement undertaking. The matter is that audit gives not absolute, but a reasonable guarantee of reliability of the financial statements. The concept of materiality is developed for this purpose in audit. Materiality is a limiting misstatement for the audit report to be valid. And there is always an auditor risk that some misstatements of the financial statements will not be found out. Materiality and auditor risks are interdependent. The higher the materiality level is, the less an audit risk is. But the less the materiality level is, the less risks for the user are.

The customer of audit should be interested in two materiality levels – preliminary and eventual. The preliminary materiality level is applied to substantiate audit labor input and its cost. The less materiality level (error level) is, the more time is necessary for auditing. And on the contrary. Preliminary size of audit (labor input) is evaluated at the planning stage, and it serves as the basis for definition of the audit cost. Therefore, it is important for a customer to know the materiality level and audit risks for which audit cost is established at the conclusion of agreements. Otherwise risks for users of the financial statements considerably increase. And detailed disclosing by auditors of a subject of the agreement is not less important. The customer of audit should know what classes of transactions of the financial statements are estimated by auditors, and what the materiality level is established on each class of transactions.

Materiality for the financial statements established for an estimation of labor input may need to be revised as a result of a change in circumstances that occurred during the audit. Therefore auditors should co-ordinate with the customer the eventual materiality level as a whole and on each class of transactions of audit at the stage of issuing an audit report. It is important for possible proceedings. But considerable quantity of auditors avoid such coordination. In our opinion customers of audit should pay attention to the given problems to decrease their own risks and risks for users of the financial statements.

In order to support decision-making in evaluating the materiality level the innovative expert system “Audit” is developed and applied in Belarus (SSDM "Audit"). The methodology applied in the program, completely corresponds to the International Standards of Audit (figure 1). The system allows the person who is not possessing specific knowledge in audit, to evaluate audit risks, materiality, labor input and audit cost at the conclusion of agreements.

Figure 1 – Interrelation between audit risk, the materiality level, labor input and audit cost



The technologies of the program allows:

- to calculate the preliminary material level using any of methods existing in world practice, to estimate audit risk using the fuzzy logic;
- to prove essential conditions of audit evidentially and to open an agreement's subject in details;
- to estimate responsibility of auditors correctly;
- to carry on negotiations at the conclusion of audit agreements effectively;
- to see visually difference of the audit offered by one company from other companies in the market.