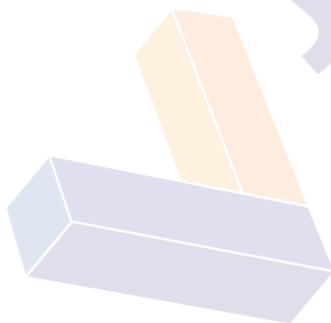


RISK, GOVERNANCE AND AUDIT

CORPORATE LEVEL

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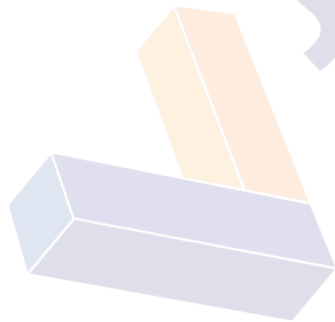


by

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INTRODUCTION TO AUDITING



Assurance Engagement

“Assurance engagement” means an engagement in which a **practitioner** expresses 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.**”

“Assurance engagement is an engagement performed by a practitioner to enable himself to express an opinion about the measurement of subject matter against a criterion. Practitioner’s expression of opinion raises the confidence of the users over the measurement of subject matter subject to the criteria applicable under consideration.”

What is Auditing?

“Auditing is an independent examination, conducted by an independent party to ascertain whether the Financial Statements of the Business Organization is prepared in accordance with Sri Lanka Accounting Standards/Applicable Reporting Framework and to ascertain whether those financial statements gives a True and Fair View”

Key Elements of Audit Engagement

- 1)
- 2)
- 3)
- 4)
- 5)

The overall objectives of a financial audit

To obtain reasonable assurance about whether the financial statement as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditors to express an opinion on whether the financial statement are prepared, in all material respects, in accordance with an applicable financial reporting framework.

OVERALL OBJECTIVE OF THE INDEPENDENT AUDITOR AND CONDUCT AN AUDIT IN ACCORDANCE WITH SRI LANKA AUDITING STANDARDS - (S.L.Au.S - 200)

SESSION OUTLINE.....

- A) Introduction
- B) Independence
- C) Integrity
- D) Objectivity
- E) Professional Competence and Due Care
- F) Confidentiality
- G) Professional Behavior

Introduction

Every professional needs to adhere to Code of Professional Conduct and Ethics, when performing the respective professional services. Likewise, as a professional, auditor also required to adhere to Code of Professional Conduct and Ethics issued by the Institute of Chartered Accountants of Sri Lanka.

Independence

Auditor needs to have complete independence when expressing independent audit opinion on the Financial Statements of the business entity.

"The Auditor's ability to express in unbiased audit opinion" is defined as Independence.

When conducting audits, the auditor should have both Physical and Mental Independence. The auditor should not allow anyone to have any uncertainties about the Auditor's ability to express an independent opinion

Independence mainly comprise of two perspective

- a) Independence in Mind/Independence in Fact

The state of mind that permit the expression of a conclusion without being affected by influences that compromise the professional judgement, thereby allowing an individual to act with integrity and exercise objectivity and professional skepticism

- b) Independence in Appearance

The avoidance of facts and circumstances that are so significant that a reasonable and informed third party would like to conclude, weighting all the specific facts and circumstances that a firm's or a member of the Audit Team's integrity, objectivity and professional skepticism has been compromised.

Factors which will have a negative impact on the Independence

- 1).....
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- 2).....
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- 3).....
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- 4).....
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- 5).....
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Integrity

The Auditor should be straightforward and maintain the honesty in all professional and business relationships. The Auditor should not purposefully deviate from the Professional Code of Conducts and Ethics when performing the professional services.

Objectivity

The Auditor should not allow bias, conflict of interest or undue influence of others to override professional or business judgments/objectives. Sole objective of the audit is to express an Independent Opinion on the Financial Statements. Therefore, Auditor should not allow any personnel interest to be contradicted with the/override the professional objective which is express of independent opinion. The Auditor should recognize the responsibility vested with him with regard to the stakeholders who are using the Audited Financial Statements when taking the Economic Decisions.

IMPORTANT

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Professional Competence and Due Care

Prior to accepting an Assurance Engagement/Audit, auditor needs to evaluate whether he/she is having the required Competencies, Capabilities, Skills and Experience to accept the Professional Services.

Once the auditor accepts the professional services, proper attention needs to be devoted for the professional service until it completed.

Auditor should not accept any professional services, if he/she does not have the required Competencies, Capabilities, Skills and Experience.

Confidentiality

Auditor should have an unlimited access to the information of the business entity/client, which is applicable to the audit. So, the business entity is bound to provide all the information which is requested by the auditor in connection to the professional services. So, while using that right, the auditor has the privilege of obtaining sensitive information.

However, the information obtains in connection to the audit,

- 1) Should not use for any personal advantage of the auditor
- 2) Should not provide that information to any personal advantage of a third party.
- 3) If the auditor provides that information to a third party, auditor needs to obtain proper and specific approval from the business organization/client.

However,

- A) If there is a legal requirement

Examples - Production of documents or other provision of evidence in the course of a legal proceeding,

- B) If there is a Professional right or duty to disclose
- C) When there is a breach of right of an Auditor, where the situation demands to safeguard the rights of the Auditor
- D) When that information requested by ICASL.

Examples - To comply with the quality review of a member body or another professional body

To respond to an inquiry or investigation by a member body or a regulatory body

the auditor need not want to seek the approval from the business entity/client

- 4) The auditor needs to protect the Confidentiality of the information, even after the termination of the professional relationship.

Professional Behavior

The auditor should not do anything which is harmful to the Profession, in his/her personal life as well as in the professional life.

The CA Sri Lanka Code of Ethics

The Code of Ethics for Professional Accountants issued by the Institute of Chartered Accountants of Sri Lanka (the CA Sri Lanka Code) sets out five fundamental principles of professional ethics and provides a conceptual framework for applying those principles. Members must apply this conceptual framework to identify threats to compliance with the principles, evaluate their significance and apply appropriate safeguards to eliminate or reduce them so that compliance is not compromised.

"A professional accountant has an obligation to evaluate any threats to compliance with the fundamental principles when the professional accountant knows, or could reasonably be expected to know, of circumstances or relationships that may compromise compliance with the fundamental principles"

A) Integrity

Chartered Accountants should be straightforward and maintain the honesty in all professional and business relationships. The Chartered Accountants should not purposefully deviate from the Professional Code of Conducts and Ethics when performing the professional services. Integrity also implies the fair dealing and truthfulness.

A professional accountant shall not knowingly be associated with reports, returns, communications or other information where the professional accountant believes that the information:

1. Contains a materially false or misleading statement.
2. Contains statements or information furnished recklessly; or
3. Omits or obscures information required to be included where such omission or obscurity would be misleading.

B) Objectivity

Chartered Accountants should not allow bias, conflict of interest or undue influence of others to override professional or business judgments/objectives. They should always focus on the main objective and should not have any personnel interest which has a conflict of interest with the professional objectives

C) Professional Competence and Due Care

All Chartered Accountant should maintain the professional knowledge and skill at the level required to ensure that the client or the employer received competent professional services based on current development in practice, legislation, and techniques. Once the professional services are accepted, all Chartered Accountants, should perform the professional services with proper Due Care, to provide the best service to the client or to the employer.

The principle of professional competence and due care imposes the following obligations on all professional accountants:

- a) To maintain professional knowledge and skill at the level required to ensure that clients or employers receive competent professional service

- b) To act diligently in accordance with applicable technical and professional standards when performing professional activities or providing professional service.

Competent professional service requires the exercise of sound judgment in applying professional knowledge and skill in the performance of such service. Professional competence may be divided into two separate phases:

1. Attainment of professional competence; and
2. Maintenance of professional competence.

The maintenance of professional competence requires a continuing awareness and an understanding of relevant technical, professional, and business developments. Continuing professional development enables a professional accountant to develop and maintain the capabilities to perform competently within the professional environment.

D) Confidentiality

Chartered Accountants, should respect the confidentiality of information acquired as a result of the professional and business relationships and therefore, not to disclose any such information to third parties without proper and specific authority, unless there is a legal or professional right or duty to disclose, nor use the information for the personal advantage of the professional accountant or third parties

A professional accountant shall maintain confidentiality of information disclosed by a prospective client or employer and maintain confidentiality of information within the firm or employing organization and should take reasonable steps to ensure that staff under the professional accountant's control also is adhering to the value.

E) Professional Behavior

Chartered Accountants should not do anything which is harmful to the Profession in his/her personal life as well as in the professional life.

The principle of professional behavior imposes an obligation on all Professional accountants to comply with relevant laws and regulations and avoid any conduct that the professional accountant knows or should know may discredit the profession. This includes conduct that a reasonable and informed third party, weighing all the specific facts and circumstances available to the professional accountant at that time, would be likely to conclude adversely affects the good reputation of the profession.

IMPORTANT

Both "A" and "B" should comply with the above mentioned 05 ethics when performing their Professional Services. However, in addition to the above mentioned 05 ethics, "B" needs to comply with Independence as well, since "B" is a person who is having the Chartered Accountant qualification who is engaged in public practice

THREATS TO FUNDAMENTAL PRINCIPLES

Threats may be created by a broad range of relationships and circumstances. When a relationship or circumstance creates a threat, such a threat could compromise, or could be perceived to compromise, a professional accountant's compliance with the fundamental principles.

A circumstance or relationship may create more than one threat, and a threat may affect compliance with more than one fundamental principle. Threats fall into one or more of the following categories:

A) Self-Interest Threat

Self Interest threats is the threat that a financial or other interest will inappropriately influence the Professional Accountant's judgement or behaviour.

Below are few situations where the Professional Accountant faced to a Self Interest Threat.

- 1) Financial Interest
Financial Interest exists where a Professional Accountant or Immediate Family Member has a financial interest with the client's affairs
- 2) Close Business Relationships
Close business relationship which arises as a result of commercial relationship or common financial interest with a client
- 3) Employment with an Audit Client
- 4) Partner on Client Board
- 5) Family and Personal Relationships
- 6) Gifts and Hospitality
- 7) Overdue Fees, including a higher % received from one client
- 8) Loans and Guarantees

B) Self-Review Threat

It is a threat that a Professional Accountant will not appropriately evaluate the results of a previous judgement made or service performed by the same Professional Accountant or by another individual with in the Professional Accountant's firm or employing organization on which the Accountant will rely when forming a judgement as part of performing a current activity or providing a current service.

From the perspective of the Auditor, the key area in which there is likely to be a self-review threat is where a firm provides services other than assurance services to an audit client.

Following are few examples for Self-Review Threat.

- 1) A firm having prepared the original data used to generate records that are the subject matter of an assurance engagement - (Preparing Accounting Records and Other Information)

- 2) A member of the assurance engagement team being or having recently been, a Directors or an Officer of the client
- 3) A member of the assurance engagement team being or having recently been, employees by the client in a position to exert significant influence over the subject matter of the engagement.
- 4) The firms performing a service for the assurance client that directly affects the subject matter information of the assurance engagement

Eg: Providing valuation services, Taxation Services

C) Familiarity Threat

It is the threat that due to a long or close relationship with the client or employee, a professional accountant will be too sympathetic to their interest and too accepting their work.

Following are few examples for Familiarity Threat.

- 1) A member of the engagement team having a close and immediate family member, who is a director or officer of the client.
- 2) Senior personnel having a long association with the assurance clients
- 3) A professional accountant accepting gifts or preferential treatments from a client.

D) Intimidation Threat

The threat that a Professional Accountant will be deterred from acting objectively because of actual or perceived pressures, including attempts to exercise undue influence over the professional accountant.

Following are few examples for Intimidation Threat.

- 1) A firm being threatened with dismissal from a client engagement.
- 2) A firm being threatened with litigation by the client.
- 3) A firm being pressured to reduce inappropriately the extent of the work performed.
- 4) Being a Professional Accountant, client exercise an undue influence to perform fraudulent financial reporting in the financial statements
- 5) Threats of dismissal from employment, influence of a dominant personality

E) Advocacy Threat

It is the threat that a professional accountant will promote a client's or employers' position to the point that the professional accountants' objectivity is compromised.

- 1) The firm promoting shares in an audit client
- 2) A professional accountant acting as an advocate on behalf of an audit in client litigation or disputes with third parties.

IMPORTANT

The Chartered Accountants should take the necessary safeguards and other measures that may eliminate threats or reduce them to an acceptable level

If not, the Chartered Accountant needs to evaluate and see whether he or she is in a position to provide the professional services.

Therefore, all the Chartered Accountants (irrespective of the designation), should comply to all the Ethics imposed by the Institute of Chartered Accountants of Sri Lanka, when performing the respective professional services

SAFEGUARDS TO ELIMINATE/REDUCE THE THREATS TO AN ACCEPTABLE LEVEL.

The ethical code outlines appropriate safeguards that must be put in place to eliminate or reduce threats to an acceptable level. Professional Accountants should always follow the fundamental ethical principles in their judgments and actions and should try to avoid excessive threats to their ethical behaviour.

Safeguards that may eliminate or reduce threats to an acceptable level fall into two broad categories:

a) Safeguards created by the profession, legislation or regulation

- 1) Educational training and experience requirements for entry into the profession
- 2) Continuous Professional Development (CPD) requirements
- 3) Corporate Governance Regulations
- 4) Professional Standards
- 5) Disciplinary measures for breach of ethical code

b) Safeguards in the work environment.

In the work environment, the relevant safeguards will vary depending on the circumstances. Work environment safeguards comprise firm-wide safeguards and engagement-specific safeguards.

Firm-wide Safeguards

- Leadership of the firm that stresses the importance of compliance with the fundamental principles.
- Leadership of the firm that establishes the expectation that members of an assurance team will act in the public interest.
- Policies and procedures to implement and monitor quality control of engagements.
- Documented policies regarding the need to identify threats to compliance with the fundamental principles, evaluate the significance of those threats, and apply safeguards to eliminate or reduce the threats.
- Documented internal policies and procedures requiring compliance with the fundamental principles.
- Policies and procedures that will enable the identification of interests or relationships between the firm or members of engagement teams and clients.
- Policies and procedures to monitor and, if necessary, manage the reliance on revenue received from a single client.
- Using different partners and engagement teams with separate reporting lines for the provision of non-assurance services to an assurance client.
- A disciplinary mechanism to promote compliance with policies and procedures.

Engagement specific safeguards

- Having a professional accountant (who was not involved), to review the work done or otherwise advice as necessary
- Rotating senior assurance team members
- Discussing ethical issues with those in charge of client governance
- Consulting an independent third party, such as professional regulation body or another professional accountant,

