1. The Audit Process :

a. Professional judgement and scepticism:

In undertaking an audit, the auditors consider themandatory and detailed GAAP that set out how a company should account for and disclose even the most complex transactions. However, many of the issues that arise in an audit—particularly those involving valuations or assumptions about the future—involve estimates to which the auditor must bring their professional judgement and experience to bear.

Indeed, many accounting measures can only ever be estimates that are inevitably based on imperfect knowledge or dependent upon future events. For example, if a company was involved in legal action, it would need to estimate the amount at which the case would be resolved; or if it was planning to sell an office building it owns, it would have to estimate the sale price.

In such cases, the auditor may determine the reasonable range of possible values, and consider whether the company's estimates lie within that range. The uncertainties that affect this judgement need to be disclosed and—if they could have a material effect—the auditors may include an emphasis of matter paragraph in their report.

These are areas where the auditors must use their experience and skill to reach an opinion on the financial statements. The words 'opinion' and 'true and fair' are deliberately chosen to make clear that judgement is involved. They underline the fact that the auditor's report is not a guarantee but rather reflects the auditor's professional judgement based on work performed in accordance with established standards.

Auditing standards also require auditors to maintain professional scepticism—an attitude that includes a questioning mind and a critical assessment of audit evidence. The ability to think in a critical manner about how the current economic environment may affect the company's financial statements, to identify significant risks of material misstatement, to develop appropriate audit responses, to obtain and assess the sufficiency and appropriateness of audit evidence and to reach well-informed professional judgements is integral to performing a quality audit.

b. Inherent limitations of an audit:

An opinion is not a guarantee of an outcome, but rather a statement of professional judgement. The auditor cannot obtain absolute assurance that financial statements are free from material misstatement because of the inherent limitations of an audit. These are caused by a number of factors. For example, many financial statement items involve subjective decisions or a degree of uncertainty (e.g., accounting estimates). Consequently, such items are subject to an inherent level of uncertainty which cannot be eliminated by the application of auditing procedures.

It should not be assumed that every single fact and detail in a set of audited financial statements has been checked and verified by the auditors, and is therefore guaranteed to be 100 percent accurate. The auditor obtains reasonable assurance by gathering evidence through selective testing of financial records.

c. Fraud:

Fraud has a corrosive effect on the trust necessary for companies to do business. Management is responsible for running the company and preventing and detecting fraud. Preventing and detecting fraud is difficult because fraud is intentionally hidden and may involve collusion by multiple participants. Even though audits are properly performed in accordance with relevant GAAS, they may not detect material fraud. However, auditors are responsible for obtaining reasonable assurance that the financial statements are not materially misstated as a result of fraud.

Importantly however, if the auditors form suspicions of fraud in the course of their work a number of things will change, including their risk assessment, the nature and extent of communications with those charged with governance, the nature and extent of audit procedures, and the evaluation of the effectiveness of the relevant internal controls and processes. The knowledge that an independent external audit will be conducted generally has a deterrent effect against fraud.

2. The five phases of an audit:

Broadly, the audit process can be summarised in five phases:

a. Planning:

Initial planning activities include formal acceptance of the client by the audit firm, verifying compliance with independence requirements, building the audit team and performing other procedures to determine the nature, timing and extent of procedures to be performed in order to conduct the audit in an effective manner.

b. Risk assessment :

Auditors use their knowledge of the business, the industry and the environment in which the company operates to identify and assess the risks that could lead to a material misstatement in the financial statements. Those risks often involve a high degree of judgement and require a significant level of knowledge and experience by the auditor, particularly on large and complex engagements. This requires a good understanding of the business and its risks, which is typically built up over a number of years as part of the audit firm's and auditor's knowledge. It also means that the auditors need to be well informed about the industry and wider environment in which the company operates, and about what its competitors, customers, suppliers and—where relevant—regulators are doing.

c. Audit strategy and plan:

Once the risks have been assessed, auditors develop an overall audit strategy and a detailed audit plan to address the risks of material misstatement in the financial statements. Among other things, this includes designing a testing approach to various financial statement items, deciding whether and how much to rely on the company's internal controls, developing a detailed timetable, and allocating tasks to the audit team members. The audit strategy and plan is continually reassessed throughout the audit and adjusted to respond to new information obtained about the business and its environment.

d. Gathering evidence :

Auditors apply professional scepticism and judgement when gathering and evaluating evidence through a combination of testing the company's internal controls, tracing the amounts and disclosures included in the financial statements to the company's supporting books and records, and obtaining external third party documentation. This includes testing management's material representations and the assumptions they used in preparing their financial statements. Independent confirmation may be sought for certain material balances such as cash.

e. Finalisation :

Finally, the auditors exercise professional judgement and form their overall conclusion, based on the tests they have carried out, the evidence they have obtained and the other work they have done. This conclusion forms the basis of the audit opinion.

Auditors interact with the company during all the phases of the audit process listed above. There will be continuing discussions and meetings with management, both at operational and senior executive levels, and with those charged with governance. Using their professional scepticism and judgement, auditors challenge management's assertions regarding the numbers and disclosures in the financial statements.