Finance Circular
No. 2011/08

To All Australian Government Entities

Clarification of the terms Audit and Assurance

Purpose

The purpose of this circular is to provide guidance to all Australian Government entities on the use of the terms audit and assurance. It applies to independent external services requested by Government that would ordinarily be carried out by audit professionals within the frameworks issued by the Auditing and Assurance Standards Board (AUASB) and Accounting Professional & Ethical Standards Board (APESB). Because audit and assurance may be used in common language these terms are susceptible to use in describing engagements that do not align with the professional standard-setting frameworks that govern such services, which in turn can lead to complications when oversight processes are discussed publicly.

Government requirements for audit and assurance, in this context, should be expressed with reference to the professional standard-setting frameworks, such as the Australian auditing standards issued by the AUASB and relevant ethical standards issued by the APESB. These standards are mandatory for members of the accounting professional bodies for carrying out audits and reviews.

Key Points

- The terms audit and assurance have specific meanings under audit and assurance standards and indicate that certain processes and procedures have been carried out.
- Unless these terms are used carefully, misleading information could be communicated to users.
- This circular is issued to clarify the meanings of these terms to assist in guiding Australian Government entities about the correct circumstances of use. It is only concerned with assurance engagements that would ordinarily be carried out by audit professionals within the frameworks issued by the AUASB and APESB. These frameworks are legally enforceable.
- It is important for the entities to first determine the service they are seeking and describe it as such.

1 For the purpose of this circular these are members of the professional accounting bodies –The Institute of Chartered Accountants, CPA Australia and the Institute of Public Accountants – and registered company auditors.
2 This circular does not concern engagements such as internal audits, energy or environmental audits, quality systems audits etc
3 These are The Institute of Chartered Accountants, CPA Australia and the Institute of Public Accountants.
Background

1. The AUASB is the chief body concerned with ensuring high quality audit and assurance standards. The terminology used by the AUASB in their issued framework is identified and explained in this circular.

What is an “assurance engagement”?

2. This is an engagement where the assurance practitioner undertakes a range of processes to reduce the risk associated with using specified information. Refer to Appendix A for a definition of assurance engagement, as per the AUASB framework.

What is an “audit engagement”?

3. An audit is one type of assurance engagement, known as a reasonable assurance engagement, which provides a higher degree of confidence than a review (see below for review). It involves objectively obtaining and evaluating evidence in a systematic fashion. The information is assessed against suitable criteria (for example, relevant accounting standards) and the auditor ultimately communicates an opinion to users. It has a strict definition in the accounting context, and involves a particular process, in line with the auditing standards issued by the AUASB. If a Government entity requires reasonable assurance, an audit engagement, performed by an audit professional, is suitable. Refer to appendix A for a definition of an audit engagement, as per the AUASB framework.

4. It is useful to note here that auditors often provide services that are not audit engagements.

Inconsistent use of terms

5. Occasionally, the terms audit and assurance are used in a way that is inconsistent between the level of assurance that is needed, the level of assurance that is requested and the level of assurance that is provided. The following two examples illustrate this:

i. Some requirements imposed by agencies are not encapsulated by the standards of the AUASB or the APESB, and can have a different meaning/interpretation to the intention of those procuring these audit and assurance services. For example, assurance providers are sometimes required to ‘certify’ certain information. This term is not used in auditing standards and if the term audit is used to describe the engagement it undervalues the level of assurance provided, as certification is akin to complete assurance. Conversely, if the engagement is in fact an audit, describing it as a certification may overstate the level of assurance actually provided.

ii. Circumstances have arisen where the term ‘verification’ is currently being used in connection with engagements that, under the AUASB’s auditing and assurance framework would be regarded as agreed-upon-procedures engagements. Such engagements result in the practitioner not actually conveying any assurance. The result is the potential for a lack of clarity for preparers, practitioners and users of the information.

6. Further examples showing where issues have arisen in the use of the terms audit and assurance, and suggestions of how these situations may be avoided, can be found in Appendix C.

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1 In this circular, certify means stating that something is correct.
Audit versus other engagements

7. As the preceding sections highlight, the process of conducting an audit is systematic and implies a particular process has been carried out. Professional accountants are bound to comply with the standards issued by the AUASB, along with the Professional Code of Conduct. There are many other types of non-assurance type engagements that may be performed by audit professionals, including the provision of expert advice (for example on taxation, solvency or forensic accounting), but these should not be referred to as an audit.

8. A review, in terms of the audit and assurance framework, is a limited assurance engagement and in contrast to an audit is not designed to obtain reasonable assurance that the financial report is free from material misstatement. A review consists of making enquiries and applying analytical and other review procedures. It may bring significant matters affecting the financial report to the assurance practitioner's attention, but does not provide all of the evidence that will be required in an audit. Refer to Appendix A for the definition of a review, as per ASRE 2400.

9. An agreed-upon-procedure is one where the auditor, entity and any related third party, have agreed that certain procedures of an audit nature will be performed and factual findings reported. It should be emphasised that no assurance is provided as a result of this. Refer to Appendix A for the definition of an agreed-upon-procedure, as per ASRS 4400.

10. Certain engagements in the public sector will have an acceptable level of risk that is significantly lower than that obtained in an audit, and in some cases certainty will be required. If an engagement of this nature is needed, the terms audit and assurance should not be used so as to avoid misleading users.

11. Furthermore, it is important to distinguish between the service provider and the service being provided. The fact that an audit firm is providing a service does not necessarily mean that an audit or assurance procedure is being performed.

12. Appendix B contains a list of engagement types and sample report wording.

Independence and ethics

13. Independence is an essential part of the audit process. This quality adds credibility to external assurance services, though it should be noted that using an external provider in itself does not ensure independence will be upheld.

14. Independence is crucial to ensure the ethical standards of objectivity and integrity are maintained by the auditor. In auditing, this encompasses:

i. independence of mind – the state of mind that permits the expression of a conclusion without being affected by influences that compromise professional judgment, thereby allowing an individual to act with integrity, and exercise objectivity and professional scepticism; and

ii. independence in appearance – the avoidance of facts and circumstances that are so significant that a reasonable and informed third party would be likely to conclude, that a firm’s, or a member of the audit and assurance team’s, integrity, objectivity or professional scepticism has been compromised.

15. Ethical standards are crucial to ensure the integrity of the audit process and APES 110 Code of Ethics for Professional Accountants provides further detail on these five requirements being:
Integrity, Objectivity, Professional Competence and Due Care, Confidentiality, and Professional Behaviour.

What do agencies need to do?

16. When seeking professional services to undertake an assignment, consider the objective of the assignment and whether this would be achieved through an audit, a review or something else (for example, an agreed-upon-procedure). Appropriate professional advice should also be obtained as part of the procurement process.

17. When proposing new legislation that will specify some form of assurance engagement that would normally be conducted by an audit professional, obtain professional advice (for example, consult the AUASB or the professional accounting bodies) on the requirements and terminology first to ensure:

i. the proposal is consistent with the standards and professional ethical requirements; and

ii. the correct description (audit/review/other) is used and that the outcome is communicated to the responsible legislative drafter.

18. As existing legislation comes up for periodic assessment, consider any provisions requiring professional examination and undertake the steps set out in section 17, above.

19. When drafting documentation in relation to those services, including briefs, press releases and speeches, ensure that the correct terminology is used and that the distinction will be understood.

Summary

20. While the words audit and assurance are commonly used words, in professional auditing standards they have strict definitions and audit professionals are bound by the standards and ethical requirements. Using the wrong terminology to describe a process could lead to a difference in expectations between agencies and stakeholders.

21. Where independent external services are required that would ordinarily be performed by an audit professional, ensure that the description and scope of the requirement accurately reflects the services required and is consistent with the standards and ethical requirements. There should be strong initial communication with experts (for example, the professional accounting bodies or AUASB) to ensure that expectations are met and to avoid the possibility of misleading users.

Further Information

22. For further information or clarification please refer to the standards and frameworks issued by the AUASB and APESB or seek advice from the professional accounting bodies. Namely, please refer to:

- Framework for Assurance Engagements
- ASA 210 - Agreeing the Terms of Audit Engagements
- ASAE 3000 - Assurance Engagements Other than Audits or Reviews of Historical Financial Information
- ASRS 4400 – Agreed-Upon Procedures Engagements to Report Factual Findings
- APES 110 - Code of Ethics for Professional Accountants
• CPA Australia
• The Institute of Chartered Accountants in Australia
• Institute of Public Accountants

Contacts

If you have any questions about this Finance Circular, please contact Accounting Policy Branch at accountingpolicy@finance.gov.au.

Peter Gibson
Assistant Secretary
Financial Reporting and Cash Management Division
Financial Management Group
Appendix A

Glossary

The following definitions are found in paragraph seven of *Framework for Assurance Engagements*:

**Assurance**: An engagement in which an assurance 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. [Emphasis added]

**Audit**: An assurance engagement where the assurance practitioner’s objective is a reduction in assurance engagement risk to an acceptably low level in the circumstances of the assurance engagement as the basis for a positive form of expression of the assurance practitioner’s conclusion. [Emphasis added]

The definition of a review is found in paragraph 16 of ASRE 2400 *Review of a Financial Report Performed by an Assurance Practitioner Who is Not the Auditor of the Entity*:

**Review**: A review, in contrast to an audit, is not designed to obtain reasonable assurance that the financial report is free from material misstatement. A review consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review may bring significant matters affecting the financial report to the assurance practitioner’s attention, but it does not provide all of the evidence that will be required in an audit. [Emphasis added]

The following definition is in paragraph four of ASRS 4400 *Agreed-Upon Procedures Engagements to Report Factual Findings*:

**Agreed-upon procedure**: An agreed-upon procedures engagement involves the performance of procedures of an assurance nature from which no conclusion or opinion is expressed by the assurance practitioner and no assurance is provided to intended users. Instead only factual findings obtained as a result of the procedures performed are reported.
## Appendix B

### Hierarchy and example report wording

<table>
<thead>
<tr>
<th>Type of assignment</th>
<th>Example of wording in report</th>
<th>Level of confidence</th>
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<tbody>
<tr>
<td>Certification</td>
<td>“I certify that...”</td>
<td>Certainty</td>
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<tr>
<td>Partial Certification</td>
<td>“I certify that, with the following qualification, ...”</td>
<td>High</td>
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<tr>
<td>Audit</td>
<td>“In our opinion, the financial report presents fairly, in all material respects, (or “gives a true and fair view of”) the financial position of [name of entity] as of [date], and of its financial performance and its cash flows for the year then ended in accordance with Australian Accounting Standards (including the Australian Accounting Interpretations).” (positive opinion)</td>
<td>Reasonable assurance</td>
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<td>Other assurance engagements e.g. review.</td>
<td>“Based on our review, which is not an audit, nothing has come to our attention that causes us to believe that the [period] financial report of [name of entity] does not present fairly, in all material respects, [or “give a true and fair view of”] the financial position of [name of entity] as at [date], and of its financial performance and its cash flows for the [period] ended on that date, in accordance with [applicable financial reporting framework].” (negative opinion)</td>
<td>Limited assurance</td>
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</table>
| Agreed-upon assurance procedures | “We have performed the procedures agreed with you and [name of any intended users party to the terms of engagement] to report factual findings for the purpose of assisting you [and [name of other intended users or class of intended users]] in assessing, in combination with other information obtained by you, the accuracy of [ ] as at [date].

“The procedures performed are detailed in the terms of the engagement of [date] and described below with respect to [ ] of [entity] as of [date], set forth in the attached schedules.

“[Management / Those Charged with Governance and any intended users party to the terms of engagement] are responsible for the adequacy or otherwise of the procedures agreed to be performed by us. You and [name of other intended users or class of intended users] are responsible for determining whether the factual findings provided by us, in combination with any other information obtained, provide a reasonable basis for any conclusions which you or other intended users wish to draw on the subject matter.” | Presentation of facts as agreed. No assurance |
## Appendix C

### Issues arising from the use of the terms audit and assurance

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<thead>
<tr>
<th>Situation</th>
<th>Issue</th>
<th>Suggestions on how to avoid</th>
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<tr>
<td>Standardised forms and work programs for audit practitioners to complete</td>
<td>Audit practitioners’ independence requirements in Australia include that they do not opine on their own work as this creates a ‘self-review’ threat to independence.</td>
<td><strong>Entity:</strong> Include all disclosures and calculations in the documentation to be completed by the responsible party, on which the audit practitioner can then independently provide an independent opinion.</td>
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<tr>
<td>and return to agencies have sometimes required calculations or disclosures</td>
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<td>that the audit practitioner would need to prepare, and then provide an</td>
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<td>opinion on. For example, stating certain financial ratios in a standardised</td>
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<tr>
<td>audit opinion form followed by an opinion that the ratios have been</td>
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<tr>
<td>reviewed.</td>
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<tr>
<td>Audit practitioners’ independence requirements in Australia include that</td>
<td>Audit practitioners cannot provide opinions about future events (i.e. whether an entity will be able to pay its debts as and when they fall due). Professional indemnity insurance issues arise where an audit practitioner is required to assume an impractical level of liability (e.g. providing a direct statement as to solvency of an entity).</td>
<td><strong>Entity:</strong> Refer to the auditing standard, ASA 570 Going Concern for the pronouncements on auditors’ considerations of going concern in auditing a financial report.</td>
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<td>they do not opine on their own work as this creates a ‘self-review’ threat</td>
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<td><strong>Auditor:</strong> Where monitoring solvency of an entity is a key reason for a reporting requirement, include information in the documentation provided to the entity that would assist the entity in forming a view, (e.g. key solvency ratios).</td>
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<tr>
<td>to independence.</td>
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<td>Entity: Include all disclosures and calculations in the documentation to be</td>
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<td>completed by the responsible party, on which the audit practitioner can</td>
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<td>then independently provide an independent opinion.</td>
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<td>Audit practitioners have sometimes been required to provide a statement</td>
<td>Certification indicates certainty as to the correctness, or other attributes of the subject matter. Such certainty is not possible where the subject matter is in itself non-exact (e.g. narrative, commentary or financial reporting where judgements would be made). Where subject matter is very voluminous/detailed, certification may be impractical and cause unintended, excessive costs for the entity.</td>
<td><strong>Entity:</strong> Where either the subject matter of the audit is non-exact or voluminous, discuss the attainable level of assurance with the auditor.</td>
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<td>on the solvency of an entity, or to cause such a statement to be included</td>
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<td>in the audited accounts.</td>
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<td>Some standardised forms have required auditors to ‘certify’ content that</td>
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<td>is either non-exact in nature, or so voluminous as to render such a level</td>
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<td>of certainty impractical. For example, certifying correctness of date of</td>
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<td>enrolment of a very large number of candidates in a particular program.</td>
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*Department of Finance and Deregulation*