



FINANCIAL AUDIT MANUAL

EXPOSURE DRAFT NOVEMBER 2016



Contents

- HOW TO USE THIS MANUAL6**
 - Overview of the financial audit process..... 6
 - Financial audit versus compliance audit 6
 - Audit process flow for financial audit 8
 - Customising the financial audit manual..... 9
- CHAPTER 1: PRE-REQUISITES11**
 - 1.1 INTRODUCTION 11
 - 1.2 CODE OF ETHICS..... 11
 - 1.3 QUALITY CONTROL..... 11
 - 1.4 THE AUDIT REVIEW PROCESS..... 14
 - 1.5 EVALUATING THE FINANCIAL REPORTING FRAMEWORK..... 18
 - 1.6 THE ANNUAL OVERALL AUDIT PLAN OF THE SAI 21
 - 1.7 SAI POLICIES AND PROCEDURES 22
 - 1.8 COMMUNICATION DURING THE AUDIT..... 23
 - 1.9 DOCUMENTING THE AUDIT 27
 - 1.10 WORKING PAPER(S) TO COMPLETE 33
- CHAPTER 2: PRE-ENGAGEMENT34**
 - 2.1 APPLICABLE STANDARDS 34
 - 2.2 OBJECTIVES 34
 - 2.3 AUDIT STEPS..... 35
 - STEP 1: Establish the audit team and evaluate capabilities and time required for the engagement..... 35
 - STEP 2: Evaluate and form a conclusion on compliance with relevant ethical requirements, including independence..... 36
 - STEP 3: Performing procedures required (where necessary) regarding the continuance of the client relationship and the specific audit engagement..... 36
 - STEP 4: Establish an understanding of the terms of the engagement..... 37
 - 2.4 WORKING PAPER(S) TO COMPLETE 38
- CHAPTER 3: UNDERSTANDING THE ENTITY39**
 - 3.1 APPLICABLE STANDARDS 39
 - 3.2 OBJECTIVES 40
 - 3.3 AUDIT STEPS..... 40

STEP 1: Obtain and document general information about the entity	40
STEP 2: Obtain information on governance structures.....	40
STEP 3: Understand the legal framework of the auditee.....	41
STEP 4: Understand the operational environment of the entity	42
STEP 5: Understand fraud risks	43
STEP 6: Understanding the entity’s internal controls	44
STEP 7: Make other relevant considerations	46
STEP 8: Identify the transactions and balances audited from the financial statements	49
3.4 HOW TO OBTAIN AN UNDERSTADNING OF THE AUDITEE	50
3.5 NOTE FOR REVIEWER.....	51
3.6 WORKING PAPER(S) TO COMPLETE	51
3.7 CONCLUSION.....	51
CHAPTER 4: MATERIALITY	52
4.1 APPLICABLE STANDARDS	52
4.2 OBJECTIVES	53
4.3 WHAT IS MATERIALITY.....	53
4.4 AUDIT STEPS.....	53
STEP 1: Select the materiality benchmark	53
STEP 2: Determine the overall materiality figure.....	54
STEP 3: Determine specific materiality figures for individual financial statement items	54
STEP 4: Determine performance materiality figures	54
STEP 5: Determine trivial thresholds.....	55
STEP 6: Determine qualitative materiality factors	55
STEP 7: Restating materiality.....	56
4.5 CONCLUSION.....	58
4.6 WORKING PAPERS TO COMPLETE.....	58
CHAPTER 5: RISK ASSESSMENT AND RESPONSE.....	59
5.1 APPLICABLE STANDARDS	59
5.2 OBJECTIVE	60
5.3 AUDIT STEPS.....	60
STEP 1: Perform Risk Assessments.....	60

STEP 2: Assess risks on a financial statement level.....	62
STEP 3: Conclude on the audit strategy	63
STEP 4: Assess risks for assertions and audited components	64
STEP 5: Address risks on a financial statement level.....	64
STEP 6: Address risks on an assertion level.....	65
STEP 7: Establish control reliance	67
STEP 8: Restate control reliance	69
STEP 9: Design substantive procedures.....	69
STEP 10: Address risk areas that need specific consideration	72
STEP 11: Decide on the timing of the audit procedures	76
5.4 NOTE FOR REVIEWER	77
5.5 CONCLUSION.....	77
5.6 WORKING PAPERS TO COMPLETE.....	78
CHAPTER 6: PERFORMING THE AUDIT & EVALUATION OF MISSTATEMENTS	79
6.1 INTRODUCTION	79
6.2 APPLICABLE STANDARDS	79
6.3 OBJECTIVES	80
6.4 AUDIT STEPS.....	80
STEP 1: Perform audit procedures – Part 1.....	80
STEP 2: Accumulate and evaluate misstatements	86
STEP 3: Perform audit work for the overall financial statements	88
6.5 NOTE FOR REVIEWER.....	90
6.6 CONCLUSION.....	90
6.7 WORKING PAPERS TO COMPLETE.....	91
CHAPTER 7: REPORTING	93
7.1 APPLICABLE STANDARDS	93
7.2 OBJECTIVES	94
7.3 AUDIT STEPS.....	94
STEP 1: Evaluate the misstatements found in the audit	94
STEP 2: Consider Key Audit Matters.....	96
STEP 3: Form an opinion and report on the financial statements	96

7.4 NOTE FOR REVIEWER 99

7.5 CONCLUSION..... 99

7.6 WORKING PAPERS TO COMPLETE..... 99

GLOSSARY 100

DRAFT

HOW TO USE THIS MANUAL

Overview of the financial audit process

The information in this manual is aimed at providing the audit team with a methodology for completing an audit. The audit working papers are standardised and the method of documenting and referencing information is also provided to ensure consistency.

The intention is that the auditor will follow the sequence in this manual and through this process will conduct the audit:

- **Chapter 1. Pre-requisites** - guidance covers ethics, quality control, annual overall audit plan, financial reporting framework and communication and documentation
- **Chapter 2. Pre-engagement activities** - includes an assessment of the objectivity, integrity and technical capacity of audit staff and establishing the budgeted time for the audit. Gaining a common understanding and expectations through issuing an engagement letter.
- **Chapter 3. Understanding the business** – during which auditors gain understanding of the auditee’s environment within which the client operates and internal controls of management.
- **Chapter 4. Materiality** – Set overall and performance materiality levels for the audit.
- **Chapter 5. Risk assessment and response** – Assess and respond to risks on a financial statement level. Gain understanding of the detailed processes for each audit component to assess risks on an assertion level. Identify and design appropriate audit responses to address the risks identified. Conclude on the overall audit strategy.
- **Chapter 6. Performing the audit and evaluating evidence** – Document the performance of the programs by completing the templates provided. Once audit programs have been performed you should evaluate audit results and look at some overall aspects before finalising the audit.
- **Chapter 7. Audit reporting** – Compile the auditor’s report and final management letter that arise from the audit process.

At the end of each stage references to the related working papers can be found. Explanatory notes, illustrations included in these working papers are indicated clearly. These notes should be removed from completed working papers as they are merely for guidance to the user.

Financial audit versus compliance audit

When deciding on the most appropriate audit approach for the audit, you need to consider how the mandate of the SAI is formulated.

A **financial audit methodology** is appropriate to follow when:

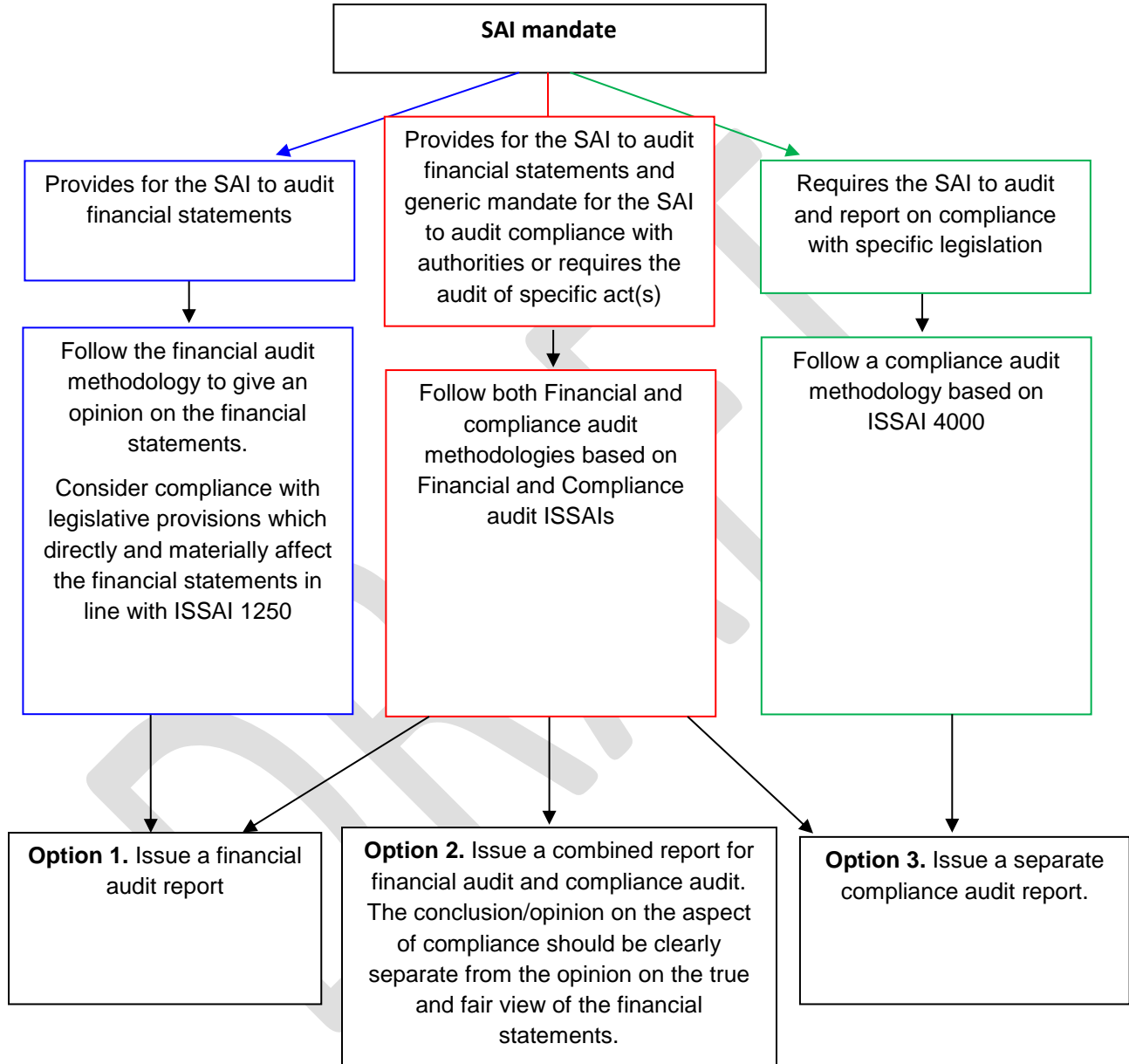
- The SAI is mandated to audit and report on the annual accounts or financial statements of government.

A **compliance audit methodology** is appropriate to follow when the mandate of the SAI:

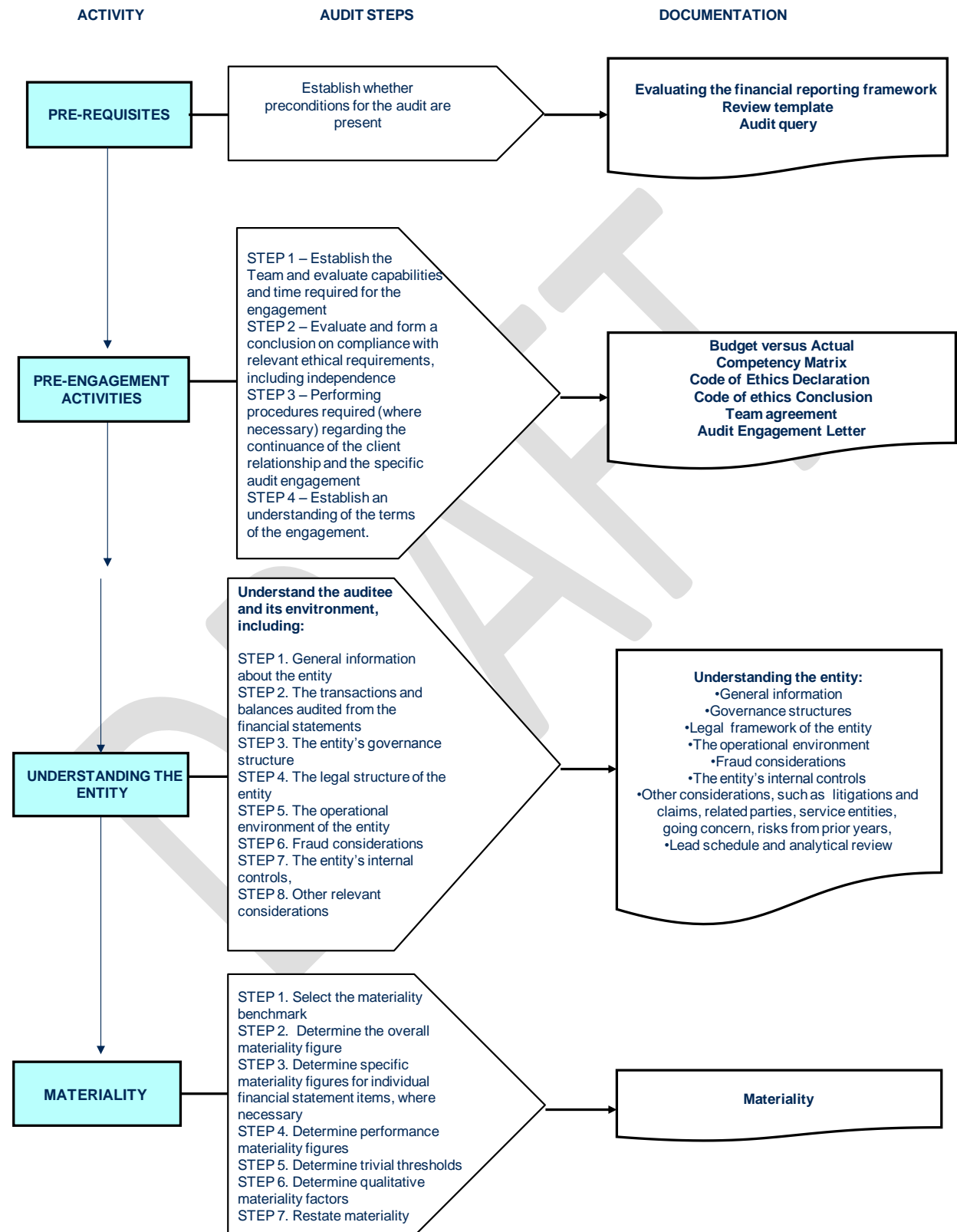
- Includes general requirement to the audit authorities, or
- Includes requirement to audit compliance with specific legislation - for example the Public Procurement Act.

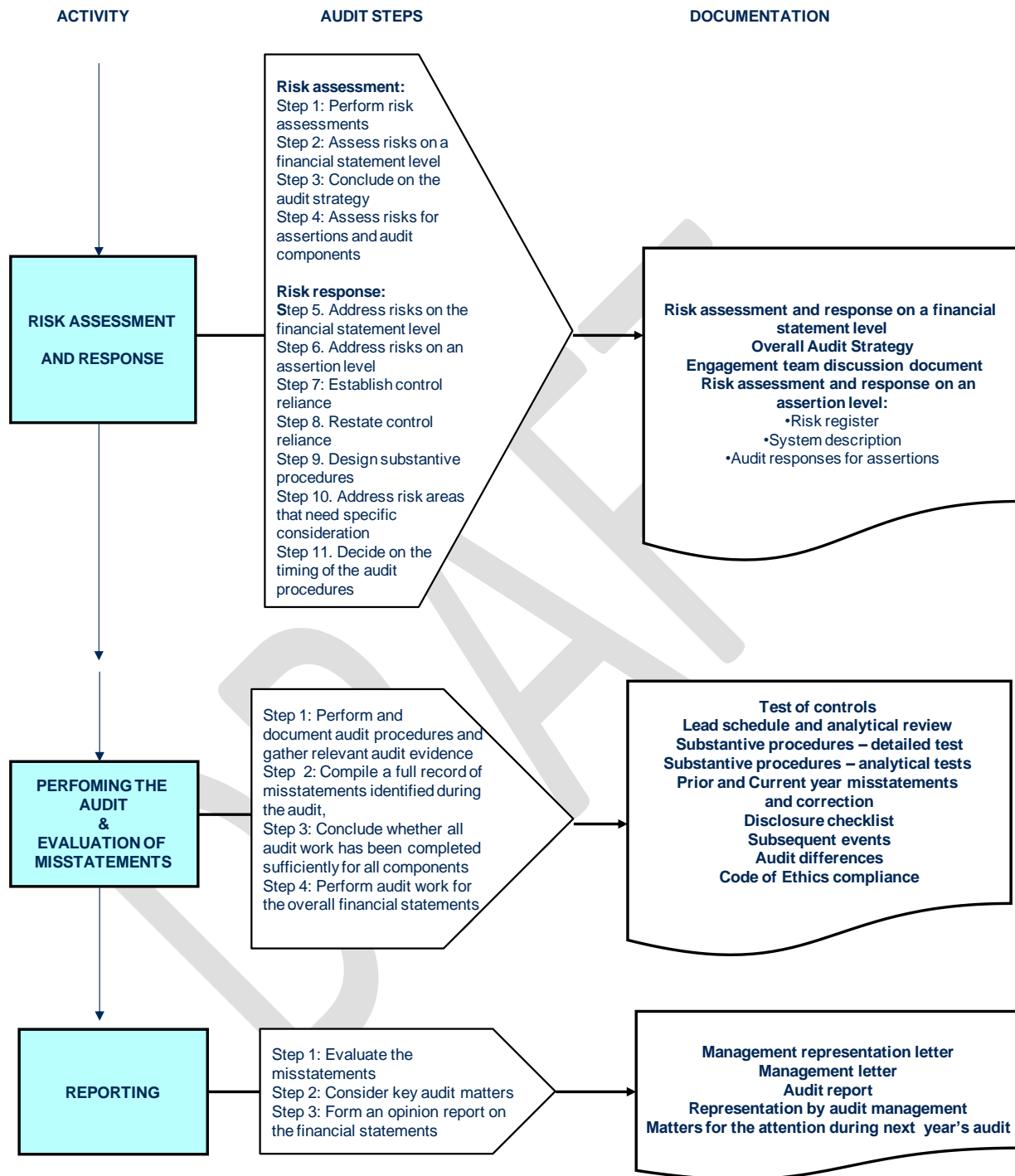
Financial and compliance audit may be reported in separate audit reports (option 1.) or it may be reported in a combined report (option 2). The diagram below depicts the options which auditors have.

Which audit methodology to use?



Audit process flow for financial audit





Customising the financial audit manual

The guidance and working papers of the manual reflect international requirements, or draw on best practices to enhance the efficiency of the audit performed. However, there may be numerous differences between SAIs in terms of their mandate, legislative environment, organisational structures etc.

There may be a need to adapt this manual to better reflect the individual circumstances of each SAI. The extent to which the manual and the work paper templates can be customised depends on that SAI's specific conditions and demands.

The SAI adopting this manual should understand their current working practices to identify what is believed to be 'good' practices. It may be decided that the SAI will follow some of these 'good' practices instead of the working paper included in this manual. This decision, however presumes a thorough understanding of the ISSAI requirements and the purpose of the working paper template replaced. The impact of any changes to a working paper due to the customisation should be considered in light of the requirements of the standards relating to the working paper.

Additional background information on the SAI may include information on the SAI, explaining legal mandates, legislative frameworks, organisational aspects and other information which is felt to be useful. As an example, working papers need to be customised to include:

- The titles of team members used in the SAI;
- Correct references to the monetary unit in use of the respective country;
- Structure of financial statements in the specific country;
- The letterhead of the SAI and bringing the documents which are externally communicated in line with communication policy of the SAI.

The audit process flow diagram should be updated with changes made to the working papers.

CHAPTER 1: PRE-REQUISITES

1.1 INTRODUCTION

This chapter focuses on the prerequisites which ensure that there is an enabling environment in which all audits are performed. Financial audit focuses on determining whether an entity's financial information is presented in accordance with the applicable financial reporting and regulatory framework. It is important that SAIs understand their mandates. In environments where compliance with authorities is the focus, SAIs should consider applying the compliance audit methodology.

1.2 CODE OF ETHICS

SAIs should have ethical rules or codes, policies and practices that are aligned with ISSAI 30, Code of Ethics. They should prevent internal conflicts of interest and corruption and ensure transparency and legality of their operations as well as actively promote ethical behaviour throughout the organisation. The ethical requirements and obligations of auditors, magistrates in the Court model, civil servants or others should be made public. Such policies and procedures should enable the SAI to monitor its independence and make provision for the following:

- Persons responsible for the audit should provide information on independence of personnel and any threats identified for audit assignments.
- Central information should be maintained, updated and monitored on the independence of personnel. This will enable the SAI to readily determine whether personnel satisfy independence requirements and take appropriate action regarding identified threats to independence that are not at an acceptable level.
- Any threats should be identified, communicated to the person in charge of the audit and eliminated or appropriately reduced by applying safeguards.
- Criteria for determining familiarity threat and safeguards to reduce such threat to an acceptable level when using the same senior personnel on an assurance engagement over a long period should be documented and adhered to; and
- Provision for rotation of the person responsible for the audit and the individuals responsible for external quality reviews after a specified period in compliance with relevant ethical requirements.

A SAI should communicate timely and widely on their activities and results, which include information about the implementation of the code of ethics. The information requires monitoring. Monitoring of the implementation of a code of ethics is also part of the internal control system.

1.3 QUALITY CONTROL

ISSAI 100 states that SAIs should adopt quality control procedures in accordance with *ISSAI*

40 – *Quality Control for SAIs and ISSAI 200 (42)* further states that -*The auditor should implement quality control procedures at the engagement level that provide reasonable assurance that the audit complies with professional standards and the applicable legal and regulatory requirements, and that the auditor’s report is appropriate in the circumstances.*

Quality control is addressed at two levels, namely at the SAI level and at the audit engagement level with respect to each individual audit engagement that is undertaken.

Quality Control at SAI Level

ISSAI 40 describes the six elements of the SAI’s system of quality control. The six elements which will be explained briefly below are: 1. Leadership responsibilities for the system of quality control; 2. Ethical requirements; 3. Client and engagement acceptance and continuance; 4. Human resources; 5. Engagement performance and; 6. Monitoring.

Leadership Responsibility for the System of Quality Control

Leadership responsibility for quality requires the Head of the SAI to take full responsibility for the quality of the work. Therefore, the Head of a SAI should develop and implement policies and procedures to ensure that quality is maintained. To implement the ISSAIs, the Head of a SAI should translate the requirements of the ISSAIs (ISSAI 40) into policies and procedures to guide the entire operations of the SAI, including the system of holding persons accountable for their quality of work such as performance appraisal system. Requisite resources such as people, infrastructure and funds should support the system and procedures initiated for quality control.

Ethical Requirements

Each SAI is expected to establish policies and procedures designed to provide them assurance that the audit personnel comply with relevant ethical requirements. This could be in the form of a code of conduct, and rotation policy to reduce familiarity threats. At the pre-engagement level, there should be a system of declaring the conflict of interest. Where threats to objectivity and independence are reported, the SAI should put measures in place such as removing the auditor from the assignment, instructing the auditor to discontinue a transaction or relationship with the entity to mitigate these threats.

Client and Engagement Acceptance and Continuance

This involves adopting policies and procedures for the acceptance and continuance of entity relationships and specific engagements. The Head of the SAI should also ensure that it has the right amount of resources such as time and technical competence of staff to perform the audit engagement. If the SAI does not have the available resources, it could consider outsourcing the audit and contracting the technical personnel to perform the engagement.

Human Resources

The SAI should be able to hire, retain, train and develop its staff and ensure that each audit team collectively has the appropriate capabilities, competence and knowledge to perform the audit in accordance with professional standards and applicable regulatory requirements.

Engagement Performance

This requires the SAI to develop and implement policies and procedures, which outline the process of audit engagement to ensure compliance with professional standards and applicable legal and regulatory requirements. The policies and procedures could be in the form of an audit manual, which outlines the audit methodologies to be used in an audit and documenting the work performed.

Critical to a quality control system at the engagement level is the need to carry out an Engagement Quality Control Review (EQCR). The review should be carried out by someone independent of the audit team, and should ensure such review is done before the audit report is issued. This review should also include an objective evaluation of the significant judgments made by the audit team, and the conclusions reached in formulating the auditor's opinion and report.

Monitoring

This requires the SAIs to establish a process to monitor its system of quality control to provide assurance that the policies and procedures in relation to quality control are relevant, adequate and operating effectively. This process can be achieved through Quality Assurance Review (QAR) of the of the quality control processes and procedures of the SAI. For small SAIs or for those who do not have the resources could use auditors independent of the audit process to carry out the QAR, or could request another SAI.

Institutional Capacity Building Framework (ICBF)

The ICBF, which was adopted in the 2006 AFROSAI-E Governing Board Meeting, consists of five domains in which a SAI can measure its development. These domains go beyond the quality control framework outlined in ISSAI 40. The additional areas in the ICBF include how the SAI is performing on the areas of independence, corporate services, communication etc. It provides a holistic approach to understand the business of the SAI, and explains how the audit disciplines are affected by the performance of other elements in the institution. To maintain this complete picture of the elements needed for the effective functioning of the SAI, the ICBF is used in AFROSAI-E as the primary vehicle for SAIs in setting up a working quality control system.

Quality Control at the Audit Level

Quality control procedures should be performed by the engagement team members for every audit as per the SAI policy. Quality control procedures are performed by team members on different levels, including the person with delegated responsibility for the audit. They are designed to ensure that each team member takes part in the responsibility for the overall quality of the audit assignment.

Team members are also responsible to provide SAI management with relevant information to enable the functioning of that part of the SAI's system of quality control relating to independence.

Role of the person responsible for the audit

The person with delegated responsibility for the audit should take overall responsibility for the quality on the audit assignment. This person should throughout the audit observe evidence for non-compliance of the audit team with ethical requirements. If any non-compliance comes to light appropriate action should be taken.

In the public sector the Auditor-General is usually the statutory auditor responsible for all audits. However, practicalities dictate that other (high level) suitably qualified audit staff with the appropriate competence, capabilities may be delegated or appointed to take over the responsibility for an assignment. Such delegation should preferably be in writing and communicated for each engagement to all relevant personnel.

The person responsible for the audit should, throughout the audit:

- Remain alert, take note and document any non-compliance with relevant ethical requirements and ensure that appropriate actions are taken;
- Take responsibility for the direction, supervision and performance of the audit engagement;
- Take responsibility for the performance of quality reviews throughout the audit
- Review the audit documentation and hold discussions with the audit team to confirm the sufficiency and adequacy of audit evidence;
- Take responsibility for ensuring that appropriate consultation is taking place on difficult or contentious matters, including the fact that appropriate conclusions are reached and implemented. Such consultation should be documented.
- Take responsibility for issuing a report which is appropriate in the circumstances.
- In addition, the person responsible for the audit should consider the results of the SAI's quality control monitoring processes as per the latest information circulated and the affect this may have audit.

1.4 THE AUDIT REVIEW PROCESS

The SAI's policies and procedures should clearly outline the different audit review levels and the role of each level of review:

The review process can be divided into the following levels (Please refer to the Audit Process for recommended review levels for the different phases and Working Papers):

- First level – lowest level of review, e.g. assistant manager/audit manager or equivalent;
- Second level – reviews may be done by the responsible senior manager or equivalent person; and
- Third level – review by the senior manager or higher. This level of review includes the person who will sign off the auditor's report.

All three levels of review should consider the following fundamental issues when reviewing an audit file:

- All required working papers and procedure steps have been adequately completed, signed by preparer and reviewer, dated and cross-referenced. When a working paper of procedural steps is omitted adequate reasons are supplied;
- The audited financial statements (and other relevant audited information) have been identified and clearly linked to the audit;
- Knowledge of business obtained is adequate to inform the auditors' decision relating to the audit approach;
- Conclusions were adequately drawn and supported by appropriate and sufficient audit evidence;
- Significant deviations from the Overall audit plan and any changes in the scope of the audit have been documented;
- Adequate level of audit coverage has been obtained for material areas;
- All significant professional judgments made have been documented and are supported by appropriate audit evidence;
- The audit was conducted in accordance with the relevant audit approach, guidelines and other directives;
- All significant audit matters have been resolved or have been appropriately reported to management in the management letter as well as in the auditor's report;
- The work performed and results obtained have been adequately documented;
- Based on the underlying audit work and findings the correct audit opinion has been expressed; and
- Reported findings are supported by adequate and sufficient audit evidence.

The working papers should be reviewed as far as possible immediately after the work has been completed. Timely review provides better control over the quality of work and the time consumed in its performance. Normally the reviewer will be on a higher level than the preparer. Quality control questionnaires have been included after each phase of the audit to facilitate timely reviews.

First level (audit supervisor/audit manager)

Depending on the size of the audit the audit supervisor or manager will conduct the first level of review. In the case of larger audits there may be more than one first-level reviewer. In such cases the reviewers should focus on the sections that have been allocated to them. First level review should be performed on an ongoing basis, for example, each time a working paper is finalized by the preparer it should be reviewed. All working papers, conclusions drawn, professional judgments made and the related audit evidence on the audit file should be reviewed. This includes the review of the following:

- Adequate and sufficient completion of working papers including clear and understandable language and spelling;
- Consistency of documented information and decisions made between different working papers;
- Significant decisions made and audit evidence supporting decisions and findings;

- The planning of the audit, balancing audit risk, tests of control and substantive tests performed, evaluating the sample sizes, conclusions, management letter issues, audit findings (exceptions), auditor's report issues, etc.; and
- Inspecting the audit procedures performed and ensuring that all the assertions were addressed.

Second level (audit manager/audit director)

The second level of review is almost as detailed as the first, but some reliance can be placed on the review work already performed. The experience and seniority of the first reviewer will influence the reliance placed on the first review conducted.

The second reviewer will still concentrate on detailed work, but to a lesser extent. Focus will be placed on documentation of key working papers, including as a minimum:

- Pre-engagement working papers, including the engagement letter;
- Links between the audited financial statements and the Lead schedule;
- Overall audit plan, including significant risk areas and audit approach;
- Appropriateness of the nature and extent of audit work performed;
- Audit summary memorandums;
- Audit differences;
- Management letter, confirming that there is adequate audit evidence supporting the findings;
- Auditor's report with supporting audit evidence for the findings.

The second reviewer should also review the work performed by the first reviewer.

Third level (audit director and all subsequent reviewers)

The third level review should be performed by the person who has delegated responsibility for the auditor's report. In certain instances, the review will be performed by more than one person within the SAI. For example, when the first level review is performed by the audit manager and the second level review is performed by the senior manager the third level review may be performed by the Director who may still not be responsible for signing off the report. In this case the person signing off the report will perform another third level review.

The person performing a third level review should be, as far as possible, involved in major decisions relating to the audit. The Overall audit strategy should be approved by the third level reviewer before any of the fieldwork is conducted. If this is not possible the third-level reviewer should at least be consulted to obtain his or her inputs regarding the audit plan and scope. This is to ensure that the correct audit approach is followed and that the person who is responsible for signing the report is aware of the aspects covered in the audit plan.

The third-level reviewer's review should focus on the following aspects:

- Work performed by the second-level reviewer;
- Appropriate and sufficient audit evidence exists to support the audit findings;
- Issues correctly raised in the management letter and auditor's report;
- Compare the work performed with the Overall audit strategy to ensure that all risk areas have been addressed and deviations from the strategy have been documented with reasons;
- Aspects relating to finalizing the audit including working papers under Audit summary and Reporting; and
- The audited financial statements, disclosure notes and the trial balance aiming to ensure that the audit sufficiently covered all significant balances and risk areas.

The scope of the third-level reviewer should be increased if he or she identifies other possible risk areas or if there is any indication that the audit file does not meet the required technical standards.

Documenting reviews

Working papers must be signed off and dated by the person who has 'prepared' and the one who has 'reviewed' the audit work. Reviews of audit work are performed on 3 levels, with the result that some working papers are reviewed more than once. When a review is complete, the reviewer should initial the working paper template and provide comments on the review sheet.

Engagement quality control reviews

In addition to the quality control procedures described above, SAIs are required to perform engagement quality control reviews of selected audits. This engagement quality control review is an independent review performed on a sample of audits which meet the established criteria. The SAI should determine in their annual overall audit plan which audits are subjected to an engagement quality control review. Usually, deciding on such reviews take into consideration aspects such as which audits carry high risk, large expenditure amongst other things.

These reviews should form part of the SAI's policies and procedures and are covered in more detail in the Quality Assurance Handbook of AFROSAI-E.

The SAI is required to establish monitoring processes designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate, and operating effectively. These procedures entail periodic quality assurance reviews which are performed on finalised audits. Engagement quality control reviews are different from the quality assurance reviews as they are conducted before the auditor's report is finalised. The auditors tasked with engagement quality control reviews should not be the same as those conducting quality assurance reviews.

The engagement quality control reviewer is a suitably qualified person or a team of individuals who are not part of the engagement team. Normally, the reviewer(s) are assigned from within the SAI. It is important that such engagement quality control reviewer should have sufficient and appropriate experience and authority to objectively evaluate the audit of the engagement team.

The performance of an engagement quality control reviews does not reduce the responsibilities of the engagement partner for the audit engagement and its performance.

The reviewer should evaluate the significant judgments made by the engagement team, and the conclusions reached in formulating the auditor's report. This evaluation includes:

- Discussion of significant matters with the engagement partner;
- Review of the financial statements and the proposed auditor's report;
- Review of selected audit documentation relating to the significant judgments the engagement team made and the conclusions it reached; and
- Evaluation of the conclusions reached in formulating the auditor's report and consideration of whether the proposed auditor's report is appropriate.

The extent of the engagement quality control review may depend, among other things, on the complexity of the audit, the level of public interest and the risk that the auditor's report might not be appropriate in the circumstances.

1.5 EVALUATING THE FINANCIAL REPORTING FRAMEWORK

The **financial reporting framework** is adopted by management of the auditee, and, where appropriate, those charged with governance in the preparation of the financial statements. The financial reporting framework selected should be acceptable in view of the nature of the entity and the objective of the financial statements and in most cases, it is required by law or regulation.

An acceptable financial reporting framework is a pre-condition for the audit. Auditors of public sector entities should identify and evaluate the relevant financial reporting framework the auditee used to prepare financial statements. The evaluation should conclude whether the financial reporting framework is acceptable to prepare the financial statements and include considerations on:

- The purpose of the financial statements, for example, whether they are prepared to meet the common financial information needs of a wide range of users (general purpose financial statements) or the financial information needs of specific users (special purpose financial statements);
- The nature of the financial statements (for example, whether the financial statements are a complete set of financial statements or a single financial statement); and
- Whether law or regulation prescribes the applicable financial reporting framework.

The form of audit opinion expressed by the auditor will also depend upon the reporting framework.

Preconditions for the audit

A financial audit conducted in accordance with ISSAIs is premised on the following conditions:

- The financial reporting framework used for preparation of the financial statements is deemed to be acceptable by the auditor. The auditor should evaluate the financial reporting framework and conclude whether it is acceptable or not. The evaluation process is described below in detail.
- Management of the entity acknowledges and understands its responsibility:
 - For the preparation of the financial statements in accordance with the applicable financial reporting framework, including, where relevant, their fair presentation;
 - For such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and
 - To provide the auditor with unrestricted access to:
 - All information of which management and, where appropriate, those charged with governance are aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;
 - Additional information that the auditor may request from management and, where appropriate, those charged with governance for the purpose of the audit; and
 - Unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

All the above aspects are confirmed and signed by the management in the Engagement letter. When the pre-conditions are not present the auditor should discuss this fact with management. Since in government there may not be an option to not undertake the audit, the impact of this limitation should be considered on the audit engagement.

Evaluating the Financial Reporting Framework of auditees

The financial reporting framework for auditees should be evaluated and there should be confirmation whether it is acceptable. The acceptability of a financial reporting framework is decided based on the nature of the entity and the objective of its financial statements.

Evaluating the financial reporting framework

SAI level evaluation of the financial reporting framework

As the same financial reporting framework is normally applicable for a group of government entities, it is most cost effective for a SAI to evaluate the acceptability of the financial reporting framework centrally at the beginning of the annual audit cycle. This approach also assists in avoiding duplication of work and possible conflicting conclusions by different auditors.

The central evaluation may be done for all government ministries preparing financial statements by using IPSAS cash basis. In addition, there may also be some additional requirements issued by the Accountant General. In this case the evaluation should also include confirming that the additional requirements are consistent with the requirements of the financial reporting framework prescribed by legislation. While some or all aspects may be considered centrally it remains the responsibility of the auditor to ensure that

the acceptability of the financial reporting framework is adequately considered, concluded and appropriate actions are taken when necessary.

The results of this central evaluation should be documented in the Annual Overall Audit Plan document of the SAI.

Criteria for evaluation

To evaluate the financial reporting framework the following aspects should be considered:

1. What is the applicable financial reporting framework for the auditee?
2. Is the relevant financial reporting framework acceptable?
3. Is the financial reporting framework a special purpose or general purpose framework?
4. Is the financial reporting framework a fair presentation framework or a compliance framework and how to report correspondingly?

Considering consolidated (government wide) accounts

In some countries, there may be only one financial statement issued centrally for the entire government. When this is the case auditors should apply the provisions of ISSAI 1600 (Special Considerations – Audits of Group Financial Statements).

The applicable financial reporting framework for the consolidated financial statements needs to be separately identified and evaluated by the auditors.

There may be additional considerations when evaluating the acceptability of the group financial reporting framework. For example, considerations may include whether it is appropriate for the framework to exclude a specific type of government entity (agency, department, bureau, corporation, fund etc.) from the group financial statements. The group auditor needs to consider whether this would result in a misleading group financial statement presentation. ***Identifying and evaluating financial reporting framework for component audits.***

If there is a requirement to perform an audit and express an opinion on the government entities which are also components of a group account, the auditors should identify and evaluate the financial reporting framework for these entities.

Considerations when the financial reporting framework is deemed unacceptable

Deficiencies in the applicable financial reporting framework indicate that the framework is not acceptable. If the financial reporting framework prescribed by law or regulation is found to be unacceptable, the auditor should:

- Request management to provide additional disclosures to avoid the financial statements being misleading;
- Draw attention to the disclosures in an emphasis of matter paragraph in the auditor's report

Unless it is required by law or regulation, auditors should not use the phrases “present fairly, in all material respects,” or “give a true and fair view” in accordance with the applicable financial reporting framework in the auditor’s opinion.

Where the law or regulation prescribes the financial reporting framework to be used for general purpose financial statements, such a financial reporting framework may be presumed to be acceptable in the absence of indications to the contrary. However, when it is determined that the framework prescribed by law and regulation is not acceptable then also consider:

- Informing the legislature; and
- Influencing standard setting by professional or regulatory organizations.

When use of the financial reporting framework is not prescribed by law or regulation, the auditor should discuss this with management. In this case management, may provide some additional disclosures or may even decide to adopt another framework that is acceptable. When management does so, the engagement letter should reflect the financial reporting framework which is acceptable.

When the deficiencies in the applicable financial reporting framework are identified after the audit engagement letter is concluded this may mean that such audit engagement is no longer applicable. When use of that framework is prescribed by law or regulation, the auditor should revert to the requirements of the previous paragraph. When use of that framework is not prescribed by law or regulation, management may decide to adopt another framework that is acceptable. When management does so, new terms of the audit engagement are agreed to reflect the change in the framework as the previously agreed terms will no longer be accurate.

1.6 THE ANNUAL OVERALL AUDIT PLAN OF THE SAI

The Audit Methodology and Standards domain of the ICBF requires SAIs to have an overall audit plan in place. The guidance in this chapter applies to the process of the SAI in compiling this plan for the regularity audit function.

Levels of plans in a SAI

Planning is done at various levels of a SAI and is a critical function in ensuring the fulfilment of goals and objectives. Plans include a strategic plan, annual operational plan, annual overall audit plan, other functional plans, business unit plans or work programs and plans for the individual audits.

Objectives of the Annual Overall Audit Plan

SAIs have wide mandates which include central and local government, public enterprises, donor funded projects and other special assignments in accordance with the SAI’S mandate. The requirements of ISSAI 12 (principle 5) include the following:

- SAIs should be responsive to changing environments and emerging risks;

- SAIs should, be aware of the expectations of stakeholders and respond to these, as appropriate, in a timely manner and without compromising their independence.
- SAIs should, in developing their work programme, respond as appropriate to the key issues affecting society.
- SAIs should evaluate changing and emerging risks in the audit environment and respond to these in a timely manner, for example by promoting mechanisms to address financial impropriety, fraud and corruption.
- SAIs should ensure that stakeholders' expectations and emerging risks are factored into strategic, business and audit plans, as appropriate.

The strategic and operational plans should take the above issues into account. Please refer to the AFROSAI-E guidance on Annual Overall Plan for more details. The annual overall audit planning process should enable the SAI to do the following:

- Compile the list of audits (standalone compliance audits should be identified separately) to be performed during the year (audit coverage).
- Assignment of audits to the different business units, considering available resources and the need to rotate audits.
- Identify audits to be performed in-house or contracted out.
- List 'small audits' which can apply the audit methodology for small entities, where applicable;
- Identify larger and high risk audits which need engagement quality control reviews.
- Distribute SAI budgets to the audit business units.
- Timing of audits and the audit calendar for the year.
- Develop strategies to clear audit backlogs.
- Plan for audits of themes or focus areas including environmental, procurement, forensic or investigative and Special audits, including those based on Parliamentary requests.

Implementation of the plan

The biggest test of any plan is in how it is implemented. What needs to be done is usually well defined in these plans but there is often a need for further guidance on how to make the provisions operational. Business unit level plans or work-plans should include more detail on how each activity is going to be carried out.

1.7 SAI POLICIES AND PROCEDURES

Outsourcing Audits

Given the mandate to carry out huge number of annual audits with limited professional staff, outsourcing is one of the suitable options to close this gap. The limited professional staff in this regard would relate to not having the required number and expertise in the SAIs to carry out their annual audits. Engaging the

Firms of Professional Accountants per se to carry out the annual audits may not appear too complicated. The main issue is whether the SAIs have technically competent staff to monitor and manage the outsourced audits.

Ensuring the quality of outsourced audits has also become a critical issue, and if not addressed, would affect the credibility of the SAIs and confidence of the stakeholders on the financial statements certified by the Firms of Professional Accountants. While outsourcing the audits, the SAIs cannot construe that they do not bear any responsibility and accountability. When the authority to outsource the audits rests with the SAIs by their respective legislations and ISSAI 20 (*Principle 5*), it is logical and justifiable to conclude that they should also assume the responsibility and accountability to manage it effectively and efficiently. Various guidance and requirements in using the work of experts are provided in ISSAI 1620. The SAI should consider whether:

- There is in existence an appropriate legal framework authorising the SAIs to outsource the audits.
- Appropriate policies have been put in place in relation to selecting the Firms of Professional Accountants and any other suitably qualified persons to be eligible to carry out the audits.
- Proper coordination and communication mechanisms and reporting requirements are in place.
- The SAI has Quality Control procedures in place to ensure the quality of outsourced audits.

Materiality

ISSAI 200 (58). The auditor should apply the concept of materiality in an appropriate manner when planning and performing the audit.

The SAI should develop guidance to auditors on how to apply the different types of materiality and the recommended percentages.

The following specific guidance should be provided:

- Appropriate benchmarks to be used for different classes of auditees
- Range of percentages to be used for overall materiality
- Examples of items where specific materiality should be used
- Recommended percentages for specific and performance materiality
- Policy and percentages for “Clearly trivial misstatements”

1.8 COMMUNICATION DURING THE AUDIT

ISSAI 200 (64). *The auditor should identify the appropriate contact person(s) within the audited entity’s governance structure and communicate with them regarding the planned scope and timing of the audit and any significant findings.*

The communication policy of the SAI

The communication policy of the SAI should cover the basic aspects of communication between auditors, the management of the auditee, those charged with governance and any other third parties relating to the audit. The policy should make provision for the following:

- The purpose, timing, format and content of communication.
- The level of responsibilities within the audit team to communicate and the person receiving the communication at the auditee or third party.
- Documentation during meetings and verbal discussions with management and those charged with governance of the audited entity. This is usually done by preparing the minutes for the meeting which should include references to all matters that were discussed and decisions that were made during the meeting.
- Timely dissemination of all documentation forming part of meetings (e.g. management letters or draft auditor's report, etc.). Documentation should ideally be distributed at least 5 working days prior to the meeting to all attendees. This may be done electronically or by delivering the relevant material to the attendees. There should be provision for additional material prior to the meeting if the exact number of attendees is not known; and
- Reasonable time to respond wherever necessary, for example, on audit queries and management letters. This may vary depending on the length of communication, where 5 working days can be used as a benchmark. This can change due to a different arrangement with the client, but it should be discussed and agreed to by both parties. Strict deadlines or other unusual circumstances can be taken into consideration each time.

Throughout the audit there should be constant communication between the auditors, the management of the audited entity and those charged with governance. Discussions with management often occur to facilitate the conduct and management of the audit engagement. They should be in the form of formal meetings with any decisions and concerns documented in the minutes of meetings and followed up. According to the provisions of this manual the following minimum information should be communicated to the auditee:

- Audit engagement letter;
- Overall audit strategy;
- Management letter(s); and
- Auditor's report.

Besides keeping management informed, information gathering is a very important reason for communicating with the auditee. Information might be gathered through interviewing personnel of the audited entity. Even though this may be an effective way of obtaining relevant information and the views of personnel, auditors should always document or confirm verbal statements with alternative documentation when used as evidence. Meetings held with personnel should be documented in the minutes of these meetings. Minutes should contain any agreements reached or requirements raised by both parties.

For material issues, confirmation may be included in the formal management representation. Alternatively, other supporting evidence may be obtained to substantiate verbal statements.

Laws or regulations or the mandate of the auditors may limit the information to be communicated to the audited entity. Auditors should be aware of these laws and regulations.

Communicating with those charged with governance

Effective two-way communication between auditors, management and those charged with governance is essential part of an audit. Communication is aimed to develop a constructive working relationship between auditors and those charged with governance while maintaining the auditor's independence and objectivity. Communication includes:

- Understanding matters related to the audit in context, the responsibilities of auditors;
- Obtaining information relevant to the audit. For example, those charged with governance may assist the auditor in understanding the entity and its environment, in identifying appropriate sources of audit evidence, and in providing information about specific transactions or events; and
- Providing timely observations to and assist in fulfilling the responsibility of those charged with governance in overseeing the financial reporting process, thereby reducing the risks of material misstatement of the financial statements.

Who to communicate with?

Firstly, the auditor needs to identify the appropriate person(s) within the entity's governance structure with whom to communicate. In the public sector, governance responsibilities may exist at several organizational levels as well as in several functions (i.e. vertically or horizontally). Thus, there may be instances where there are several distinct groups which are identified as those charged with governance. Furthermore, when the audit involves both financial statement objectives as well as compliance objectives and in some cases, that may involve separate governance bodies which need to be identified.

In situations where matters are communicated to subgroups of those charged with governance (such as an audit committee or an individual) auditors may need to convey the information, in full or in summary, to the whole governing body. This is particularly relevant in the public sector where it is not uncommon for those charged with governance to be involved in managing the entity. Auditors need to be particularly sensitive to meet the needs and expectations of the legislature or appropriate regulators about matters communicated to other governance levels, particularly where the matters may be of broad public interest or speculation.

Audit committees exist in many governments. Although their specific authority and functions may differ, auditors' communication with the audit committee has become a key element in the auditor's communication with those charged with governance.

Good governance principles suggest that:

- The auditor will be invited to regularly attend meetings of the audit committee;

- The chair of the audit committee and, when relevant, the other members of the audit committee, will liaise with the auditor periodically;
- The audit committee will meet the auditor without management present at least annually.

What to communicate?

Auditors should communicate to those charged with governance matters identified during the normal course of the audit including:

- The form, timing and the expected general content of communications.
- The responsibilities of the auditor in relation to the audit, such as the responsibility for expressing an opinion on the financial statements and the fact that the audit does not relieve management or those charged with governance of their responsibilities.
- Overview of the planned scope and timing of the audit.

The scope and timing of the audit may be defined in relevant legislation or the audit mandate. Communication regarding the planned scope and timing of the audit may assist the auditor to better understand the entity and its environment. Auditors may find it helpful to communicate their understanding of which components' financial information should be included in the entity's financial statements and to use the entity's response to verify their understanding. For example, it may be difficult to determine if, and to what extent, joint ventures (including private and public sector entities), are to be included in the entity's consolidated financial statements of an audited entity. Communication should take place through an engagement letter and the overall audit summary.

- Significant findings and key audit matters

Communication includes significant findings noted during the audit and other matters, which are in the auditor's professional judgment significant to the oversight of the financial reporting process. Significant findings should be communicated in writing when oral communication is not deemed sufficient. These may include the auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures. Auditors may have access to information relevant to those charged with governance from auditing other entities in government, such as material errors in transactions with the audited entity which also affect other entities, or designs of relevant controls which have provided efficiency gains in other entities. Communicating this type of information to those charged with governance may add value to the audit when circumstances permit. However, legislation, regulation, ministerial directives, or ethical requirements may prohibit communicating this type of information.

If the auditor identifies risks of material misstatement which the entity has either not controlled, or for which the relevant control is inadequate, or if in the auditor's judgment there is a material weakness in the entity's risk assessment process, then the auditor includes such internal control weaknesses in the communication of audit matters of governance interest.

- Written representations the auditor is requesting unless those charged with governance are involved in managing the auditee.

- Significant difficulties encountered during the audit may include such matters as delays in management providing required information or the unavailability of expected information and restrictions imposed on the auditor by management.
- Compliance with independence and Code of ethics requirements.

Auditors should communicate compliance with relevant ethical requirements including independence and political neutrality. Public sector auditors' independence and objectivity are critical to their ability (a) to hold governments accountable to legislatures and the public, and (b) to help identify threats to the good stewardship of public funds, such as corruption.

How and when to communicate?

The purpose, form and persons involved in the communication should be determined by the Communication policy of the SAI.

Communication should take place on a timely basis. This is especially important when the audit takes place throughout the year or when an interim audit is performed. Matters relating to planning and scope of the audit should be communicated early in the audit.

Auditors should evaluate whether the two-way communication between the auditor and those charged with governance has been adequate for the audit. If the two-way communication is not adequate, the auditor should take appropriate action. In the public sector, appropriate action may include communicating with the legislature or the appropriate regulators, or funding agencies.

When communication has taken place orally auditors need to document the date and place of such communication. All written correspondence should be retained and filed.

1.9 DOCUMENTING THE AUDIT

ISSAI 200 (70) states: The auditor should prepare audit documentation that is sufficient to enable an experienced auditor, with no prior knowledge of the audit, to understand the nature, timing and extent of the audit procedures performed to comply with the relevant standards and the applicable legal and regulatory requirements, the results of those procedures and the audit evidence obtained, as well as significant matters arising during the audit, the conclusions reached in their regard, and significant professional judgments made in reaching those conclusions. The documentation should be prepared at the appropriate time.

This section outlines:

- The nature, types and purpose of audit documentation
- Form, content and extent of the audit documentation
- How to document audit findings
- The assembly of the final audit file

Audit documentation

The auditor should prepare, on a timely basis audit documentation that provides sufficient and appropriate record of the basis for the auditor's report and evidence that the audit was performed in accordance with ISSAIs and applicable legal and regulatory requirements.

In addition, the auditor should prepare documentation to enable an experienced auditor, having no previous connection with the audit, to understand significant matters arising during the audit, the conclusions reached thereon, and significant professional judgements made in reaching those conclusions. Significant matters in this context may not only be material misstatements in the financial statements, but also matters relating to lack of compliance, violations of contract provisions or grant agreements or any other matters auditors are required to report on.

Audit documentation refers to all relevant working papers and audit evidence that has been obtained throughout the audit. Where working papers are not applicable, only the fact that they are not applicable and the reasons therefore should be documented. There is no need to print or put copies of these checklists in the working paper file.

In some public sector environments, such as in a Court of Accounts environment, auditors may be subject to laws and regulations requiring precise documentation procedures related to rules of evidence. Public sector auditors should familiarize themselves with these additional requirements relating to audit documentation and that are designed to ensure compliance with applicable rules of evidence.

Nature of audit documentation

Audit documentation may be recorded manually, electronically or on other media. Electronic working papers, for example, may be generated through using audit software or by preparing working papers on a spreadsheet.

Audit documentation includes working papers compiled by auditors containing audit programs, analyses, issues memoranda, summaries of significant matters, letters of confirmation and representation, checklists, and correspondence (including e-mail) concerning significant matters.

In addition, audit documentation may include abstracts or copies of the entity's records, for example, significant and specific contracts and agreements.

Types of audit documentation

Audit documentation either relates solely to the current year or they may be of a more permanent nature.

The audit file for the current year should include all the working papers and supporting evidence relating to the current year's audit objectives. There might be working papers and supporting evidence that is applicable for more than one financial year. In such cases, it may be appropriate to retain them in the current audit file, placing a copy in the previous year's current file each time a schedule is carried forward. An example of this could be the system descriptions that may not change from one year to another.

The permanent file contains information of continuing nature about the entity's operations, accounting systems and other features (for example loan/funding agreements) that are important to the conduct of the audit. The contents of the permanent file should be reviewed at every audit and schedules updated to show the latest position. Schedules considered to be outdated should be removed from the permanent file and filed in the current file of the year they relate to.

Purpose of audit documentation

The purpose of audit documentation is to provide a record of how the objectives of an audit assignment were achieved and how the audit was planned and performed in accordance with ISSAIs and applicable legal and regulatory requirements.

The audit documentation is therefore to:

- Assist auditors to plan and perform the audit.
- Assist in discharging supervision and review responsibilities
- Enable the audit team to be accountable for its work.
- Retain a record of matters of continuing significance to future audits.
- Enable the conduct of quality control reviews
- Enable the conduct of external quality assurance reviews in accordance with applicable legal, regulatory or other requirements.

Extent of audit documentation

The auditor should prepare the audit documentation to enable an experienced auditor, having no previous connection with the audit, to understand the following matters:

- Nature, timing and extent of the audit procedures performed to comply with ISSAIs and applicable legal and regulatory requirements including the identification of specific characteristics of items being tested;
- Results of the audit procedures and the audit evidence obtained;
- Significant conclusions reached;
- Discussions of significant matters with management and others on a timely basis;
- How information that is contradictory or inconsistent with the auditor's conclusions has been addressed in forming the final conclusion;
- How the audit objectives have been achieved by using alternative audit procedures and, unless otherwise clear, the reasons for the departure from the requirements of the ISSAIs;
- Any new or additional audit procedures and conclusions after the date of the auditor's report, together with the circumstances encountered, audit evidence obtained, conclusions reached and their effect on the auditor's report.

Contents of audit documentation (working papers) and audit evidence

Regarding the form and content of working papers, the auditor should prepare working papers that are sufficiently complete and detailed to provide an overall understanding of the audit. Working papers should contain at least the following information:

- The client's name, year-end, person preparing and reviewing the working paper, and respective dates for preparation and review;
- Explanations for tick-marks used should be provided;
- The work performed for example description of the audit procedure or review executed;
- The source of the sample of information that was used to perform the audit procedure (for example the source may be the ledger);
- List the transactions that were selected to be audited or the extent of the review performed;
- Sufficient information to enable re-performance of the procedure, e.g. document numbers, dates, names, reference numbers, etc.;
- The value or amount of the sample selected and coverage obtained;
- Results of the procedures performed;
- Conclusion on the work performed based on, and warranted by, the work performed and supporting audit evidence;
- Explanations, motivations of basis used when using professional judgment and conclusions reached;
- Indication that all schedules, prepared by the auditee, have been cast and cross-cast;
- Indication of the purpose of photocopied or scanned documents; and
- References to other working papers or documents.

Documenting audit findings

Audit findings, exceptions or queries should be raised and documented in the required format as soon as discovered. These findings are communicated to the auditee through the following available means:

- Audit query;
- Management letter; and
- Auditor's report.

Audit queries are a more informal means of communication (*Refer to working paper OC 2. Audit query*). These queries are sent via the accounting officer to the relevant division heads where the queries reside. This way management has an opportunity to give timely feedback or comments and additional information to the auditors. There is no restriction on the number of queries that may be sent by the auditor, but it is advised to avoid sending endless numbers of individual queries. The audit manager should rather collect the queries and send them simultaneously (for example, all queries for the week should be sent on Fridays). All such arrangements should be communicated and agreed to with the auditee.

Unresolved material findings which will be considered for reporting should nonetheless always be included (and this way repeated) in the management letter. Repeating unresolved findings will alert management to the items that will potentially appear in the auditor's report. This will ensure that auditor's reports do not contain issues that will 'surprise' management.

The management letter is normally issued at the end of the engagement summarising all unresolved findings previously raised in queries and any new issues not yet raised. Management is requested to give comments on the findings raised in the management letter.

The draft auditor's report will be presented to the auditee before it is finalised. Depending on the circumstances it may be done simultaneously with the management letter (e.g. if all findings already been reported to management). The management letter and auditor's report is dealt with in more detail under Part 6 of this manual.

The final audit file

The auditor should assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis after the date of the auditor's report. The audit file contains audit documentation relating to a specific audit.

The completion of the assembly of the final audit file after the date of the auditor's report is an administrative process that does not involve the performance of new audit procedures or the drawing of new conclusions. Changes may, however, be made to the audit documentation during the final assembly process if they are administrative in nature. Examples of such changes include:

- Deleting or discarding superseded documentation.
- Sorting, collating and cross-referencing working papers.
- Signing off on completion checklists relating to the file assembly process.
- Documenting audit evidence that the auditor has obtained, discussed and agreed with the relevant members of the engagement team before the date of the auditor's report.

When the auditor finds it necessary to modify existing audit documentation or add new audit documentation after the assembly of the final audit file has been completed, the auditor should, regardless of the nature of the modifications or additions, document:

- When and by whom they were made, and (where applicable) reviewed;
- The specific reasons for making them.

As a rule, the auditor ordinarily excludes from audit documentation superseded drafts of working papers and financial statements, notes that reflect incomplete or preliminary thinking, previous copies of documents corrected for typographical or other errors, and duplicates of documents.

Cross-referencing

All working papers documentation placed in the supporting files should have individual reference numbers.

The following documentation can be regarded as audit evidence:

- Original source documents (payment advices, invoices, tender documents and vouchers of the audited entity); and
- Schedules/working papers completed by the auditors such as a summary listing of selected transactions to test included in the work done by the auditor stating and explaining the conclusions that were drawn.

The final audited financial statements with trial balance where applicable should be referenced to the lead schedule.

It is important that the audit findings are referenced to the original source documents and not only to working papers / schedules compiled by the auditors. Auditors should be throughout the audit aware of these requirements and file copies of the audited source documents where the problems were found.

In certain instances, there will be no original source document available to support a finding. For example, this is the case when the lack of an adequate policy or process is reported.

As a rule of thumb the source documents should be cross-referenced to the summaries and working papers where the audit work has been documented and concluded on and vice versa.

Contents of the audit file

For an audit to be completed a set of pre-defined audit files must be compiled. These files are compulsory and should include all the audit phases and applicable working papers. It is recommended that SAIs should develop Model Audit Files which can be referred to as examples on how an audit file may be compiled.

When the auditor performs the audit procedures standard tick-marks should be included in the working paper or on the source documentation (as applicable) to demonstrate the audit tests performed and the results of these tests. These tick-marks must be inserted on each source document audited.

Document retention and confidentiality

Audit files should be retained with nothing deleted or discarded from them) for the period of retention required by the SAI but not less than 5 years from the date of the auditor's report.

SAIs also need to observe any legislative requirements for confidentiality of information and balance these requirements with the provisions of transparency which requires professional judgment. Requests which are made by third parties relating to audit documentation, in which instance the SAI should normally refer the request to the auditee and consult with relevant parties before releasing the information. Legislation may grant access to audit correspondence, for example where electronic or other post journals are open to public scrutiny. Documentation which is of confidential nature should be identified and treated as such.

The SAI should have clear procedures on different types of information including lines of responsibility for authorising disclosure of audit documentation and routines for making such information available.

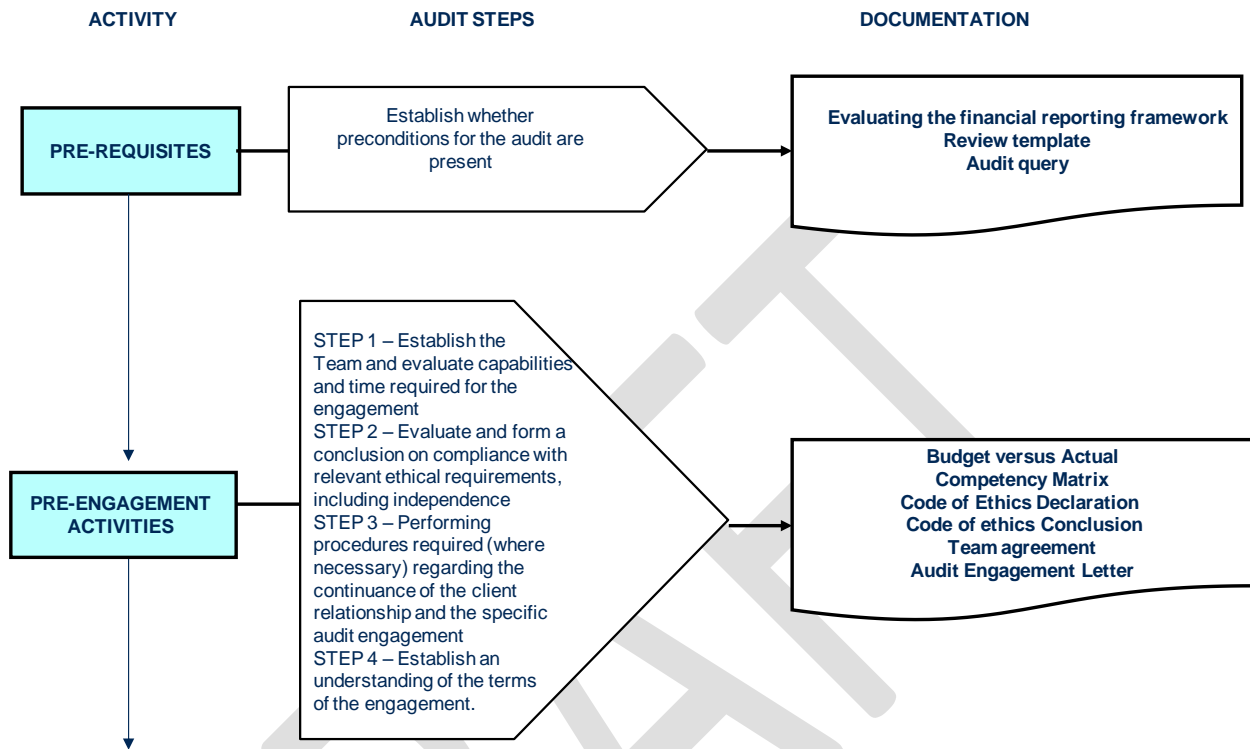
In some environments where the public sector audit work is contracted out by the SAI to other auditors, the other auditors should follow the same documentation requirements as the SAI itself.

1.10 WORKING PAPER(S) TO COMPLETE

W/P Ref	Working Paper	Objectives of the working paper	Completed by	Reviewed by
P1	Evaluating the financial reporting framework	The checklist enables the evaluation whether the financial reporting framework of the auditee is acceptable.	Centrally – by assigned team	SAI management
P2	Review Template	To document coaching / review notes issued by the reviewer and the responses on these notes.	Audit Team supervisor	Engagement Partner
P3	Audit query	To provide a basis for communication of findings with the client.	Audit Team supervisor	Audit Manager

CHAPTER 2: PRE-ENGAGEMENT

Where are we in the process?



2.1 APPLICABLE STANDARDS

On level 3 of the ISSAI framework

ISSAI 200 par 18-31
 ISSAI 200 par 40
 ISSAI 200 par 46-47
 ISSAI 200 par 46 -47
 ISSAI 200 par 161

On level 4 of the ISSAI framework

ISSAI 1200
 ISSAI 1210
 ISSAI 1220
 ISSAI 1300

2.2 OBJECTIVES

This is a key phase of the audit which assists you to identify and evaluate events or circumstances that may adversely affect your ability to plan and perform the audit engagement. The engagement partner (as

defined in the office policy) and other key members of the engagement team should be responsible for this phase. The objective of carrying out the pre-engagement activities is to ensure that:

- You maintain the necessary independence and ability to perform the engagement.
- There is no misunderstanding with the client as to the terms of the engagement.

2.3 AUDIT STEPS

STEPS IN THE PRE-ENGAGEMENT PHASE

STEP 1 – Establish the team and evaluate capabilities and time required for the engagement

STEP 2 – Evaluate compliance with relevant ethical requirements, including independence

STEP 3 – Performing procedures required (where necessary) regarding the continuance of the client relationship and the specific audit engagement

STEP 4 - Establish an understanding of the terms of the engagement.

STEP 1: Establish the audit team and evaluate capabilities and time required for the engagement

By this stage, the office plans should already have details of the team which is supposed to undertake the audit. Please refer to the preceding chapter relating to the different types of office plans. The designated person responsible for the audit should be satisfied that the entire audit team, and any external experts, collectively have the competence and capabilities to:

- a) carry out the audit in accordance with the relevant standards and the applicable legal and regulatory requirements; and
- b) enable the auditor to issue a report that is appropriate in the circumstances.

The team leader should use the Competency matrix working paper to record the names of the team allocated for the audit and their respective competencies in relation to the specific audit.

The discrepancies in relation to required capacities should be documented. The action to be followed where deficiencies are noted can include the following;

- Self-study of manuals, standards, legislative or accounting frameworks for team members who are not familiar;
- Assigning coaching responsibilities to more senior team members;
- More frequent reviews of work performed;
- Providing short courses on specific problem areas, this could even mean going through the financial reporting framework together as a team and resolve misunderstandings.

Conclusion on the capacity of the audit team should be documented and signed by the person responsible for the audit.

The Budget versus Actual Hours working paper should be used to fill in the planned budgeted hours (or days) for all the activities which relate and the budgeted time allocated to each member. The budget time

may be estimated, or based on actual time spent on the audit activities from last year. This working paper should be informed by the budgets set out in the operational plan of the SAI. The budget should be reviewed from time to time to reflect any changes to estimates, for example after the risk assessment. Throughout the audit the actual hours / days taken to perform the audit should be documented. If used correctly, this working paper will allow audit management to monitor the progress of audit work and take corrective action where necessary. Reasons for variances between actual and budgeted hours should be documented.

The team leader should use the information in the Budget vs Actual WP to complete the Team agreement working paper. This working paper should be signed by each team as the confirmation that they have understood the extent of tasks assigned to them relating the audit and taken note of the timeframes given to complete the tasks.

STEP 2: Evaluate and form a conclusion on compliance with relevant ethical requirements, including independence

Each audit team member should complete and sign the Code of ethics declaration for the audit assignment. The engagement partner should ensure that team members understand the principles of the Code of ethics and based on the individual declarations conclude for the audit assignment.

If there are any identified breaches, the engagement partner should determine whether they create a threat to independence for the audit engagement and take appropriate action to eliminate such threats or reduce them to an acceptable level by applying safeguards, or, to withdraw the affected individual withdraw from the audit engagement.

If the engagement partner cannot resolve the issues, this should be promptly reported to the SAI.

STEP 3: Performing procedures required (where necessary) regarding the continuance of the client relationship and the specific audit engagement

As stated in the preceding chapter, the acceptance and continuance process is influenced by the fact that SAIs are mandated to audit certain public sector entities. They do not have the option to decline or withdraw from mandatory engagements.

The engagement partner must refer to the SAI policy for Acceptance and continuance of auditee relationships and specific engagements. The engagement partner should undertake or continue relationships and engagements where the SAI:

- Is competent to perform the engagement and has the capabilities, including time and resources;
- Is able to comply with relevant ethical requirements; and
- Has considered the integrity of the auditee and does not have information that would lead it to conclude that the auditee lacks integrity.

The Competency matrix and Budget versus engagement working papers will assist the engagement partner to conclude in this regard. The person designated engagement partner should use information from previous audits to form a high-level opinion relating to the integrity of the auditee.

STEP 4: Establish an understanding of the terms of the engagement

The engagement letter is used to communicate to management of the audited entity regarding the objective and scope of the regularity audit and the SAI's obligations as established by law. Agreement is reached on the mutual understanding on the issues communicated and the letter is signed by both parties to evidence this agreement. It is in the interest of both the entity and SAI that the engagement letter is agreed upon before the commencement of the audit to avoid any misunderstandings.

The objective of the auditor is to agree with management of the auditee on the basis upon which the audit is to be performed, through:

- Establishing whether the preconditions for an audit are present. This refers to the use of an acceptable financial reporting framework in the preparation of the financial statements and the agreement of management to the premise on which an audit is conducted (The high-level evaluation of the financial reporting framework for a group of auditees should be undertaken on a SAI level and it is described in the preceding chapter); and
- Confirming that there is a common understanding between the auditor and management the terms of the audit engagement in writing.

The engagement partner must follow the procedures as required by the SAI policy and use the approved templates to complete the engagement letter.

The following factors may make it appropriate for the Engagement Partner to revise the terms of the audit engagement or to remind the entity of existing terms:

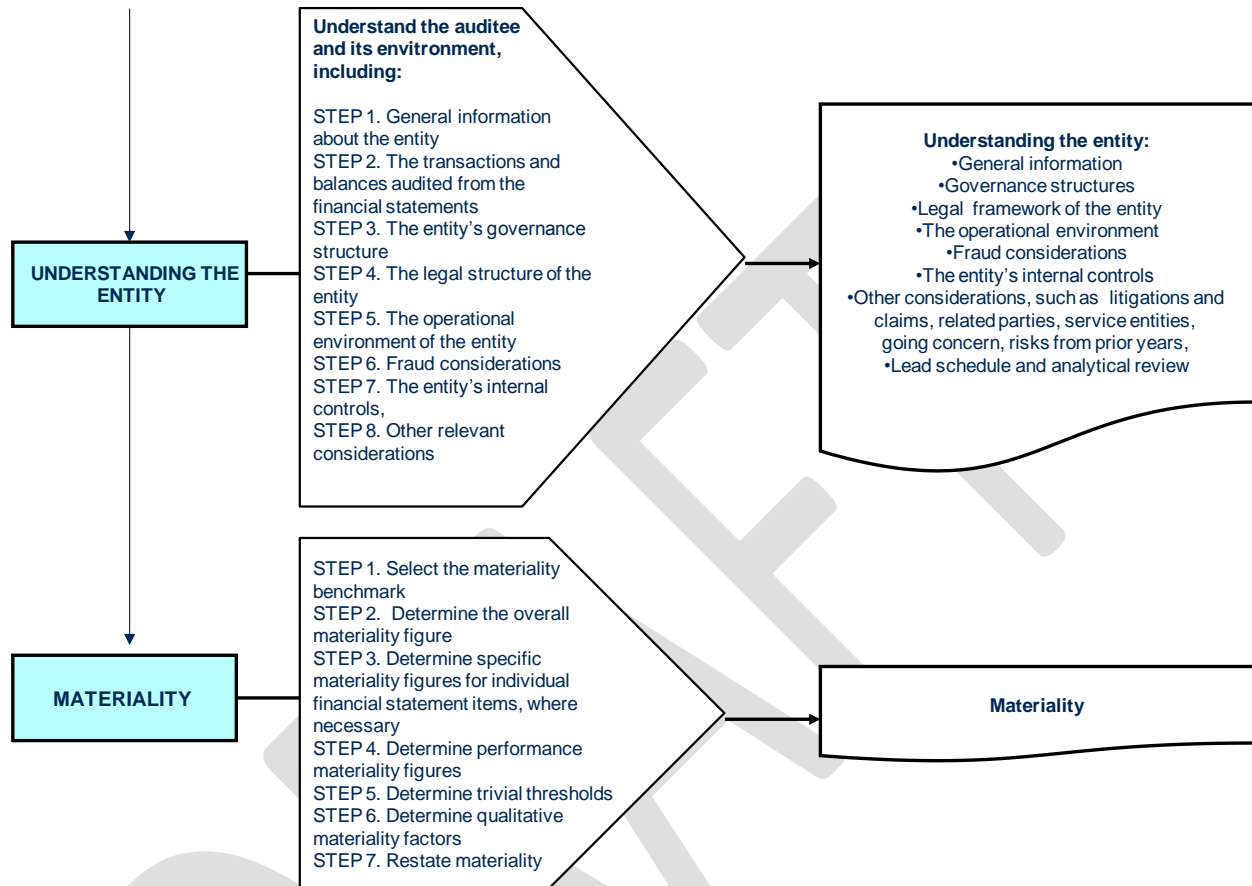
- Any indication that the entity misunderstands the objective and scope of the audit. Indicators may include late responses on requests by auditors for evidence or responding to audit queries.
- Any revised or special terms of the audit engagement.
- A recent change of senior management.
- A significant change in nature or size of the entity's operations.
- A change in legal or regulatory requirements.
- A change in the financial reporting framework adopted in the preparation of the financial statements.
- A change in other reporting requirements.

2.4 WORKING PAPER(S) TO COMPLETE

W/P Ref	Working Paper	Objectives of the working paper	Completed by	Reviewed by
PE 1	Budget versus actual	Include the planned budgeted hours (or days) as estimated including activities which relate to the audit.	Audit Supervisor /Team leader	Engagement partner
PE 2	Competency matrix	Record the names of the audit team allocated for the audit and their respective competencies in relation to the specific audit.	Audit Supervisor /Team leader	Engagement partner
PE 3	Code of ethics declaration	Consider the compliance of the audit team members with the principles of the code of ethics. Document conflicts of interests and actions taken in response.	All team members	Engagement partner
PE 4	Code of ethics conclusion	Conclude on the audit team's compliance with code of ethics.	Audit Supervisor /Team leader	Engagement partner
PE 5	Team agreement	Agreement on the scope of the work required by each team member.	Audit Supervisor /Team leader	Audit Manager
PE 6	Audit engagement letter	Communicate the terms of audit engagement to inform management and agree regarding the expectations on the audit.	Audit Supervisor /Team leader	Engagement partner

CHAPTER 3: UNDERSTANDING THE ENTITY

Where are we in the process?



3.1 APPLICABLE STANDARDS

On level 3 of the ISSAI framework

ISSAI 200 par. 85-91
ISSAI 200 Par. 104-109
ISSAI 200 par. 110-117

On level 4 of the ISSAI framework

ISSAI 1240
ISSAI 1250
ISSAI 1315
ISSAI 1330
ISSAI 1402
ISSAI 1520

ISSAI 1550
ISSAI 1570
ISSAI 1610

3.2 OBJECTIVES

You should obtain an understanding of the audited entity's environment and internal controls. This is done with the view of identifying risks and enables you to:

- Assess the risk of material misstatement whether due to fraud or error; and
- Plan and perform the audit efficiently and effectively.

3.3 AUDIT STEPS

You should gain understanding the entity and its environment, including the following aspects:

STEP 1. Obtain and document general information about the entity

STEP 2. Obtain information on the entity's governance structure

STEP 3. Understand the legal framework of the entity

STEP 4. Understand the operational environment of the entity

STEP 5. Understand fraud considerations

STEP 6. Understand the entity's internal controls,

STEP 7. Make other relevant considerations

STEP 8. Identify the transactions and balances audited from the financial statements

STEP 1: Obtain and document general information about the entity

Under general information you should document and consider risks relating to administrative aspects. These include the type of entity is audited, addresses, legal representation, banking details. Contact person(s) within the audited entity's governance structure should be identified to communicate the planned scope and timing of the audit and any significant findings.

It should be considered whether information recorded may lead to any risks or how it may influence the audit of the audited entity. The type of entity, for example, may have implications on the auditee's legal and governance structure. Significant changes or lack of staff in key positions is noted this may also imply risks.

You should also be aware of any other audit engagement(s) which may be running parallel to the financial audit. These may include compliance, performance or even forensic audit. It is a good idea to meet the auditor from the other team to exchange experiences, risks and findings.

STEP 2: Obtain information on governance structures

Those charged with governance

Those charged with governance is central for an auditee. You need to establish what function fulfils this role for the auditee. It may be an independent board or the board of directors or the director general. Once the function for those charged with governance is identified, you should inspect the documents to understand their roles and responsibilities especially relating to the financial statements.

It may pose a challenge to identify those charged with governance when the auditee is part of a broader structure with governance bodies at several organisational levels. Thus, in some cases several distinct groups may be identified as being charged with governance.

Audit committee

In some instances, those charged with governance may delegate the audit and risk assessment issues to an audit committee. If so, you would report to the audit committee, but the standards require you to also meet at least annually with those charged with governance.

Internal audit

The internal audit function is used by management to examine, evaluate and monitor the adequacy and effectiveness of internal controls of the auditee. Internal audit forms part of the control environment of the auditee and therefore it is important to consider, even if the work performed did not directly relate to the financial statements.

When the auditee has an internal audit function you should:

- Evaluate whether the work done by the internal auditors is adequate for you to put reliance on for purposes of the audit; and
- If yes, determine the extent of planned reliance on the work of the internal auditors. The effect of this reliance on the nature, timing or extent of your work should also be assessed.

The scope of the external audit may be reduced due to the reliance placed on the work of internal audit.

Expectations of the legislature and other users of the auditor's report

It is important to understand and try to meet the expectations of the legislature. This is often something that is taken care of by the SAI management, but it can also be relevant to the individual audit. Sometimes it is impossible to meet the expectations of the legislature within the mandate of a financial audit. If so, the SAI management should discuss the expectations with the legislature and consider examining previous PAC reports on the auditee.

Other external oversight structures

Other external oversight structures may include external committees or boards for example, Hospital Boards for the Ministry of Health. As this may vary from one type of entity from another it is important to understand their role and the reporting and other responsibilities of the auditee relating to these oversight bodies.

STEP 3: Understand the legal framework of the auditee

Laws and regulations

Laws and regulations may be categorized into those that affect the financial statements and those which affect operations of the entity may vary substantially.

- Some laws or regulations have a **direct effect on the** determination of material amounts and disclosures in the **financial statements** such as tax and pension laws and regulations.
- Others may not directly affect the financial statements but are **fundamental to the operations** of the entity, the ability to continue its operations, or to avoid material penalties. An example may be the compliance with the terms of an operating license.

You need to understand and consider the laws and regulation which may materially impact of both on the financial information presented and on the operations of the auditee.

You need to obtain audit evidence regarding the auditee's compliance with the provisions of those laws and regulations which have direct effect on the financial statements. For laws and regulations which effect the operations of the entity audit work may be limited to specific audit procedures for those aspects which relate to disclosures in the financial statements, i.e. inspecting correspondence, if any, with the relevant licensing or regulatory authorities.

This means that most acts, including the procurement act will only be looked at under the circumstances where the entity may risk a material fine for not complying or when an appeal of the procurement may risk serious delays that will lead to increased costs for the entity. Unless this is the case it is often near impossible for you to prove that the non-compliance has led to increased costs.

Environmental laws are treated the same way, unless a non-compliance may lead to material fines or costs for restoration it will not be part of the financial audit.

You use the overall materiality to determine what would be a material fine or extra cost.

During the Understanding the entity phase you should gain understanding of which laws may fall into which category and the impact they may have on the financial statements.

Non-compliance with the budget law, may lead to a material misstatement in the financial statement. It is recommended that such non-compliance is reported in a separate opinion to clarify the conclusions to the users of the audit report.

Financial reporting framework

The financial reporting framework is normally evaluated for the whole government sector by the SAI. However, in certain circumstances you may conclude that there is a need for additional disclosures to make the financial statements true and fair. If so you should ask management of the auditee to include such additional disclosures to the financial statements.

Accounting policies

The audited entities normally have their own accounting policies. You must establish whether they are relevant and if there have been any changes since last year. If so, establish the reasons for the changes.

STEP 4: Understand the operational environment of the entity

The nature of the audited entity

You need to gain understanding of the nature of the entity, its mandate and how it is financed. This information will give you indications of possible risks for material misstatements in the financial statement. For example, extensive reliance for an entity to collect fees may create cash flow problems. Similarly, there may be risks relating to the type of operations of the auditee, i.e. increased risks for bribes and threats in an operation involved with inspections.

Decisions due to political processes

Changes in geographic locations or closures of existing locations, reorganizations, including transfer of activities to other entities, new program areas, budgetary constraints or cut backs are all examples of decisions which have a major impact on the entity and may lead to increased costs or need to reduce staff that has a financial impact.

Programme objectives and strategies

Programme objectives and strategies, which may include public policy elements and therefore have implications for the risk assessment. A new strategy or programme objective for the entity may indicate increased cost or cut backs. Either way this is an important risk to consider.

STEP 5: Understand fraud risks

What is fraud?

Misstatements in the financial statements can arise from either fraud or error. The distinction is that fraud is caused intentionally while an error is unintentional. It is the responsibility of management of the auditee and those charged with governance to implement internal controls to prevent and detect fraud.

During gaining knowledge of the entity you should identify and assess the risks of material misstatement due to fraud at the financial statement level, and at the assertion or component level.

Objectives of the auditor in auditing fraud

Your objectives are:

- To identify and assess the risks of material misstatement of the financial statements due to fraud;
- To obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, and
- Design and implement appropriate responses to the identified risk.

You need to apply professional scepticism throughout the audit. Recognise that fraud could exist, and internal controls effective to discover errors may not be effective to discover fraud. There are two types of fraud – fraudulent financial reporting and misappropriation of assets.

You should obtain evidence regarding:

- Management's assessment of the risk of fraud;
- Management's process for identifying and responding to the risks of fraud in the entity, including any specific transactions or account balances where risk of fraud is likely to exist;

- Any actual, suspected or alleged fraud affecting the entity identified and whether those charged with governance, selected officials, board members have knowledge of these;
- The internal controls established by management to mitigate the risk of fraud, processes for identifying and responding to the risks of fraud and monitoring by those charged with governance;
- Whether unusual or unexpected relationships that have been identified in performing analytical procedures, including those related to revenue accounts, may indicate risks of material misstatement due to fraud; and
- Whether any information obtained throughout the audit indicates that fraud risk factors are present.

In terms of this, you should be able to identify the **red flags (fraud risks)** in a particular audit area or component.

Management override – significant risk

Management has the opportunity to controls to process invalid transactions, manipulate accounting records and to prepare fraudulent financial statements. The risk of management overriding controls is present in all entities. Due to the unpredictable way in which such override could occur, the risk of material misstatement due to fraud is thus a significant risk.

To respond to the risk of management override of controls, you need to:

- Test the appropriateness of material journal entries especially around the financial year end;
- Review accounting estimates for biases in management’s judgment and decisions made;
- Evaluate business rationale for significant transactions that are outside the normal course of business or otherwise unusual transactions.

Communicating fraud

Although you may suspect or, in rare cases, find evidence of fraud, you should not make legal determinations of whether fraud has actually occurred unless you are required at law to do so. Suspected or actual fraud should be communicated on a timely basis to the appropriate level of management and to those charged with governance. There may also be statutory reporting responsibility including legislature, regularity bodies and enforcement authorities, prosecutors and police.

STEP 6: Understanding the entity’s internal controls

Internal controls of auditee

You should understand the audited entity’s internal controls relevant to the audit, including:

- Communication and enforcement of integrity and ethical values to understand the control environment;
- Relevant internal controls including the manual and the information technology (IT) environment;
- Procedures, within the entity, for identifying business risks relevant to financial reporting objectives.

You should evaluate the design and implementation of the controls. Internal controls are adequately designed when they can prevent, or detect misstatements and errors. If controls are not appropriately designed, you should not consider its implementation but report the ineffective design to management.

Internal control consists of the following components:

- The control environment;
- The entity's risk assessment process;
- The information system, including the related processes, relevant to financial reporting, and communication;
- Control activities; and
- Monitoring of controls.

Some of it, such as control activities will be documented and evaluated for each audited component.

Considering the information technology (IT) environment

Most government entities use Integrated Financial Management Information Systems (IFMIS) to process financial or non-financial transactions. As part of understanding the operations of the auditee there is also a need to evaluate the IT environment.

You should gain an understanding of the auditee's application systems to:

1. Identify major application systems involved in processing financial information. If there are different modules available, auditors should also understand which modules are actually implemented from the system (general ledger, payroll, accounts receivable etc.). For example, the auditee may use an IFMIS system to document financial transactions. However, there may be other systems such as a payroll system calculating and documenting transactions relating to payroll. Also, note the non-financial systems.
2. Understand how different financial and non-financial systems interlink or feed information into the system which generates information for the financial statements. There may also be other systems documenting information on revenue collected, or debtors, which may regularly interface with the financial system. The frequency and nature of such links between systems should be understood and documented.

You, as financial auditor have a responsibility to look at the IT functions within the auditee. However, in the case of a centralised system some risks will be addressed by centralised controls. These controls may be applicable for all ministries, local authorities or sometimes for the entire government. These controls may be audited by a central team – often IT auditors of the SAI. You, as the financial auditor, should still identify and audit the risks and relevant controls within the auditee. For example, there may be a password policy on a governmental level but its application will happen on an entity level. You need to establish whether the policies are applied by the auditee.

You should understand what kind of information is transferred from one system to another? How often does this happen? Also, the modules or sub-systems used should be understood and documented.

Evaluating internal controls

At the end of gaining understanding of internal controls, you should be able to assess the general level of internal controls. You may find that the auditee has:

- good internal controls;

- medium internal controls; or
- low internal controls.

The assessment on internal controls links to the calculation of performance materiality. This means that if the general level of internal controls is good fewer items will be picked for the risk assessment, because there is a perception that the internal controls will prevent or detect any errors.

STEP 7: Make other relevant considerations

Litigations and claims against the entity

Litigations and claims often have a financial impact on the financial statements and should therefore be considered as risks for material misstatements.

Service organisations

The auditee may have outsourced some of its key functions to another organization. The first question is **whether the outsourced function relevant to the financial processes**. The services provided and the controls over them are only relevant for the audit when they influence the entity's:

- Information systems linked to financial reporting, for example when transactions, such as the payroll function, which materially impact the salaries figure in the financial statements is outsourced.
- Compliance with relevant legislative requirements;
- Procedures to initiate, record, process or correct transactions as necessary, transferred to the general ledger and reported in the financial statements. For example, when IT functions are outsourced.
- The maintenance of appropriate internal controls as applicable; and
- The delivery of services.

Services provided relating purely to processing of transactions - for example processing transactions by financial institutions or banks is not considered under this section.

When the outsourced function is relevant

When you find that the function is relevant to financial processes you should obtain audit evidence regarding the internal controls in place reducing the risk of material misstatements to financial reporting.

Related parties

Related party can be defined as:

- Another entity over which the auditee has control or significant influence, directly or indirectly through one or more intermediaries; or
- Another entity that is under common control with the auditee through having:
 - Common controlling ownership;
 - Owners who are close family members; and
 - Common key management.

Government entities under common control by a state (i.e. a national, regional or local government) are not considered related unless they engage in significant transactions or share resources to a significant extent with one another.

You should ask management of the entity about any related parties and investigate if there are any transactions with these related parties. There may also be instances where there are no transactions but there should have been, i.e. rent has not been charged to a related party.

The objectives of the audit are to:

- Obtain sufficient understanding of related party relationships and transactions of the auditee to recognise risks including the risk of fraud, and
- Conclude whether the financial statements, insofar as they are affected by those relationships and transactions achieve fair presentation in line with applicable financial reporting framework or that it is not misleading.
- Conclude that related party transactions are in compliance with legislative requirements – where applicable.

Understanding the work of an expert

“Expert” means a person or firm possessing special skill, knowledge and experience in a particular field other than accounting and auditing and whose work you may use or to obtain sufficient appropriate audit evidence.

Examples of when you may consider using the work of an expert include the following:

- Valuations of certain types of assets, for example land and buildings;
- Determination of amounts using specialized techniques or methods, for example, an actuarial valuation; and
- Legal opinions concerning interpretations of agreements, statutes and regulations

The objectives of the work you need to perform are:

- To determine whether to use the work of an auditor’s expert; and
- If using the work of an auditor’s expert, to determine whether that work is adequate for your purposes.

Going concern / Sustainability of services

How does the going concern assumption apply in public sector?

An entity is a going concern when it is reasonably certain that it will continue to meet its statutory obligations for the foreseeable future. Statutory obligations arise created by laws and regulations. In other words, a public sector entity can be seen as going concern when it is able to fulfil both its financial obligations as well as those which are prescribed by law.

Governments, and in particular, central governments, ordinarily do not become legally insolvent or bankrupt because these governments have wide-ranging powers to levy rates, fees or taxes and so are able to adjust their revenues to meet their obligations. However, in some cases governments themselves

may have large liabilities and rely on assistance from other governments. Such governments may become 'insolvent' in the sense of not being able to meet their obligations when they become due.

General purpose financial statements are prepared on the assumption that the audited entity is a going concern and will continue to meet its statutory obligations for the foreseeable future. Since the going-concern assumption is a fundamental principle in the preparation of financial statements, management must assess the audited entity's ability to continue as a going concern even if the financial reporting framework does not explicitly require them to do so.

When looking at going concern in public sector, entities lacking appropriate funding or spending more than their resources cover are affected differently to their private sector counterparts. A public sector entity will not necessarily go 'out of business' but rather it will not be able to continue operations and deliver the required services to the public or to other public sector entities. This may manifest differently in practice:

- No services delivered on primary mandates of the entity (such as no health services provided, closing of schools etc.);
- Significant impact on the services (nurses are appointed instead of doctors) as a result of lack of ability to attract the right level of skills
- Lack of ability to pay creditors including consultants who perform work on behalf of the entity which has a negative impact on economics of the country on an overall level.

Factors which may influence your assessment of risk:

- Risk of changes in government policy
- Operational risk such as insufficient working capital to continue operations, cash flow problems and lack of funding usual relationships identified in the financial statements (e.g. liabilities exceeding assets)

Additional procedures when events or conditions are identified

When events or conditions have been identified, which may cast significant doubt on the entity's ability to continue delivering services you should perform additional procedures to assess management's plans and actions.

Further guidance is available as per the Reporting chapter to this manual if you conclude that use of the going-concern assumption is appropriate in the circumstances and adequate disclosure is made in the financial statements, but that a material uncertainty exists.

Prior year's audit reports

You should consider issues reported in prior year's auditor's report, management letter and the reports of the Public Accounts Committee'. Material issues, especially those which have been repeated over many years should be identified as risk areas. The corrective actions taken by management will be followed-up during fieldwork, not at this point. You should also review all reports previously issued by performance or any other type of audits.

For initial audits or where there has been a change of auditors, information should be gathered through communicating with the predecessor auditor, who may ordinarily have the previous experience with the entity that is considered when planning recurring engagements.

STEP 8: Identify the transactions and balances audited from the financial statements

Identifying audit components

The purpose of a lead schedule is to link the audit work performed to the audited financial statements. It is important that the totals shown can easily be traced to the final, audited financial statements.

Populating the lead schedule begins with identifying material or significant classes of transactions from the financial statements for audit purposes. For this you need to consider both quantitative and qualitative materiality. For example, a component which is not material may be identified for audit due to its nature and the risks attributed to it. There may also be instances that two or more immaterial balances of the same nature, i.e. expenditures can be grouped together to form a material audit component.

It is suggested that identifying the audited components from the financial statements should be done after an overall materiality figure is calculated.

Compiling the lead schedule requires you to understand the basis behind the account balances. This will enable you to group similar type transactions into audit components.

Identifying audit components from the financial statements starts with considering the items included on the face of the financial statements. How much detail should be included? To what extent should the balances be consolidated or further broken-up?

You can start by listing all material balances on the main financial statements separately in the Lead schedule. If it is necessary to break the balances and transactions down into sub-components for audit work this may also be done in the System description (Risk assessment for assertions working paper).

Breaking the balances on the face of the financial statements into sub-components may result in too many audit components with possibly similar risks and processes. This may lead to duplication of audit work for risk assessment and even sampling which can be avoided if the components are grouped together.

Analytical review

Analytical procedures at this point are performed to obtain an understanding of the entity and identify risks. Comparing actual to budgeted amounts and prior year figures allow you to identify large differences.

Keep in mind that merely stating that there are differences is not enough to identify risks. You need to request management to comment on the differences and evaluate the risks considering these explanations.

3.4 HOW TO OBTAIN AN UNDERSTANDING OF THE AUDITEE

The various risk assessment procedures are prescribed in the working papers are:

- **Inquiries** of management and other personnel within the entity; This may include discussions with personnel on different levels of the entity, knowledgeable persons outside the entity, other auditors involved in other audits running within the entity.
- **Analytical procedures** whereby relationships between the following is considered:
 - Expenditure versus appropriation
 - Benefit payments, such as child support and pensions versus demographic allocations
 - Interest as a percentage of debt compared to the established borrowing rate
- **Observing or inspection** of documents such as
 - Legislative reports or minutes
 - Additional documents prepared by management for the legislature, such as performance reports or funding requests
 - Testimonies of agency officials
 - Ministerial and other directives
 - Official records of proceedings of the legislature.
- **Observing / re-performing** the application of specific controls

Relevant audit evidence may be obtained through a combination of inquiries and other risk assessment procedures, such as the corroboration of inquiries through observation or inspection of documents. Inquiry alone, however, is not sufficient to draw conclusions and should be supported with further procedures and evidence.

Using previous year's audit work

The entity's environment and internal controls may not have changed significantly from prior year. For continuing engagements, your previous experience with the entity and both the permanent file information and the previous year's audit files contribute to the understanding of the entity. When completing the working papers under this section, you may use the knowledge which was gained during previous years' audit, for example on the entity's organizational structure, operations, systems and controls. You should still confirm that the facts have not changed from the prior year before drawing conclusions. Appropriate audit procedures, such as walk-through procedures or inspection of documents may be necessary to establish whether changes have occurred.

3.5 NOTE FOR REVIEWER

By the act of signing off a work paper, as a reviewer you are attesting that you have ensured the following:

- All relevant information for the purposes of concluding on this stage of the audit process has been duly considered.
- You agree with the conclusions made on each work paper, that all coaching notes have been addressed appropriately.

This manual ensures the compliance with ISSAIs on level 3 of the framework. Should you be required to comply with ISSAIs on level 4 of framework, you need to read the relevant standards on level 4 to ensure full compliance with all the requirements.

3.6 WORKING PAPER(S) TO COMPLETE

W/P Ref	Working Paper	Objectives of the working paper	Completed by	Reviewed by
UE 1	Understanding the entity	Gain understanding of different aspects of the auditee's external and internal environment which may influence the financial statements.	Auditor / Audit supervisor / Team leader	Audit Manager
UE 2	IT Control Checklist	Identify high level risks relating to the manual and computerised control environment.	Auditor / Audit supervisor / Team leader	Audit Manager

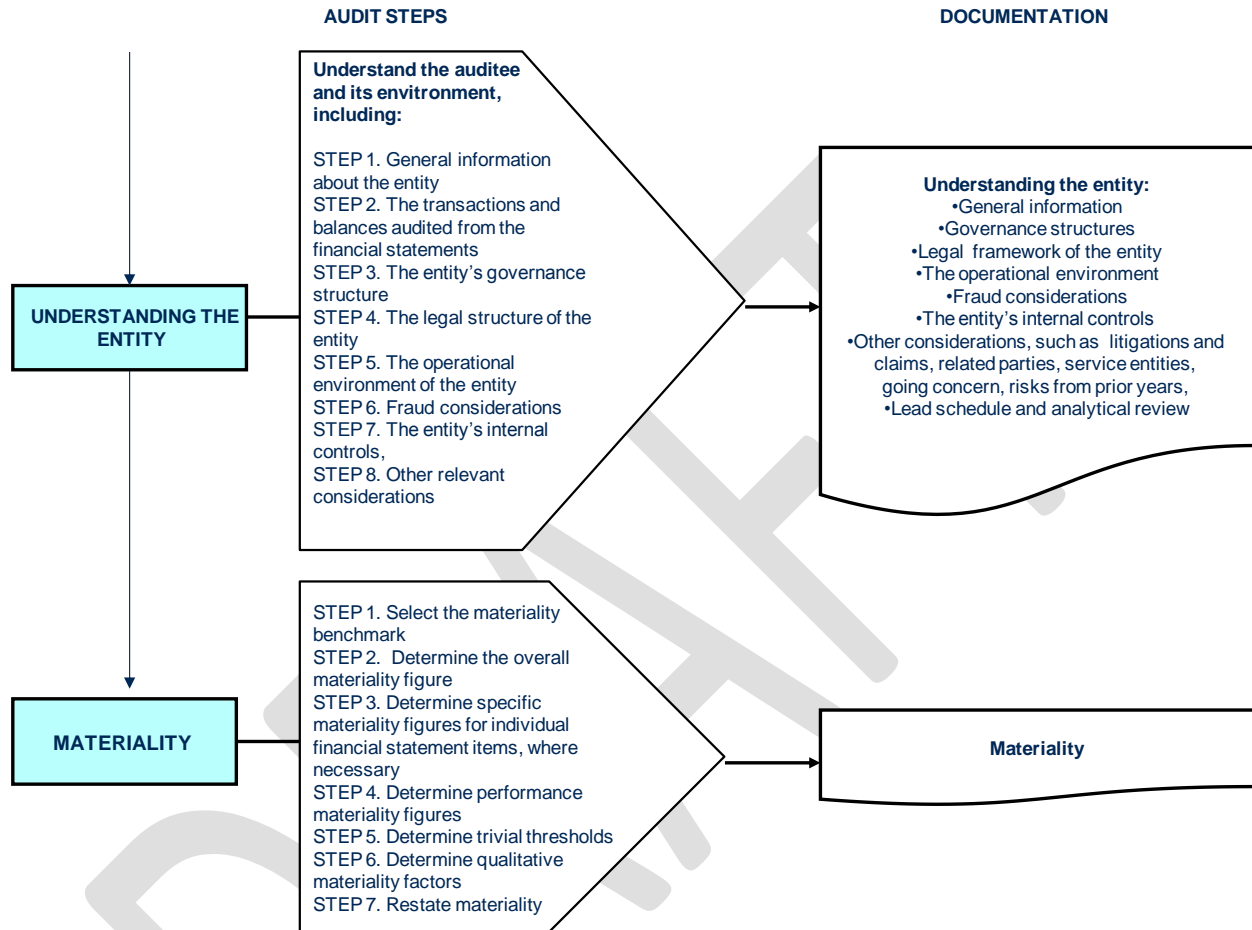
3.7 CONCLUSION

After gaining an understanding of auditee and identifying risks you will calculate the materiality figures and then proceed to the risk assessment phase of the audit. There you will consider the risks identified so far. Those risks which affect the financial statements as a whole and those which can be linked to an assertion will be documented in the respective working papers. These risks will form basis of the next phase on risk assessment and response.

The conclusion on the internal controls you will use during the calculation of materiality.

CHAPTER 4: MATERIALITY

Where are we in the process?



4.1 APPLICABLE STANDARDS

On level 3 of the ISSAI framework

ISSAI 200 par. 58
 ISSAI 200 Par. 140

On level 4 of the ISSAI framework

ISSAI 1320

4.2 OBJECTIVES

You should apply the concept of materiality in an appropriate manner when planning and performing the audit. Your objective is to apply the concept of materiality appropriately throughout the audit, especially when

- Identifying the components to be audited (overall planning)
- Determining the nature, timing and extent of audit procedures (detailed planning); and
- Evaluating the effect of misstatements (reporting)

4.3 WHAT IS MATERIALITY

Misstatements, including omissions, are material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

You make judgments about materiality based on your professional judgment regarding both the financial effect on the financial statement (quantitative materiality) and nature of the misstatement (qualitative materiality). The level of materiality is based on a consideration of the common financial information needs of users. In addition, the inherent nature or characteristics of items also need to be considered as this may render them material.

Materiality is used in planning the audit work, but also to evaluate the findings from the audit work. It is important to remember that it is only a tool and it may be necessary to deviate from the set materiality when evaluating findings.

4.4 AUDIT STEPS

Materiality is set on four different levels; overall materiality, performance materiality, specific materiality and clearly trivial. The following audit steps should be followed;

STEP 1 – Select the materiality benchmark

STEP 2 – Determine the overall materiality figure

STEP 3 – Determine specific materiality figures for individual financial statement items, where necessary

STEP 4 – Determine performance materiality figures

STEP 5 – Determine trivial thresholds

STEP 6 – Determine qualitative materiality factors

STEP 7 – Restate materiality

STEP 1: Select the materiality benchmark

The first step in calculating the overall materiality figure is to select an appropriate benchmark. The benchmark is normally an item in the financial statements. In an audit of a public sector entity, total cost or net cost (expenses less revenues or expenditure less receipts) may be appropriate benchmarks. Where a public sector entity has custody of public assets, assets may be an appropriate benchmark. Other examples of benchmarks that may be appropriate, depending on the circumstances of the entity, include categories of reported income such as total revenue or expenses, total or net asset value, total equity and profit before tax for some entities. When the most appropriate item is volatile, other items may be more appropriate to base materiality on. For example, when an asset rich entity has changing asset figures from one year to the next, this may not be appropriate to base materiality on.

STEP 2: Determine the overall materiality figure

You calculate the overall materiality figure using the benchmark selected in STEP 1. The appropriate benchmark to be used should be based on the guidelines set by the SAI management.

STEP 3: Determine specific materiality figures for individual financial statement items

As described above, the overall materiality should be determined for the financial statements as a whole. However, if you believe that for some balances or disclosures a lesser amount of materiality is applicable, a specific materiality may be calculated for that audited component. You shall consider lower materiality for audit component when the following apply:

- When law, regulation or the applicable financial reporting framework affects users' expectations regarding the measurement or disclosure of certain items (for example, related party transactions, and the remuneration of management and those charged with governance).
- Key disclosures are required for the entity (for example, research and development costs, consultancy costs etc.).
- When the attention of the user is focused on a particular aspect of the entity's operations that is separately disclosed in the financial statements (for example, a newly acquired mine or hospital, or census performed in the year etc.).

Specific materiality is often used for matters that are material by nature rather than value. In some situations, a matter well below the quantitative materiality level may be determined as material based on the nature of the item or the circumstances related to the misstatement. For example:

- The information that there are a number of transactions with related parties may be very significant to a person making a decision based on the financial statements.
- The existence of a fraud by management (however immaterial) would likely be significant to financial statement users;
- Where emphasis is placed on the issue by applicable laws and regulations and the compliance to it. For example, overspending may be deemed material irrespective of the amounts involved; and
- If the matter(s) in the public's interest or the sensitivity of the matter. In some cases, the fact that there is a need for legislative oversight and regulation in a particular area.
- Sensitive payments, i.e. remuneration to top management

Specific materiality can also be used for setting a higher overall materiality for an area, i.e. when the tax authority has all tax revenue in their financial statements, this revenue could have a higher overall materiality than the one calculated using total expenditure.

STEP 4: Determine performance materiality figures

The purpose of setting the performance materiality at a lower level than overall materiality is to provide for a buffer to reduce the probability that the total of uncorrected and undetected misstatements in the financial statements exceeds the overall materiality level. If you perform the audit to only identify individual misstatements exceeding overall materiality, there would still be a risk that the aggregate of individually immaterial misstatements would exceed the overall materiality. So, you should perform some additional work that is sufficient to allow for a margin or buffer for possible undetected misstatements.

For this reason, performance materiality is used for determining the nature, timing and extent of audit procedures to be performed. Performance materiality can also be used to identify which items in the financial statements should be included in the risk assessment (when we identify the material accounts, balances).

The performance materiality is identified as a percentage of the overall materiality. The percentage used to calculate performance materiality is based on the conclusions on the general level of internal controls in the entity. The higher the risk of material misstatement is for the audit the lower the level of performance materiality and vice versa. As the performance materiality calculation requires the assessment of the risk of material misstatement auditors should confirm at the end of strategic planning that the correct percentage is used.

Performance materiality is used to plan which items in the financial statements should be included in the risk assessment and in the planning of the audit. Performance materiality is based on the general level of internal controls at the entity, where:

- good internal controls give a performance materiality of 75% of the overall materiality,
- medium internal controls give a performance materiality of 50% of the overall materiality, and
- low internal controls give a performance materiality of 25% of the overall materiality.

This means that if the general level of internal controls is good, fewer items will be picked for the risk assessment, because there is a perception that the internal controls will prevent or detect any errors.

STEP 5: Determine trivial thresholds

During the audit, all errors and misstatements are accumulated, except for those which can be regarded as clearly trivial. Clearly trivial misstatements would not need to be accumulated because it is expected that the accumulation of such amounts clearly would not have a material effect on the financial statements.

When there is any uncertainty about whether one or more items are clearly trivial, the matter is considered not to be clearly trivial.

You should not bother about those findings and not record them in the summary of findings. Clearly trivial is normally calculated at 1% of overall materiality. The purpose of setting a level for clearly trivial is to indicate to the audit team what to look for and what not to look for and thus focusing on the material areas and bigger findings.

STEP 6: Determine qualitative materiality factors

In the public sector, you also have to consider qualitative aspects of materiality due to the public interest.

The public interest reflects the fact that all public funds represent the taxpayers' money and therefore the accountability for spending public money is much greater than for a private business.

ISSAI 1320: P10 gives more guidance on the issues to be considered as follows:

When determining whether a particular class of transactions, account balance, disclosure, or other assertion which is part of the financial reporting framework, is material by virtue of its nature, public sector auditors take into account qualitative aspects such as:

The context in which the matter appears, for example if the matter is also subject to compliance with authorities, legislation or regulations, or if law or regulation prohibits overspending of public funds, regardless of the amounts involved;

- The needs of the various stakeholders and how they use the financial statements;
- The nature of the transactions that are considered sensitive to users of the financial statements;
- Public expectations and public interest, including emphasis placed on the particular matter by relevant committees in the legislature, such as a public accounts committee, including the necessity of certain disclosures;
- The need for legislative oversight and regulation in a particular area; and
- The need for openness and transparency, for example if there are particular disclosure requirements for frauds or other losses.

Although financial audit does not directly aim to address these objectives, it should however be kept in mind throughout the audit.

(Need for more concrete examples)

STEP 7: Restating materiality

You may need to calculate materiality before the final financial statement is available, using budgeted figures, estimated amounts or interim financial information. As soon as final information is available you have to revise the calculated overall materiality and performance materiality.

You also have to revise the materiality if you become aware of information during the audit that would have caused you to determine a different materiality. At the end of the audit you should consider whether the materiality level(s) is still appropriate. You document any revision to the materiality in the Audit differences working paper.

The table below summarises the different types of materiality and how they are used during the audit.

	Overall	Specific	Performance
Purpose	To establish the threshold for determining whether the financial statements are free from material misstatement, whether due to error or fraud	To establish a threshold(s) (lower than overall materiality) to be applied to particular classes of transactions, account balances, or disclosures where misstatements of lesser amounts than overall materiality for the financial statements could reasonably be expected to influence the	To establish the threshold(s) (lower than overall or specific materiality) that ensures immaterial misstatements (less than overall or specific materiality) are identified, and provide you with a safety margin.

	Overall	Specific	Performance
		economic decisions of users.	
Basis of Calculation	What level of misstatement in the financial statements would be tolerable to users? Normally a percentage of total expenditure or total revenue is used.	What level of misstatement relating to special circumstances in a particular class of transactions, account balances, or disclosures could reasonably be expected to influence the economic decisions of users?	<ul style="list-style-type: none"> - What amounts of audit work will be required to; - Identify misstatements below - overall or specific materiality - Leave a sufficient buffer for undetected misstatements.
Rules of Thumb (For Use as a Starting Point)	Materiality is a matter of professional judgment rather than a mechanical exercise.	Establish a lower, specific materiality amount (based on professional judgment) for the audit of specific or sensitive financial statement areas.	No specific guidance is provided in the standards Percentages range from 60% (of overall or specific materiality), where there is a higher risk of material misstatement, up to 85%, where the assessed risk of material misstatement is less.
Use in audit	Determining whether uncorrected misstatements individually or in aggregate exceed overall materiality	Determining whether uncorrected misstatements individually or in aggregate, exceed the specific materiality	<ul style="list-style-type: none"> - Assessing the risks of material misstatement; and - Determining further audit procedures to respond to assessed risks.
Revision as the audit progresses	A change in circumstances that occurred during the audit due to: <ul style="list-style-type: none"> - New information - Change in your understanding of the entity 	A change in general circumstances	<ul style="list-style-type: none"> - Change in assessed risks - Nature and extent of misstatements found when performing further audit procedures; or - Change in understanding of the entity.

4.5 CONCLUSION

Once you have set materiality levels you may proceed to the risk assessment phase of the audit. Remember that the selection of the audited components from the financial statements in the Understanding the entity working paper should be based on the overall materiality figure. Refer back to part 8 of that working paper if this was not done.

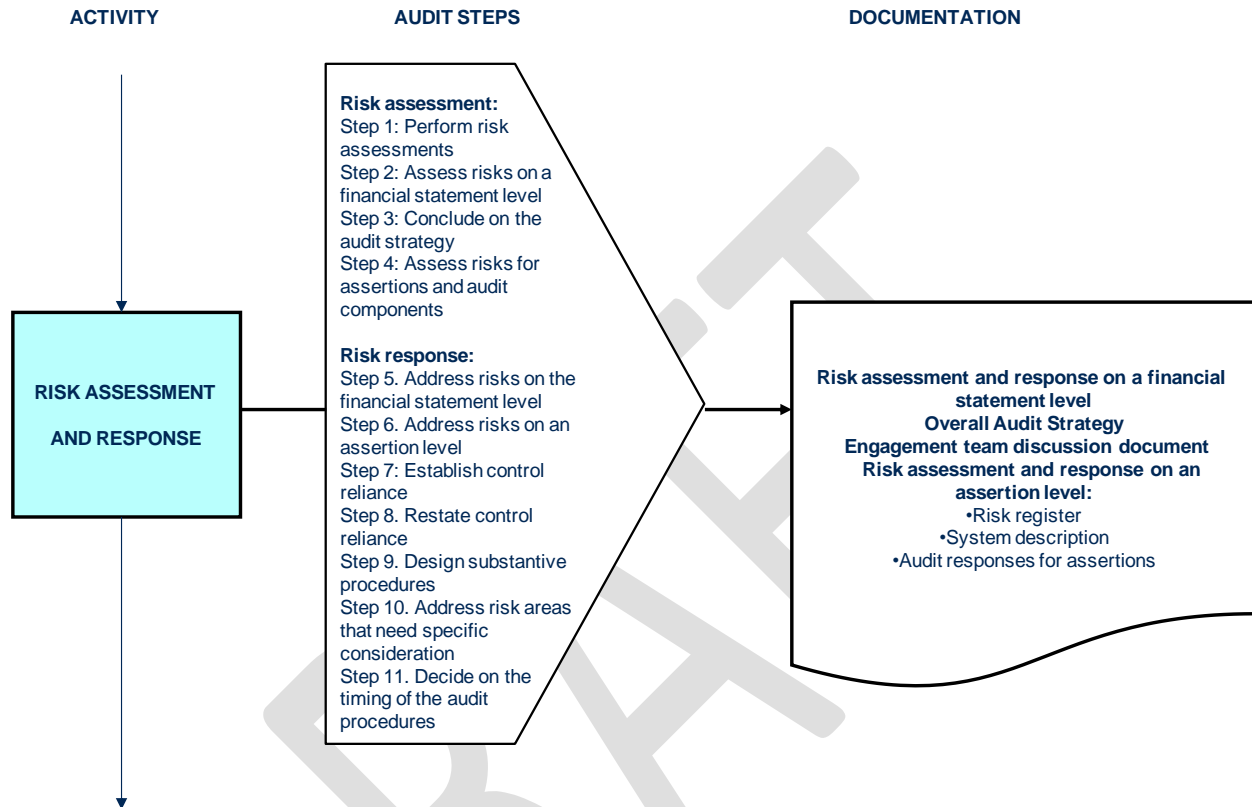
This manual ensures the compliance with ISSAIs on level 3 of the framework. Should you be required to comply with ISSAIs on level 4 of framework, you need to read the relevant standards on level 4 to ensure full compliance with all the requirements.

4.6 WORKING PAPERS TO COMPLETE

W/P Ref	Working Paper	Objectives of the working paper	Completed by	Reviewed by
M1	Planning materiality	Document the following with relevant explanations for calculations: <ul style="list-style-type: none">• Overall materiality for the financial statements as a whole;• If applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures;• Performance materiality; and• Any revision to materiality.	Auditor / Audit supervisor / Team leader	Audit Manager

CHAPTER 5: RISK ASSESSMENT AND RESPONSE

Where are we in the process?



5.1 APPLICABLE STANDARDS

Risk assessment

On level 3 of the ISSAI framework:
ISSAI 200 par. 92-95

On level 4 of the ISSAI framework:
ISSAI 1315
ISSAI 1330

Risk response

On level 3 of the ISSAI framework

ISSAI 200 par. 82; 87
ISSAI 200 Par. 92
ISSAI 200 par. 102
ISSAI 200 par. 104

ISSAI 200 par. 110, 132

On level 4 of the ISSAI framework

ISSAI 1240
ISSAI 1300 §9
ISSAI 1330.5; 6; 7
ISSAI 1540
ISSAI 1550
ISSAI 1570
ISSAI 1501
ISSAI 1505

5.2 OBJECTIVE

The objective of risk assessment phase is to assess the risks of material misstatement:

- On a financial statement level; and
- On an assertion level for the classes of transactions, account balances and disclosures which are selected for audit.

At the end of the risk assessment you should understand where to focus the audit work, e.g. on the areas which are mostly exposed to damage or loss, whether it may be due to human error or malicious act.

The objective of the risk response phase is to design appropriate audit procedures to address the assessed risks of material misstatement in the financial statements. You should understand the nature and timing of audit procedures design an appropriate mix of tests of controls, tests of detail, substantive analytical procedures to provide audit evidence and reasonable assurance at the assertion level.

5.3 AUDIT STEPS

- Step 1. Perform risk assessments
- Step 2. Assess risks on a financial statement level
- Step 3. Conclude on the audit strategy
- Step 4. Assess risks for assertions and audit components
- Step 5. Address risks on the financial statement level
- Step 6. Address risks on an assertion level
- Step 7: Establish control reliance
- Step 8. Restate control reliance
- Step 9. Design substantive procedures
- Step 10. Address risk areas that need specific consideration
- Step 11. Decide on the timing of the audit procedures

STEP 1: Perform Risk Assessments

What are risks and why are we looking at them?

A risk represents uncertainty or the potential to lose or gain something of value. For financial audit, what this means is that for these higher risk areas there is a bigger chance for the financial statements to be materially misstated. Risk assessment forms a very important part of our audit as we need to ensure that the limited time and resources are spent on areas which are susceptible to material risk - or in other words – are important.

Audits of financial statements carry the risk that you will express an inappropriate conclusion if the subject matter information is materially misstated (this is called the audit risk). The audit risk links closely to the risk that material misstatements will not be detected during the audit (detection risk). The audit therefore should be carefully planned, including risk identification procedures followed by selecting adequate responses to reduce the audit risk to an acceptable level.

During gaining knowledge of the entity you may have identified various weaknesses in evaluating the auditee's financial information, internal controls, control environment, risk management practices etc. We have also identified the audit components for the audit and perform a basic analytical review.

The risks you identified during the Understanding the entity phase of the audit will form basis of the high-level risk assessment which is described in this chapter. In addition, the risks and controls for each of the audit component will be also evaluated.

Risk identification and assessment is an ongoing process throughout the audit. New risks may arise during the year, already identified and assessed risks may need to be reassessed. Once this is done, the planning documents are updated.

Inherent risks

Inherent risk refers to the susceptibility of a class of transaction, account balance or disclosure to a misstatement that could be material.

These risks are inherently in the processes, for example the fact the cash may be stolen. What this means is that you know what will most likely go wrong for each audited component. For example, cash received will most likely be lost or stolen and consequently not recorded and banked. The risks inherently in the processes do not change over time. What may change from one auditee to another is the impact which these risks can have on the specific items. For example, one entity may have material inventory as opposed to another entity which may carry inventory at a lower value. The inherent risk that inventory may go missing should be ranked much higher at entity with material inventory. You would naturally evaluate and test relevant management controls at this entity relating to inventory. At the second entity, this may not be identified as high risk and much less audit work is planned.

Control risks

Control risk refer to the risk that a material misstatement is not prevented and / or detected by the entity's internal controls. For example, if the inherent risk is that cash may be stolen, the controls risk may be that management has not instituted controls to prevent or detect money going missing.

Significant risks

Significant risks are as it is in the name – those inherent risks which are deemed to be so severe and material that they require special audit attention. It is important to note that not all inherent risks are significant and that all entities don't necessarily have any significant risks. When identifying significant risks, you need to apply professional judgment. However, the standard outlines the instances when auditors should identify significant risks:

- If there is a risk which may lead to fraud;
- Motivation to misstate results
- Relation to recent significant economic, accounting or other developments;
- Non-routine or unusual transactions, outside normal course or operations with significant human error factor;
- Transactions involving related parties;
- Complex transactions;
- Significant estimations with high degree of subjectivity; and
- Audit adjustments or differences in prior year's audit.
- The risk also affects compliance with laws and regulations.

Remember to exclude the effects of any controls when deciding on the significance of a risk.

Material misstatements

It is important to understand the concept of material misstatement and how it relates to risks. By the end of the audit you need to be reasonably sure that all material misstatements have either been identified and corrected by management's controls or picked up and reported during the audit.

High inherent or significant risk does not mean that there the specific component will have a material misstatement. Assessing risks is the first step to identifying the areas where you need to look, do further audit work to ensure that material misstatements – should there be any - are identified.

Material misstatements normally happen when there is a high level of inherent risk without working management controls.

Key Audit Matters

Key audit matters are those matters that, according to professional judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance. The identification of key audit matters is done at every stage of executing the audit hence it is a process rather than an event which is only considered at reporting stage.

STEP 2: Assess risks on a financial statement level

Risks of material misstatement at the financial statement level are risks that relate pervasively to the financial statements as a whole and potentially affect many assertions. Examples of such as risks may be the lack of risk assessment by management, management override of controls, management's general lack of competence, management's integrity or the reliability of the entity's records. Although identifying risks is important, you are not expected to have a long list of risks at the financial statement level. Many entities may not have any risks on the financial statement level.

The first question you need to ask is whether you found a risk on a financial statement level? If yes, it is important to consider these high-level risks carefully and understand what impact they may have and what areas they may affect. For these risks there needs to be further audit work done to gain appropriate understanding.

When risks are identified, they should be documented in the Risk Assessment on a financial statement level. When there is no overall risk which can be pinpointed, this should be documented in the working paper.

For all risks identified on this level you need to ask whether it affects the reliability of the financial statements or related evidence as a whole (pervasive risk), or does it affect specific audited components. If it affects a specific audited component or assertion the risk is documented in the Risk Assessment for the relevant component and assertion affected.

How do we identify risks on a financial statement level?

As pointed out earlier risks are identified during the Understanding of the entity phase of the audit. In addition, for continuing engagements it is recommended that an initial high level risk assessment should be undertaken by the engagement partner together with the team leader. This assessment is based on professional judgment and experience, and is not intended to capture all possible risks, but to capture the most (maximum 5) important risks of material misstatement.

Questions at this point may include:

- What are the main areas where misstatements could occur for this entity?
- Are there any known cases of internal control breaches?
- Are there any risks of irregularities?
- Are there any risks related to transactions with related parties?

Examples of risks on a financial statement level may include a risk of management override or significant failures in general controls within the IT system.

These risks should be included and assessed in the first section of the Risk assessment on a financial statement level.

STEP 3: Conclude on the audit strategy

Discuss risks among the engagement team

The audit team should discuss the overall objectives of the audit and the susceptibility of the entity's financial statements to material misstatements.

The objective of discussing risks at this point is for the auditors to gain better understanding of the potential for material misstatements, especially within the areas of audit they are involved in and to provide additional knowledge from the team to the risk assessment process.

It also allows more experienced members of the team to share significant aspects regarding the auditee.

When it is not practical to include all audit members in the discussion, the engagement partner should decide who will participate and determine what must be communicated to engagement team members not involved in the discussion.

The discussions should be driven by the engagement partner and all resolutions should be documented in the Team Discussion working paper.

Document the overall audit strategy

The overall audit strategy is based on the main risks identified in step 2 and 3 and any other important risks that you may have identified as main risk areas. The overall audit strategy also includes a short description on audit responses to these risks. This may be a very short document summing up the main issues from the risk assessment procedure.

Additional information, such as a list of audited component may be included as per SAI requirement.

STEP 4: Assess risks for assertions and audited components

For each audit component identified in the Lead schedule (Step 8. Understanding the business working paper) you need to assess the risks of material misstatements.

The risk identification and assessment in the Risk assessment on an assertion level working paper. The worksheets of this working paper should be compiled separately for each audited component.

Compile a risk register

In the risk register inherent risks are listed and numbered. It is documented whether they are significant risks and to which assertion they link.

After the internal controls for risks are considered you need to include whether a control reliance or a substantive approach is followed during the audit.

Document the systems and processes for each component

Consider whether it is necessary to break up the audit component into sub-components. If you need to do that, then document the sub-components here. For example, salaries may be broken down to overtime and leave paid.

Assessing risks begins with gaining an understanding of the systems and processes in place relating to the audited component. The documentation should include the actual practices followed by the auditee. It should include the processes or activities undertaken, who is responsible with specific attention on internal controls.

STEP 5: Address risks on a financial statement level

Risk on the financial statements level needs specific considerations by you and cannot be handled by a specific audit procedure. Instead these risks might in several cases affect all the accounts, due to their nature (as explained in Step1 on performing risk assessment).

To address these risks you could consider the following activities:

- To ensure that the team has more skilled and competent resources
- To ensure that the engagement partner is present when audit work is performed and pay more attention to the review of audit papers and documentation
- Adjust the timing of the audit and plan for more not announced visits
- Use the sceptical thinking more “extensively” especially when evaluating audit evidence
- In cases the risk is referred to risk for manipulation of the financial statements you should consider more extensive tests (test of details)
- In cases where risk of fraud has been identified, the team should consider to have more discussions and follow-up meetings to ensure that everybody is focused and look for relevant audit evidence
- Consider to use external confirmations more extensively when possible
- More in-depth analytical reviews by the end of the year
- Consider to use own experts in more complicated areas instead of relying on management experts or internal audit.

Risk on financial statement level can be related to fraud, deficiencies in internal control environment or other further guidance on specific risk may be found in the Risk assessment on a financial statement working paper (insert link).

STEP 6: Address risks on an assertion level

Perform the walkthrough

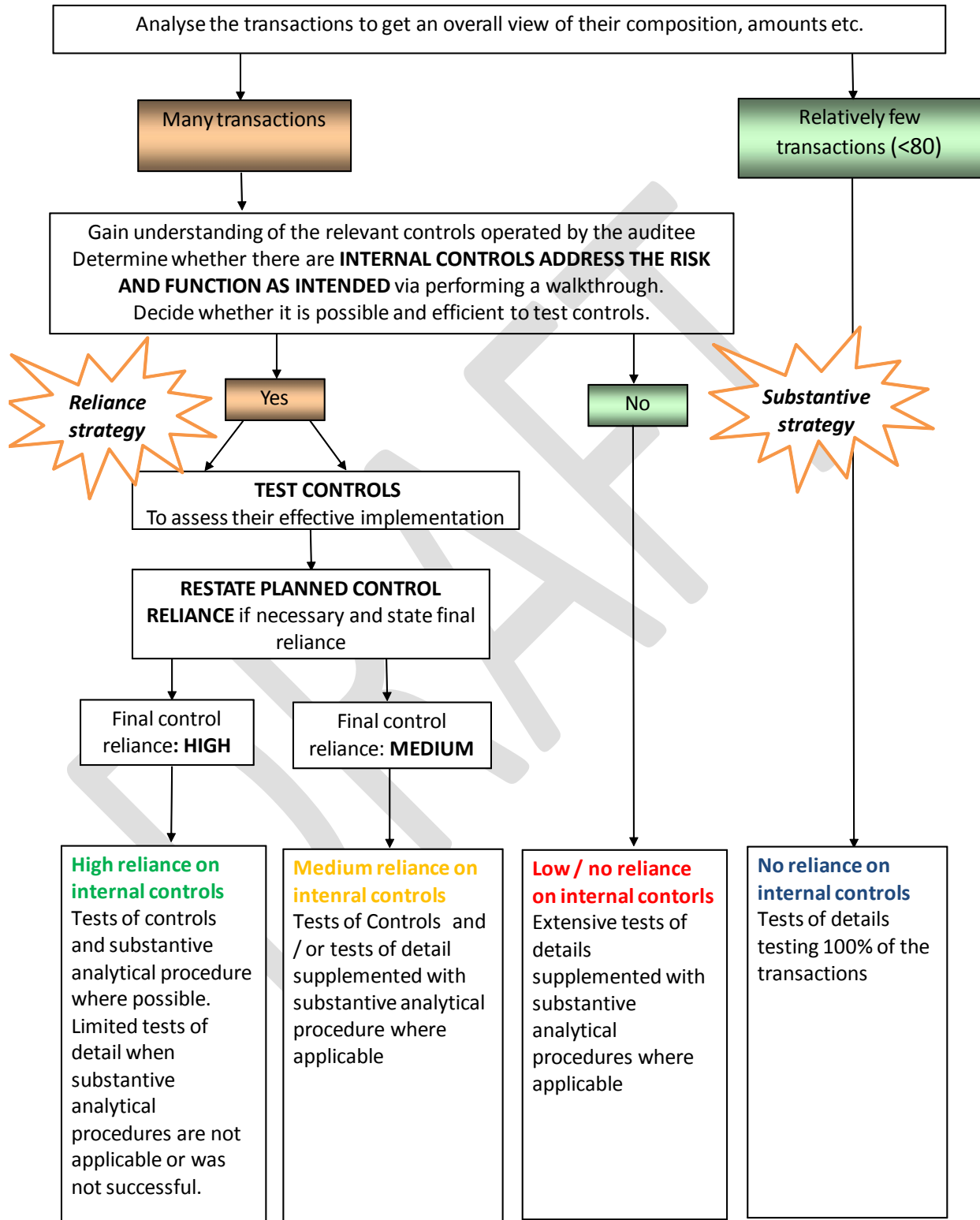
The walkthrough is aiming at answering the question: have internal controls addressing the risk been implemented?

The walkthrough is documented in section B of the Audit responses for assertion working paper. It is documented in a narrative format. You need to make sure that there is enough information on the working of internal controls to support decisions made on control reliance.

Can you place reliance on internal controls?

The decision you need to make here is whether you will follow a control reliance approach or whether you will not test controls but follow a fully substantive audit approach.

Decision tree for deciding on the audit approach



Your decision whether to rely on the controls and the extent of reliance should be supported by an understanding of the internal controls and a walkthrough.

Document the planned reliance on controls

Do you rely on controls?	Level of reliance	What does it mean?
Yes	High reliance	High reliance indicates that the entity has implemented controls which lower the risks identified by you.
Yes	Medium reliance	Medium reliance indicates that the entity has to some extent implemented controls to limit the risks identified by you. The level of risk is then considered to be medium.
No	No / Low reliance	No / low reliance indicates that the entity has not implemented relevant controls to limit the risks identified by you. The level of risk is then considered to be high. In most cases, significant risk will be related to low reliance on IC due to the specific character of the risk.

When would you decide to use the substantive strategy?

Here are two situations:

- After your preliminary analysis of an internal controls, you determine that the control itself is either not in place or it is ineffective. For example, regarding cash disbursements, maybe the auditee’s check-signing policy isn’t stringent enough (In most cases two or more signatures are required on checks over a certain amount.). Or perhaps blank company cheques aren’t kept under lock and key.
- After a preliminary analysis of the transactions you identify that the population on consists of limited number of transactions. In this case testing the control would be inefficient.

STEP 7: Establish control reliance

Tests of controls are audit procedures designed to evaluate the operating effectiveness of controls in preventing or detecting or correcting the material misstatement on assertion level.

When can test of controls be used?

By principle you should plan for more audit work to be performed for significant or high risk areas and less audit work for low risk areas. Whether you can place reliance on internal controls or not will determine the choice of the relevant types audit procedures and the extent of testing required

Test of controls should only be used when:

- You have concluded that internal controls can be relied upon. You may choose to rely on controls when these adequately address the risk and they are implemented by the auditee (based on the walkthrough). You may identify a high or medium reliance on internal controls as appropriate. (Input from your risk assessment for assertions working paper).

- Substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level. For example, when there are many transactions (though the internal control system has to be reliable).

Considerations when planning tests of controls

If you use test of controls as an audit procedure you will get audit evidence on how well the internal controls have been implemented at the auditee. It is not enough to gather evidence through interviews, process mapping and the walkthroughs. You need to understand:

- Whether the controls were applied consistently during the entire period under audit; and
- By whom or by what means they were applied but also whether the person performing the controls have understood the purpose of the controls performed.

Tests of controls are different from substantive tests of detail as you would normally inspect evidence that someone at the auditee has performed checks, verified details and authorized transactions and reconciliations etc. However, sometimes a test of control might be similar to a test of details when it comes to the actual performance. This is the case, for example when you test the effectiveness of the control, meaning that you will also have to double check that the asset isn't wrongly classified. This test of effectiveness does not need to be performed on all tested controls. You should apply professional judgment to decide when and how many.

You should keep in mind that the tested controls may depend upon other, indirect controls and, if so, whether it is necessary to obtain audit evidence supporting the effective operation of those indirect controls. Indirect control may be related to the functioning general controls in an IT system.

Relying on the work performed during previous audits

You may rely on results or evidence obtained from tests of controls performed during previous year audits. If this is the approach taken, you still need to establish that no significant changes happened to those controls subsequent to the previous audit. This is done through a walk-through documented in the Risk assessment for assertions working paper.

The following should be considered when deciding whether reliance can be placed on controls based on tests of controls performed in the previous year:

- Most relevant when you place high reliance on internal controls and the controls implemented still address the identified risk;
- The other elements of internal control confirm reliance on controls for example the control environment, the entity's monitoring of controls, and the entity's risk assessment process;
- Automated controls are considered to be more constant in its application;
- The effectiveness of general IT-controls; do you have indications that there have been changes, if so, you need to evaluate those and conclude if they affect your possibility to rely on the audit evidence from last year;
- The effectiveness of the control and its application by the entity, including the nature and extent of deviations in the application of the control noted in previous audits, and whether there have been personnel changes that significantly affect the application of the control;
- Whether the lack of a change in a particular control poses a risk due to changing circumstances; and
- The risks of material misstatement and the extent of reliance on the control.

Even if evidence is used from prior year 's work you should still document the conclusions reached about relying on such controls that were tested in a previous audit.

If there have not been such changes to the controls, you should still test the controls at least once in every third audit. Tests of controls this way should be spread over a 3-year period so that some controls are tested during each audit.

When you plan to rely on internal controls for a significant risk you need to test such controls during the current year and not rely on work performed in previous years. Significant risks are very specific and often relate to fraud, related party transactions etc. so in many cases it is not possible to find reliable controls. But in cases where the entity has estimates in the financial statements they might use an automatized system for calculations you might have identified internal controls to rely on.

STEP 8: Restate control reliance

Restating reliance on the controls may be necessary when planned high or medium reliance is no longer appropriate. In such cases, you need to restate reliance to no/low reliance and perform more extensive substantive testing.

It may be that you initially planned to place reliance on the controls but during tests of controls you find that the controls are not working as anticipated. Alternatively, during substantive testing, you detect misstatements in amounts or frequency greater than is consistent with your previous risk assessments. In both cases, you would revise control reliance to a lower level and perform more extensive substantive tests.

It may also be that you placed reliance on internal controls and the controls were tested satisfactorily. During substantive testing, however, you detect misstatements which are not consistent with a well working internal control system. In such case, you should revise the high control reliance to low or no reliance and perform more extensive substantive tests. Further guidance is provided in the *Performing the audit programs and evaluation of misstatements* chapter.

STEP 9: Design substantive procedures

Irrespective of the whether control reliance is planned you should design and perform substantive procedures for each material class of transactions, account balance, and disclosure.

You could either choose test of details or analytical substantive procedures. Which procedure you choose to perform depends on the characteristics of the transactions.

If your chosen audit procedure is a substantive procedure you have already fulfilled the requirement but if you have chosen test of controls, you need to supplement the test with test of details. The extent of the supplementary test of details is for your professional judgment and for example you could chose a judgmental sampling or MUS technique if high reliance on IC.

Substantive Analytical procedures

What are Substantive Analytical procedures?

Substantive analytical procedures are applied when you can develop an expected value for the audited accounts/balances/ transactions, using information about the entity, i.e. expected salary figure by using average salary for different sectors or average interest rate paid compared to bank interest rates. The expected value should be compared to the actual amounts in the financial statements. The variance should be lower than the accepted amount for the procedure to provide audit evidence.

You need to conclude that there is reliable data available and that is possible to calculate precise expected values. These conclusions will be based on the information from the risk assessment/evaluation of internal control phase.

When can Substantive Analytical procedures be used?

This audit procedure is complicated and should **only** be used when:

- You are very well familiar with the data and the accounts but also with all the factors/indicators which will affect the outcome of the account. For example, payrolls.
- The level of precision to predict an outcome must be high.

This procedure might be most effective for the accounts where you know all the indicators such as payroll where you know the salaries and number of employees. If not, this procedure might not be efficient enough as it requires a high level of audit evidence.

If you audit a significant risk area you are not able to choose substantive analytical procedures as the only audit procedure. In these cases, you need to combine it with test of controls or test of details.

Substantive test of details

What is test of details?

Test of details could be:

- Selecting samples for verification or inspection. You will identify transactions, invoices to be verified whether they are correctly stated in relation to the identified assertions.
- External confirmations, confirming balances with outside parties.
- Recalculation of estimates or other relevant calculations.

External confirmations are efficient method to collect audit evidence and can provide very reliable audit results. It can be used to obtain evidence about:

- The presence or absence in agreements or arrangements with third parties of legislated or other terms and conditions such as guarantees of performance or funding;
- The commitment of expenditures that have not yet been authorized by the legislature;
- The continued eligibility of individuals in receipt of pensions, income assistance, annuities or other ongoing payments; or
- The presence of — side deals with suppliers for the return of goods for credit to use funding that would have otherwise lapsed in a subsequent fiscal period.

However, auditors should keep in mind the objectivity and independence of the third party especially within government and considering the relationship between the audited entity and the third party.

An overriding requirement when selecting items for testing is that you must ensure that the population and its underlying information is **sufficiently complete and accurate** for obtaining reliable audit evidence. You should ensure that the source from which the items are to be selected is a complete and accurate record of the total population to be tested. You must have a thorough understanding of the population to be tested (the nature of the population and the characteristics of its items).

In the case of tests of details, you may perform data analytics or population profiling to obtain a deeper understanding of the composition of a total or balance, and its characteristics in terms of the types of transactions/ items, their source/ origin, volume, timing of occurrence, parties involved, segment characteristics (either business or geographic), etc.

If you were to conclude that the available information is not sufficiently complete and accurate to an extent that the planned procedures cannot reasonably be performed, considers performing alternative procedures. If alternative procedures are also not possible, the situation represents a limitation on the scope of the work.

How to design an audit procedure?

You need to consider the character of the assertion as some audit procedures might be more proper for some assertions and less relevant for other.

If your risk relates to the assertion **completeness** you need to know that this risk usually requires that you have a good picture of the internal controls relating to the entire process, from the time the transaction is initiated, received and then accounted for. This means that it would often be required to do some tests of controls (especially when it refers to large transaction volumes) or more extended walk-through. In those cases, where you choose test of details as audit procedure instead of test of controls then you should be careful when defining the population and remember that it will probably be more than the transactions accounted for on the specific account, as there might be a risk that the transaction is not accounted for at all or accounted on other accounts.

When your risk only relates to assertions **existence** or **occurrence**, test of details might be more relevant than test of controls. This is partially also relevant for **valuation**, if the valuation is done manually and not by automatic calculations that are controlled through comprehensive IT systems. You should in these cases also consider obtaining external confirmation in cases where it is deemed to be relevant, for example when dealing with shares, property, bad debts, national debt etc.

When the risk addresses **cut-offs** it is difficult to identify the most relevant audit procedure as it will depend on the amount of transactions. One option is to use the CAAT techniques to analyse and identify transactions that occurred after the closing date, especially when it involves large transactions. When there are only few transactions you would probably look at all of them, 100% test of details.

Responses for significant risks

Significant risks

For significant risk areas with no/low reliance on controls you should include tests of details as substantive procedures. You need to have a proper understating of the internal controls related to the risk, not meaning that you need to test the controls.

Significant risks require much more in-depth audit work (extent) and can be complex. You should consider using an expert if the audited area is complex such as legal issues, tax etc. For certain risks, you may find that performing substantive procedures alone will not reduce the risks of material misstatement at the assertion level to an acceptably low level. Such risks may relate to the inaccurate or incomplete recording of routine and significant classes of transactions or account balances, the characteristics of which often permit highly automated processing with little or no manual intervention. In such cases, the entity's controls over such risks are relevant to the audit and you shall obtain an understanding of them.

As external confirmations received directly by you represent more reliable evidence it is appropriate to respond to significant risks.

STEP 10: Address risk areas that need specific consideration

The audit areas which need specific considerations

In this section, you will find guidance on the appropriate audit procedures (responses) when you find risk of material misstatement relating to estimates, fraud, going concern, inventory, segment information, related parties, claims and litigations and service organizations.

Audit procedures to obtain relevant audit evidence for these areas are discussed below.

Accounting estimates

If your risk relates to estimates, you have to consider:

- How has the management chosen the method/technique used?
- Is this technique common within the business?
- How the management has considered alternative assumptions or scenarios and why these has not been used
- How the management has dealt with uncertainty in the estimates and are they disclosing the level of uncertainty in the financial statements?
- If the assumptions the management has used are relevant
- The purpose of the estimates and whether the management has the relevant capacity
- If you conclude that the management have not dealt with uncertainty in an adequate way, you need perform additional audit procedures.

As these areas are often complicated you may consider using an expert to get a second opinion. If the management has used their own experts it is recommended that you also have a discussion with them.

For more information refer to ISSAI 1540.

Response to fraud

Risk of fraud is often categorized as significant risk area. You not only need to respond to any identified risk related to fraud but you also need to perform specific mandatory audit procedures as there is always a risk that the management overrides the controls.

The risk of fraud can be both on financial statement level and on assertion level. For guidance on how to handle risk related to financial statement level, see step 5. When the risk of fraud is related to the assertion level you should consider the following when designing your audit procedures:

- More sceptical behavioural towards audit evidence
- If fraud is related to management override you should place no reliance on internal controls for the relevant component.
- Plan for unexpected audit visits when performing audit procedures such as test of details
- Interview employees related to the transactions where risk of fraud has been identified
- If you are dealing with a large population of transaction, use CAAT to analyse and identify any transactions that might be odd for example large amounts, same amounts that appears repetitively, “too even” amounts, extremely small amounts that appears repetitively etc.
- Consider using external confirmations, for example when the risk relates to payables/debts or bank
- Use an expert in complicated areas.
- If risk refers to risk of fraudulent behaviour related to cash, you should ensure to count the cash/bank deposits more regularly
- If risk refers to property being misused, then you could consider participating in inventory missions.

As there is always a risk that the management overrides the controls (risk related to **fraud**) you have to perform specific mandatory procedures to respond to this risk:

- Test the appropriateness of material journal entries recorded in the general ledger especially around the financial year end and making inquiries about any unusual or inappropriate activity relating to the processing of journals. Examples of such transactions maybe relating to privatization of government services, real-estate purchases or sales etc. Consider whether there is a need to further test journal entries and other adjustments.
- If the financial statements include accounting estimates, you need to review those and look for biases in management’s judgment and decisions made that could result in material misstatement due to fraud.
- Evaluate business rationale for significant transactions that are outside the normal course of business or otherwise unusual transactions, if you have identified any of those.

For more information refer to ISSAI 1240.

Related parties

A risk referring to related party transactions can often be classified as a significant risk, especially those identified outside the entity normal course of business. In your risk assessment, you have identified any significant transaction outside the normal course of operations and evaluated whether they are inside the normal course of operations by inquires to the management, read and analyse contracts related to the transactions.

If you identify transaction for related parties during your audit you need to obtain audit evidence that these transactions as well are inside the normal course of operations and you follow the same procedures as you have done in you risk assessment.

The risk is that the financial statements will not reflect the transactions and not about the authorization. E.g. rent is not charged, machinery is used by different entities, staff is on loan without accounting consequence. The FS will not reflect truly all the expenses etc. for the period.

Inspection of documents and substantive analytical review may assist in determining the extent of misstatement (e.g. rent not charged).

When there is no information to establish the extent of the possible misstatement than you may have to just report the facts.

For more information refer to ISSAI 1550.

Going concern

As part of your risk assessment you have assess the risk for going concern and evaluated management's assessment of the entity's ability to continue as a going concern.

You need to gather sufficient appropriate audit evidence to confirm or dispel whether a material uncertainty exists through carrying out audit procedures considered necessary, including considering the effect of any plans of management and other mitigating factors.

If you identified risk of material misstatement you need to proceed with further audit procedures, as:

- Discuss with management plans for future actions and consider any additional information.
- Obtain written representations from management regarding its plans for future action. However, management of the entity may not be fully knowledgeable regarding the future financing of the auditee. You may consider a direct confirmation from the department or executive responsible for providing financial backing or future funding to the entity.

For more information refer to ISSAI 1570.

Inventory

To obtain evidence regarding the existence of material inventory disclosed in the financial statements, you need to attend the physical inventory count at the end of the financial year. This is to:

- Evaluate management's instructions and procedures for recording and controlling the results of the entity's physical inventory counting;
- Observe the performance of management's count procedures;
- Inspect the inventory; and perform test counts; and
- Performing audit procedures over the entity's final inventory records to determine whether they accurately reflect actual inventory count results.

If you cannot attend the inventory count you should design and perform alternative audit procedures to obtain evidence regarding the existence and condition of inventory.

Additional procedures need to be performed when the physical inventory counting is conducted at a date other than the date of the financial statements to obtain audit evidence about whether changes in inventory between the count date and the date of the financial statements are properly recorded.

When material inventory is under the custody and control of a third party you should request confirmation from the third party as to the quantities and condition of inventory and perform inspections.

For more information refer to ISSAI 1501.

Segment information

When there is information disclosed on segment information in the financial statements, you should ensure that segment information is disclosed in accordance with the applicable financial reporting framework.

Examples may be reporting incomes and expenditures by fund, appropriation, program or category which forms part of the normal audit. You may be required to give an opinion on such information either as part of the overall audit opinion or separately.

Audit procedures to be performed:

- Gain understanding of the methods used by management in determining segment information;
- Evaluate whether such methods are likely to result in disclosure in accordance with the applicable financial reporting framework (such as elimination of inter-segment amounts, sales, transfers, charges etc.);
- Where appropriate, test the application of such methods; and
- Perform analytical procedures or other audit procedures appropriate in the circumstances.

Litigations and claims

When the auditee has existing litigations, and claims you need to obtain evidence relating to the completeness of disclosed information. You should seek direct communication with the entity's legal counsel. If the legal counsel is external, you can ask management to request the counsel to communicate directly with you.

The following procedures are applicable:

- Obtain a letter from the entity's legal council on outstanding claims and litigations and the possible financial effects.
- Confirm that the liabilities are correct in the AFS in line with the confirmation letter.
- As legal matters can be complicated you should consider using an expert or management's expert.
- You should also evaluate the independence and objectivity of the legal counsel.

If management refuses to give you the permission to communicate with the entity's legal counsel, this would be a scope limitation and should ordinarily lead to a qualified opinion or a disclaimer of opinion. The impact on your report would be considered in a similar manner when auditor is not able to obtain sufficient adequate audit evidence.

For more information refer to ISSAI 1501.

Service organisations

During the Understanding the entity phase you may have found that the auditee has outsourced some functions to a third party. When you found that the function is relevant to financial processes you should obtain audit evidence regarding the internal controls in place reducing the risk of material misstatements to financial reporting.

The nature and extent of audit work to be performed depends on:

- How significant these services to the auditee, i.e. do they affect internal controls?
- The nature and materiality of the transactions processed or accounts or financial reporting processes affected by the service organization;
- The degree of interaction between the activities of the service organization and those of the user entity; and
- The nature of the relationship between the user entity and the service organization, including the relevant contractual terms for the activities undertaken by the service organization.

Quite often you will find that the service organisation is a centralized government entity. If this is the case, this entity is most likely audited by the SAI. You can ensure that relevant audit work on the internal controls is performed by having discussions and looking at audit reports of the service organization.

When the service organization is not audited by the SAI, you should consult the '*Guidance on using the service organisation's auditor's report*' to identify suitable actions.

When you are not able to obtain a sufficient understanding from the user entity the following procedures may be performed:

- Obtaining a report by the auditor of the service organization conveying reasonable assurance on the controls of the service organization, if available;
- Contacting the service organization, through the auditee, to obtain specific information;
- Visiting the service organization and performing procedures that will provide the necessary information about the relevant controls at the service organization; or
- Using another auditor to perform procedures that will provide the necessary information about the relevant controls at the service organization.

For more information refer to ISSAI 1402.

STEP 11: Decide on the timing of the audit procedures

Timing for the test of controls

You should test and evaluate the operating effectiveness of controls throughout the financial year under audit.

Most of the tests of controls can be performed after year end. The selection of controls to be tested, however should be spread out through the year. When controls have been tested during an interim period, you should obtain evidence regarding the functioning of the controls after the interim period.

In cases where you have tested the necessary amount of controls covering the period of for example January - October or January – July, you should then before the year-end ensure that the controls has been in place up to the final completion of the financial statements. This can be done by:

- interviewing the responsible for the controls to verify that controls has been in place up to the final date
- follow up on documentation on the performed tests (overall level)

If you during your follow up identify any changes in the process when it comes to practices, the functionality of the controls etc. you need to consider whether these changes might have an implication on your risk assessment and conclusions on reliance on internal controls. If the changes affect your conclusion on reliance, you need to revise the risk assessment and if necessary choose another audit procedure.

Some tests of controls can only be performed during the financial year or at specific times. For example, attending an inventory count can only be done on specific dates. Planning in this regard becomes important.

Timing for test of details

When substantive procedures are performed at an interim date, you should perform further substantive procedures or substantive procedures to cover the remaining period that provide a reasonable basis for extending the audit conclusions from the interim date to the period end.

If you have identified risk of fraud you should ensure that you plan for unexpected fieldwork if possible and to visit the entity for testing on a more regular basis.

5.4 NOTE FOR REVIEWER

By the act of signing off a work paper, as a reviewer you are attesting that you have ensured the following:

- All relevant information for the purposes of concluding on this stage of the audit process has been duly considered.
- You agree with the conclusions made on each work paper, that all coaching notes have been addressed appropriately.

5.5 CONCLUSION

Now you have done your detailed planning and it is time to move on to selecting your samples and performing the audit procedures. The next phase also includes evaluation of the results of each audit procedure. If you acquire additional information that you deem as important to the audit, you must add it onto the relevant work paper and assess the impact of that information on the audit.

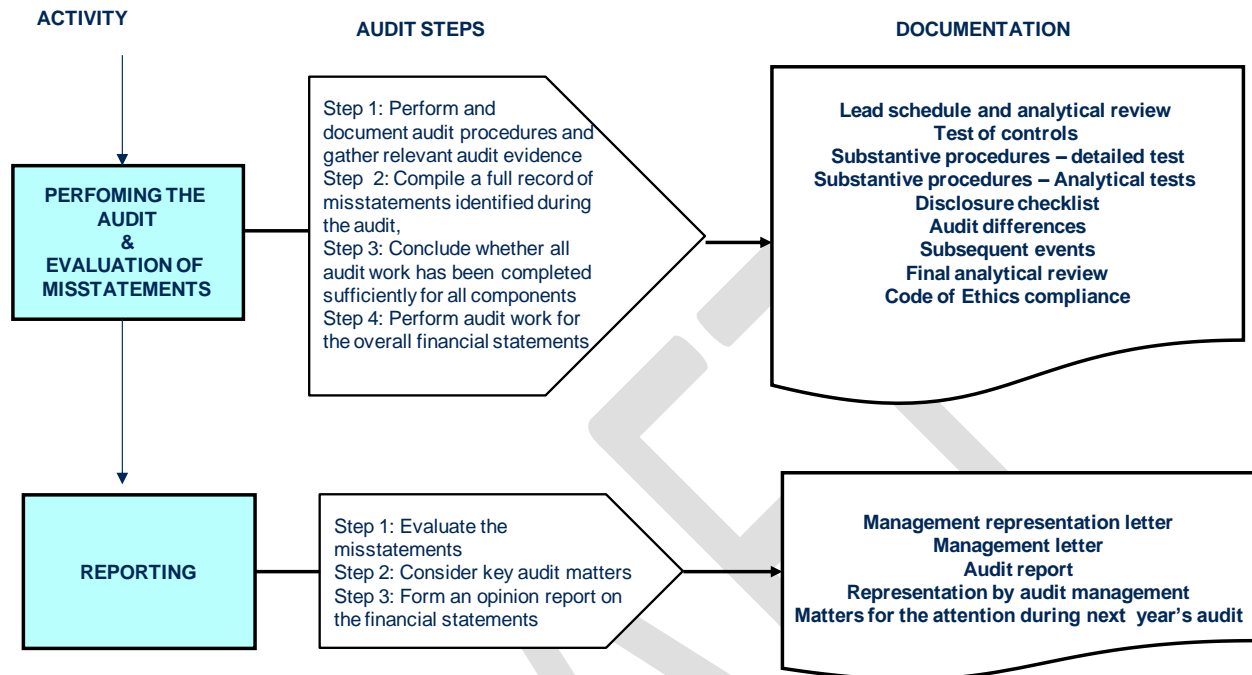
This manual ensures the compliance with ISSAIs on level 3 of the framework. Should you be required to comply with ISSAIs on level 4 of framework, you need to read the relevant standards on level 4 to ensure full compliance with all the requirements.

5.6 WORKING PAPERS TO COMPLETE

W/P Ref	Working Paper	Objectives of the working paper	Completed by	Reviewed by
RA 1	Risk assessment on a financial statement level	Document risks on a financial statement level, if any, and identify appropriate responses to address these risks.	Audit Manager	Audit Director
RA 2	Risk assessment for assertions	Document the processes, risks and controls for audit components and assertions. Assess the risk of material misstatement for each assertion.	Auditor	Audit Manager
RA 3	Team discussion document	Document the discussion by the audit team on the overall objectives of the audit and the susceptibility of the entity's financial statements to material misstatements	Audit Manager	Audit Director
RA 4	Overall audit strategy	Document the audit strategy based on the main risks identified for the audit, including those on a financial statement level and the responses identified for those risks.	Audit Manager	Audit Director

CHAPTER 6: PERFORMING THE AUDIT & EVALUATION OF MISSTATEMENTS

Where are we in the process?



6.1 INTRODUCTION

In the previous Chapter, you obtained guidance on how to plan the audit to ensure that it is conducted in an effective and efficient manner. You also obtained guidance on how to address the assessed risks of material misstatement in the financial statements, by choosing appropriate audit procedures.

6.2 APPLICABLE STANDARDS

On level 3 of the ISSAI framework

ISSAI 200 par. 102
ISSAI 200 par. 126
ISSAI 200 par. 134-138
ISSAI 200 Par. 139-142

On level 4 of the ISSAI framework

ISSAI 1240
ISSAI 1250
ISSAI 1315
ISSAI 1330
ISSAI 1450
ISSAI 1500
ISSAI 1520
ISSAI 1530

ISSAI 1560
ISSAI 1580
ISSAI 1701

6.3 OBJECTIVES

The objectives of this Chapter are to give the auditor guidance in meeting the following audit objectives:

- Performing relevant procedures for each material class of transactions, account balance and disclosure, irrespective of the assessed risks of material misstatement;
- Determining the extent of testing (sample sizes)
- Documenting audit procedures in such a way as to obtain sufficient appropriate audit evidence and thus draw conclusions on which to base the auditor's opinion;
- Keeping a full record of misstatements identified during the audit;
- Identify key audit matters and concluding on whether sufficient audit work has been done for all components.

6.4 AUDIT STEPS

1. Perform and document audit procedures and gather relevant audit evidence
2. Compile a full record of misstatements identified during the audit,
3. Conclude whether all audit work has been completed sufficiently for all components
4. Perform audit work for the overall financial statements

STEP 1: Perform audit procedures – Part 1

Perform tests of controls

The following **four steps** are performed to complete the tests of controls (discussed separately hereunder):

1. Determine the sample size,
2. Select the sample items,
3. Perform the planned procedures on the selected items,
4. Evaluate the sample results and conclude.

Step 1: Determine the sample size

You should identify the sample size for the population which is relevant to the audit program. The table below gives you guidance on how many controls needs to be tested if you decide that test of controls is a relevant audit procedure.

Recommended sample sizes for tests of control

Levels of Reliance	No / low reliance	Medium reliance	High reliance
Yearly	0	1	1
Quarterly	0	3	4

Monthly	0	6	9
Weekly	0	20	30
Daily	0	30	50
More than daily	0	30	50
Automatic system controls	0	1	1

Step 2: Select the sample items

The purpose of sampling is to draw conclusions about the entire population, you should to select a representative sample by choosing sample items which have characteristics typical of the population, and the sample needs to be selected so that bias is avoided. The following two methods may be used:

Random number sampling

Random numbers may be generated by a computer (CAATs or excel) or may be drawn from a random number table. The use of random numbers gives every sampling unit in the population the same probability of being selected.

Interval sampling

Interval sampling is to select sampling units at uniform intervals throughout the population beginning randomly. The sizes of the population and the sample determine the uniform interval. The number of items in the population is divided by the required sample size to determine the interval. For example, a population of 10 000 items divided by a required sample of 100 items would give a sampling interval of 100 (10 000/100). Systematic sampling also gives every sampling unit the same probability of being selected.

Step 3: Perform the planned procedures on the selected items

You should test controls on each item selected. You should document the work done in working paper "Test of controls".

Step 4: Evaluate the sample results and conclude

When performing the planned procedures on the items selected for the sample, the auditor may identify control deviations. You may encounter a situation where the number of control deviations indicate that controls cannot be relied upon even before testing is completed. You should than stop testing. It will only make sense to continue testing if there is a chance that a medium level of reliance is still possible, although a high level of assurance was originally planned for.

After finalising the tests of control, you need to investigate and understand the reasons for the deviations found. For example, consider whether the deviations are isolated human errors or are they likely to reoccur due to a systematic control failure. Isolated errors which are not likely to reoccur mean that you may still place reliance on the controls. However, if the errors are more systematic, or as such that they may re-occur it will be more likely that reliance on the operating effectiveness of the control(s) is affected.

You should document the work done in working paper "Test of controls".

Decisions on further actions

Finally, the auditor decides what further action is required, based on the conclusion on the sample results. The different possibilities are discussed as follows:

You need to consider the following:

You may conclude that the tests of controls that have been performed provide an appropriate basis for reliance on the controls (no deviations or deviations are trivial). In this case, you keep reliance at high and proceed with substantive testing.

If the auditor initially planned to obtain a high level of assurance, but control deviations have been identified, the following options exist:

- You may extend the sample size if you wish to obtain a high level of reliance, which could be possible if the sample size is increased and you only have a reasonably few number of deviations (1 to 2).
- Although the number of control deviations means that a high level of reliance cannot be obtained, it may still be possible for the auditor to obtain a medium level of assurance. You need to reduce the reliance from high to medium and proceed to substantive procedures.
- If there are more than 10% deviations in the population, you must restate to No/Low reliance as you cannot rely on the controls therefore you need to perform more extensive substantive procedures.
- You may decide that reliance on a different/ alternative control could possibly provide the assurance that is being sought.

Control deviations identified would normally also represent deficiencies in internal controls thus they should be communicated to management and to those charged with governance.

Performing substantive analytical procedures

This section of the guide only relates to the substantive analytical procedures when used to address risks identified in the audit plan. Substantive analytical procedure is different from the analytical procedures used in the planning phase and when concluding on the audit. The purpose of analytical procedures at the planning phase is designed to identify risk whilst a substantive analytical procedure is designed to obtain audit evidence and provide assurance.

You can use substantive analytical procedure for a population where it is possible to develop an expected value for the recorded amount or ratio. To identify the misstatement, you then compare the expected value to the actual.

The following **three steps** are performed in respect to the performance of substantive analytical procedures and to conclude on the *population being tested* (discussed separately hereunder):

1. Establish the expected value of the population being audited
2. Define the tolerable error margin
3. Compare results and conclude

Step 1: Establish the expected value of the population being audited

The expected value will be calculated based on the dependent variables/indicators that affect the outcome (trends, context).

EXAMPLE 1:

In the event that the auditor audits the assertion occurrence for salaries it will not be enough to compare the outcome of salaries with the auditors knowledge about changes in the number of staff. The auditor should be able to specify:

- Salary for various types of salary groups if available (level of salary range)
- Data on the anticipated salary per group
- How many people are in each category and how many are expected to leave or be recruited

EXAMPLE 2:

Expected value for School fees can be calculated by multiplying number of students by annual fee charged per student.

You should use professional judgment to establish how detailed an analysis should be.

- Gather the data from the data sources/systems
- Calculate, by using the data for the indicators.

Step 2: Define the tolerable error margin (deviation)

The deviation that can be accepted should be less than 5% of the expected value. A higher deviation would not give a sufficient assurance to reduce the sample size for test of detail. The level of 5% is based on professional judgment and experience; it may be changed at SAI level and not by individual auditors.

Step 3: Compare results and conclude

You should compare the actual outcome in the financial statements with the expected value calculated as per Step 1 above.

If the difference between the expected value and the actual value is less than the tolerable difference (5%) as calculated, this will give you assurance towards the disclosed amounts / ratios.

In cases where the difference is above the tolerable difference of 5%, you need to take further actions, such as:

- questions to the management, to explain the reason for the higher/lower outcome, than predicted, (for example it can be that the staff turnover was bigger than expected),
- Ask for documentation verifying the explanations. Note that higher risk requires more persuasive audit evidence,
- Assess whether the audit evidence is relevant and reliable and in line with the auditor's knowledge of the business and the information that you have.

If you can verify and corroborate the explanation for the deviation, you can reduce the number of tests of detail.

When you cannot accept the explanation to the deviation you cannot rely on substantive analytical procedure and should proceed to performing tests of detail.

Performing substantive tests of details

Tests of details are substantive procedures that are performed to detect material misstatements at the assertion level for individual financial statement items (classes of transactions, account balances or disclosures); i.e. to obtain audit evidence whether a financial statement item is free from material misstatement.

Tests of details are planned as part of the overall mix of procedures to obtain sufficient appropriate audit evidence based on the reliance on internal controls – either a Low/No; Medium or High reliance level.

The following **four steps** are performed in respect of the audit sample to complete the tests of details and to conclude on the *population for sampling* (discussed separately hereunder):

1. Determine the sample size
2. Select the sample items
3. Perform the planned procedures on the selected items
4. Evaluate the sample results and conclude

Step 1: Determine the sample size

To select items for testing, the auditor must consider what represents the population for testing in the circumstances. There are many ways of sampling for the purposes of this manual you are recommended to choose one of the following 3:

- **Selecting all items**

The auditor may decide that it will be most appropriate to examine the entire population of items that make up an account balance, class of transactions or disclosure (100% examination). This approach ensures that the auditor obtains direct evidence in relation to the entire population under consideration however it may not always be practicable or efficient.

- **Selecting specific items (Stratification)**

You may decide to select specific items (e.g. high value and unusual items) from a population for testing based on the consideration of quantitative factors or qualitative factors or a combination of both attaching to those items. When selecting specific items, you should also select a small random sample from the remainder of the population especially where there is a fraud risk. For example, if the specific items add up to 80% you should still choose some items from the remaining 20%.

- **Selecting a sample of items**

You may decide to select a sample from the whole population. Depending on your reliance on internal controls (after tests of controls) you will choose the following reliance factors when calculating your sample size.

RELIANCE ON IC	NO / LOW	MEDIUM	HIGH
Reliance factor used for sampling for tests of detail	3.0	1.6	0.9
If substantive analytical procedures are successful reduce the reliance factor to calculate sample size for tests of detail.	-0.9	-0.9	-0.9
Reliance Factor for tests of detail if substantive analytical procedure is successful	2.1	0.7	0.0

For example, if you perform tests of controls based on high control reliance and substantive analytical procedure was successfully performed, you don't have to carry on with tests of details.

To calculate the sample size for tests of detail the following formula may be used:

Sample size = Population balance x Reliance factor / Tolerable misstatement (performance materiality)

The population balance audited is as per the financial statements. The reliance factor is identified after tests of controls and based on the table above. The tolerable misstatement is usually the performance materiality.

Step 2: Select the sample items

The purpose of sampling is to draw conclusions about the entire population, the auditor endeavours to select a representative sample by choosing sample items which have characteristics typical of the population, and the sample needs to be selected so that bias is avoided. The following two methods may be used:

Random number sampling

Random numbers may be generated by a computer (CAATs or excel) or may be drawn from a random number table. The use of random numbers gives every sampling unit in the population the same probability of being selected.

Interval sampling

Interval sampling is to select sampling units at uniform intervals throughout the population beginning randomly. The sizes of the population and the sample determine the uniform interval. The number of items in the population is divided by the required sample size to determine the interval. For example, a population of 10 000 items divided by a required sample of 100 items would give a sampling interval of 100. Systematic sampling also gives every sampling unit the same probability of being selected.

Step 3: Perform the planned procedures on the selected items

The tests of details concerned must be capable of being performed on each item selected. Once a sample of items to be tested is selected, the auditor must test the whole sample. It may happen that evidence is provided for some but not all items selected. The auditor must test the whole sample and may not stop even if the misstatements already identified exceed materiality. The auditor cannot conclude whether the sample provides a reasonable basis for concluding on the population that has been tested without performing the procedures on all the items selected in the sample (or on replacement items, if

appropriate). In addition, without testing all the items the auditor will not be able to make the requisite projection of the misstatement in the sample to the population. This is documented in workpaper "Test of Detail".

Step 4: Evaluate the sample results and conclude

When performing the planned procedures on the items selected for the sample, the auditor may identify misstatements. Errors and misstatements are measured in terms of the monetary value by which the sampled item is misstated. The misstatements are either due to lack of evidence (supporting documents) or actual errors. You need to aggregate these two types of misstatements separately. For error, you project them to the whole population, but when you lack evidence you will not project.

The projected misstatement is calculated using the following formula:

Projected misstatement = Total misstatement amount ÷ Total sample amount x Total population amount

N.B *"Total misstatement amount" is the sum total of all the misstatements identified in the sample; overstatements and understatements netted off, but excluding any anomalous misstatements*

Apart from quantifying the misstatement, the auditor is required to investigate the nature, cause and circumstances of the misstatements identified and evaluate their possible effect on the purpose of the audit procedure and on other areas of the audit.

If the projected misstatements for errors exceed your performance materiality you should restate your reliance on internal controls to Low/No reliance and recalculate your sample size based on this restated reliance. If your original reliance was already set at Low/No, you should select another sample of the same size to ensure that your projected errors are more reliable before concluding.

When you cannot obtain audit evidence the sample size should not be extended and replacement items may also not be selected. Once a sample of items to be tested is selected and evidence is provided for some but not all items the auditor is required to test the whole sample and may not stop even if the misstatements already identified exceed materiality. The auditor cannot conclude whether the sample provides a reasonable basis for concluding on the population that has been tested without performing the procedures on all the items selected in the sample. If no audit evidence is provided for any items in the sample, then the sample cannot be audited and all items will represent a limitation.

STEP 2: Accumulate and evaluate misstatements

You should accumulate all your misstatements from all the audit work performed by the audit team. Draw a conclusion on whether all the planned audit work has been performed and whether there is anything else you have to do before you can close the audit and report.

The results of the procedures, including any misstatements identified with respect to particular financial statement items have to be evaluated in order to conclude whether the financial statements as a whole are free from material misstatement.

To evaluate the misstatements that have been identified during the audit, the following shall be done:

- a. Obtain an understanding of the results of audit procedures performed on individual financial statement items,
- b. Accumulate the misstatements taking into consideration the correction of misstatements,
- c. Consider the effect of uncorrected misstatements from the prior period,
- d. Determine whether uncorrected misstatements are material individually or in aggregate.

A: Obtain an understanding of the results of audit procedures performed on individual financial statement items

Misstatements are measured in terms of the monetary-value by which the affected financial statement item is misstated, or are indicated by referring to the monetary -value of an item(s) that could not be tested owing to a limitation on the scope of the audit. Misstatements can also refer to items other than monetary -value errors, such as classifications, presentations and disclosures.

Each identified misstatement is classified as a disagreement misstatement or a limitation misstatement. An inability to perform a specific procedure does not constitute a limitation if the auditor can obtain the audit evidence by performing alternative procedures. Therefore, the auditor attempts to resolve any limitation by performing alternative procedures to obtain sufficient appropriate evidence. Considerations of time and cost are not an excuse not to perform alternative procedures (the auditor must take care not to impose his/her own limitations on the audit work).

Once a misstatement is identified (a disagreement misstatement or a limitation misstatement), the auditor investigates its nature, cause and circumstances (which may require additional or follow-up inquiries, inspections or observations). The auditor must understand the assertion(s) affected, why the misstatement occurred and how the misstatement occurred.

The auditor's understanding of the nature, cause and circumstances of identified misstatements provides important input to the auditor's evaluation of whether the item being tested (or possibly other items) may be materially misstated in that it provides a basis for the consideration of relevant qualitative factors in the circumstances (discussed in further detail hereunder).

B: Accumulate the misstatements taking into consideration the correction of misstatements,

The auditor shall accumulate misstatements identified during the audit.

The auditor is concerned with whether particular classes of transactions, account balances or disclosures (at the level of the individual financial statement line items) are free from material misstatement. Therefore, as the audit progresses identified misstatements are *accumulated* in the **Work paper XXX** – which is a specific schedule of misstatements for each particular financial statement item.

C: Consider the effect of uncorrected misstatements from the prior period

In addition to accumulating misstatements identified pertaining to the current period, the auditor considers the effect of uncorrected misstatements related to prior periods on the current period auditor's opinion.

The auditor shall consider whether uncorrected misstatements from the prior period have an effect on the current period auditor's opinion by including all prior year misstatements in the *schedule of prior year uncorrected misstatements* (using the relevant standard working paper template).

Prior period uncorrected misstatements shall be evaluated against current period materiality (i.e. relevant current period materiality figures and qualitative factors in relation to the effect(s) or possible effect(s) in the context of the current period financial statements).

Misstatements from the prior period that have been corrected satisfactorily will be indicated as such in the schedule of prior year uncorrected misstatements. The status of uncorrected misstatements from the prior period will remain unchanged and these will be evaluated to determine whether they are material individually or in aggregate.

C: Determine whether uncorrected misstatements are material individually or in aggregate.

Prior to evaluating the effect of uncorrected misstatements, the auditor is required to reassess materiality to confirm whether it remains appropriate in the context of the entity's actual financial statements. This revision may be because of the auditor becoming aware of information during the audit that would have caused the auditor to have determined a different amount initially.

Taking into account any revision of materiality that may be required, the auditor uses the following materiality figure(s) for purposes of evaluating the effect of uncorrected misstatements:

- Overall materiality figure; and
- If applicable, any specific materiality figure(s) that applies to the particular class of transactions, account balance or disclosure.

The auditor's evaluation commences with evaluating each uncorrected misstatement individually in terms of its effect on the particular financial statement item (class of transactions, account balance or disclosure) concerned. Compare the quantum/amount-value of each uncorrected misstatement with the relevant materiality figure:

- If a specific materiality figure has been determined for the particular financial statement item, that materiality figure (which will be an amount lower than the overall materiality figure) must be used. Otherwise, the overall materiality figure is used.
- If the misstatement exceeds the relevant materiality figure (specific materiality or overall materiality, as applicable), the misstatement is quantitatively material and, therefore, material to the financial statements as a whole.
- If the misstatement does not exceed the relevant materiality figure (specific materiality or overall materiality, as applicable), the misstatement is not quantitatively material, but the auditor continues to evaluate relevant qualitative factors to make a final determination whether the misstatement is material to the financial statements as a whole.

STEP 3: Perform audit work for the overall financial statements

After concluding on the audit work for the different components, you need to consider overall aspects and conclude on the audit as a whole.

AUDIT STEPS

1. Confirm the teams independence,
2. Consider subsequent events,
3. Update lead schedule and perform final analytical review,

Step 1 - Verify the teams independence

Before starting the evaluation and reporting you shall verify that the team is still independent of the auditee. This is documented in the Code of Ethics Compliance working paper. This is important since things may have changed since the start of the audit and any independence issue has to be cleared. Some independence issues may be handled through counter actions within the team.

Step 2 - Consider subsequent events

You should obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report that require an adjustment to, or disclosure in, the financial statements have been identified. You should also respond appropriately to facts that became known after the date of the auditor's report and which, had they been known at that date, might have caused the auditor to amend the auditor's report.

Normally subsequent events are more relevant under accrual accounting, with cash based accounting; you can more or less disregard subsequent events.

Consider if there are any events occurring between the date of the financial statements and the date of the auditor's report

The events you should focus on are those that would have an effect on the financial statements if they had been know earlier. For entities with cash based accounting it is very unlikely that there will be any such events. The longer time elapses between the date of the financial statements and the auditor's report the higher the risk is that such events would occur. Therefore you should strive to minimize the time gap between the date of the financial statements and the date of the auditor's report.

The types of events that would ordinarily be identified are:

- events that provide evidence of conditions that existed at the date of the financial statements (e.g. a verdict in a legal procedure); and
- events that provide evidence of conditions that arose after the date of the financial statements (e.g. value of assets or similar).

You normally obtain audit evidence about such events through discussion with management and reading minutes of management meetings.

Note that if the entity has an obligation to include performance information in the financial statements there could be events that affect this information too. Perform any more audit work

Consider if the events would require an adjustment to or disclosure in the financial statements

If the event would require an adjustment to or disclosure in the financial statements, find out if the auditee is willing to make an amendment. If so, ensure that your auditor's report refers to the amended financial statements. If not, consider if this should influence your opinion.

Consider events after the date of the auditor's report that would have caused amendment if being known at an earlier stage.

You have no obligation to perform audit work after issuing the auditor's report, but if you get information about events that occur after the date of the auditor's report but before the financial statements are published you shall consider if there is a need to amend the financial statements or the auditor's report.

If you have identified any such events, you should discuss with management how they intend to address the matter and consider the possibility to issue a new auditor's report. But if you decide to do so it is crucial to ensure that stakeholders can identify that there is a new auditor's report so that they do not rely on the old report. This is done partly by including an Emphasis of Matters paragraph in the new auditor's report, referring to a note in the amended financial statements explaining the reason for the amendment.

Step 3: Update lead schedule and perform analytical reviews

Update the lead schedule with any changes in the final financial statements. If there are any changes re-perform your analytical review on these components. Document your work in the lead schedule.

Step 4: Conclude on the adequacy of audit work performed

The final step is to draw a conclusion on if all the planned audit work has been performed and whether there is anything else you have to do before you can close the audit and report.

6.5 NOTE FOR REVIEWER

By the act of signing off a work paper, as a reviewer you are attesting that you have ensured the following:

- All relevant information for the purposes of concluding on this stage of the audit process has been duly considered.
- You agree with the conclusions made on each work paper,
- that all coaching notes have been addressed appropriately

You can also get audit evidence from external confirmations (though getting external confirmation can be defined as a substantive audit procedure). You can also use audit experts or management experts to get second opinions to support your conclusions and if you have identified the need in the risk assessment you need to ensure that you evaluate their independence, skills etc. by using the Work of an expert working paper (refer to chapter on Understanding the business).

6.6 CONCLUSION

Now you have done your field work and evaluation of audit misstatements and it is time to move on to the audit reporting. The next phase also includes evaluation of key audit matters and the results of other

audit information. If you acquire additional information that you deem as important to the audit, you must add it onto the relevant work paper and assess the impact of that information on the audit.

This manual ensures the compliance with ISSAIs on level 3 of the framework. Should you be required to comply with ISSAIs on level 4 of framework, you need to read the relevant standards on level 4 to ensure full compliance with all the requirements.

6.7 WORKING PAPERS TO COMPLETE

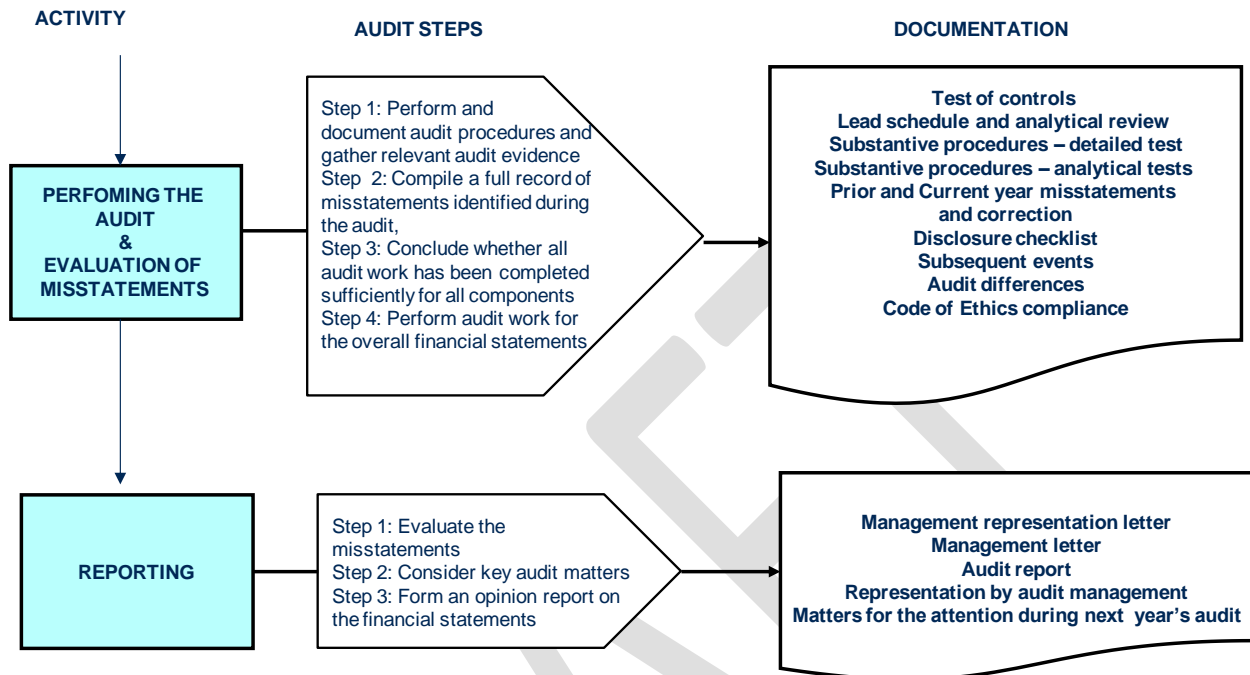
W/P Ref	Working Paper	Objectives of the working paper	Completed by	Reviewed by
PA 1	Tests of controls	Document the performance of tests of controls	Auditor	Audit supervisor / manager
PA 2	Lead schedule and analytical review	To break down the audited component and identify any further focus areas relating to the component Perform an analytical review of the final figures in the financial statements. The objective is to establish if there are any irregular differences that need more audit work.	Audit supervisor	Audit manager
PA 3	Substantive procedures – detailed tests	Document the performance of substantive procedures	Auditor	Audit supervisor / manager
PA 4	Substantive procedures – analytical tests	Document the performance of substantive analytical procedures	Auditor	Audit supervisor / manager
PA 5	Prior and Current year misstatements and correction	Evaluation of the effect of prior year errors on the auditor's report. Documentation of all quantifiable current year misstatements and errors and the evaluation of the effect of these errors on the auditor's report.	Auditor	Audit supervisor / manager
PA 6	Disclosure checklist	To ensure that the financial statements includes all mandatory disclosures	Auditor	Audit supervisor / manager
PA 7	Subsequent events	Identify any subsequent events that should affect the financial statements	Audit supervisor	Audit manager
PA 8	Code of ethics compliance	A follow-up that the team is still independent	Audit Supervisor / Team leader to	Audit manager

			ensure that all team members sign the declaration	
PA 9	Using the work of an expert	To determine the extent of use of the work of an expert (if any).	Audit Supervisor / Team leader to ensure that all team members sign the declaration	Audit manager

DRAFT

CHAPTER 7: REPORTING

Where are we in the process?



7.1 APPLICABLE STANDARDS

On level 3 of the ISSAI framework

ISSAI 200 par. 143-146
 ISSAI 200 par. 147-148
 ISSAI 200 par. 149-151
 ISSAI 200 par. 152-156
 ISSAI 200 par. 157-161
 ISSAI 200 par. 162-168
 ISSAI 200 par. 169-170

On level 4 of the ISSAI framework

ISSAI 1260
 ISSAI 1265
 ISSAI 1700
 ISSAI 1705
 ISSAI 1706
 ISSAI 1720

7.2 OBJECTIVES

You should form an opinion based on an evaluation of the conclusions drawn from the audit evidence obtained, as to whether the financial statements as a whole are prepared in accordance with the applicable financial reporting framework. The opinion should be expressed clearly in a written report that also describes the basis for the opinion.

7.3 AUDIT STEPS

1. Evaluate the misstatements
2. Consider key audit matters
3. Form an opinion report on the financial statements

STEP 1: Evaluate the misstatements found in the audit

The auditor should keep a full record of misstatements identified during the audit, and communicate to management and those charged with governance, as appropriate and on a timely basis, all misstatements recorded during the audit.

Gather and document all misstatements

All misstatements identified during the audit, except those that are clearly trivial, should be documented in the audit differences working paper. You shall invite management of the auditee to correct the misstatements. If management is unwilling to do so, you shall find out why. If management corrects the misstatements, you shall perform additional audit procedures to ensure that the misstatement has in fact been corrected and add this to the information in the working paper. Management and those charged with governance should be informed of the effect the misstatements may have, individually or in aggregate on the opinion in the auditor's report.

Evaluate the misstatements

You shall evaluate whether uncorrected misstatements are material, individually or in aggregate. When doing so you use the set materiality from planning. However, the materiality is just a benchmark and misstatements below the set materiality may still be considered material, when using your professional judgment. At the same time misstatements above the set materiality may not be considered material.

You may consider sorting the misstatements in three categories: material, not material, but important and trivial. Any compliance audit findings should be separated from the financial audit findings. Material misstatements should be carried forward to the next section, forming an opinion. Material and not material but important findings should be communicated to the auditee.

Further guidance on evaluating misstatements is included in ISSAI 1450.

Decide on level and timing of communication

You shall report the misstatements timely to the auditee. Reporting is normally done in a management letter to the auditee, but the ISSAIs allow for verbal communication as an alternative. You shall choose

the alternative that is most efficient or, when there are set procedures in the office, follow these procedures. Describe the misstatements clearly, and when appropriate include recommendations. It is important to have a clear picture of the message to be conveyed to the auditee so that it is understood. Try to give a broader picture and include descriptions on why the misstatement occurred, rather than just describing the misstatements. Also, try to find the cause of the misstatements. The reason for reporting timely and during the cause of the audit is to give the auditee a chance to correct the misstatements.

By reporting on deficiencies in the internal controls you can not only help the auditee prevent or detect misstatements, but you also help improve the public sector at large.

There is more guidance on communication with management and those charged with governance in ISSAI 1260 and 1265.

Send the draft management letter to the auditee to verify the facts

To verify that you have not misunderstood anything it is important to give the auditee the possibility to verify the facts in the management letter before it is finalised. At the same time, you may also ask for their comments to the recommendations.

Obtain a written representation

Finally, you shall ask management of the auditee for a written representation. The representation letter is often the only possible way to get audit evidence about the management's. The written representation is used as audit evidence for managements understanding of their role and responsibilities for the financial statements and implementing internal controls. The representation letter also includes assurance that management has provided the auditor with all relevant information and documentation and that they consider any uncorrected misstatements as not material. There is a template representation letter to use, but you may add other aspects as necessary. The template could be sent to the auditee for management to sign and send back to you before you can issue the auditor's report. Normally the accounting officer or permanent secretary is responsible for the representations. The fact that we want a representation letter should be communicated and agreed in the engagement letter at the beginning of the audit.

You should ensure that you get the Management representation letter signed as soon before you sign the auditor's report as practically possible. If management makes amendments to the representation letter or refuses to sign it you have to consider whether you can rely on other information obtained from management and also consider issuing a modified opinion.

There is more guidance on written representation in ISSAI 1580.

Issue the final management letter

After getting feedback and comments from the auditee you can now finalise the management letter. Management letters shall be issued by the senior manager. Prior to the issuance of the audit report a final management letter shall be issued to ensure that all findings from the audit are included in one management letter. This management letter should be signed by the assistant Auditor General.

STEP 2: Consider Key Audit Matters

Key audit matters are those matters that, according to professional judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance.

Key Audit Matters (KAM) are areas which you think have been important in the audit work you have performed. It could be high risk areas where you have performed a lot of audit work, difficult areas where you may have had difficulties obtaining audit evidence or circumstances that occurred during the audit and which had a significant impact on the audit plan. Choose the most significant of these matters to describe as KAM in the auditor's report.

Describe KAM in the auditor's report under the heading Key audit matters. The description of each KAM shall include:

- a. An explanation of why you have considered the matter to be one of most significance in the audit and, its effect on the audit if you consider it necessary; and
- b. A reference to any related disclosure(s) in the financial statements.

See also the template Auditor's report.

STEP 3: Form an opinion and report on the financial statements

The auditor should form an opinion based on an evaluation of the conclusions drawn from the audit evidence obtained, as to whether the financial statements as a whole are prepared in accordance with the applicable financial reporting framework. The opinion should be expressed clearly in a written report that also describes the basis for the opinion.

Form an opinion based on the evaluation of the conclusions drawn from the audit evidence

Based on the evaluation of findings against the set materiality you shall form an opinion on the complete set of financial statements. There are four different types of opinions:

- Unqualified – where there are no material misstatements, individually or in aggregate
- Qualified – where there is one or more material misstatements or possible material misstatement
- Adverse – where the misstatements are pervasive and thus affect a large part or the whole of the financial statements
- Disclaimer – where the auditor has not been able to obtain sufficient audit evidence but not due to the auditor or SAI and the possible misstatement could be material and pervasive. (e.g. a scope limitation from management)

Pervasive effects on the financial statements are those that are not confined to specific elements, accounts or items in the financial statements. These misstatements represent a substantial part of the financial statements.

	Auditor’s judgment about the pervasiveness of the effects or possible effects on the financial statements	
Nature of matter giving rise to the modification	Material, but not pervasive	Material and pervasive
Financial statements are materially misstated	<i>Qualified opinion</i>	<i>Adverse opinion</i>
Inability to obtain sufficient appropriate audit evidence (not due to the auditor)	<i>Qualified opinion</i>	<i>Disclaimer of opinion</i>

The opinion has a separate paragraph in the auditor’s report the title of the paragraph should indicate what type of opinion is given.

An unqualified opinion should read: “The financial statements give a true and fair view/present fairly, in all material respects, the financial position of [auditee] as at [date] and its financial performance and its cash flows for the year then ended in accordance with [the financial reporting framework]” for a fair presentation framework. For a compliance framework, the opinion should read “The financial statements are prepared, in all material respects, in accordance with [the financial reporting framework]”

A qualified opinion should read: “Except for the effects of the matter/s described in the Basis for Qualified Opinion paragraph the financial statements (same as for unqualified opinion).”

An adverse opinion should read: “Because of the significance of the matter/s described in the Basis for Adverse Opinion paragraph the financial statements.... (same as for unqualified opinion).”

A disclaimer of opinion should read: “Because of the significance of the matter/s described in the Basis for Disclaimer of Opinion paragraph, [the auditor] has not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion and accordingly [the auditor] does not express an opinion on the financial statements.”

There is a template auditor’s report for you to use that will support you in writing the auditor’s report.

Describe the basis for the opinion, if qualified, adverse or disclaimer

The basis for the opinion explains the misstatement/s found in the financial statements (or possible misstatements in areas where you have not been able to obtain sufficient appropriate audit evidence). You should make the description as to the point as possible, explaining the misstatement and the effect on the financial statements. Try to avoid using technical language, keeping in mind that the users of the report are often not accountants.

Example 1.1 – qualified opinion:

The Entity has not collected revenue regarding xx. I estimate that the uncollected revenue amounts to xx.

Example 1.2 – qualified opinion:

The financial statement includes assets that are no longer with the Entity. The value of these assets is xx and the financial statements are misstated by this amount.

Example 2 – adverse opinion:

The Entity's internal control system has not been effective and therefore there are many material errors in the financial statements.

Example 3 – disclaimer of opinion:

The management has not allowed access to a significant part of the books and relevant documentation to support the financial statements.

Add any Emphasis of Matter paragraphs or Other Matter paragraphs

Emphasis of Matter and Other Matter paragraphs should be used sparingly to highlight information that is important for the user's understanding of the financial statements and the audit thereof. Emphasis of Matter paragraphs refer to a statement or information in the financial statements, e.g. information about a pending litigation with a possible big impact on the financial statements. Other Matter paragraphs gives you a possibility to communicate a matter that is not presented or disclosed in the financial statements and that you think is relevant to the users' understanding of the audit, the auditor's responsibilities or the auditor's report.

When using Emphasis of Matter or Other Matter paragraphs it is important to include that your opinion is not modified in respect of the matter.

Handle any supplementary information presented with or together with the financial statements

If the financial statements contain any supplementary information or issued together with supplementary information, you have to either make sure it is clearly separated so that you can clearly define in the Auditor's report which parts are included in the audit. If this is not possible you shall read the information to ensure that it is consistent with the audited financial statements. If there are inconsistencies with the audited financial statements you shall conclude what needs to change and as management to do the correction. You shall describe any uncorrected inconsistencies in the Other Matters paragraph.

7.4 NOTE FOR REVIEWER

As a reviewer, you have the responsibility to agree and accept all draft reports before they are sent to the auditee as a draft or a final version. You also have the responsibility to explain the need for written representation to management of the auditee.

7.5 CONCLUSION

Now the audit work is complete and reported. All that remains to do is to finalise the documentation and draw conclusions on how to audit next year. You shall consider and document what went well and what can be improved in the audit work next year as a basis for the planning of the audit next year.

This manual ensures the compliance with ISSAIs on level 3 of the framework. Should you be required to comply with ISSAIs on level 4 of framework, you need to read the relevant standards on level 4 to ensure full compliance with all the requirements.

7.6 WORKING PAPERS TO COMPLETE

W/P Ref	Working Paper	Objectives of the working paper	Completed by	Reviewed by
R 1	Management representation letter	To obtain some audit evidence as to whether management has understood their responsibilities for the financial statements and has provided all information to the auditors.	Audit supervisor	Audit Director or person responsible for the auditor's report
R 2	Management letter	The objective is to report all important findings to the auditee.	Audit supervisor	Audit Director or person responsible for the auditor's report
R 3	Auditor's report	The conclusion on the audit of the financial statements	Audit supervisor	Audit Director or person responsible for the auditor's report
R 4	Representation by audit management	A final documentation of the review done of the audit	All senior / top managers involved in the audit.	Audit Director or person responsible for the auditor's report to sign the letter
R 5	Matters for attention during next year's audit	Issues to bring forward to next year's audit. Both things that went well and things that can be improved should be included	Audit supervisor	Audit manager

GLOSSARY

Term	Explanation
Access controls	Procedures designed to restrict access to on-line terminal devices, programs and data. Access controls consist of “user authentication” and “user authorization.” “User authentication” typically attempts to identify a user through unique logon identifications, passwords, access cards or biometric data. “User authorization” consists of access rules to determine the computer resources each user may access. Specifically, such procedures are designed to prevent or detect: <ul style="list-style-type: none"> (a) Unauthorized access to on-line terminal devices, programs and data; (b) Entry of unauthorized transactions; (c) Unauthorized changes to data files; (d) The use of computer programs by unauthorized personnel; and (e) The use of computer programs that have not been authorized.
Accounting estimate	An approximation of the amount of an item in the absence of a precise means of measurement.
Accounting records	Generally include the records of initial entries and supporting records, such as checks and records of electronic fund transfers; invoices; contracts; the general and subsidiary ledgers; journal entries and other adjustments to the financial statements that are not reflected in formal journal entries; and records such as work sheets and spreadsheets supporting cost allocations, computations, reconciliations and disclosures.
Accruals Accounts	A financial statement that discloses payments in the period they are incurred and income in the period it is earned.
Adverse opinion	(see Modified auditor’s report)
Agreed-upon procedures engagement	An engagement in which an auditor is engaged to carry out those procedures of an audit nature to which the auditor and the entity and any appropriate third parties have agreed and to report on factual findings. The recipients of the report form their own conclusions from the report by the auditor. The report is restricted to those parties that have agreed to the procedures to be performed since others, unaware of the reasons for the procedures may misinterpret the results.
Analytical procedures	Evaluations of financial information made by a study of plausible relationships among both financial and non-financial data. Analytical procedures also encompass the investigation of identified fluctuations and relationships that are inconsistent with other relevant information or deviate significantly from predicted amounts.
Annual report	A document issued by an entity, ordinarily on an annual basis, which includes its financial statements together with the auditor’s report thereon.
Applicable financial reporting framework	The financial reporting framework adopted by management in preparing the financial statements that the auditor has determined is acceptable in view of the nature of the entity and the objective of the financial statements, or that is required by law or regulations.
Application controls in information technology	Manual or automated procedures that typically operate at a business process level. Application controls can be preventative or detective in nature and are designed to ensure the integrity of the accounting records. Accordingly,

Term	Explanation
	application controls relate to procedures used to initiate, record, process and report transactions or other financial data.
Appropriateness	The measure of the quality of evidence, that is, its relevance and reliability in providing support for, or detecting misstatements in, the classes of transactions, account balances, and disclosures and related assertions.
Assertions	Representations by management, explicit or otherwise, that are embodied in the financial statements.
Assess	Analyse identified risks of to conclude on their significance. "Assess," by convention, is used only in relation to risk. (also see Evaluate)
Assistants	Personnel involved in an individual audit other than the auditor.
Association	(see Auditor association with financial information)
Assurance	(see Reasonable assurance)
Assurance engagement	<p>An engagement in which a practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria. The outcome of the evaluation or measurement of a subject matter is the information that results from applying the criteria (also see Subject matter information). Under the "International Framework for Assurance Engagements" there are two types of assurance engagement a practitioner is permitted to perform: a reasonable assurance engagement and a limited assurance engagement.</p> <p><i>Reasonable assurance engagement</i> The objective of a reasonable assurance engagement is a reduction in assurance engagement risk to an acceptably low level in the circumstances of the engagement as the basis for a positive form of expression of the practitioner's conclusion.</p> <p><i>Limited assurance engagement</i> The objective of a limited assurance engagement is a reduction in assurance engagement risk to a level that is acceptable in the circumstances of the engagement, but where that risk is greater than for a reasonable assurance engagement, as the basis for a negative form of expression of the practitioner's conclusion.</p>
Assurance engagement risk	The risk that the practitioner expresses an inappropriate conclusion when the subject matter information is materially misstated.
Attendance	Being present during all or part of a process being performed by others; for example, attending physical inventory taking will enable the auditor to inspect inventory, to observe compliance of management's procedures to count quantities and record such counts and to test-count quantities.
Audit components	Types of transaction or account balance subject to similar internal controls or risks. For instance, "salaries", "purchases" and "income from fees and charges".
Audit documentation	The record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached (terms such as "working papers" or "workpapers" are also sometimes used).

Term	Explanation
Audit evidence	All the information used by the auditor in arriving at the conclusions on which the audit opinion is based. Audit evidence includes the information contained in the accounting records underlying the financial statements and other information.
Audit firm	(see Firm)
Audit matters of governance interest	Those matters that arise from the audit of financial statements and, in the opinion of the auditor, are both important and relevant to those charged with governance in overseeing the financial reporting and disclosure process. Audit matters of governance interest include only those matters that have come to the attention of the auditor as a result of the performance of the audit.
Audit of financial statements	The objective of an audit of financial statements is to enable the auditor to express an opinion whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. An audit of financial statements is an assurance engagement (see Assurance engagement).
Audit objectives	The specific objectives of an audit are to test "Audit Assertions".
Audit opinion	(see Opinion)
Audit Procedures	Instructions for auditors to gather evidence. Comprises of substantive procedures, analytical procedures and tests of controls.
Auditor's report	The auditors' opinion as to whether the financial statements, in all material respects, fairly present the results of operations of the audited entity in accordance with the prescribed accounting practice and in the manner required by the relevant act. An opinion is expressed as to whether anything came to the auditors' attention that causes them to believe that material non-compliance with laws and regulations, applicable to financial matters, had occurred.
Audit risk	Audit risk is the risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated. Audit risk is a function of the risk of material misstatement (or simply, the "risk of material misstatement") (i.e., the risk that the financial statements are materially misstated prior to audit) and the risk that the auditor will not detect such misstatement ("detection risk").
Audit sampling	<p>The application of audit procedures to less than 100% of items within an account balance or class of transactions such that all sampling units have a chance of selection. This will enable the auditor to obtain and evaluate audit evidence about some characteristic of the items selected 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.</p> <p><i>Non-statistical sampling</i> Any sampling approach that does not have the characteristics of statistical sampling.</p> <p><i>Population</i> The entire set of data from which a sample is selected and about which the auditor wishes to draw conclusions. A population may be divided into strata, or</p>

Term	Explanation
	<p>sub-populations, with each stratum being examined separately. The term population is used to include the term stratum.</p> <p><i>Sampling risk</i> Arises from the possibility that the auditor’s conclusion, based on a sample may be different from the conclusion reached if the entire population were subjected to the same audit procedure.</p> <p><i>Sampling unit</i> The individual items constituting a population, for example checks listed on deposit slips, credit entries on bank statements, sales invoices or debtors’ balances, or a monetary unit.</p> <p><i>Statistical sampling [the approach in this manual does not deal with principles of statistical sampling]</i> Any approach to sampling that has the following characteristics: (a) Random selection of a sample; and (b) Use of probability theory to evaluate sample results, including measurement of sampling risk.</p> <p><i>Stratification</i> The process of dividing a population into subpopulations, each of which is a group of sampling units which have similar characteristics (often monetary value).</p> <p><i>Tolerable error</i> The maximum error in a population that the auditor is willing to accept.</p> <p><i>Total error</i> Either the rate of deviation or total misstatement.</p>
Audit trail	How individual transactions can be traced from their origins to the general ledger and financial statements, and which allows figures in financial statement to be analysed into individual transactions. Establishing audit trails is the responsibility of management.
Auditee	The audited entity
Auditor	<p>Auditor – “Auditor” is used to refer to the person or persons conducting the audit, usually the Auditor-General or person who is delegated to sign the auditor’s report, the other members of the engagement team, or, as applicable, the entire Supreme Audit Institution (SAI).</p> <p><i>Existing auditor</i> The auditor of the financial statements of the current period.</p> <p><i>External auditor</i> Where appropriate the term “external auditor” is used to distinguish the external auditor from an internal auditor.</p>

Term	Explanation
	<p><i>Incoming auditor</i> The auditor of the financial statements of the current period, where either the financial statements of the prior period have been audited by another auditor (in this case the incoming auditor also known as a successor auditor), or the audit is an initial audit engagement.</p> <p><i>Internal auditor</i> A person performing an internal audit.</p> <p><i>Other auditor</i> An auditor, other than the principal auditor, with responsibility for reporting on the financial information of a component, which is included in the financial statements audited by the principal auditor. Other auditors include affiliated firms, whether using the same name or not, and correspondents, as well as unrelated auditors.</p> <p><i>Predecessor auditor</i> The auditor who was previously the auditor of an entity and who has been replaced by an incoming auditor.</p> <p><i>Principal auditor</i> The auditor with responsibility for reporting on the financial statements of an entity when those financial statements include financial information of one or more components audited by another auditor.</p>
Auditor association with financial information	An auditor is associated with financial information when the auditor attaches a report to that information or consents to the use of the auditor’s name in a professional connection.
Cash accounts	A kind of financial statement which discloses payments in the period they are made and income in the period it is received. Different from accruals accounts.
Comparatives	<p>Comparatives in financial statements, may present amounts (such as financial position, results of operations, cash flows) and appropriate disclosures of an entity for more than one period, depending on the framework. The frameworks and methods of presentation are as follows:</p> <p>(a) Corresponding figures where amounts and other disclosures for the preceding period are included as part of the current period financial statements, and are intended to be read in relation to the amounts and other disclosures relating to the current period (referred to as “current period figures”). These corresponding figures are not presented as complete financial statements capable of standing alone, but are an integral part of the current period financial statements intended to be read only in relationship to the current period figures.</p> <p>(b) Comparative financial statements where amounts and other disclosures for the preceding period are included for comparison with the financial</p>

Term	Explanation
	statements of the current period, but do not form part of the current period financial statements.
Comparative financial statements	(see Comparatives)
Compilation engagement	An engagement in which accounting expertise, as opposed to auditing expertise, is used to collect, classify and summarize financial information.
Component	A division, branch, subsidiary, joint venture, associated company or other entity whose financial information is included in financial statements audited by the principal auditor.
Component of a complete set of financial statements	The applicable financial reporting framework adopted in preparing the financial statements determines what constitutes a complete set of financial statements. Components of a complete set of financial statements include: a single financial statement, specified accounts, elements of accounts or items in a financial statement.
Comprehensive basis of accounting	A comprehensive basis of accounting comprises a set of criteria used in preparing financial statements which applies to all material items and which has substantial support.
Computer-assisted audit techniques	Applications of auditing procedures using the computer as an audit tool (also known as CAATs).
Computer information systems (CIS) environment	Exists when a computer of any type or size is involved in the processing by the entity of financial information of significance to the audit, whether that computer is operated by the entity or by a third party.
Confirmation	A specific type of inquiry that is the process of obtaining a representation of information or of an existing condition directly from a third party.
Control activities	Those policies and procedures that help ensure that management directives are carried out. Control activities are a component of internal control.
Control environment	Includes the governance and management functions and the attitudes, awareness and actions of those charged with governance and management concerning the entity's internal control and its importance in the entity. The control environment is a component of internal control.
Control Procedures	The policies and procedures adopted by an entity's management to protect against fraud, losses, illegality or error, and to achieve its objectives. Control procedures may prevent illegality or error (such as a requirement for two authorising signatures before the entity purchases items above a stated value), or enable the entity to detect and correct them (reconciliations for instance).
Control risk	(see risk of material misstatement)
Corresponding figures	(see Comparatives)
Criteria	The benchmarks used to evaluate or measure the subject matter including, where relevant, benchmarks for presentation and disclosure. Criteria can be formal or less formal. There can be different criteria for the same subject matter. Suitable criteria are required for reasonably consistent evaluation or measurement of a subject matter within the context of professional judgment.

Term	Explanation
	<p><i>Suitable criteria</i></p> <p>Exhibit the following characteristics:</p> <ul style="list-style-type: none"> (a) Relevance: relevant criteria contribute to conclusions that assist decision-making by the intended users; (b) Completeness: criteria are sufficiently complete when relevant factors that could affect the conclusions in the context of the engagement circumstances are not omitted. Complete criteria include, where relevant, benchmarks for presentation and disclosure; (c) Reliability: reliable criteria allow reasonably consistent evaluation or measurement of the subject matter including, where relevant, presentation and disclosure, when used in similar circumstances by similarly qualified practitioners; (d) Neutrality: neutral criteria contribute to conclusions that are free from bias; and (e) Understandability: understandable criteria contribute to conclusions that are clear, comprehensive, and not subject to significantly different interpretations.
Current file	Includes all the working papers applicable to the current audit year. For instance, it includes the planning memorandum, audit programme, and the results of audit tests.
Current period figures	Amounts and other disclosures relating to the current period.
Database	A collection of data that is shared and used by many different users for different purposes.
Date of the financial statements	The date of the end of the latest period covered by the financial statements, which is normally the date of the most recent balance sheet in the financial statements subject to audit.
Date of approval of the financial statements	The date on which those with the recognized authority assert that they have prepared the entity's complete set of financial statements, including the related notes, and that they have taken responsibility for them. In some jurisdictions, the law or regulation identifies the individuals or bodies (for example, the directors) that are responsible for concluding that a complete set of financial statements has been prepared, and specifies the necessary approval process. In other jurisdictions, the approval process is not prescribed in law or regulation and the entity follows its own procedures in preparing and finalizing its financial statements in view of its management and governance structures. In some jurisdictions, final approval of the financial statements by shareholders is required before the financial statements are issued publicly. In these jurisdictions, final approval by shareholders is not necessary for the auditor to conclude that sufficient appropriate audit evidence has been obtained. The date of approval of the financial statements for purposes of the ISSAIs is the earlier date on which those with the recognized authority determine that a complete set of financial statements has been prepared.
Date of the auditor's report	The date selected by the auditor to date the report on the financial statements. The auditor's report is not dated earlier than the date on which the auditor has

Term	Explanation
	obtained sufficient appropriate audit evidence on which to base the opinion on the financial statements. Sufficient appropriate audit evidence includes evidence that the entity's complete set of financial statements has been prepared and that those with the recognized authority have asserted that they have taken responsibility for them.
Date the financial statements are issued	The date that the auditor's report and audited financial statements are made available to third parties, which may be, in many circumstances, the date that they are filed with a regulatory authority.
Detection risk	The risk that the procedures performed by the auditor to reduce audit risk to an acceptably low level will not detect a misstatement that exists and that could be material, either individually or when aggregated with other misstatements.
Disclaimer of opinion	(see Modified auditor's report)
Double entry accounting	An accounting practice that requires that for any accounting entry, there is a matching debit and credit recorded in the general ledger
Electronic Data Interchange (EDI)	The electronic transmission of documents between organizations in a machine-readable form.
Emphasis of matter paragraph(s)	(see Modified auditor's report)
Employee fraud	Fraud involving only employees of the entity subject to the audit.
Encryption (cryptography)	The process of transforming programs and information into a form that cannot be understood without access to specific decoding algorithms (cryptographic keys). For example, the confidential personal data in a payroll system may be encrypted against unauthorized disclosure or modification. Encryption can provide an effective control for protecting confidential or sensitive programs and information from unauthorized access or modification. However, effective security depends upon proper controls over access to the cryptographic keys.
Engagement documentation	The record of work performed, results obtained, and conclusions the practitioner reached (terms such as "working papers" or "workpapers" are sometimes used). The documentation for a specific engagement is assembled in an engagement file.
Engagement letter	An engagement letter documents and confirms the auditor's acceptance of the appointment, the objective and scope of the audit, the extent of the auditor's responsibilities to the client and the form of any reports.
Engagement quality control review	A process designed to provide an objective evaluation, before the report is issued, of the significant judgments the engagement team made and the conclusions they reached in formulating the report.
Engagement quality control reviewer	A partner, other person in the firm, suitably qualified external person, or a team made up of such individuals, with sufficient and appropriate experience and authority to objectively evaluate, before the report is issued, the significant judgments the engagement team made and the conclusions they reached in formulating the report.

Term	Explanation
Engagement team	All personnel performing an engagement, including any experts contracted by the firm in connection with that engagement.
Entity's risk assessment process	A component of internal control that is the entity's process for identifying business risks relevant to financial reporting objectives and deciding about actions to address those risks, and the results thereof.
Environmental matters	(a) Initiatives to prevent, abate, or remedy damage to the environment, or to deal with conservation of renewable and non-renewable resources (such initiatives may be required by environmental laws and regulations or by contract, or they may be undertaken voluntarily); (b) Consequences of violating environmental laws and regulations; (c) Consequences of environmental damage done to others or to natural resources; and (d) Consequences of vicarious liability imposed by law (for example, liability for damages caused by previous owners).
Environmental performance report	A report, separate from the financial statements, in which an entity provides third parties with qualitative information on the entity's commitments towards the environmental aspects of the business, its policies and targets in that field, its achievement in managing the relationship between its business processes and environmental risk, and quantitative information on its environmental performance.
Environmental risk	In certain circumstances, factors relevant to the assessment of inherent risk for the development of the overall audit plan may include the risk of material misstatement of the financial statements due to environmental matters.
Error	An unintentional misstatement in financial statements, including the omission of an amount or a disclosure.
Evaluate	Identify and analyse the relevant issues, including performing further procedures as necessary, to come to a specific conclusion on a matter. "Evaluation," by convention, is used only in relation to a range of matters, including evidence, the results of procedures and the effectiveness of management's response to a risk. (also see Assess)
Existing auditor	(see Auditor)
Expected error	(see Audit sampling)
Experienced auditor	An individual (whether internal or external to the firm) who has a reasonable understanding of: (a) Audit processes; (b) ISSAIs and applicable legal and regulatory requirements; (c) The business environment in which the entity operates; and (d) Auditing and financial reporting issues relevant to the entity's industry.
Expert	A person or firm possessing special skill, knowledge and experience in a particular field other than accounting and auditing.
External audit	An audit performed by an external auditor.
External auditor	(see Auditor)
External confirmation	The process of obtaining and evaluating audit evidence through a direct communication from a third party in response to a request for information about a particular item affecting assertions made by management in the financial statements.

Term	Explanation
Fair value	The amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.
Financial Audit	An audit that aims to give an opinion on whether financial statements are complete and accurate, and on whether transactions are legal and regular (accord with relevant laws and regulations). Audit of entity's compliance with laws and regulations (regularity) is therefore part of financial audit.
Financial Control	Internal controls intended to help entities minimise their exposure to avoidable financial risks and ensure that financial information is reliable. Financial controls include control procedures intended to help the entity maintain proper accounting records, safeguard assets, and prevent and detect fraud.
Financial statements	A structured representation of historical financial information, including related notes, intended to communicate an entity's economic resources or obligations at a point in time or the changes therein for a period of time in accordance with a financial reporting framework. The related notes ordinarily comprise a summary of significant accounting policies and other explanatory information. The term "financial statements" ordinarily refers to a complete set of financial statements as determined by the requirements of the applicable financial reporting framework (such as IPSAS), but can also refer to a single financial statement.
Firewall	A combination of hardware and software that protects a WAN, LAN or PC from unauthorized access through the Internet and from the introduction of unauthorized or harmful software, data or other material in electronic form.
Firm	A sole practitioner, partnership or corporation or other entity of professional accountants.
Forecast	Prospective financial information prepared based on assumptions as to future events which management expects to take place and the actions management expects to take as of the date the information is prepared (best-estimate assumptions).
Fraud	An intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage. Two types of intentional misstatement are relevant to the auditor: misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets (also see Fraudulent financial reporting and Misappropriation of assets).
Fraudulent financial reporting	Involves intentional misstatements, including omissions of amounts or disclosures in financial statements, to deceive financial statement users.
Financial reporting framework	The financial reporting framework adopted by management and, where appropriate, those charged with governance in the preparation of the financial statements that is acceptable in view of the nature of the entity and the objective of the financial statements, or that is required by law or regulation. The term "fair presentation framework" is used to refer to a financial reporting framework that requires compliance with the requirements of

Term	Explanation
	<p>the framework and:</p> <p>(i) Acknowledges explicitly or implicitly that, to achieve fair presentation of the financial statements, it may be necessary for management to provide disclosures beyond those specifically required by the framework; or</p> <p>(ii) Acknowledges explicitly that it may be necessary for management to depart from a requirement of the framework to achieve fair presentation of the financial statements. Such departures are expected to be necessary only in extremely rare circumstances.</p>
General IT-controls	Policies and procedures that relate to many applications and support the effective functioning of application controls by helping to ensure the continued proper operation of information systems. General IT-controls commonly include controls over data centre and network operations; system software acquisition, change and maintenance; access security; and application system acquisition, development, and maintenance.
General Ledger	An entity's accounting record that holds details of individual transactions processed. General ledger accounts typically group transactions e.g. salaries.
Going concern assumption	Under this 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 realize its assets and discharge its liabilities in the normal course of business.
General purpose financial statements	Financial statements prepared in accordance with a financial reporting framework that is designed to meet the common information needs of a wide range of users.
Government business enterprises	Businesses that operate within the public sector ordinarily to meet a political or social interest objective. They are ordinarily required to operate commercially, that is, to make profits or to recoup, through user charges a substantial proportion of their operating costs.
Historical financial information	Information expressed in financial terms in relation to a particular entity, derived primarily from that entity's accounting system, about economic events occurring in past time periods or about economic conditions or circumstances at points in time in the past.
Independence	<p>Comprises:</p> <p>(a) Independence of mind—the state of mind that permits the provision of an opinion without being affected by influences that compromise professional judgment, allowing an individual to act with integrity, and exercise objectivity and professional scepticism; and</p> <p>(b) Independence in appearance—the avoidance of facts and circumstances that are so significant a reasonable and informed third party, having knowledge of all relevant information, including any safeguards applied, would reasonably conclude a firm's, or a member of the assurance team's, integrity, objectivity or professional scepticism had been compromised.</p>
Information system relevant	A component of internal control that includes the financial reporting system, and consists of the procedures and records established to initiate, record,

Term	Explanation
to financial reporting	process and report entity transactions (as well as events and conditions) and to maintain accountability for the related assets, liabilities and equity.
Inherent risk	(see risk of material misstatement)
Initial audit engagement	An audit engagement in which either the financial statements are audited for the first time; or the financial statements for the prior period were audited by another auditor.
Inquiry	Inquiry consists of seeking information of knowledgeable persons, both financial and non-financial, throughout the entity or outside the entity.
Inspection (as an audit procedure)	Examining records or documents, whether internal or external, or tangible assets.
Interim financial information or statements	Financial information (which may be less than a complete set of financial statements as defined above) issued at interim dates (usually half-yearly or quarterly) in respect of a financial period.
Internal audit	An appraisal activity established within an entity as a service to the entity. Its functions include, amongst other things, examining, evaluating and monitoring the adequacy and effectiveness of internal control.
Internal auditor	(see Auditor)
Internal control	The process designed and effected by those charged with governance, management and other personnel to provide reasonable assurance about the achievement of the entity's objectives regarding reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations. Internal control consists of the following components: (a) The control environment; (b) The entity's risk assessment process; (c) The information system, including the related business processes, relevant to financial reporting, and communication; (d) Control activities; and (e) Monitoring of controls.
Investigate	Inquire into matters arising from other procedures to resolve them.
IT environment	The policies and procedures that the entity implements and the IT infrastructure (hardware, operating systems, etc.) and application software that it uses to support business operations and achieve business strategies.
Limited assurance engagement	(see Assurance engagement)
Limitation on scope	A limitation on the scope of the auditor's work may sometimes be imposed by the entity (for example, when the terms of the engagement specify that the auditor will not carry out an audit procedure that the auditor believes is necessary). A scope limitation may be imposed by circumstances (for example, 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 records are inadequate or when the auditor is unable to carry out an audit procedure believed desirable.
Local Area Network (LAN)	A communications network that serves users within a confined geographical area. LANs were developed to facilitate the exchange and sharing of resources

Term	Explanation
	within an organization, including data, software, storage, printers and telecommunications equipment. They allow for decentralized computing. The basic components of a LAN are transmission media and software, user terminals and shared peripherals.
Management	The person(s) with executive responsibility for the conduct of the entity's operations. For some entities in some jurisdictions, management includes some or all of those charged with governance, for example, executive members of a governance board.
Management fraud	Fraud involving one or more members of management or those charged with governance.
Management representations	Representations made by management to the auditor during an audit, either unsolicited or in response to specific inquiries.
Material	A matter is material if knowledge of it would be likely to influence the user of the financial statements.
Material inconsistency	Exists when other information contradicts information contained in the audited financial statements. A material inconsistency may raise doubt about the audit conclusions drawn from audit evidence previously obtained and, possibly, about the basis for the auditor's opinion on the financial statements.
Material misstatement of fact	Exists in other information when such information, not related to matters appearing in the audited financial statements, is incorrectly stated or presented.
Material weakness	A weakness in internal control that could have a material effect on the financial statements.
Materiality	Information is material if its omission or misstatement could influence the economic decisions of users taken based on the financial statements. Materiality depends on the size of the item or error judged in the particular circumstances of its omission or misstatement. Thus, materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic which information must have if it is to be useful.
Misappropriation of assets	Involves the theft of an entity's assets and is often perpetrated by employees in relatively small and immaterial amounts. However, it can also involve management who are usually more capable of disguising or concealing misappropriations in ways that are difficult to detect.
Misstatement	<p>A difference between the amount, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework. Misstatements can arise from error or fraud.</p> <p>Where the auditor expresses an opinion on whether the financial statements are presented fairly, in all material respects, or give a true and fair view, misstatements also include those adjustments of amounts, classifications, presentation, or disclosures that, in the auditor's judgment, are necessary for the financial statements to be presented fairly, in all material respects, or to give a true and fair view</p>

Term	Explanation
Modified auditor's report	<p>An auditor's report is considered to be modified if either an emphasis of matter paragraph(s) is added to the report or if the opinion is other than unqualified:</p> <p><i>Matters that Do Not Affect the Auditor's Opinion</i> Emphasis of matter paragraph(s)—An auditor's report may be modified by adding an emphasis of matter paragraph(s) to highlight a matter affecting the financial statements which is included in a note to the financial statements that more extensively discusses the matter. The addition of such an emphasis of matter paragraph(s) 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.</p> <p><i>Matters that Do Affect the Auditor's Opinion</i> Qualified opinion—A qualified opinion is expressed when the auditor concludes that an unqualified opinion cannot be expressed but that the effect of any disagreement with management, or limitation on scope is not so material and pervasive as to require an adverse opinion or a disclaimer of opinion.</p> <p>Disclaimer of opinion—A disclaimer of opinion is 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.</p> <p>Adverse opinion—An adverse opinion is 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.</p>
Monetary Unit Sample	A method of sampling transactions for direct substantive procedures whereby a relatively high value item is more likely to appear in the sample than a lower value item.
Monitoring (in relation to quality control)	A process comprising an ongoing consideration and evaluation of the firm's system of quality control, including a periodic inspection of a selection of completed engagements, designed to enable the firm to obtain reasonable assurance that its system of quality control is operating effectively.
Monitoring of controls	A process to assess the effectiveness of internal control performance over time. It includes assessing the design and operation of controls on a timely basis and taking necessary corrective actions modified for changes in conditions. Monitoring of controls is a component of internal control.
Non-compliance	Refers to acts of omission or commission by the entity being audited, either intentional or unintentional that are contrary to the prevailing laws or regulations.
Non-sampling risk	(see Audit sampling)
Non-statistical sampling	(see Audit sampling)

Term	Explanation
Objective	See Audit Objectives.
Observation	Consists of looking at a process or procedure being performed by others, for example, the observation by the auditor of the counting of inventories by the entity's personnel or the performance of control activities.
Opening balances	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 effects of transactions of prior periods and accounting policies applied in the prior period.
Opinion	The auditor's report contains a clear written expression of opinion on the financial statements. An unqualified opinion is 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. (also see Modified auditor's report)
Other auditor	(see Auditor)
Other information	Financial or non-financial information (other than the financial statements or the auditor's report thereon) included – either by law or custom – in the annual report.
Overall audit strategy	Sets the scope, timing and direction of the audit, and guides the development of the more detailed audit plan.
PCs or personal computers (also referred to as microcomputers)	Economical yet powerful self-contained general purpose computers consisting typically of a monitor (visual display unit), a case containing the computer electronics and a keyboard (and mouse). These features may be combined in portable computers (laptops). Programs and data may be stored internally on a hard disk or on removable storage media such as CDs or floppy disks. PCs may be connected to on-line networks, printers and other devices such as scanners and modems.
Permanent file	Contains information about the audited entity of continuing interest and relevance from year to year. For instance, this file contains the entity's legal framework, and working papers setting out previous years' assessment of inherent risk and control risk.
Planning	Involves establishing the overall audit strategy for the engagement and developing an audit plan, to reduce audit risk to an acceptably low level.
Population	(see Audit sampling)
Principal auditor	(see Auditor)
Professional judgment	The application of relevant training, knowledge and experience, within the context provided by auditing, accounting and ethical standards, in making informed decisions about the courses of action that are appropriate in the circumstances of the audit engagement.
Professional scepticism	An attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence.
Professional standards	IAASB engagement standards, as defined in the IAASB's "Preface to the International Standards on Quality Control, Auditing, Assurance and Related Services," and relevant ethical requirements, which ordinarily comprise Parts A and B of the IFAC Code of Ethics for Professional Accountants and relevant national ethical requirements.

Term	Explanation
Programming controls	Procedures designed to prevent or detect improper changes to computer programs that are accessed through on-line terminal devices. Access may be restricted by controls such as the use of separate operational and program development libraries and the use of specialized program library software. It is important for on-line changes to programs to be adequately documented, controlled and monitored.
Public sector	National governments, regional (for example, state, provincial, territorial) governments, local (for example, city, town) governments and related governmental entities (for example, agencies, boards, commissions and enterprises).
Qualified opinion	(see Modified auditor's report)
Quality controls	The policies and procedures adopted by a firm designed to provide it with reasonable assurance that the firm and its personnel comply with professional standards and regulatory and legal requirements, and that reports issued by the firm or engagement partners are appropriate in the circumstances.
Reasonable assurance (in the context of quality control)	A high, but not absolute, level of assurance.
Reasonable assurance (in the context of an audit engagement)	A high, but not absolute, level of assurance, expressed positively in the auditor's report as reasonable assurance, that the information subject to audit is free of material misstatement.
Reasonable assurance engagement	(see Assurance engagement)
Recalculation	Consists of checking the mathematical accuracy of documents or records.
Reconciliations	Where entity officials compare two pieces of financial data, or financial and non-financial data, to ensure complete and accurate processing of transactions. For instance, comparing ("reconciling") a bank statement with internal records of payments made or money received, establishing the reasons for any difference, and making corrections where differences have been caused by incomplete or inaccurate processing. A kind of control procedure.
Regularity Audit	An audit that aims to assess whether transactions accord with relevant laws and regulations. Part of Financial Audit
Related party	A party is related to an entity if: <ul style="list-style-type: none"> (a) Directly, or indirectly through one or more intermediaries, the party: <ul style="list-style-type: none"> i. Controls, is controlled by, or is under common control with, the entity (this includes parents, subsidiaries and fellow subsidiaries); ii. Has an interest in the entity that gives it significant influence over the entity; or iii. Has joint control over the entity; (b) The party is an associate (as defined in IAS 28, "Investments in Associates") of the entity;

Term	Explanation
	<p>(c) The party is a joint venture in which the entity is a venturer (see IAS 31, “Interest in Joint Ventures”);</p> <p>(d) The party is a member of the key management personnel of the entity or its parent;</p> <p>(e) The party is a close member of the family of any individual referred to in (a) or (d);</p> <p>(f) The party is an entity that is controlled, jointly controlled or significantly influenced by, or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in (d) or (e); or</p> <p>(g) The party is a post-employment benefit plan for the benefit of employees of the entity, or of any entity that is a related party of the entity.</p>
Related party transaction	A transfer of resources, services or obligations between related parties, regardless of whether a price is charged.
Related services	Comprise agreed-upon procedures and compilations.
Re-performance	The auditor’s independent execution of procedures or controls that were originally performed as part of the entity’s internal controls, either manually or through the use of CAATs.
Responsible party	<p>The person (or persons) who:</p> <p>(a) In a direct reporting engagement, is responsible for the subject matter; or</p> <p>(b) In an assertion-based engagement, is responsible for the subject matter information (the assertion), and may be responsible for the subject matter.</p> <p>The responsible party may or may not be the party who engages the practitioner (the engaging party).</p>
Review (in relation to quality control)	Appraising the quality of the work performed and conclusions reached by others.
Review engagement	The objective of a review engagement is to enable an auditor to state whether, on the basis of procedures which do not provide all the evidence that would be required in an audit, anything has come to the auditor’s attention that causes the auditor to believe that the financial statements are not prepared, in all material respects, in accordance with an applicable financial reporting framework.
Review procedures	The procedures deemed necessary to meet the objective of a review engagement, primarily inquiries of entity personnel and analytical procedures applied to financial data.
Risk assessment procedures	The audit procedures performed to obtain an understanding of the entity and its environment, including its internal control, to assess the risks of material misstatement at the financial statement and assertion levels.
Risk of material misstatement	<p>Risk of material misstatement is the risk that the financial statements are materially misstated prior to audit. This consists of two components, described as follows at the assertion level:</p> <p>(i) Inherent risk – The susceptibility of an assertion about a class of transaction, account balance or disclosure to a misstatement that could be material, either</p>

Term	Explanation
	<p>individually or when aggregated with other misstatements, before consideration of any related controls.</p> <p>(ii) Control risk – The risk that a misstatement that could occur in an assertion about a class of transaction, account balance or disclosure and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity’s internal control.</p>
Sampling risk	(see Audit sampling)
Sampling unit	(see Audit sampling)
Scope of an audit	The audit procedures that, in the auditor’s judgment and based on the ISSAIs, are deemed appropriate in the circumstances to achieve the objective of the audit.
Scope of a review	The review procedures deemed necessary in the circumstances to achieve the objective of the review.
Scope limitation	(see Limitation on scope)
Segment information	Information in the financial statements regarding distinguishable components or industry and geographical aspects of an entity.
Significance	The relative importance of a matter, taken in context. The significance of a matter is judged by the practitioner in the context in which it is being considered. This might include, for example, the reasonable prospect of its changing or influencing the decisions of intended users of the practitioner’s report; or, as another example, where the context is a judgment about whether to report a matter to those charged with governance, whether the matter would be regarded as important by them in relation to their duties. Significance can be considered in the context of quantitative and qualitative factors, such as relative magnitude, the nature and effect on the subject matter and the expressed interests of intended users or recipients.
Significant risk	A risk that requires special audit consideration.
Small entity	<p>Any entity in which:</p> <p>(a) There is concentration of ownership and management in a small number of individuals (often a single individual); and</p> <p>(b) One or more of the following are also found:</p> <ol style="list-style-type: none"> i. Few sources of income; ii. Unsophisticated record-keeping; and iii. Limited internal controls together with the potential for management override of controls. <p>Small entities will ordinarily display characteristic (a), and one or more of the characteristics included under (b).</p>
Special purpose auditor’s report	<p>A report issued in connection with the independent audit of financial information other than an auditor’s report on financial statements, including:</p> <p>(a) A complete set of financial statements prepared in accordance with another comprehensive basis of accounting;</p>

Term	Explanation
	(b) A component of a complete set of general purpose or special purpose financial statements, such as a single financial statement, specified accounts, elements of accounts, or items in a financial statement; (c) Compliance with contractual agreements; and (d) Summarized financial statements.
Statistical sampling	(see Audit sampling)
Stratification	(see Audit sampling)
Subject matter information	The outcome of the evaluation or measurement of a subject matter. It is the subject matter information about which the practitioner gathers sufficient appropriate evidence to provide a reasonable basis for expressing a conclusion in an assurance report.
Subsequent events	International Accounting Standard (IAS) 10, "Events After the Balance Sheet Date," deals with the treatment in financial statements of events, both favourable and unfavourable, that occur between the date of the financial statements (referred to as the "balance sheet date" in the IAS) and the date when the financial statements are authorized for issue and identifies two types of events: (a) Those that provide evidence of conditions that existed at the date of the financial statements; and (b) Those that are indicative of conditions that arose after the date of the financial statements.
Substantive procedures	Audit procedures performed to detect material misstatements at the assertion level; they include: (a) Tests of details of classes of transactions, account balances, and disclosures; and (b) Substantive analytical procedures.
Sufficiency	Sufficiency is the measure of the quantity of audit evidence. The quantity of the audit evidence needed is affected by the risk of misstatement and by the quality of such audit evidence.
Summarized financial statements	Financial statements summarizing an entity's annual audited financial statements for the purpose of informing user groups interested in the highlights only of the entity's financial performance and position.
Supplementary information	Information that is presented together with the financial statements that is not required by the applicable financial reporting framework used to prepare the financial statements, normally presented in either supplementary schedules or as additional notes.
Supreme Audit Institution	The public body of a State which, however designated, constituted or organized, exercises by virtue of law, the highest public auditing function of that State.
Test	The application of audit procedures to some or all items in a population.
Tests of control	Tests performed to obtain audit evidence about the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements at the assertion level.

Term	Explanation
Those charged with governance	The person(s) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process. For some entities in some jurisdictions, those charged with governance may include management personnel, for example, executive members of a governance board of a private or public sector entity or an owner-manager.
Tolerable error	(see Audit sampling)
Total error	(see Audit sampling)
Transaction	An individual payment made by an entity, or an individual amount received by an entity.
Transaction logs	Reports that are designed to create an audit trail for each on-line transaction. Such reports often document the source of a transaction (terminal, time and user) as well as the transaction's details.
Trial Balance	An accounting record that summarises all debit and credit entries recorded in the general ledger, and which is the basis for producing the financial statements. The net value of transactions recorded in the Trial Balance should be zero.
Uncertainty	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.
Unqualified opinion	(see Opinion)
Walk-through test	Involves tracing a few transactions through the financial reporting system.
Wide Area Network (WAN)	A communications network that transmits information across an expanded area such as between plant sites, cities and nations. WANs allow for on-line access to applications from remote terminals. Several LANs can be interconnected in a WAN.
Working papers	The material prepared by and for, or obtained and retained by, the auditor in connection with the performance of the audit. Working papers may be in the form of data stored on paper, film, electronic media or other media.