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## **Audit Processes and Reports**

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### **Abstract**

The main goal of the audit is the research of the financial report in accordance with the established framework of financial reporting, that is, examining whether the financial reports truthfully and objectively show the financial situation of the business entity in all important issues, the results of operations and changes in the financial position of the business entity and the expression of the authoritative comparative opinion on the verification of financial reports communicated with the stakeholders in the form of an audit report.

**Keywords:** audit processes; financial reporting; audit report.

### **1. Introduction**

The main goals of the audit has been changing by the time. In the middle of the nineteenth century the primary goal of the audit was the disclosure of fraud and errors, it is a result of the increased number of abuses by the management and the others employees in the business entities. Over time impose of a new primary goal of the audit has started, it is attestation of the credibility, i.e. confidentiality of the financial reports through notifying their reality and objectivity. The main goal of the audit is realized with mediation of the system of goals which are connected with the research of individual positions of the balance sheet and the balance of success, as with the items in the accounts of the nominal ledger.

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These goals comprehend analysis of the allegation of the management to the client. Management most often vouch that 'financial reports of the business entity are made according to the International Accountant Standards', and the duty of the auditor is to check whether the allegation is correct. In the operation of audit of the correctness of the allegation of the management, the auditor while auditing should pass through these categories:

- Existence (origination and occurrence) and the condition of the finances (physical and economical);
- Possession of the finances (rights and liabilities);
- Integrity (thoroughness and completion);
- Authenticity (accuracy and exactness);
- Evaluation (valuation) of the balance position and allocation of the charges;
- Exhibition and disclosure (displaying, presentation, disclosure and explanation);
- Intersection (causality and breakage)

To substantiate the existence and the condition of the capital business entity, the auditor should execute observation, i.e. walk and preview of the documentation. Confirmation of the economical state of the capital assets and stock is more difficult than confirming its physical state. It is very often that the physical well stores are not needed or the spot products cannot be supplied, etc. So we can make an adequate conclusion auditor collects other types of evidence too, as an example the conversations with the employees or usage of their former experience. The existence of the requirements of the customer's auditor upholds with receipts and invoices, and the funds from the bank with statement from the bank. The improvement of the property is important as occasion that in the practical work often appear different situations, as an example: stock is held by a third person, business entity – the client has sold the right to seek a third person, the capital assets are supplied on the basis of leasing compact or lease with the right of taking over etc. The balancing, i.e. the valuation of the positions of the financial reports is a process of vocation of the resources as they are implied in the balance sheet and the profit and loss account. To strike a balance implies on the content, i.e. the aspect of material of the regular annual and periodical financial reports which affect directly as on the presentation of the financial state of the balance sheet, so on the exhibition of the accrued results of working with the profit and loss account. That's why in the process of regular financial report of the business entity, utmost importance is attached on the balancing. The business entity must give an explanation about the method of valuation which has been used and consistently applied from one to another preschedule period. As for a special explanations, it can be recalled that they are stated in the report on the operation. With the help of such set and performed audit goals, audit analysis are created that lead to the achievement of its primary goal. Determination of the audit goals and revenues of establishing the audit strategy – the plan and the program..

## **2. Process of audit**

The main component of this process is the gathering of the evidence that are related to the reports of economic events and results of the operation. While implementing the audit, the auditor gets financial reports of the business entity – entity of the audit, that has to be checked thoroughly and on the basis of the realized analysis, to form and express professional, objective and before all, independent opinion. While implementing the

operations about the audit of the financial reports, the auditor's primary goal is to determine if the reports, i.e. the claims of the entities of the audit correspond with the determined criteria, which often are connected with certain rules prescribed by the legislative body, with the plan or with other standards about the performances determined by the manager or the accountant standards, respectively other authority entities.

### ***2.1 Phases of the process of audit***

We can conclude that the process of revision is composed of the following few phases:

- The management of the client demands audit services;
- Submitting a letter of engagement by the auditor;
- Accepting the engagement and meeting the client;
- Developing a global strategy;
- Setting up a hypothesis: if the financial reports of the client are made according to the law, the generally accepted accountant principles and standards;
- Identifying the goals of the audit;
- Planning and programming the audit process;
- Collecting and valuation of the proof material (risk analysis of the audit, the analysis of the internal control and independent analysis);
- Reviewing the evidence and the audit operation;
- Formation of an opinion and assembling the audit report

### ***2.2 Identifying of the general assertions given in the financial reports***

While completing the audit process, the auditor has to be able to recognize or to identify the general vouches given in the financial reports. There are seven vocations given by the management in the financial reports, and those are:

1. Existence or development – This applies to the determination of the management of business entity that the whole property, liabilities and capital that are given in the balance sheet exactly and physically they exist as that, and all the income, expenses, profit or wastage occurred respectively really have occurred in the fiscal period for what are composed the financial reports.
2. Rights and liabilities – This refers to the management's claim that the business entity is the owner of the property included in the balance sheet, and that the liabilities towards suppliers and other liabilities are legal and must be paid. The rights and liabilities also relate to the right to use, that is, the right of assets and liabilities that are not a legal obligation.
3. Completeness – This management's claim shows that all transactions and accounts that need to be included in the financial statements, i.e. all assets, liabilities, equity, income, expenses, profits and wastage are really included in them, and that there is no unreasonable (undisclosed) property, liabilities

or transactions. When auditors check the complete claim, they check whether some balance sheet items are underestimated, or some positions that had to be included in the financial statements are omitted, etc.

4. Valuation and allocation – These claims relate to cash and cash equivalents, realization and supply and indicate that the amounts presented are correctly valued.
5. Presentation and disclosure – This statement of the management of the business entity indicates that all components of the financial reports, including the notes in addition to those reports, are properly classified, described and disclosed.
6. Accuracy – This assertion relates to the mathematical accuracy of transactions, and to the initial collection and recording of transactions in the general ledger.
7. Distinction – This claim relates to whether the transactions carried out are made immediately before and after the year and are recorded in an appropriate period.

### **3. Concepts of audit during the implementation of the audit process**

The audit of the financial statements is an important process focused on the collection and assessment of sufficient component evidence, which will later serve as a solid basis for forming an objective, component and independent opinion of the auditor in relation to the audited financial reports. In the process of auditing financial reports, great attention is paid to the following types of concepts:

- concept of materiality
- concept of audit risk
- concept of audit evidence

The concept of materiality (significance) is taken into account by the auditor while planning the nature, time schedule and the scope of the audit procedures (when planning the audit) and when evaluating the results of the audit. There is a direct correlation between the concept of materiality (significance) and the problem of audit risk, and it has the treatment of one of the most significant and most complex segments of the audit profession. When performing the audit, the auditor should consider the significance and its relationship with the audit risk. The concept of materiality presupposes in all segments of audit to take into account at the same time the comprehensiveness and rationality of the procedures, not only in the planning phase of the activities, checking the existence and functioning of accounting internal controls, checking the balance data, but also in the reality and objectivity of the basic reports. Also, the concept of materiality intertwines and enters deep into financial reporting because this concept itself pays the most attention to the objectivity of data entered in the framework of the audited financial reports. For an easier understanding of the essence of materiality, its precise formulation is undoubtedly important. Hence, the concept of materiality or, more simply, 'materiality' or 'material significance' is identified as a criterion used by accountants and auditors to differentiate the important and relative of the less important and less relative issues. The second concept refers to audit risk where the purpose

of an audit-based approach is to concentrate auditors on those areas where there is the greatest possibility of errors. At the same time, the risk of an audit is the risk that the auditor will provide an appropriate opinion on the financial report, although it is possible for the auditor to express an opinion that the financial reports are not honest and impartial when in fact they are. The third concept applied to the audit of the financial reports, which is the concept of audit's evidence. In this concept, it is emphasized that prior to the opinion of the auditor, he 'must obtain a satisfactory evidence material by way of inspection, observation analysis and independent balance confirmation in order to provide a reliable basis for expressing the opinion the financial reports that are subject to the audit[1].

### ***3.1 Concept of audit risk***

Audit risk refers to the fact that auditors will not be able to disclose material errors in the financial reports, i.e. the financial reports are not objective and realistic, and auditor cannot disclose it. It represents the danger faced by auditors. During the implementation of the audit process, two types of risk can appear. The first type of risk arises from the relationship of the client's business entity, and the other type of risk is that the auditor may give an inaccurate report on the audit of the financial reports, for example to give a positive audit opinion on the financial reports that are misrepresented, or a negative opinion on financial reports that are accurate and correct. Audit risk is the risk that the auditor will misrepresent an (unqualified) opinion on the financial reports that contain a material error. The audit process during its implementation is at risk that the auditor, in spite of the sufficient amount of relevant evidence that he has received, may be subject to an inadequate audit opinion. There is no way to reduce the audit risk to zero and therefore auditors should respect the standards and provide sufficient evidence as the basis for expressing an audit opinion. The quality of the audit is related to the auditor's ability to detect material errors and to give an independent and objective audit opinion on the reality and objectivity of the financial reports, and this will be achieved by implementing appropriate acts and procedures during the audit process[2].

### ***3.2 Audit risk and its components***

It is the risk of occurrence of errors as a result of the very environment within which the business operates. It includes factors such as the complicated production process, sophisticated information technology, sales to third-world countries and the high-tech industry. Nowadays, as a result of automation of business processes, many important parts of business processes are invisible to the observer. The information technology used in organizations is fully understood by only a small number of people from the organization itself. No example, this is the case with estimation models and decision models used in large banks and brokerage/trade houses. The facts above create new types of operational risk as a result of the existing business environment. The inevitable risk is the risk of occurrence of errors of material nature. It depends on the nature of the issue being analyzed and the nature of the organization itself for the purpose of the audit, as well as the degree of susceptibility to errors of judgment in a particular area. However, although auditors cannot do anything to influence the inevitable risk, it is very important that they be aware of the existence of it. Only in this way will the auditors be able to concentrate their audit efforts on areas where difficulties can arise. In order to assess the inevitable risk, the auditor must evaluate the environment in which the organization operates and the characteristics of the

specific issues or areas that are subject to the audit[3].

### **3.3 Control risk**

Control risk is defined as the risk of the errors that cannot be prevented before they occur, or that they will not be detected after they have occurred due to weaknesses in the control system. In order to adequately plan their audit work, auditors must assess the contractual risk. A certain control risk will always exist, due to the built-in constraints on any internal control structure. The auditor can assess the control risk at the maximum level when it is assumed that policies or procedures are not effective, or may not be worthwhile assessing their effectiveness. If the auditor assesses the control risk at the maximum level, it is expected to provide audit evidence regarding the design and operation of the relevant policies and procedures in order to justify such an assessment. Control risk is evaluated through a detailed analysis of the relative internal control systems and the implementation of procedures for testing their suitability and function. The initial risk of the evaluation also provides an assessment of the overall quality of the control system. Where control risk is expected to be high, the auditor has little chance of gaining confidence in the system through analyzing the controls, in order to assess the effectiveness of internal controls. The auditor can then decide, that a more economical way to gain the trust he needs is other sources of data and therefore increase the degree of detailed analysis during the audit[4].

### **3.4 Detection risk**

The detection risk is that risk that the auditor faces when a material error occurs, which has not been identified either by the internal control system, or during the detailed analysis by the auditor. Once the inevitable and control risk are assessed, the auditors make a decision on the required level of analyzing that they need to gain reasonable assurance that all material errors will be identified. If the unavoidable and control risk are high in a specific area, then the auditor determines a low level of detection risk, which means that extensive, detailed audit analyzing will be carried out. On the other hand, if the inevitable and control risk is low, the auditors can afford a higher level of detection risk, which will mean a reduction in the scope of detailed analyzing.

## **4. Audit report**

The internal audit report is the most significant part of the audit cycle. Proper reporting to the internal audit can help clarify significant issues and establish a joint review focusing on managerial acts. The audit report is used to communicate with the users about the intent, scope and results of the work performed. The notice may be more informal depending on the intent and purpose of the internal audit activities. Reporting the internal audit and communications is aimed at raising awareness of risk, minimizing expected gaps, and eliminating actions that will improve internal control or effectiveness[5].

### **4.1 Types of audit reports**

- Standard, those who are composed of three main parts: Executive summary, Detailed report and action plan;
- Audit memorandum, which is used for fast and extraordinary audits, audits to the results of the change-

after-audit activities when only a small number of findings are observed and in situations where there is a need to produce a temporary audit report that lasts for a longer period of time.

#### **4.2 Writing an audit report**

Each audit institution has developed its own reporting structure, many of which are still trying to improve their audit reports, independently of which different types of reporting forms can be found by the auditors in the same institution.

The form of the audit report cannot bypass the basic elements that should be mandatory:

- Goals, scope and methodology;
- Audit results, including findings, conclusions and recommendations;
- Application and implementation of the International Standards on Auditing, standards for internal control of the public sector and National Law Rules and Standards;

Reports need to be accurately defined:

- Which standards have been applied in the opinion and the finding that certain processes or transactions did not comply with them or the National Legal Regulations;
- What negative effects have the established findings in practice, which risks are involved in the same;
- What steps should be taken in order to correct or completely change the situation;
- The audit report will be relevant if the auditor applies the basic principles:
  - The report should include the necessary facts;
  - Do not incorporate facts that are not important;
  - Every reporting element/fact should have meaning;
  - The dates and the numbers should be correct and relevant;
  - The facts and the conclusions should be separated;
  - Reference to other materials and data should be understandable;
  - All the conclusions and recommendations should be supported with facts. The auditor should considerate that if in the report he quote only the fact, than the report would be useless. That's why he should strive on data retrieval from the findings, with possibility to give a recommendation.

Regarding to the specificity of this type of audit of the system of internal controls, audit report should have the following content:

- Executive summary:
  - a. The subject of the audit;
  - b. Legal basis;
  - c. Responsibility of the management of the entity and the auditor;

- d. Goals of the audit;
- e. Compliance with the standards;
- Access of the audit:
  - a. Work plan;
  - b. Coverage of the work;
  - c. Applied methodology;
- Key findings, risks and control aspects
  - a. Description of the existing accounting and internal control system;
  - b. Control aspects;
  - c. Risk assessment;
  - d. Recommendations;
- Comments/undertaken measures by the entity on the given recommendations

Auditor's report should undertake clearly expressed written opinion about the financial reports of the business entity. The audit report should have appropriate title which clearly indicates that this is the independent auditor's report. The report is most often addressed to the shareholders or the board of directors of the business entity where the audit is conducted, or as required by the circumstances of the engagement. The introductory part of the audit report lists, the financial reports that have been audited, the title of each of the reports constituting the financial reports is given, and an overview of the significant accounting policies and some explanatory notes and the date and the accounting period with whom are covered the financial reports. The report also contains a statement that the management of the business entity is responsible for the financial reports, and the auditor is responsible for issuing the audit opinion on the basis of the conducted audit. The report describes the scope of the audit, it is indicated that the audit is conducted in accordance with international and national principles and standards, which should emphasize which principles and standards were used in the preparation of the financial reports and gives a description of the audit. The date of the report should be after the audit date and no earlier than the date when the financial reports were signed by the management. The audit report contains the name and exact location of the auditor responsible for the audit and should be signed with the personal name of the auditor, and the firm accepts the responsibility for the audit[6].

The auditor should strive for the audit report to achieve the following goals:

- The results of the performed audit should be transferred in a simple and comprehensible manner to the highest state bodies, representatives of different levels of government, and to the audited entity;
- The audit reports should be published in order to be properly understood and accepted;
- In addition to the findings, the audit reports should contain recommendations for overcoming the identified deficiencies and weaknesses;
- To facilitate the monitoring of the undertaken measures by the entities.



The certified auditor prepares a report on the performed audit in accordance with the International Standards on Auditing. The report of the certified auditor shall contain: explanation of the scope of the performed audit, full name of the audited, the accounting reports that were matter to the analysis, indication of the application of the auditor's standards or the reasons for not applying those standards, the opinion of the certified auditor as to whether the accounting reports objectively reflect the financial position and results of the business operation, the date when the audit is started and completed. If the certified auditor determines in the course of the audit the facts that indicate the disgrace or serious damage to the audited, or if violations of the law are found, the certified auditor is obligated to explain this in the audit report.

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