SUPPLEMENTARY MATERIAL: AUDITING 310.

Dear student

These notes are meant to supplement the Auditing 310 Study Guide. The following topics are covered:

1. AUDIT EVIDENCE AND SAMPLING
2. AUDIT COMPLETION
3. THE AUDIT REPORTS

These three topics are an addition to the material in the study guide you are currently using.

You are encouraged to read widely from other sources that are included as reference text books.

Let me also take this opportunity to echo what Iain Gray and Stuart Manson (2014) said in their book entitled “The Audit Process.

As an examination subject, auditing tends to be more literary than numeric. Numeracy is certainly required in certain areas such as being able to make analytical reviews of accounting information, but the overriding ability required is to Marshall your thoughts in a logical fashion, select what is relevant to the question posed by the examiner and write your answers clearly and concisely within the time limit imposed.

Here are a number of suggestions that would probably guide you in the examination room.

GENERAL EXAMINATION HINTS

1. Syllabus

The first thing to be said is that you must know the syllabus. That is the subject area examinable at Auditing 310. Another important aspect is the level of knowledge required from you as a student.

2. Control over time

All examinations are restricted in duration and three hours will be the normal length of time at your disposal. It is vital that you recognize the importance of attempting all questions required as it is normally far easier to get the first 50 percent of marks on any question than the last 50 percent. This means that you must allocate your time to enable all questions and parts of questions to be attempted. It will be usual for marks allocated to questions and parts of questions to be stated and your first task should be to convert marks to time in minutes. this you can do by multiplying the marks by 1.8 to give time in minutes in a three hour examination.

I am incidentally not suggesting that you should adhere slavishly to a particular length of time. Most students will be able to answer some questions better than others and it would be foolish to leave a question when you still have important points to make. It would equally be foolish, however to answer only four questions (say) and to be marked out of 80 per cent instead of 100 percent.

3. Understanding the question

I have read numerous examiners comments on the way that students have performed in the examination room and one comment that appears over and over again is: Many students do not
appear to have read the questions carefully enough. A good tip when reading through any question and the examination requirements is to ask yourself the questions: what does the examiner expect from me? What aspect of the syllabus is being examined?

It is also vital that you read the requirements carefully. If the examiner says for instance ‘Comment briefly on the four items in the internal audit job specification, indicating with examples the extent to which they might impinge upon the work of the statutory auditor. The examiner will expect you not only to comment but also to give examples. It is useful in this context to realize that the examiner will have prepared a marking schedule and that marks will have been allocated to suitable examples. This means that comment without examples will inevitably make it impossible to give you all the marks allocated to the question.

Closely linked to understanding the question is the use of information provided. For instance many questions will contain figures such as turnover and profit before tax and the financial impact of matters requiring attention by the auditor. Examiners may not mention materiality directly but will certainly expect you to consider the significance of the matters in relation to other figurative information provided. Thus if you are told that profit before is N$500 000, that the stated inventory figure is N$250 000 and that your audit tests have detected and an overstatement of inventories of N$24 000, you should be prepared to state with reasons whether you regard the overstatement of profit and inventory by 4.8 per cent and 9.6 per cent respectively as material or not. An approach like this will be worth a mark or two.

4. Form of answer

This is linked to understanding the question but I wish to emphasize particularly that you should note the examiner’s requirements as to the form of answer. If the examiner, for instance, asks you to draft an engagement letter, the examiner expects you to answer in a form of a letter. If a memorandum on internal controls is required, then clearly your answer should be drafted as a memorandum. It is likely in such cases that the examiner will have allocated marks for style and layout. On the other hand, if the examiner asks you (say) to list the reasons for which audit working papers are prepared, your answer would more properly be written as a numbered list of points.

As far as possible you should not try to waste time by giving extensive definitions such as those of audit risk, inherent risk, control risk and detection risk (unless you are required to do so. This is particularly required at this level of Auditing 310. Basically your answer should show clearly that you know what these terms mean. For instance you might say something like: The fact that credit control procedures are weak means that control risk will be high in this area and the auditor’s will need to ensure that detection risk is low, by increasing substantive procedures such as

5. Length of answer

This is linked to time allocation. If the examiner expects you to write for eight or nine minutes to get your five marks, he will not be impressed with five lines. Most examiners will be disinclined to give you one mark per line. I do not wish to you to think that I am being flippant in this respect,
merely that you should recognize the need to produce a complete answer within the time constraints.

One other matter I would mention is the length of answers prepared by examiners. It will not normally be possible under examination conditions to reproduce answers in the scope and detail of the suggested solutions. They are intended to be teaching/learning guides as much as answers to the question per se. This is inevitable. I suggest as you will agree if you reflect upon the fact that most answers produced under examination conditions are likely to be incomplete.

6. Relevance

Many students disgorge on to the script all they know about a subject area whether relevant or not, hoping, no doubt that some of it will be worth a mark or two. We call this the ‘dustbin syndrome’ and you must avoid it at all costs. You will only gain marks if your answer is relevant to the question.
UNIT 1
AUDIT EVIDENCE

I have already mentioned in the previous chapters that the auditor is required to obtain evidence about misstatements in financial statements usually caused by error but sometimes caused by fraud. In this chapter I shall look at how they start to do this.

First I shall address the question of what evidence is and how auditors go about collecting it. It is important to understand that there are two types of tests performed to collect evidence. Tests of control and substantive procedures.

Although I have referred to misstatements in general terms up to now auditing standards actually require auditor’s to be concerned with material misstatements. Here I will outline what materiality is and how it helps auditor’s determine what to test and in doing that they end up collecting audit evidence.

LEARNING OUTCOMES

Upon completion of this unit you should be able to:

- Explain the assertions contained in the financial statements
- Explain the use of assertions in obtaining audit evidence
- Explain the principles and objectives of testing transactions, accounts balances and disclosures
- Discuss the sources and relative merits of the different types of evidence available
- Define audit sampling and explain the need for sampling
- Identify and discuss the differences between statistical and non-statistical sampling
- Discuss and provide relevant examples of, the application of the basic principles of statistical sampling and other selective testing procedures
- Discuss the results of statistical sampling including consideration of whether additional testing is required
- Describe why smaller entities may have different control environments
- Describe the types of evidence likely to be available in smaller entities
- Discuss the quality of evidence obtained
- Explain the need for and the importance of audit documentation
- Explain the procedures to ensure safe custody and retention of working papers

If auditors are to

- Form an opinion which is worth something
• Be paid good money for it

They will need to base their opinion on valid evidence

EVIDENCE ABOUT WHAT EXACTLY?

Financial statements are complex documents

They consist of:

Statement of profit or loss and other comprehensive income

Statement of financial position

Statement of cash flows

Notes to the accounts

Each of which contains numbers of headings:

Revenue

Expenditure

Non-current assets

Inventories

Receivables

Payables, etc.

Management is responsible for the preparation of financial statements that give a true and fair view, but what does that really mean?

For each item in the financial statements, management is making assertions

Assertions like:

• This factory is owned by the company
• The receivables really do owe us this money and will pay fairly soon
• The payroll expense was for the company’s genuine employees working on the company’s business.
• Financial statement assertions

Auditor’s therefore need evidence that these assertions are

• Occurrence- did the transactions actually take place?
• Completeness- is all transactions or balances that should be included in the financial statements, actually included?
• Accuracy- are the amounts correct
• Cut-off - Are transactions accounted for in the correct period?
• Classification - are transactions recorded in the proper accounts?
• Existence - do the assets or liabilities actually exist?
- **Rights and obligations** - do the client own or have other rights over the assets and have a genuine obligation to pay liabilities?
- **Valuation** - is assets or liabilities included at appropriate amounts?
- **Allocation** - is account balances included in appropriate accounts?
- **Classification and Understandability** - are items in the financial statements disclosed under appropriate headings and in such a way that they can be readily understood by readers?
- **Accuracy** - are the amounts disclosed in the financial statements appropriate?

These assertions are important because they have an impact on how the auditor gathers evidence.

There are 13 different types of assertions across the three headings although some of them repeat each other and this may seem to be a rather daunting task to remember.

Remember that the audit evidence required depends on both:

- The nature of the item being tested
- **AND**
- The assertion being tested

And it can all be simplified down to **four key questions** that the auditor needs to answer:

Should it be in the accounts at all?
- Occurrence
- Existence
- Rights and obligations
- Cut-off

Is it included at the right value?
- Accuracy
- Valuation

Are there any more?
- Completeness

Is it disclosed properly?
- Classification
- Allocation
- Understandability

Here are some examples of the activities that auditor’s do to gain evidence using the assertions.

- **Existence** - inspect the assets
- **Valuation** - inspects evidence of cost/valuation (invoices etc.)
- **Rights and obligations** - inspect evidence of ownership (title deeds, invoices, etc.)
- **Cut-off** - inspect documents /observe processes (dates on invoices, despatch notes, etc.)
- **Completeness** - look for evidence of undisclosed items (payments to suppliers omitted from payables list, omitted dividends from shares,
Do assertions matter to auditors?

Assertions matter to auditor’s because:

- The auditor chooses suitable procedures based on the nature of the item in the financial statements being audited.
- The procedures will be refined further depending on which assertion about the item the auditor is testing.
- Different items - different approach.
- The audit approach to testing receivables will be different from testing payroll:

<table>
<thead>
<tr>
<th>ITEM</th>
<th>AUDIT TEST EXAMPLES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts</td>
<td>Carry out third party confirmation</td>
</tr>
<tr>
<td>Receivables</td>
<td>Review correspondence and aged analysis for Evidence of delinquent receivables Test subsequent receipts of cash from Customers</td>
</tr>
<tr>
<td>Payroll</td>
<td>Inspect timesheets Inspect authorised pay rates Verify employees are genuine through Contracts of employment Check tax and other deductions</td>
</tr>
</tbody>
</table>

Different assertions - different approaches

For a single item in the financial statements - e.g. freehold property, the auditor may need to use different approaches to different assertions

<table>
<thead>
<tr>
<th>ASSERTION</th>
<th>AUDIT TEST EXAMPLES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Existence</td>
<td>Inspect the property concerned</td>
</tr>
<tr>
<td>Valuation</td>
<td>Agree cost to purchase</td>
</tr>
<tr>
<td></td>
<td>Contract or subsequent</td>
</tr>
<tr>
<td></td>
<td>Revaluation to valuer's report</td>
</tr>
<tr>
<td></td>
<td>Re-perform depreciation calculations</td>
</tr>
<tr>
<td>Rights and obligations</td>
<td>Inspect title deeds</td>
</tr>
</tbody>
</table>
Cut-off | inspect purchase contract to verify date of purchase
Completeness | Review repairs account, correspondence with lawyers and property consultants for evidence that there are no additional properties

**Note:** The completeness assertion tends to be the most difficult assertion to test. It is usually easier to verify items we know about than think about what should be there but is not.

Do the following activity. Feedback is given at the end of this unit.

**Activity 1**
- Name the five assertions associated with transactions
- Name the four assertions associated with account balances
- Name the four assertions associated with disclosures in financial statements
- Why do assertions matter to auditors?

**HOW DOES THE AUDITOR TEST THINGS?**

**AUDIT PROCEDURES**
- Inspection of records or documents
- Inspection of intangible assets
- Observation
- Enquiry
- Confirmation
- Recalculations
- Re-performance
- Analytical procedures

We have seen above that:
- The nature of the transaction or balance being audited and the assertion being tested demand different approaches from the auditor
ISA 500 identifies eight types of procedures that the auditor can adopt to obtain audit evidence

INSPECTION OF RECORDS OR DOCUMENTS

INSPECTION OF TANGIBLE ASSETS

- Will usually give pretty conclusive evidence of existence
- May give evidence of valuation eg obvious evidence of impairment of inventory or non-current assets
- Unlikely to give evidence of rights and obligations e.g. a vehicle may be leased, inventory held on behalf of a third party etc.

OBSERVATION

- Involves looking at a process or procedure
- May well provide evidence that a control is being operated, e.g. double staffing or a cheque signatory examining supporting documentation

ENQUIRY

- Enquiry is a major source of audit evidence, however the results of enquiries will usually need to be corroborated in some way through other audit procedures
- The answers to enquiries may themselves be corroborative evidence
- Management representations
- The auditor obtains written representations from management to confirm oral enquiries where:
  - The issue is material or
  - Where other sources of evidence cannot reasonably be expected to exist or
  - Where other evidence is of lower quality

CONFIRMATION

- A specific form of enquiry
- Examples of use:
  - Circularisation of Receivables
  - Confirmation of bank balances
  - Confirmation from legal advisers of actual or contingent liabilities arising from legal proceedings
  - Confirmation of inventories held by third parties
• Confirmation of investment portfolios by investment managers

RECALCULATION
• Checking the arithmetical accuracy of the clients calculations

REPERFORMANCE
• Maybe something relatively simple, e.g. test checking inventory counts
• May be more sophisticated, e.g. using IT tools to check a receivable ageing

ANALYTICAL PROCEDURES
The consideration of the relationships between figures in the financial statements or between financial and non-financial information

Activity 2
1. What are the eight types of audit procedures?
2. What are the two purposes for which the auditor must use analytical procedures?
3. What is the third use of analytical procedures available to the auditor?
4. Why does the auditor need to obtain management representations?
5. Give three examples where an auditor might use confirmations

HOW MUCH EVIDENCE DOES THE AUDITOR REQUIRE
What to do depend on transactions or balance and which assertions to use
How much to do depends on risk purpose of the procedure and quality of available evidence
We have seen that the types of audit procedure the auditor can carry out are quite limited such as inspection, observation, enquiry etc. and that the audit procedures are driven by the nature of the transaction or balance being audited and the assertion being tested.
We now need to consider how much evidence the auditor needs.
This is driven by:
• The risk of material misstatement
• The quality of the evidence obtained
• The purpose of the procedure (test of controls or substantive test)

These three factors - risk, purpose and quality - have a complex relationship as we shall see.
Although risk is the most important factor, as everything the auditor does on an audit is in response to the assessed level of risk, we will consider it after we have dealt with the quality and the purpose of audit evidence

QUALITY OF EVIDENCE - SUFFICIENT APPROPRIATE EVIDENCE
ISA 500 Paragraph 2 states that the auditor should obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the audit opinion.

The key question here is:

What do we mean by:

- Appropriate?
- Sufficient?

Appropriate breaks down into two qualities

- reliable
- relevant

And sufficient, reliable and relevant are all interlinked.

SUFFICIENT

There needs to be enough evidence and what is enough is a matter of professional judgement.

EXAMPLE 1

For the client’s bank balance, one confirmation letter from the bank (if the client has only one bank account) will be enough and indeed is all there is available

The bank letter will not however give the auditor all the information required. There will need to be consideration of the bank reconciliation as well

So two sources of evidence combining to be sufficient

EXAMPLE 2

To test purchases for a manufacturing client where there are literally thousands of transactions a year, the auditor may well decide to extract a statistical sample of purchase transactions to test to purchase orders, invoices, delivery notes etc. But how many items should there be in the sample? Statistical sampling theory will give some help here- see below- but ultimately it is a question for the auditor’s professional judgement

RELIABLE - ISA 500 gives the above guidance

<table>
<thead>
<tr>
<th>This is better</th>
<th>This is worse</th>
</tr>
</thead>
<tbody>
<tr>
<td>Independent external evidence</td>
<td>Internally generated evidence</td>
</tr>
<tr>
<td>Internal evidence subject to effective controls</td>
<td>Internal evidence not subject to such controls</td>
</tr>
<tr>
<td>Evidence obtained directly by the auditor</td>
<td>Evidence obtained indirectly or by inference</td>
</tr>
</tbody>
</table>
The Link between sufficient and reliable

Broadly speaking, the more reliable the evidence the less of it the auditor will need. However the relationship is quite subtle.

If the evidence is found to be unreliable, looking at a greater quantity of such evidence will never be sufficient

RELEVANT

As we have seen above the nature of the evidence the auditor wants depends on the nature of the transaction or balance being tested and the assertion being tested

PERSUASIVE BUT NOT CONCLUSIVE

Consider:

- The auditor gives an opinion about the financial statement NOT a certificate that the financial statements are correct
- The audit report gives reasonable NOT absolute assurance about the financial statements

Audit procedures are designed to reduce the risk that the financial statements contain MATERIAL misstatements NOT to eliminate all possibility of error

The reason for all this lack of absolute, definitive certainly is the nature of audit evidence which is gathered by human beings in real live organisations

The auditor gathers evidence on a test basis (The sample may or may not be representative)

People make mistakes (both client and auditor)

Documents could be forged (increasingly easy with digital technology)

The client’s personnel may not always tell the truth

As a result, we have to say that audit evidence is PERSUASIVE Rather than conclusive in nature.

This also means that the auditor will need to gather evidence from a variety of sources.

AUDIT SAMPLING

Need for sampling
It will be impossible to test every item in any accounting population because of the cost involved - remember the audit gives reasonable NOT absolute assurance. The audit evidence gathered therefore will be on a test basis- hence the need for the auditor to understand the implications and effective use of sampling

However it is important to understand that:

There is no requirement to use sampling laid down in the ISAs

100% testing may be appropriate in certain circumstances-particularly where there is a small population of high- value items

The use of analytical procedures and a variation on analytical procedures may be a more effective and efficient method of gathering audit evidence

Because analytical procedures are a requirement of ISA 520 at the planning and overall review stage of the audit, it is sensible to make best use of the work done.

In other circumstances some form of sampling will be used

The definition of sampling set out in ISA 530 audit sampling and other means of testing is:

Audit sampling involves the application of audit procedures to less than 100% of items within a class of transactions or account balance such that all sampling units have a chance of selection. This will enable the auditor to obtain and evaluate audit evidence about some characteristics of the items selected in order to form or assist in forming a conclusion concerning the population from which the sample is drawn. Audit sampling can use either a statistical or a non-statistical approach. (ISA 530)

7.2 STATISTICAL AND NON-STATISTICAL SAMPLING

Statistical sampling means any approach to sampling that has the following characteristics:

Random selection of a sample, and

The use of probability theory to evaluate sample results which includes measurement of sampling risks.

A sampling approach that does not have both these characteristics is considered non-statistical sampling. (ISA 530)

Statistical sampling requires the following:

RANDOM SELECTION, eg generating a random number to determine which item or N$ in the population is the first in the sample and using a sampling interval, usually based on tolerable error, to select subsequent items

JUDGEMENTAL or HAPHAZARD SAMPLING - Picking say two invoices from each month ,or focusing on a particular period do not usually count as statistical sampling because of the risk of bias in selecting the sample.
EVALUATION OF RESULTS using probability theory, e.g. if a sample with a total value of N$100 000 contains errors of N$1000, it may be possible to extrapolate and say that there may be an error of 1% in the population as a whole, i.e. N$ 30000 in a population of N$ 3m or N$100 000 in a population of N$10m.

Clearly this will depend on how representative the sample is and the margin of error according to probability theory.

To be representative a sample needs to be of sufficient size
- Usually at least 30 items- and the larger the sample size, the greater the precision it will give.

If the results of the sample reveal potential errors which might be material, the auditor has to resolve the problem
- by considering whether there were special circumstances surrounding the errors, e.g. the absence of a key member of the client’s staff and carrying out additional testing on items or the period likely to be affected.
- by deciding whether because the risk of misstatement has clearly increased, which will lead to an increase in the level of materiality, the new level of materiality is too high. If it is, it will be necessary to increase the level of testing. However, care needs to be taken over this.

Now try this activity below to test your understanding.

Activity 3
What three qualities must audit evidence have?
Which type of evidence is more reliable- a faxed copy of a contract or the original contract?
Which is more reliable- the clients bank statement or the confirmation letter from the bank direct to the auditor?
Give two reasons why audit evidence is likely to be persuasive rather than conclusive
Give two examples where it would be appropriate to use statistical sampling

AUDIT DOCUMENTATION.
Why do we need working papers?
The job of working papers is to:

- Provide a record of the basis for the auditor’s report
- Provide evidence that the audit was conducted in accordance with ISAs and legal and regulatory requirements
- To assist with the planning, performance, supervision and review of the audit
• To aid the auditor’s defence if subsequently sued for negligence

PRINCIPLES

There are two major principles. If it is not recorded, it didn’t happen.

• If there is nothing on file, there is no evidence that the necessary procedures were completed, so there can be no basis for the audit opinion

• If it can’t be understood, it might as well not have happened.

Clarity is important for two reasons:

• Completeness - If the working papers are easy to understand it will be more obvious if anything has been omitted

• Efficiency- Working papers need to be reviewed for quality control purposes and to ensure that the audit opinion is justified. The reviewer may be at a senior level in the firm and therefore time will be charged at an expensive rate. Clear working papers will keep the time spent and therefore the cost to a minimum.

STRUCTURE AND LAYOUT

THE FILE

There are two broad areas of the file

The control part consisting of:

-the planning section

-the completion and review section

The main working papers are divided into the relevant sections of the financial statements e.g. noncurrent assets, inventories, receivables etc.

8.2 CUSTODY AND RETENTION OF WORKING PAPERS

WHO OWNS THE WORKING PAPERS?

The auditor does. This is important because:

Access to the working papers is controlled by the auditor, not the client, which is an element in preserving the auditor’s independence

In some circumstances care may need to be taken when copies of client generated schedules are incorporated into this file.

SECURITY

Working papers must be kept secure.

Audits are expensive exercises. If the files are lost or stolen, the evidence they contain will need to be recreated so the work will need to be done again. The auditor’s may be able to recover the
costs from their insurers but otherwise it will simply represent a loss to the firm. Either way, prevention is better than cure

By its nature audit evidence will comprise much sensitive information that is confidential. If the files are lost or stolen; the auditor’s duty of confidentiality will be compromised.

There have been cases of unscrupulous clients altering auditor’s working papers to conceal frauds.

The implications of IT based audit systems are also far reaching.

By their nature, laptops are susceptible to theft, even though the thief may have no interest in the contents of the audit file. Nevertheless, all the problems associated with re-performing the audit and breaches of confidentiality remain.

It is also more difficult to be certain who created or amended computer based files than manual files- handwriting, signatures and dates have their uses- and this makes it harder to detect whether the files have been tampered with.

This means that the following precautions need to be taken.

If files are left unattended at clients’ premises- overnight or during lunch breaks- they should be security locked away, or if this is impossible, taken home by the audit team.

When files are left in a car, the same precautions should be taken as with any valuables.

IT-based systems should be subject to passwords, encryption and back up procedures.

RETENTION

ISA 230 states that audit documentation should be retained for FIVE years from completion of the audit. Many firms keep working papers for longer than this because information may still be required for tax purposes.

All of this means that firms need to make arrangements for:

Secure storage of recent files

Archiving older files

Archiving and backup of IT-based files

SMALL ENTITIES

Smaller commercial entities will usually have the attributes above most of which are double edged in a good news/bad news kind of way:

LOWER RISK: Smaller entities may well be engaged in activity that is relatively simple and therefore lower risk. However, this will not be true for small-often one person businesses- where there is a high level of expertise in a particular field, e.g. consultancy businesses, creative businesses, the financial sector.
DIRECT CONTROL BY OWNER MANAGERS is a strength because they can know what is going on and have the ability to exercise real control. They are also in a strong position to manipulate the figures or put private transactions through the books.

SIMPLER SYSTEMS: Smaller entities are less likely to have sophisticated IT systems, but pure, manual systems are becoming increasingly rare. This is good news in that many of the bookkeeping errors associated with smaller entities may now be less prevalent. However, a system is only as good as the person operating it.

The normal rules concerning the relationship between risk and the quality and quantity of evidence apply irrespective of the size of the entity.

The quantity of evidence may well be less than for a larger organisation.

It may be more efficient to carry out 100% testing in a smaller organisation.

SMALL NOT FOR PROFIT ORGANISATIONS

Small, not-for-profit organisations have all the attributes of other small entities. Arguably, however, the position is more difficult for the auditor because:

While most small businesses are under the direct management of the owner, small not-for-profit organisations tend to be staffed by volunteers and the culture is more likely to be one of trust rather than accountability.

Below is the feedback to the activities in this unit:

ACTIVITY 1

1.

- Occurrence
- Completeness
- Cut-off
- Accuracy
- Classification

2.

- Existence
- Rights and obligations
- Completeness
- Valuation and allocation

3.
• Occurrence and rights and obligations
• Completeness
• Classification and understandability
• Accuracy and valuation

4

The assertion being tested will have an influence over the nature of the audit procedure used.

ACTIVITY 2

1.

• Inspection of records or documents
• Inspection of assets
• Observation
• Enquiry
• Confirmation
• Recalculation
• Re-performance
• Analytical procedures

2.

• To assist with planning the audit
• All the review stage to make sure that the financial statements make sense

3

As substantive procedure

4

• Where the issue is material
• Where other sources of evidence cannot reasonably be expected to exist
• Where other evidence is of lower quality
• Where it is specifically required by an ISA

5

• Circularisation of debtors
• Confirmation of bank balances
• Confirmation from legal advisers of actual or contingent liabilities arising from legal proceedings
• Confirmation of inventory held by third parties
• Confirmation of investment portfolios by investment managers

ACTIVITY 3

1.
• Sufficient
• Relevant
• Reliable

2.
The original contract- (but consider - how do you know it is original)

3.
The bank confirmation letter because it is independent third -party evidence.
(but beware , it has been known for frauders to type letters on paper stolen from a bank)

4.
• The auditor gathers evidence on a test basis( the sample may or may not be representative)
• People make mistakes (both client and auditor)
• Documents could be forged (increasingly easy with digital technology)
• The client’s personnel may not always tell the truth

5.
• Purchases transaction testing
• Revenue transaction testing
• Payroll transactions testing

UNIT SUMMARY

Auditor’s must gather sufficient reliable evidence with which to support their opinion

The evidence has to be relevant to the item or assertion being tested

When the directors prepare accounts they are making assertions about the items in the accounts, items omitted from the accounts and the accounts as a whole
Assertions underpin the financial statements. They are divided into three parts: assertions about transactions, assertions about balances, and assertions about presentation and disclosures. These are broadly analogous to the statement of comprehensive income, the statement of financial position, and the financial statements as a whole.

There are many different varieties of evidence. Some varieties are of more value to the auditor’s than others.

Established methods of collecting evidence are based on the auditor’s own tests. Other forms of evidence include representations from third parties and confirmations from those charged with governance or the directors.

Not all evidence has the same degree of reliability. Evidence from the auditor’s tests and confirmation from independent third parties is much more reliable than representations from directors. Written evidence is more reliable than oral evidence.

Auditors should try to collect evidence from a variety of different sources.

IAS 500 audit evidence discusses relevance, reliability, and sufficiency and gives some criteria for assessing these qualities in audit evidence.
UNIT 2

AUDIT COMPLETION

This unit deals with review and completion procedures on an audit. Review procedures have two aspects. Firstly auditor’s need to review the final accounts, considering whether the accounts comply with statutory requirements, the figures make sense (final analytical review) and the accounts give a true and fair view. Auditors have a specific responsibility to consider opening balances and comparatives, and information published along with the accounts.

The second part of the review deals with events that have taken place since the statement of financial position date.

Auditor’s need to consider whether the accounts should be prepared on a going concern basis. This is a very important task since going concern is one of the fundamental accounting concepts and misjudgement in this area can lead to considerable bad publicity.

It can be very difficult to explain why a company whose accounts did not contain any mention of going concern problems and who received an unqualified audit report shortly afterwards, went into liquidation.

Completion procedures auditors undertake include obtaining representations from management in areas where those representations are significant audit evidence. Auditor’s may also send a final internal control report to management and there are various other procedures involved in signing the accounts and tidying the audit file which are best dealt with by means of a completion checklist.

LEARNING OUTCOMES

Upon completion of this unit you will be able to:

- Explain the purpose and nature of carrying out an overall review of the financial statements prior to expressing an audit opinion and outline the purpose and nature of:
  - The application of analytical procedures
  - A review of opening balances and comparatives
  - A review of events after the statement of financial position date
  - An evaluation of going concern

- Explain the purpose of a letter of representation

- Describe the contents of a letter of representation and provide examples of typical representations made in such a letter
OVERALL REVIEW OF FINANCIAL STATEMENTS

Once the bulk of the substantive procedures have been carried out, the auditor’s will have a draft set of financial statements which should be supported by appropriate and sufficient audit evidence. As the beginning of the end of the audit process, it is usual for the auditor’s to undertake an overall review of the financial statements.

This review of the financial statements in conjunction with the conclusions had drawn from the other audit evidence obtained gives the auditor’s a reasonable basis for their opinion on the financial statements. It should be carried out by a senior member of the audit team with appropriate skills and experience.

COMPLIANCE WITH ACCOUNTING REGULATIONS

The auditor should consider whether:

- The information presented in the financial statements is in accordance with local/national statutory requirements
- The accounting policies employed are in accordance with accounting standards, properly disclosed, consistently applied and appropriate to the entity.

When examining the accounting policies, auditors should consider:

- Policies commonly adopted in particular industries
- Policies for which there is substantial authoritative support
- Whether any departures from applicable accounting standards are necessary for the financial statements to give a true and fair view
- Whether the financial statements reflect the substance of the underlying transactions and not merely their form
- When compliance with local/national statutory requirements and accounting standards is considered, the auditor’s may find it useful to use a checklist

REVIEW FOR CONSISTENCY AND REASONABLENESS

The auditor’s should consider whether the financial statements are consistent with their knowledge of the entity’s business and with the results of other audit procedures, and the manner of disclosure is fair.

The principal considerations are as follows:

- Whether the financial statements adequately reflect the information and explanations previously reached during the course of the audit.
- Whether it reveals any new factors which may affect the presentation of, or disclosure in, the financial statements
• Whether analytical procedures applied when completing the audit, such as comparing the
information in the financial statements with other pertinent data, produces results which
assist in arriving at the overall conclusion as to whether the financial statements as a whole
are consistent with their knowledge of the entity’s business

• Whether the presentation adopted in the financial statements may have been unduly
influenced by the directors desire to present matters in a favourable or unfavourable light

The potential impact on the financial statements of the aggregate of uncorrected misstatements
identified during the course of the audit and the preceding period’s audit, if any

ANALYTICAL PROCEDURES

Analytical review procedures are used as part of the overall review procedures at the end of an
audit.

Remember the areas that the analytical procedures at the final stage must cover

• Important accounting ratios
• Related items
• Changes in products; customers
• Price and mix changes
• Wages changes
• Variances
• Trends in production and sales
• Changes in material and labour content of production
• Other income statement expenditure
• Variations caused by industry or economy factors

As at other stages, significant fluctuations and unexpected relationships must be investigated and
documented. At this stage the auditor is concerned whether the financial statements are internally
consistent, so predictable relationships in particular will be important.

ISA 700 (Revised) The Independent Auditor’s Report on a complete set of general purpose financial
statements also address this issue.

It states that forming an opinion as to whether the financial statements give a true and fair view
involves evaluating the fair presentation of the financial statements.

The auditor must consider:

• Whether the financial statements are consistent with the auditor’s understanding of the
entity and its environment
• The overall presentation, structure and content of the financial statements

• Whether the financial statements including disclosures in the notes, faithfully represent the underlying transactions and events

Analytical procedures performed at or near the end of the audit help to corroborate conclusions formed during the audit and assist in arriving at the overall conclusion regarding their presentation.

OPENING BALANCES

Opening balances are those account balances which exist at the beginning of the period. Opening balances are based upon the closing balances of the prior period and reflect the effect of:

• Transactions of prior periods

• Accounting policies applied to the prior period

ISA 510 Initial engagements- opening balances provides guidance on opening balances:

• When the financial statements of an entity are audited for the first time

• When the financial statements for the prior period were audited by another auditor

To be specific this is what ISA 510.2 states:

• For intial audit engagements, the auditor should obtain sufficient appropriate audit evidence that:

  • The opening balances do not contain misstatements that materially affect the current period’s financial statements

  • The prior period’s closing balances have been correctly brought forward to the current period or when appropriate have been restated; and

  • Appropriate accounting policies are consistently applied or changes in accounting policies have been properly accounted for and adequately presented and disclosed.

AUDIT PROCEDURES

Appropriate and sufficient audit evidence is required on the opening balances and this depends on matters such as the following.

• The accounting policies followed by the entity

• Whether the prior period’s financial statements were audited and, if so, whether the auditor’s ‘s report was modified

• The nature of the accounts and the risk of their misstatement in the current period’s financial statements

• The materiality of the opening balances relative to the current periods financial statements.
The auditor must consider whether opening balances reflect the application of appropriate accounting policies and that those policies are consistently applied in the current period’s financial statements. When there any changes in the accounting policies or application thereof, the auditor should consider whether they are appropriate and properly accounted for and adequately disclosed.

When the prior periods financial statements were audited by another auditor, the current auditor may be able to obtain sufficient appropriate audit evidence regarding opening balances by reviewing the predecessor auditor’s working papers. In these circumstances, the current auditor would also consider the professional competence and independence of the predecessor auditor.

If the prior periods financial statements were not audited or when the auditor is not able to be satisfied by using the procedures described above, the auditor must perform other procedures such as those discussed below.

For current assets and liabilities some audit evidence can usually be obtained as part of the current periods audit procedures. For example the collection (payment) of opening accounts receivables (account payables) during the current period will provide some audit evidence of their existence, rights and obligations, completeness and valuation at the beginning of the period.

In the case of inventories, however, it is more difficult to for the auditor to be satisfied as to inventory on hand at the beginning of the period. Therefore, additional procedures will usually be necessary such as:

(a) **Observing a current physical inventory count** and reconciling it back to the opening inventory quantities.

(b) **Testing the valuation** of the opening inventory items

(c) Testing gross profit and cut off

A combination of these procedures may provide sufficient appropriate audit evidence.

For non-current assets and liabilities, the audit will ordinarily examine the records underlying the opening balances. In certain cases, the auditor may be able to obtain confirmation of the opening balances with third parties, eg for long-term debt and investments. In other cases, the auditor may need to carry out additional audit procedures.

Audit conclusion and reporting

ISA 510.11

If after performing audit procedures including those set out above, the auditor is unable to obtain sufficient appropriate evidence concerning opening balances, the auditor’s report should include:

(a) a qualified opinion

(b) a disclaimer of opinion; or

(c) in those jurisdictions where it is permitted, an opinion which is qualified or disclaimed regarding the results of operations and unqualified regarding financial position.
If the opening balances contain misstatements which could materially affect the current period’s financial statements, the auditor should inform management, and predecessor’s auditor.

ISA 510.12

If the effect of the misstatement is not properly accounted for and adequately presented and disclosed, the auditor should express a qualified opinion or an adverse opinion as appropriate. The report will also be modified if accounting policies are not consistently applied.

ISA 510.13

If the current periods accounting policies have not been consistently applied in relation to the opening balances and if change has not been properly accounted for and adequately presented and disclosed, the auditor should express a qualified opinion or an adverse opinion as appropriate.

If the prior period auditor’s report was modified, the auditor should consider the effect on the current period’s financial statements. For example, if there was a scope limitation, such as one due to inability to determine opening inventory in the prior period, the auditor may not need to qualify or disclaim the current period’s audit opinion. The ISA finishes:

ISA 510.14

However if a modification regarding the prior period’s financial statements remains relevant and material to the current periods financial statements, the auditor should modify the current auditor’s report accordingly.

COMPARATIVES

ISA 710 Comparatives establishes standards and provide guidance on the auditor’s’ responsibilities regarding comparatives.

ISA 710.2

The auditor should determine whether the comparatives comply in all material respects with the financial reporting framework applicable to the financial statements being audited.

Comparatives are presented differently under different countries’ financial reporting frameworks. Generally comparatives can be defined as corresponding amounts and other disclosure for the preceding financial reporting period(s), present for comparative purpose. Because of these variations in countries’ approach to comparatives, the ISA refers to the following frameworks and methods of presentation.

Comparatives are presented in compliance with the relevant financial reporting framework the essential audit reporting differences are that:

- For corresponding figures, the auditor’s report only refers to the financial statements of the current periods.
• For Comparative financial statements the auditor’s reports only refer to each period that financial statements are presented.

ISA 710 provides guidance on the auditor’s responsibilities for comparative and for reporting on them under the two frameworks in separate sections.

Corresponding figures
The auditor’s responsibilities

ISA 710.6
The auditor should obtain sufficient appropriate audit evidence that the corresponding figures meet the requirements of the applicable financial reporting framework.

Audit procedures performed on the corresponding figures are usually limited to checking that the corresponding figures have been correctly reported and are appropriately classified. Auditors must assess whether:

• Accounting policies are used for the corresponding figures are consistent with those of the current period or whether appropriate adjustments and/or disclosure have been made.

• Corresponding figures agree with the amounts and other disclosures presented in the prior period or whether appropriate adjustments and/or disclosure have been made.

When the financial statements of the prior period:

• Have been audited by other auditor’s or

• Have not been audited by auditor’s

The incoming auditor’s assess whether the corresponding figures meet the conditions specified above and also follow the guidance in ISA 510 Initial anagement - opening balances.

4.6 if the auditor’s become aware of a possible material misstatement in the corresponding figures when performing the current period audit, then they must perform any necessary additional procedures.

Reporting

ISA 710.10
When the comparatives are presented as corresponding figures, the auditor should issue an audit report in which comparatives are not specifically identified because the auditor’s opinion is on the current period financial statements as a whole, including the corresponding figures.

The auditor’s report will only make any specific references to corresponding figures in the circumstances described below. We will look at a specific example of the wording of auditor’s reports in such circumstances below.

Firstly, there is the problem of what happens when the auditor’s reports for the previous period was modified.
If a modified report was issued, but the matter which gave rise to it is resolved and properly dealt within the financial statement, the current report will not usually refer to the previous modification. If the matter is material to the current period, however, the auditor’s may include emphasis of matter paragraph to deal with it.

In performing the audit of the current period financial statements, the auditor’s, in certain unusual circumstances, may become aware of a material misstatement that affects the prior period financial statements on which an unmodified report has been previously issued.

ISA 710.15

In such circumstances, the auditor should consider the guidance in ISA 560 Subsequent events and:

If the prior period financial statements have been revised and reissued with a new auditor’s report, the auditor should obtain sufficient appropriate audit evidence that the corresponding figures agree with the revised financial statements; or

If the prior period financial statements have not been revised and reissued, and the corresponding figures have not been properly restated and/or appropriate disclosures have not been made, the auditor should issue a modified report on the current period financial statements modified with respect to the corresponding figures included therein.

In these circumstances, if the prior period financial statements have not been revised and an auditor’s report has not been reissued, but the corresponding figures have been properly restated and/or appropriate disclosures have been made in the current period financial statements, the auditor’s may include an emphasis of matter paragraph describing the circumstances and referencing to the appropriate disclosures. In this regard, the auditor’s also guidance in ISA 560 Subsequent events.

Incoming auditor’s: additional requirements

When the prior period financial statements were audited by other auditor’s, in some countries the incoming auditors can refer to the predecessor’s auditor’s report on the corresponding figures in the incoming auditor’s report for the current period.

ISA 710.17

When the auditor decides to refer to another auditor, the incoming auditor’s report should indicate:

- That the financial statements of the prior period were audited by another auditor;
- The type of report issued by the predecessor auditor and, if the report was modified, the reasons therefore; and
- The date of that report
- Such a reference would be added to the first paragraph of the audit report.
• ‘The financial statements of the Company as of December 31, 20X3, expressed an unqualified opinion on those statements’

• The situation is slightly different if the prior period financial statements were not audited

ISA 710.18

When the prior period financial statements are not audited, the incoming auditor should state in the auditor’s report that the corresponding figures are unaudited.

The inclusion of such a statement does not, however, relive the auditors of the requirement to perform appropriate procedures regarding opening balances of the current period. Clear disclosure in the financial statements that the corresponding figures are unaudited is encouraged.

ISA 710.19

In situations where the incoming auditor identifies that the corresponding figures are materially misstated, the auditor should request management to revise the corresponding figures or if management refuses to do so, appropriately modify the report.

Comparative financial statements
The auditor’s responsibilities

ISA 710.20

The auditor should obtain sufficient appropriate audit evidence that the comparative financial statements meet the requirements of the applicable financial reporting framework.

This is effectively involves the auditor’s following the same procedures on the prior period statements as noted above.

Reporting

ISA 710.24

When the comparatives are presented as comparative financial statements, the auditor should issue a report in which the comparatives are specifically identified because the auditor’s opinion is expressed individually on the financial statements of each period presented.

The auditor’s may therefore expresses a modified opinion or include an emphasis of matter paragraph with respect to one or more financial statements for one or more period, whilst issuing a different report on the financial statements.

The auditor’s may become aware of circumstances or events that materially affect the financial statements of a prior period during the course of the audit for the current period.

ISA 710.25

When reporting on the prior period financial statements in connection with the current year’s audit, if the opinion on such prior period financial statements is different from the opinion
previously expressed, the auditor should disclose the substantive reasons for the different opinion in an emphasis of matter paragraph.

Incoming: additional requirements

Again, there are procedures where the prior period financial statements are audited by other auditor’s.

ISA 710.26

When the financial statement of the prior period were audited by another auditor.

The predecessor auditor may reissue the audit report on the prior period with the incoming auditor only reporting on the current period; or

The incoming auditor’s report should state that the prior period was audited by another auditor and the incoming auditor’s report should indicate:

That the financial statements of the prior period were audited by another auditor;

The type of report issued by the predecessor auditor and if the report was modified, the reasons therefor; and

The date of that report

In performing the audit on the current period financial statements, the incoming auditor’s may become aware of a material misstatement that affects the prior period financial statements on which the predecessor auditor’s had previously reported without modification.

ISA 710.28

In these circumstances, the incoming auditor should discuss the matter with management and, after having obtained management’s authorisation, contact the predecessor auditor and propose that the prior period financial statements be restated. If the predecessor agrees to reissue the audit report on the restated financial statements of the prior period, the auditor should follow the guidance.

The predecessor auditor’s may not agree with the proposed restatement or they may refuse to reissue the audit report for the prior period financial statements. In such cases, the introductory paragraph of the auditor’s report may indicate that the predecessor auditor’s reported on the financial statements of the auditor’s report may indicate that the predecessor auditor’s reported on the financial statements of the prior period before restatement.

In addition, if the incoming auditors are engaged to audit and they perform sufficient procedures to be satisfied as to the appropriateness of the restatement adjustment, they may also include the following paragraph in report.

We also audited the adjustment described in note X that was applied to restate the 20X1 financial statements. In our opinion, such adjustments are appropriate and have been properly applied’
The other circumstance is that the prior period financial statement may not have been audited.

ISA 710.30

When the prior period financial statements are not audited, the incoming auditor should state in the auditor’s report that the comparative financial statements are unaudited.

Again, the inclusion of such a statement does not relieve the auditors of the requirement to carry out appropriate procedures regarding opening balances of the current period. Clear disclosure in the financial statements that the comparative financial statements are unaudited is encouraged.

ISA 710.31

In situations where the incoming auditor identifies that the prior year unaudited figures are materially misstated, the auditor should request management to revise the prior year’s figures or if management refuses to do so, appropriately modify the report.

SUBSEQUENT EVENTS

‘Subsequent events’ include

- Events occurring between the period end and the date of the auditor’s report.
- Facts discovered after the date of the auditor’s report

ISA 560 subsequent events begin by stating that:

ISA 560.2

The auditor should consider the effect of subsequent events on the financial statements and on the auditor’s report.

You should remember from your Drafting Financial Statement studies that IAS 10 Events after the balance sheet date deals with the treatment in financial statement of events, favourable and unfavourable, occurring after the period end. It identifies two types of events:

Those that provide further evidence of conditions that existed at the balance sheet date

Those that is indicative of conditions that arose subsequent to the balance sheet date

Events occurring up to the date of the auditor’s report

ISA 560.5

The auditor should perform procedures designed to obtain sufficient appropriate audit evidence that all events up to the date of the auditor’s report that may require adjustment of, or disclosure in, the financial statements have been identified.
These procedures should be applied to any matters examined during the audit which may be susceptible to change after the year end. They are in addition to tests on specific transactions after the date of the financial statements, e.g. cut-off tests.

The ISA lists procedures to identify subsequent events which may require adjustment or disclosure. They should be performed as near as possible to the date of the auditor’s report.

Review and updates of these procedures may be required, depending on the length of the time between the procedures and the signing of the auditor’s report and the susceptibility of the items to change over time.

ISA 560.8

When the auditor becomes aware of events which materially affect the financial statements, the auditor should consider whether such events are properly accounted for and adequately disclosed in the financial statements.

Facts discovered after the date of the auditor’s report but before the date the financial statements are issued

The financial statements are the management’s responsibility. They should therefore inform the auditors of any material subsequent events between the date of the auditor’s report and the date the financial statements are issued. The auditor’s do not have any obligation to perform procedures, or make enquiries regarding the financial statements after the date of their report.

ISA 560.9

When, after the date of the auditor’s report but before the date the financial statements are issued, the auditor becomes aware of a fact which may materially affect the financial statements, the auditor should consider whether the financial statements need amendment, should discuss the matter with the management and should take action appropriate in the circumstances.

When the financial statements are amended, the auditor’s should extend the the procedures discussed above to the date of their new report, carry out any other appropriate procedures and issue a new audit report dated no earlier than the date of approval of the amended financial statements.

The situation may arise where the statements are not amended but the auditor’s feel they should be.

ISA 560.12

When management does not amend the financial statements in circumstances where the auditor believes they need to be amended and the auditor’s report has not been released to the entity, the auditor should express a qualified opinion or an adverse opinion.

If the auditor’s report has already been issued to the entity then the auditor’s should notify those who are ultimately responsible for the entity (the management or possibly a holding company in a
group), not to issue the financial statements or auditor’s reports to third parties. If they have already been so issued, the auditor’s must take steps to prevent the reliance on the auditor’s reports. The action taken will depend on the auditor’s legal rights and obligations and the advice of the auditor’s lawyer.

Facts discovered after the financial statements have been issued

Auditors have no obligation to perform procedures or make enquiries regarding the financial statements.

ISA 560.15

When, after the financial statements have been issued, the auditor becomes aware of a fact which existed at the date of the auditor’s reports and which, if known at that date, may have caused the auditor to modify the auditor’s report, the auditor should consider whether the financial statements need revision, should discuss the matter with management, and should take the action as appropriate in the circumstances.

The ISA gives the appropriate procedures which the auditor’s should undertake when management revises the financial statements.

- Carry out the audit procedures necessary in the circumstances.
- Review the steps taken by management to ensure that anyone in receipt of the previously issued financial statements together with the auditor’s report thereon is informed of the situation.
- Issue a new report on the revised financial statements

ISA 560.17

The new auditor’s report should include an emphasis of matter paragraph referring to a note to the financial statements that more extensively discusses the reason for the revision of the previously issued financial statement and to the earlier report issued by the auditor.

Where local regulations allow the auditor to restrict the audit procedures on the financial statements to the effects of the subsequent event which caused the revision, the new auditor’s report should contain a statement to that effect.

Where the management does not revise the financial statements but the auditor’s feel they should be revised, or if the management does not intend to take steps to ensure anyone in receipt of the previously issued financial statements is informed of the situation, then the auditor’s should consider steps to take, on a timely basis, to prevent reliance on their report. The actions taken will depend on the auditor’s legal rights and obligations (e.g. to contact the shareholders directly) and legal advice received.
GOING CONCERN.

The meaning of going concern is explained below:

Under the going concern assumption, an entity is ordinarily viewed as continuing in business for the foreseeable future with neither the intention nor the necessity of liquidation ceasing trading or seeking protection from creditors pursuant to laws or regulations. Accordingly assets and liabilities are recorded on the basis that the entity will be able to realise its assets and discharge its liabilities in the normal course of business.

ISA 570.2

When planning and performing audit procedures and in evaluating the results thereof, the auditor should consider the appropriateness of management’s use of the going concern assumption in the preparation of the financial statements.

The ISA states that when preparing accounts, management should make an explicit assessment of the entity’s ability to continue as a going concern. Most accounting frameworks provided by IAS 1, require management to do so.

When management are making the assessment, the following factors should be considered:

- The degree of uncertainty about the events or conditions being assessed increases significantly the further into the future the assessment is made.
- Judgements are made on the basis of the information available at the time.
- Judgements are affected by the size and complexity of the entity, the nature and condition of the business and the degree to which it is affected by external factors.

The following list gives examples of possible indicators of going concern problems.

a) Financial indications

- Net liabilities or net current liability position
- Fixed-term borrowings approaching maturity without realistic prospects of renewal or repayment, or excessive reliance on short-term borrowings
- Indications of withdrawal of financial support by creditors
- Negative operating cash flows indicated by historical or prospective financial statements.
- Adverse key financial ratios
• Substantial operating losses or significant deterioration in the value of assets used to generate cash flows
• Arrears or discontinuance of dividends
• Inability to pay creditors on due dates
• Inability to comply with terms of loan agreements
• Change from credit to cash-on-delivery transactions with suppliers
• Inability to obtain financing for essential new product development or other essential investments

b) Operating indications
• Loss of key management without replacement
• Loss of a major market, franchises, license, or principal supplier
• Labour difficulties or shortages of important supplies

c) Other indications
• Non-compliance with capital or other statutory requirements
• Pending legal proceedings against the entity that may, if successful, result in judgements that could not be met
• Changes in legislation or government policy

The significance of such indications can often be mitigated by other factors

a) The effect of an entity being unable to make its normal debt repayments may be counterbalanced by management’s plans to maintain adequate cash flows by alternative means, such as by disposal of assets, rescheduling of loan repayments, or obtaining additional capital

b) The loss of a principal supplier may be mitigated by the availability of a suitable alternative source of supply.

Auditor’s responsibilities

Auditors are responsible for considering
• The appropriateness of the going concern assumption
• The existence of material uncertainties about the going concern assumption that need to be disclosed in the accounts
In obtaining an understanding of the entity, the auditor should consider whether there are events or conditions and related business risks which may cast significant doubt on the entity’s ability to continue as a going concern.

The auditor should remain alert for audit evidence of events or conditions and relevant business risks which may cast significant doubt on the entity’s ability to continue as a going concern in performing audit procedures throughout the audit. If such events or conditions are identified, the auditor should, in addition to performing the procedures, consider whether they affect the auditor’s assessments of the risks of material misstatements.

Management may already have made preliminary assessment of going concern when performing risk procedures, if so, the auditor’s would review potential problems management had identified and management’s plans to resolve them. Alternatively, auditors may identify problems as a result of discussions with management.

The auditor should evaluate management’s assessment of the entity’s ability to continue as a going concern.

The auditor should consider:

- The process management used
- The assumptions on which management’s assessment is based
- Management’s plan for future action

If management’s assessment covers a period of less than twelve months from the balance sheet date, the auditor ask management to extend its assessment period to twelve months from the balance sheet date.

Management should not need to make a detailed assessment, and auditor’s carry out detailed procedures, if the entity has a history of profitable operations and ready access to financial resources.

The auditor should inquire of management as to its knowledge of events or conditions and related business risks beyond the period of assessment used by management that may cast significant doubt on the entities ability to continue as a going concern.

Because of the time period is some way into the future, the indications of potential going concern problems would have to be significant. Auditor’s do not have to carry out specific procedures to identify potential problems which may occur after the period covered by management assessment. However they should be alert during the course of the audit for any indications of future problems.
When events or conditions have been identified which may cast significant doubt on the entity’s ability to continue as a going concern, the auditor should:

(a) Review management’s plans for future actions based on its going concern assessment

(b) Gather sufficient appropriate evidence to confirm or dispel whether or not a material uncertainty exists through carrying out audit procedures considered necessary, including considering the effect of any plans of management and other mitigating factors; and

(c) Seek written representations from management regarding its plans for future actions

When questions arise on the appropriateness of the going concern assumption, some of the normal audit procedures carried out by the auditor’s may take on an additional significance, auditor’s may also have to carry out additional procedures to update information obtained earlier. The ISA lists various procedures which the auditor’s should carry out in this context

• Analyse and discuss cash flow, profit and other relevant forecasts with management
• Analyse and discuss the entity’s latest available interim financial statements
• Review the terms of debentures and loan agreements and determine whether they have been breached
• Read minutes of the shareholders, those charged with governance and relevant committees for reference to financing difficulties
• Enquire of the entity’s lawyers regarding litigation and claims
• Confirm the existence, legality and enforceability of arrangements to provide or maintain financial support with related and third parties
• Assess the financial ability of such parties to provide additional funds
• Consider the entity’s position concerning unfulfilled customer orders
• Review events after the period end for items affecting the entity’s ability to continue as a going concern

The auditor should discuss with management its plans for future action for example plans to liquidate assets, borrow money or restructure debt, reduce or delay expenditure or increase capital and assess whether these are feasible and are likely to improve the situation

When analysis of cash flow is significant factor, auditors should consider

• The reliability of the information system for generating the information
• Whether there is adequate support for the assumptions underlying the forecast
• How recent forecasts have differed from actual results.
Based on the audit evidence obtained, the auditor should determine if, in the auditor’s judgement, a material uncertainty exists related to events or conditions that alone or in aggregate, may cast significant doubt on the entity’s ability to continue as a going concern.

An uncertainty will be material if it has a great potential impact as to require clear disclosure of its nature and implications in the accounts. The accounts should:

(a) Adequately describe the principal events or conditions that give rise to the uncertainty about continuance as a going concern, and management’s plans to deal with the situation

(b) State clearly that a material uncertainty exists and therefore the entity may be unable to realise its assets and discharge its liabilities in the normal course of business.

If adequate disclosure is made in the financial statements the auditor should express an unqualified opinion but modify the auditor’s report by adding an emphasis of matter paragraph that highlights the existence of the material uncertainty relating to an event or condition that may cast significant doubt on the entity’s ability to continue as a going concern and draws attention to the note in the financial statements that discloses the matters.

The auditor’s report is considered in detail in the next chapter. The ISA gives an example of an emphasis of matter paragraph in such circumstances

Emphasis of matter example:

Without qualifying our opinion we draw attention to Note X in the financial statements. The company incurred a net loss of XXX during the year ended 31 December 201X and as of that date, the company’s current liabilities exceeded its current assets by xxx and its total liabilities exceeded its total assets by xxx. These conditions along with other matters as set forth in note x indicate the existence of a material uncertainty which may cast significant doubt about the company’s ability to continue as a going concern.

The auditor’s may express a disclaimer of opinion if for example there are multiple material uncertainties.

UNIT SUMMARY

Auditor’s must perform and document an overall review of the accounts before reaching an opinion. This review should include a review of accounting policies and a review for consistency and reasonableness

Auditors should perform procedures to verify opening balances if they themselves did not audit those balances at the end of the previous period.

Auditor’s responsibilities on comparatives vary depending on whether they are corresponding figures or comparative financial statements
UNIT 3
THE EXTERNAL AUDIT OPINION

INTRODUCTION
In this unit I will deal in detail the audit report, the public product of the auditor’s work. I examine the form of the audit report. Remember the current version of the audit report is designed to close the expectation gap by stating the responsibilities of auditor’s and directors and setting out the work which auditor’s perform to obtain a basis for their opinion.

I shall then examine qualified audit reports. These are given when that auditors are not satisfied that the accounts give a true and fair view, and hence have to give a qualification (or qualifications) to the audit opinion. Qualifications arise for two reasons. Firstly if the auditors are not convinced that they have obtained all the evidence that ought to be available to them, they qualify their audit opinion on grounds of limitation of scope. Secondly if the auditor’s do not agree with amounts, accounting policies or disclosures in the financial statements, they issue a qualification on the grounds of disagreements.

A further problem for auditor’s concerns areas where they do have all the evidence that they can expect to obtain, but there nevertheless remain considerable uncertainties surrounding those areas. If significant uncertainties of this sort exist, auditor’s must make reference to them in the audit report, but will not qualify their audit report if they are happy with the way the uncertainties have been treated in the accounts.

THE AUDITOR’S REPORT ON FINANCIAL STATEMENTS

ISA 700 (revised) The Independent Auditor’s Report on a Complete Set Of General Purpose Financial Statement establishes standards and provides guidance on the form and content of the auditor’s report issued as a result of an audit performed by an independent auditor of the financial statements of an entity.

ISA 700.4
The auditor’s report should contain a clear expression of the auditor’s opinion on the financial statements.

The auditor’s opinion states whether the financial statements ‘give true and fair view’ or ‘are presented fairly, in all material respects’ in accordance with the applicable financial reporting framework. ISA 700 states that these phrases are equivalent.

The applicable financial reporting framework (either IASs or relevant national standards and practices) provides a context for the auditor’s evaluation.

ISA 700.11
The auditor should evaluate the conclusions drawn from the audit evidence obtained as the basis for forming an opinion on the financial statements.
When forming an opinion on the financial statements, the auditor evaluates whether, based on the auditor evidence obtained, there is **reasonable assurance** about whether the financial statements taken as a whole are free from material misstatement. This involves:

Concluding whether **sufficient appropriate evidence** has been obtained to **reduce risk** to an acceptably low level.

Evaluating the effects of uncorrected misstatements identified.

Forming an opinion includes an evaluation of whether:

The **accounting policies** selected and applied are **consistent** with the financial reporting framework and are **appropriate** in the circumstances;

The **accounting estimates** made by management are **reasonable** in the circumstances.

The information presented in the financial statements, including accounting policies is **relevant**, **reliable**, **comparable** and **understandable**

**Disclosures** are **sufficient** to enable users to understand the effect of material transactions and events.

ISA 700 states that forming an opinion also involves evaluating the fair presentation of the financial statements.

If the results of this evaluation are positive the auditor will issue an **unqualified** opinion.

Elements of the auditor’s report

The auditor’s report includes the following basic elements, usually in the following layout.

**Title**

**Address**

**Introductory paragraph**

**Management’s responsibility** for the financial statements

Auditor’s responsibility

Auditor’s opinion

**Other** reporting responsibilities

Auditor’s signature

Date of the auditor’s report

Auditor’s address

A measure of uniformity in the form and content of the auditor’s report is desirable because it helps to promote the reader’s understanding and to identify unusual circumstances when they occur.
These components are discussed in detail below, but in order for you to see the overall effect of the report, this is an example of an unqualified report produced by the standard.

ISA 700.58

The auditor’s report should be in writing

INDEPENDENT AUDITOR’S REPORT

[Appropriate Addressee]

Report on the Financial Statement

We have audited the accompanying financial statements of ABC Company, which comprises the balance sheet as at December 31 20X1, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management’s Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor’s Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor’s judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity’s preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity’s internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.
Opinion

In our opinion, the financial statements give a true and fair view of (or “present fairly, in all material respects”) the financial position of ABC Company as of 31 December, 20X1, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Report on Other Legal and Regulatory Requirements

[Form and content of this section of the auditor’s report will vary depending on the name of the auditor’s reporting responsibilities]

[Auditor’s signature]

[Date of the auditor’s report]

[Auditor’s address]

ISA 700.18

The auditor’s report should have a title that clearly indicates that it is the report of an independent auditor.

The term ‘independent auditor’ in the title distinguishes the auditor’s report from reports that might be issued by others, such as by officers of the entity.

ISA 700.28

The auditor’s report should be addressed as required by the circumstances of the engagement

Addressee

The report is ordinarily addressed either to the shareholders or to those charged with governance of the entity whose financial statements are being audited.

Introductory paragraph

In the case of financial statements prepared in accordance with IFRSs a complete set of financial statements includes a balance sheet, an income statement, a statement of changes in equity, a cash flow statement and a summary of significant accounting policies and other explanatory notes.

ISA 700.22

The introductory paragraph in the auditor’s report should identify the entity whose financial statements have been audited and should state that the financial statements have been audited.

The introductory paragraph should also:

Identify the title of each of the financial statements that comprise the complete set of financial statement

Refer to the summary of significant accounting policies and other explanatory notes; and

Specify the date and period covered by the financial statement
In the case of the financial statements prepared in accordance with IFRSs a complete set of financial statements includes a balance sheet, an income statement, a statement of changes in equity, a cash flow statement and a summary of significant accounting policies and other explanatory notes.

Management responsibility

ISA 700.28

The auditor’s report should state that management is responsible for the preparation and presentation of the financial statements in accordance with the applicable financial reporting framework and that this responsibility includes:

Designing, implementing and maintaining internal control relevant to the preparation and fair presentations of financial statements that are free from material misstatement, whether due to fraud or error;

Selecting and applying appropriate accounting policies; and

Making accounting estimates that are reasonable in the circumstances.

This part of the audit report emphasises that the financial statements are the representations of management. To fulfil this responsibility the management *designs and implements internal control*, selects and applies *appropriate accounting policies* and exercises judgement in making *accounting estimates*.

Auditor’s responsibility

ISA 700.32

The auditor’s report should state that the responsibility of the auditor is to express an opinion on the financial statements based on the audit.

This statement is made in order to contrast the role of the auditor with that of management.

ISA 700.34

The auditor’s report should state that the audit was conducted in accordance with International Standards on Auditing. The auditor’s report should also explain that those standards require that the auditor comply with ethical requirements and that the auditor plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatements.

This provides the reader with assurance that the audit has been carried out in accordance with established standards.

The auditor’s report will also include a description of the key features of the audit. This will address the following issues.
• That the audit involves the performance of procedures to obtain audit evidence about the
amounts and disclosures in the financial statements.

• Procedures selected depend on the auditor’s assessment of risk.

• Internal control is considered for the purpose of designing audit procedures, not for the
purpose of expressing an opinion on its effectiveness

• That an audit includes evaluation the appropriateness of the accounting policies used, the
reasonableness of accounting estimates made by management and the overall presentation
of the financial statements.

The report should also state that sufficient appropriate evidence has been obtained to provide the
basis of the auditor’s opinion.

Opinion paragraph

ISA 700.39

An unqualified opinion should be expressed when the auditor concludes that the financial
statements give a true and fair view or are presented fairly, in all material respects, in accordance
with the applicable financial reporting framework

The terms used to express the auditor’s opinions are ‘give a true and fair view’ or ‘present fairly, in
all material respects’, and are equivalent. Both terms indicate, amongst other things, that the
auditor considers only those matters that are material to the financial statements.

The financial reporting framework is determined by IASs, rules issued by professional bodies, and
the development of general practice within a country, with an appropriate consideration of fairness
and with due regard to local legislation. To advise the reader of the context in which ‘fairness’ is
expressed, the auditor’s opinion would indicate the framework upon which the financial statements
are based by using words such as ‘in accordance with International Financial Reporting Standards’
or ‘…in accordance with accounting principles generally accepted in Country X…’

Other reporting responsibilities

ISA 700.48

When the auditor addresses other reporting responsibilities within the auditor’s report on the
financial statements, these other reporting responsibilities should be addressed in a separate
section in the auditor’s report that follows the opinion paragraph.

In some jurisdictions the auditor may have additional responsibilities to report on the matters, such
as the adequacy of accounting books and records.

The auditor should address these in a separate section of the report in order to clearly distinguish
them from the auditor’s opinion on the financial statements.

Auditor’s signature
ISA 700.50

The auditor’s report should be signed.

The firm as a whole usually assumes responsibility for the audit, but in some countries an individual partner may be required to take responsibility and sign in his or her own name.

Date of report

ISA 700.52

The auditor should date the report on the financial statements no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the opinion on the financial statements.

This informs the reader that the auditor has considered the effect on the financial statements and on the report of events and transactions of which the auditor became aware and that occurred up to that date. The auditor should not date the report earlier than the date on which management have accepted responsibility for the financial statements.

This section has introduced you to the standard audit report where the auditor is able to express an unqualified opinion and no modification is necessary. The next section looks at how the audit is affected when problems of various varying severity arise in the audit.

Activity 1.

The following is an unqualified audit report which has been signed by the auditors of Kiln, a limited liability company.

INDEPENDENT AUDITOR’S REPORT

[Appropriate Addressee]

Report on the Financial Statements

We have audited the accompanying financial statements of Kiln company, which compromises the balance sheet as at December 31, 20X3, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes

Management’s Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards. This responsibility includes; designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatements whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are responsible in the circumstances.
Auditor’s Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free of misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor’s judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity’s preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity’s internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements give a true and fair view of (or “presently fair, in all material respects.”) the financial position of Kiln Company as of December 31, 20X3, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards

Auditor’s signature

Date

Auditor’s address

Required

Explain the purpose and meaning of the following phrases taken from the above unqualified audit report

‘... which compromise the balance sheet ... the income statement ... and the cash flow statement

‘... in accordance with International Standards on Auditing.’

‘In our opinion...’

MODIFIED REPORTS
Modified audit reports arise when auditors do not believe that they can state without reservation that the accounts give a true and fair view. There are dealt with in ISA 701

**Modifications to the independent auditor’s report**

An auditor’s reports is considered to be modified in the following situations

- **Matters that do not affect the auditor’s opinion: emphasis of a matter**
- **Matters that do affect the auditor’s opinion**
  - Qualified opinion
  - Disclaimer of opinion
  - Adverse opinion

**Matters that do not affect the auditor’s opinion**

**KEY TERM**

In certain circumstances, an auditor’s report may be modified by adding an emphasis of matter to highlight a matter affecting the financial statements which is included in a note to the financial statements that more extensively discuss the matter. The addition of such an emphasis of matter paragraph does not affect the auditor’s opinion. The auditor may also modify the auditor’s report by using an emphasis of matter paragraph(s) to report matters other than those affecting the financial statements.

The paragraph would preferably be included after the opinion paragraph and would ordinarily refer to the fact that the auditor’s opinion is not qualified in this respect.

**ISA 701 distinguishes between going concern matters and other matters**

ISA 701.6/7

The auditor should modify the auditor’s report by adding a paragraph to highlight a material matter regarding a going concern problem.

The auditor should consider modifying the auditor’s report by adding a paragraph if there is a significant uncertainty (other than a going concern problem), the resolution of which is dependent upon future events and which may affect the financial statements.

**KEY TERM**

An uncertainty is a matter whose outcome depends on future actions or events not under the direct control of the entity but that may affect the financial statements.

The following example of an emphasis of matter paragraph is given by the ISA, which would be added to the end of the standard unqualified wording given in section 2 above.

Without qualifying our opinion we draw attention to Note X to the financial statements. The Company is the defendant in a lawsuit alleging infringement of certain patent rights and claiming
royalties and punitive damages. The company has filed a counter action, and preliminary hearing and discovery proceedings on both actions are in progress. The ultimate outcome of the matter cannot presently be determined, and no provision for any liability that may result has been made in the financial statements.

An illustration of an emphasis of matter paragraph relating to going concern is set out in ISA 570 _Going concern_.

Without qualifying our opinion we draw attention to Note X in the financial statements which indicates that the Company incurred a net loss of XXX during the year ended December 31, 20X1 and, as of that date, the Company’s current liabilities exceeded its total assets by XXX. These conditions, along with other matters as set forth in Note X indicate the existence of a material uncertainly which may cast significant doubt about the Company’s ability to continue as a going concern.

This type of paragraph will usually be sufficient to meet the auditor’s reporting responsibilities. In extreme cases, however, involving multiple uncertainties that are significant to the financial statements, a _disclaimer of opinion_ may be required instead (see below).

The auditor may also modify the report by using an emphasis of matter paragraph for matters which do _not_ affect the financial statements. This might be the case if amendment is necessary to other information in a document containing audited financial statements and the entity refuses to make the amendment. An emphasis of matter paragraph could also be used for _additional statutory reporting responsibilities_.

Matters that do affect the auditor’s opinion

An auditor may not be able to express an unqualified opinion when either of the following circumstances exist and, in the auditor’s judgement, the effect of the matter is or may be _material_ to the financial statements

There is a _limitation on the scope_ of the auditor’s work.

There is a _disagreement_ with management regarding the acceptability of the accounting policies selected, the method of their application or the adequacy of financial statement disclosures.

There are different types and degrees of modified opinion.

A limitation on scope may lead to a _qualified opinion_ or a _disclaimer of opinion_.

A disagreement may lead to a _qualified opinion_ or an _adverse opinion_.

3.11 The ISA describes these different methods and the circumstances leading to them as follows

ISA 701.12-14

A _qualified opinion_ should be expressed when the auditor concludes that an unqualified opinion cannot be expressed but the effect of any disagreement with management, or limitation on scope is not so material and pervasive at to require an adverse opinion or a disclaimer of opinion. A
qualified opinion should be expressed as being ‘except for the effects of the matter to which the qualification relates’.

A disclaimer of opinion should be expressed when the possible effect of a limitation on scope is so material and pervasive that the auditor has not been able to obtain sufficient appropriate audit evidence and accordingly is unable to express an opinion on the financial statements.

An adverse opinion should be expressed when the effect of a disagreement is so material and pervasive to the financial statements that the auditor concludes that a qualification of the report is not adequate to disclose the misleading or incomplete nature of the financial statements.

312. the concept of materiality was discussed in chapter 5 and you can now see the fundamentals importance in auditing

ISA 701.15

Whenever the auditor expresses an opinion that is other than unqualified, a clear description of all the substantive reasons should be included in the report and, unless impracticable, a quantification of the possible effect(s) on the financial statements

This world is usually be set out in a separate paragraph preceding the opinion of disclaimer of opinion and may include a reference to a more extensive discussion (if any) in a note to financial statement.

Limitation on scope

There are two circumstances identified by the standard where there might be a limitation on scope.

Firstly, a limitation on the scope of the auditor’s work may sometimes be imposed by the entity (eg when the terms of the engagement specify that that the auditor will not carry out an audit procedure that the auditor seems necessary).

However, when the limitation in claim in the terms of the proposed engagement is such that the auditor believes that the need to express a disclaimer of opinion exists, the auditor would usually not accept such a limited audit engagement, unless required by statute. Also, a statutory auditor would not accept such an audit engagement when the limitations infringes on the auditor’s statutory duties.

Secondly, a scope limitation may be imposed by circumstances (e.g. when the timing of the auditor’s appointment is such that the auditor is unable to observe the counting of physical inventories). It may also arise when, in the opinion of the auditor, the entity’s accounting record are inadequate or when the auditor is unable to carry out an audit procedure believed to be desirable. In these circumstances, the auditor would attempt to carry out reasonable alternative procedures to obtain sufficient appropriate audit evidence to support an unqualified opinion.
 ISA 701.18

Where there is a limitation on the scope of the auditor’s work that requires expression of a qualified opinion or a disclaimer of opinion, the auditor’s report should describe the limitation and indicate the possible adjustments to the financial statements that might have been determined to be necessary had the limitation not existed.

The following examples are given of reports under a limitation on scope.

Limitations on scope - qualified opinion

“We have audited.. (Remaining words are the same as illustrated in the introductory paragraph - see paragraph 60 of ISA 700).

Management is responsible for ... (remaining words are the same as illustrated in the management’s responsibility paragraph - see paragraph 60 of ISA 700)

Our responsibility is to express an opinion on this financial statement based on our audit. Except as discussed in the following paragraph, we conducted our audit in accordance with ... (remaining words are the same as illustrated in auditor’s responsibility paragraph - see paragraph 60 of ISA 700)

We did not observe the counting of the physical inventories as of December 31, 20X1, since that date was prior to the time we initially engaged as auditor’s for the company. Owing to the nature of the company’s records, we were unable to satisfy ourselves as to inventory quantities by other audit procedures.

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to satisfy ourselves as to the physical inventory quantities, the financial statement gives a true and fair view... (Remaining words are the same as illustrated in the opinion paragraph - paragraph 60 ISA 700)

Limitation on scope - disclaimer of opinion

“We are engaged to audit the accompanying financial statements of ABC company, which comprise the balance sheet as December 31 20X1 and the income statement, statement of changes in equity and cash flow statement for the year then ended, and the summary of significant accounting policies and other explanatory notes.

Management irresponsible for (remaining words are the same as illustrated in management’s responsibility paragraph - see paragraph 60 ISA 700)

(omit the sentence stating the responsibility of the auditor)

(the paragraph discussing the scope of the audit would either be committed or amended according to the circumstances.)

(add a paragraph discussing limitation as follows:}
We are not able to observe all physical inventories and confirm accounts receivable due to limitation placed on the scope of our work by the company.

Because of the significant of the matter discussed in the preceding paragraph, we do not express an opinion of the financial statement.

Disagreeing with management

The auditor may disagree with management about matters such as the acceptability of accounting policies selected, the method of their application, or the adequacy of disclosure in the financial statements.

ISA 701.20

If such disagreements are material to the financial statements, the auditor should express a qualified or an adverse opinion.

The following examples are given in the standard:

Disagreeing on accounting policies - inappropriate accounting method - quantified opinion

“we have audited .... (Remaining words are the same as illustrated in the introductory paragraph - see paragraph 60 of ISA 700)

Management is responsible for (remaining words are the same as illustrated in management’s responsibility paragraph - see paragraph 60 of ISA 700)

Our responsibility is to ... (remaining words are the same as illustrated in the auditor’s responsibility paragraph - see paragraph 60 of ISA 700)

As discussed in note X to the financial statement, no depreciation has been provided in the financial statement which practice, in our opinion, it is not accordance with the international financial reporting standards. The provision for the year ended December 31 20X1, should be xxx based on the straight line method of depreciation using annual rates of 5% for the building and 20% for the equipment. Accordingly, the fixed asset should be reduced by accumulated depreciation of xx and the loss for the year and accumulated deficit should be increased by xxx and xxx, respectively.

In our opinion expect for the effect on the financial statement of the matter referred to in the preceding paragraph, the financial statement give a true and fair ... (remaining words are the same as illustrated in the opinion paragraph - see paragraph 60 of ISA 700)

Disagreement on accounting policies - inadequate disclosure - qualified opinion

“we have audited .... (Remaining words are the same as illustrated in the introductory paragraph - see paragraph 60 of ISA 700)

Management is responsible for (remaining words are the same as illustrated in management’s responsibility paragraph - see paragraph 60 of ISA 700)
Our responsibility is to ... (remaining words are the same as illustrated in the auditor’s responsibility paragraph - [see paragraph 60 of ISA 700)

On January 20X2, the company issued debentures in the amount of xxx for the purpose financing plant expansion. The debentures agreement restricts the payment of future cash dividends to earning after December 31, 19X1. In our opinion, disclosure of this information is required by...

In our opinion, except for the omission of the information included in the proceeding paragraph the financial statement give a true and fair view of. (Remaining words are the same as illustrated in the opinion paragraph - see paragraph 60 of ISA 700)

Disagreeing on accounting policies - inadequate Disclosure - Adverse opinion

“we have audited .... (Remaining words are the same as illustrated in the introductory paragraph - see paragraph 60 of ISA 700)

Management is responsible for (remaining words are the same as illustrated in management’s responsibility paragraph - see paragraph 60 of ISA 700)

Our responsibility is to ... (remaining words are the same as illustrated in the auditor’s responsibility paragraph - [see paragraph 60 of ISA 700)

(paragraph(s) discussing the disagreement.)

In our opinion, because of the effect of the matter discussed in the preceding paragraph(s0, the financial statement do not give a true or fair view of (or ‘ do not present fairly, in all material respects’) the financial position of ABC Company as of December 20,19X1 , and of its financial performance and its cash flows for the year then ended in accordance with international financial reporting standard.

UNIT SUMMARY

ISA 700 the auditor’s report on a corporate set of general purpose financial statements gives guidance on the basic audit report where no modification is required

ISA 701 Modifications to the independent auditor’s report deals with situations where the modifications of the report is required

An emphasis of matter paragraph can be used to highlight certain items without altering auditor’s unqualified opinion

There are two types of circumstances which may affect the auditor’s opinion

Limitation of scope

Disagreement

You must be able to discuss true and fair view ( or present fairly/0 although this is not easy given the lack of comprehensive definition

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You will not be asked to draft complete unqualified and modified audit reports, however, you should be able to list the basic contents and explain the terms used in the ISAs. You may be asked to draft the opinion paragraph of an audit report including qualifications.

The examples of qualifications are given only as an indication of what is required. Each case will be different and will require different disclosures.