Audit Manual

For

Small and Medium Sized Practices (SMPs)

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Objectives

The Primary objective of the Audit Manual for Small and Medium-Sized Practices is to support Small Audit Firms to document audit work that provide;

- A sufficient and appropriate record of the basis for the auditor's report; and
- Evidence that the audit was planned and performed in accordance with International Standards on Auditing (ISAs) and applicable legal and regulatory requirements.

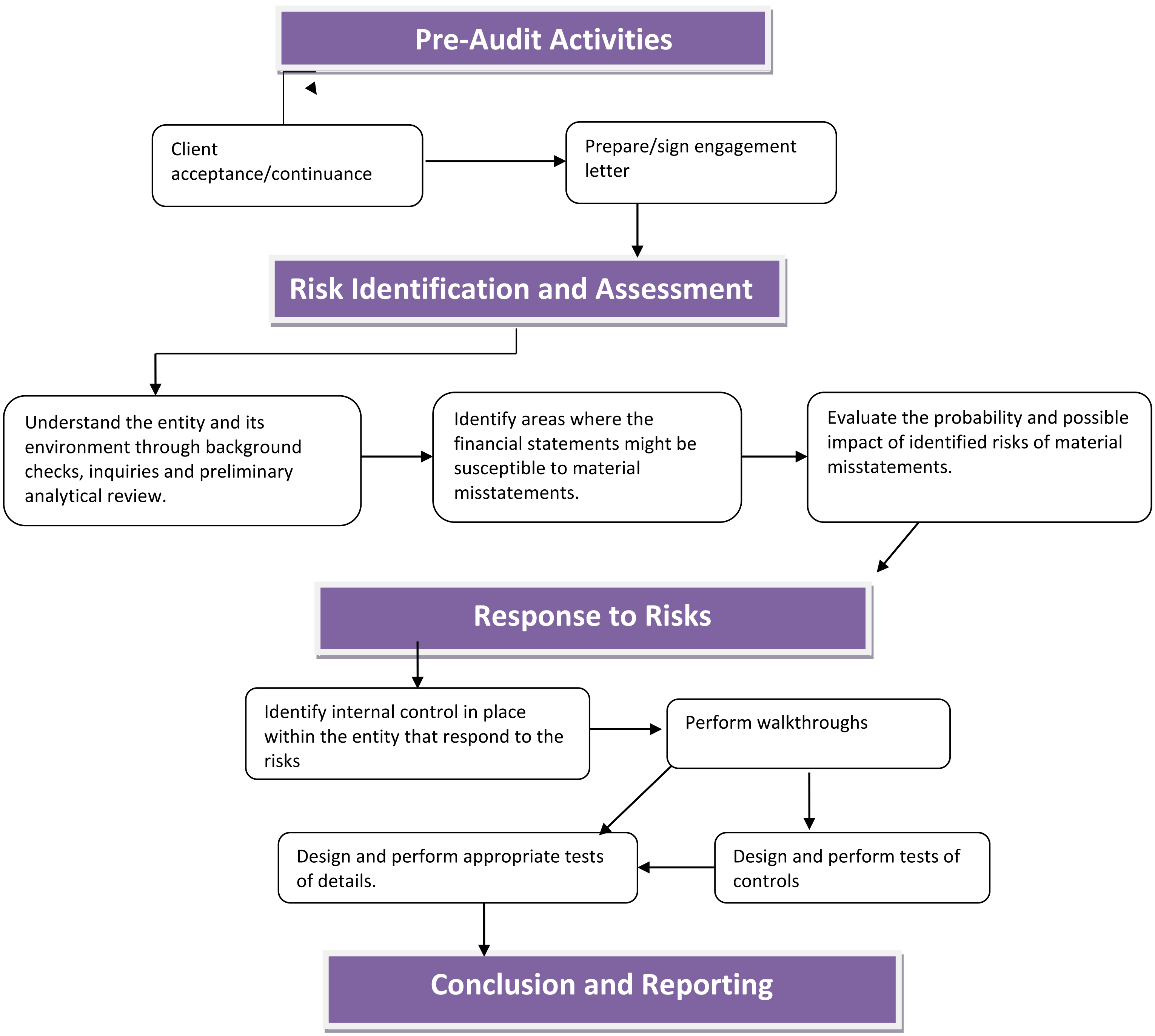
The manual has been organised in compliance with International Standards on Auditing (ISAs).

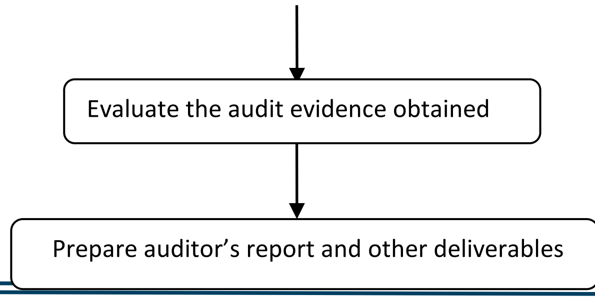
Applicability and Criteria for use

The Audit Manual is recommended for use on audit engagements where all or some of the following criteria are met.

- There is a concentration of ownership and management in a small number of individuals.
- The entity has few sources of income.
- The entity's record-keeping is not complex.
- The nature of the entity's business is not expected to change significantly in the short run.
- The entity is not a significant and public listed company.

The Risk Based Audit Process





Pre-Audit Activities

1.1 Client Acceptance and Engagement Continuance Procedures

The section documents the policies and procedures for accepting an engagement. The engagement can either be a new one or existing one. The procedures in this section can be documented by using the acceptance /engagement continuance form. The form must be completed and signed off by the Partner prior to any detail work being commenced on the audit. Refer to **Appendix 1** for a sample of the form.

When the engagement is new, acceptance procedures are performed but if it is an existing client, the continuance procedures are performed.

1.1.1 Client Acceptance Procedures

This section documents the policies and procedures that must be followed before accepting a new engagement.

Client acceptance procedures are performed before agreeing to provide services for a new client, while continuance procedures are performed for each new engagement to an existing client.

Policy

As a result of the risk involved in audit engagement, every new audit engagement must comply with the procedures for engaging a new client.

Procedures

Preliminary Information of the Engagement

Obtain details of the engagement which should include the industry the entity operates, the size of the entity and any regulatory requirements among others. The engagement partner shall be satisfied that appropriate procedures regarding the acceptance and continuance of client relationships and audit engagements have been followed, and shall determine that conclusions reached in this regard are appropriate. (Ref: ISA 220 Para. A8-A9)

Firm Experience

It is the duty of the Partner to determine whether the firm has the required expertise to carry out the new engagement.

Competent Personnel

The partner should determine if the firm has the right personnel to carry out the engagement, in terms of skills, education and experience (ISA 220 Para A8-A9).

Consultation with Outgoing Auditor(s)

There is need to seek clearance, in writing from the outgoing auditor(s) before a new engagement is accepted. This is required as part of the Professional Code of Conduct and Guide for Members. Such clearance must be filed in the permanent audit file and a copy in the audit working paper file. If in the course of obtaining the clearance, the outgoing auditor(s) is of the opinion that the engagement should not be accepted, he must state his reasons in writing to the incoming auditor(s). However, the incoming auditor must make his judgment in line with the requirements of the Professional Code of Conduct and Guide for Members.

Background Check
It is required that a background check be carried out for all new engagements and should be documented. The check must cover but not limited to the following:

- The Directors of the prospective client
- Alleged corruption charges against the company or its Directors
- Legality of the company's products
- Compliance with money laundering prohibition Act by the Company and it's directors.

Client Acceptance Risk

When all the above procedures have been carried out, there is need to access the level of risk exposure by the firm. The basis for determining the risk level is a matter of professional judgment. The levels of risks are:

- **High Risk Profile Engagement:** This is where the risk of the engagement can adversely affect the firm, it is advisable to reject the engagement. This should be done in writing without stating your findings.
- **Medium Risk Profile Engagement:** Where the risk will not have material effect on the firm, the Partner/Firm must develop plans to mitigate the risk. Where the risk identified cannot be mitigated, the engagement must not be accepted.
- **Low Risk Profile Engagement:** Where the risk level is adjudged to be low, the engagement could be accepted.

1.2 Engagement Letter

1.2.1 Agreeing Terms of Engagement on Acceptance of the Audit
Having decided to accept the audit, the auditor shall agree the terms of audit engagement either through a formal contract or through an audit engagement letter (which is the general practice). The Auditor is advised to go through the template in **ISA 210- Agreeing the Terms of Audit** Engagement and modify it according to the requirements of the engagement.
Refer to **Appendix 2** for engagement letter template**.**

1.2.2 Preconditions for an Audit
a) Determine whether the financial reporting framework to be applied in the preparation of the financial statements is acceptable; and
b) Obtain the agreement of directors that it acknowledges and understands its responsibility for the following:
(i) the preparation of the financial statements in accordance with the applicable financial reporting framework, including where relevant their fair presentation;
(ii) the internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error; and
(iii) providing the auditor with:
a. Access to all information and explanation which management is aware are relevant to the

preparation of the financial statements such as records, documentation and other matters;
b. Additional information that the Auditor may request from management/directors/those charged with governance for the purpose of the audit; and
c. Unrestricted access to persons within the entity from whom the Auditor determines necessary to obtain audit evidence.

1.2.3 Limitation on Scope Prior to Audit Engagement Acceptance

If management or those charged with governance impose a limitation on the scope of the auditor's work in terms of a proposed audit engagement such that the Auditor believes the limitation will result in the auditor disclaiming an opinion on the financial statements, the Auditor may not accept such a limited engagement unless required by law or regulation to do so.
The agreed terms shall include the following among others:
(a) The objective and scope of the audit;
(b) The responsibilities of the Auditor;
(c) The responsibilities of the directors;
(d) Identification of the applicable financial reporting framework for the preparation of the financial statements; and
(e) Reference to the expected form and content of any reports to be issued by the Auditor and a statement that there may be circumstances in which a report may differ from its expected form and content.

1.2.4 Recurring Audits

On recurring audits, the Auditor shall assess whether circumstances require the terms of the audit engagement to be revised and whether there is a need to remind the entity of the existing terms of the audit engagement.

1.2.5 Changes in Terms of Audit Engagement

Where a request has come to the Auditor to change the terms of engagement, the auditor should consider the justification given for the change. To accept or decline such request is a matter of his professional judgment having considered the relevant laws, auditing standards, ethical issues considerations and the prevalent circumstances. The Auditor may agree to the change where the change is required due to:

- change in circumstances that affects the entity's requirements for an audit.
- misunderstanding concerning the nature of the service originally requested.

The change in terms of an audit engagement would not be justified where the change relates to information that is incorrect, incomplete or otherwise unsatisfactory. For example, where the Auditor is unable to obtain sufficient and appropriate audit evidence regarding an assertion in a financial statement and the entity asks for the audit engagement to be changed to a review or agreed upon procedure engagement to avoid a qualified opinion or disclaimer of opinion.

If the Auditor is unable to agree to a change of the terms of the audit engagement and is not permitted by management to continue the original audit engagement, the auditor should:

- Withdraw from the audit engagement where possible under applicable laws or regulation; and
- Determine whether there is any obligation, either contractual or otherwise, to report the circumstances to other parties, such as those charged with governance, owner or regulators.

Risk Identification and Assessment

2.1 Understanding the Entity and Its Environment

The auditor shall perform risk assessment procedures to provide a basis for the identification and assessment of risks of material misstatement at the financial statement and assertion levels. Risk assessment procedures by themselves, however, do not provide sufficient appropriate audit evidence on which to base the audit opinion. (Ref: ISA 315 Para. A1-A5)

The risk assessment procedures shall include the following:

- Inquiries of management, of appropriate individuals within the internal audit function (if the function exists), and of others within the entity who in the auditor's judgment may have information that is likely to assist in identifying risks of material misstatement due to fraud or error. (Ref: ISA 315 Para. A6–A13)
- Analytical procedures. (Ref: ISA 315 Para. A14-A17)
- Observation and inspection. (Ref: ISA 315 Para. A18)

Professional standards require the audit team to identify and assess risks of material misstatements at (1) the financial statement level and (2) the assertion-level for classes of transactions, account balances and disclosures, whether due to error or fraud. Risk assessment means identifying the risks that could cause the financial statements to be materially misstated. One important aspect of risk assessment procedure is to understand the entity and its environment, including its internal control. This understanding is essential in identifying risks of material misstatements, whether due to error or fraud, relating them to the financial statement assertions, and assessing the likelihood that they could cause a material misstatement.

Obtaining an understanding of the entity and its environment and assessing risk is a continuous process that occurs throughout the audit. Risk assessment does not occur solely at the planning stage. Instead the audit team continually remains alert for additional risks while conducting the engagement. If additional risks or modifications to the original risks are noted, the audit team may need to adjust the audit plan.

The risk assessment process is the foundation for the audit. The audit team needs to first conduct a thorough risk assessment (including fraud risk) process and then properly designs and performs procedures that directly respond to the identified risks.

In addition to enhancing the effectiveness and efficiency of the audit, understanding the entity helps to develop meaningful, timely and constructive recommendations to management and those charged with governance. The understanding the entity's industry can be gained from periodicals, trade association publications, professional publications, internet sites and so on.

Inquiries can also be made of management and others within the entity about possible areas in the financial statements where the risk of material misstatements is more likely.

The audit team should hold regular meetings to discuss the susceptibility of the financial statements to risk of material misstatements as the audit progresses.

An understanding of the entity and its environment helps to:

- identify areas that may need special attention (i.e., significant risks)
- understand how accounting data is produced, recorded, processed, reviewed and stored
- identify important estimates, such as valuation of inventories, allowances for doubtful accounts, and percentage of completion of long-term contracts
- identify situations requiring management judgments such as the valuation of assets
- understand management's determination as to the selection of appropriate accounting principles applied and the adequacy of presentation and disclosures in the financial statements.

2.1.1 Guidelines for Obtaining the Understanding

Nature of the entity

- the entity's business operations, including location, products and/or services, sources of revenue, markets, major customers and suppliers, competition, related parties, outsourced activities, employment
- its ownership structure and governance (who owns the business and those charged with governance)
- the types of investments (planned or recent acquisitions, securities, loans, fixed assets, special-purpose entities), including related matters such as debt covenants, leasing activities, off-balance sheet arrangements and the use of derivatives
- the way it is financed (this includes how the business obtains funds to operate) accounting principles and industry practices, revenue recognition policies, accounting for complex or unusual transactions, financial statement presentation and disclosures.

Industry, regulatory and other external factors, including the applicable accounting framework

- industry conditions, such as the competitive environment, supplier and customer relationships, technological considerations related to its products, energy supply and cost
- regulatory environment including the applicable accounting principles and industry-specific practices, the type and extent of regulatory oversight, the legal and political environment, including taxation and trade issues, government policies and environmental requirements
- general economic conditions, interest rates, inflation and financing options

Objectives, strategies, and related business risks

- the objectives or overall plans for the entity (defined by those charged with governance) to address business risks
- strategies (operational approaches set by management to achieve these objectives)
- the related business risks (events, conditions, circumstances or actions that could adversely affect the entity's ability to achieve its objectives and execute its strategies, including the risk of a material financial statement misstatement)

These risks may be related to:

- industry developments
- new products and services (for example, increased product liability risks)
- business expansion
- new accounting pronouncements
- financing requirements (current or future)
- use of Information Technology (IT)

Measurement and review of financial performance

- key ratios, operating statistics and performance indicators (financial and non financial)
- budgets, variance analyses, segment information and divisional, departmental, and other level performance reports
    - comparison of performance with peers
    - employee performance measures

Internal control

- the company's internal control at the entity level
- activity-level controls

2.2 Materiality

The audit team's consideration of materiality on an engagement is a matter of professional judgment. It reflects the perception of how misstatements could reasonably be expected to influence the economic decisions of users of the financial statements.

The users of the financial statements refer to users as a group, not specific individual users. Materiality provides guidance to auditors' professional judgments in assessing the common financial information needs of such users of financial statements. It is reasonable for the audit team to assume that users:

- have reasonable knowledge of the business and economic activities and accounting; and a willingness to study the information in the financial statements with reasonable diligence.
- understand that financial statements are prepared and audited to levels of materiality.
- recognize the uncertainties inherent in the measurement of amounts based on the use of estimates, judgment, and the consideration of future events.
- make reasonable economic decisions on the basis of the information in the financial statements.

The concept of materiality is applied by the audit team in:

- planning and performing the audit;
- evaluating the effect of identified misstatements on the audit;
- evaluating the effect of uncorrected misstatements on the financial statements; and
- forming the opinion in the auditor's report.

2.2.1 Steps in Applying Materiality

The four major steps in the application of materiality to an audit include:

Step 1: Determine the Overall Materiality
To determine the overall materiality, the Auditor first establishes the materiality level for the financial statements as a whole. This can only be arrived at by determining the benchmark and applying the benchmark percentage. The benchmark table is as follows:

Benchmark	Rate	Consideration
Net Profit before tax	3% to 10%	Profit oriented entities
Turnover	1% to 3%	Not for profit entities
Total Asset	1% to 3%	Not for profit entities or Other than not for profit entities where profit/loss before tax is not considered appropriate.
EBITDA	2.5% to 3.5%	Entities where EBITDA is considered the appropriate benchmark.
Net Assets	1% to 2.5%	Entities where net assets is considered the appropriate benchmark.

Step 2: Determine the Performance Materiality
The amount set by the audit team is less than the Overall Materiality, to reduce to an appropriately low level, the probability that the aggregate of undetected misstatements exceeds Overall Materiality.

Performance Materiality must be set at a lower percentage of the Overall Materiality so as to allow the audit team to plan for possible undetected misstatements that may occur during the engagement. The following sliding scale of percentage, based upon an estimate of the engagement risk associated with the client should be applied:

Engagement Risk		
Low	Medium	High
90%	75%	50%

Step 3: Determine the Materiality at the transaction level or class of account
It is required that the audit team should determine the materiality amount on a class of account. The amount is expected to be lower than the performance materiality. The following basis can be used:

- Professional Judgment: The audit team takes a fraction of the performance materiality based on professional judgment.
- Ratio Approach: The audit team may decide to take a fraction of the performance materiality as the account class materiality, for instance, one third (1/3) of the overall materiality or two third (2/3) of the overall materiality. This could be effectively utilized based on the risk of material misstatement in that class of account. The table below provides a guide:

Risk of Material Misstatements		
Low	Medium	High
High Percentage of performance materiality should be used	Medium or average performance materiality can be used	Low proportion of the performance materiality must be used

- Formula Approach: The audit team uses the weight of the account class to the total account class, for instance, where the Inventory has about 40% of the Total Assets. This can mathematically be computed as:
  (Performance Materiality minus Acceptable level of misstatement) X (Account Class / Total Value of the Class e.g. Total Assets or Total Liabilities)

Step 4: Acceptable Unadjusted Amount
This is a trivial amount that the audit team will not adjust in the financial statements. The amount must be less than the performance materiality. The guidance provided below must be applied to all engagements:

The amount to be allowed as acceptable unadjusted amount should range from 0.5% to 2 % of the performance materiality.

2.2.2 Revision of Materiality
The audit team must ensure that at the evidence evaluation level of all engagements, where the level of the identified risk is higher than expected, the materiality level will be adjusted down to give room for further audit work. As such, the audit work paper must document the adjustment on the materiality level and as well adjust all work papers to reflect the level of work carried out.

Refer to **Appendix 3** for materiality template

2.3 Financial Statement Assertions

The objective of the auditor is to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels, through understanding the entity and its environment, including the entity's internal control, thereby providing a basis for designing and implementing responses to the assessed risks of material misstatement.

Assertions are representations by management, explicit or otherwise, that are embodied in the financial statements, as used by the auditor to consider the different types of potential misstatements that may occur.

Assertions used by the auditor in considering the different types of potential misstatements that may occur may fall into the following categories:

1. Assertions about classes of transactions and events, and related disclosures, for the period under audit:

   - Occurrence—transactions and events that have been recorded or disclosed, have occurred, and such transactions and events pertain to the entity.
   - Completeness—all transactions and events that should have been recorded have been recorded, and all related disclosures that should have been included in the financial statements have been included.

- Accuracy—amounts and other data relating to recorded transactions and events have been recorded appropriately, and related disclosures have been appropriately measured and described.
- Cutoff—transactions and events have been recorded in the correct accounting period.
- Classification—transactions and events have been recorded in the proper accounts.
- Presentation—transactions and events are appropriately aggregated or disaggregated and clearly described, and related disclosures are relevant and understandable in the context of the requirements of the applicable financial reporting framework.

2. Assertions about account balances, and related disclosures, at the period end:

    - Existence—assets, liabilities, and equity interests exist.
    - Rights and obligations—the entity holds or controls the rights to assets, and liabilities are the obligations of the entity.
    - Completeness—all assets, liabilities and equity interests that should have been recorded have been recorded, and all related disclosures that should have been included in the financial statements have been included.
    - Accuracy, valuation and allocation—assets, liabilities, and equity interests have been included in the financial statements at appropriate amounts and any resulting valuation or allocation adjustments have been appropriately recorded, and related disclosures have been appropriately measured and described.
    - Classification—assets, liabilities and equity interests have been recorded in the proper accounts.
    - Presentation—assets, liabilities and equity interests are appropriately aggregated or disaggregated and clearly described, and related disclosures are relevant and understandable in the context of the requirements of the applicable financial reporting framework.

2.4 Fraud Risk

Misstatements in the financial statements can arise from either fraud or error. The distinguishing factor between fraud and error is whether the underlying action that results in the misstatement of the financial statements is intentional or unintentional.

Although fraud is a broad legal concept, for the purposes of the ISAs, the auditor is concerned with fraud that causes a material misstatement in the financial statements. Two types of intentional misstatements are relevant to the auditor – misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets. Although the auditor may suspect or, in rare cases, identify the occurrence of fraud, the auditor does not make legal determinations of whether fraud has actually occurred.

The primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management.

An auditor conducting an audit in accordance with ISAs is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error. Owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with the ISAs.

2.4.1 Responses to the Assessed Risks of Material Misstatement Due to Fraud

The auditor shall determine overall responses to address the assessed risks of material misstatement due to fraud at the financial statement level. These include audit procedures whose nature, timing and extent are responsive to the assessed risks of material misstatement due to fraud at the assertion level.

Risk of Management Override of Controls
Management is in a unique position to perpetrate fraud because of management's ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Although the level of risk of management override of controls will vary from entity to entity, the risk is nevertheless present in all entities. Due to the unpredictable way in which such override could occur, it is a risk of material misstatement due to fraud and thus a significant risk. The auditor is required to design and perform audit procedures to:

1. Test the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements.
2. Review accounting estimates for biases and evaluate whether the circumstances producing the bias, if any, represent a risk of material misstatement due to fraud.
3. For significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual given the auditor's understanding of the entity and its environment and other information obtained during the audit, the auditor shall evaluate whether the business rationale (or the lack thereof) of the transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets.

Risk of Fraud in Revenue Recognition
Material misstatements due to fraudulent financial reporting relating to revenue recognition often results from an overstatement of revenues. The risk of fraud in revenue recognition may be greater in some entities than others. There may be pressures or incentives on management to commit fraudulent financial reporting through inappropriate revenue recognition.

The presumption that there are risks of fraud in revenue recognition may be rebutted where it may be possible to conclude that there is no risk of material misstatement due to fraud relating to revenue recognition. The auditor is expected to evaluate which types of revenue and revenue transactions give rise to risks of fraud in revenue recognition at the assertion level.

2.5 Analytical Procedures

Analytical procedures are one of many financial audit processes which help an Auditor understand the client's business and changes in the business, and to identify potential risk areas to plan other audit procedures.
Analytical procedures include comparison of the entity's financial information (data in financial statement) with

- prior periods
- budgets

- forecast etc.

It also includes consideration of predictable relationships i.e. ratios, such as:
- gross profit to sales,
- payroll costs to employees,
- Financial information and non-financial information, for examples the CEO's reports and the industry news.

Possible sources of information about the client include:
- Interim financial information
- Budgets
- Management accounts
- Non-Financial information
- Bank and cash records
- VAT returns
- Board minutes
- Discussion or correspondence with the client at the year-end

Analytical procedures are performed at three stages of audit: at the planning, in the execution and at the conclusion of the audit. These three stages are risk assessment procedures, substantive analytical procedures and final/overall analytical procedures.

Analytical procedures are required by ISA 315 to be completed as part of the risk assessment process.

Analytical procedures performed at the risk assessment stage assist the Auditor to better understand the business and to plan the nature, timing and extent of audit procedures.

2.6 Discussion with management

Inquiries can also be made of management and other knowledgeable persons within the entity as regards areas within the entity as a whole and the financial statements in particular that are more likely to result in material misstatement. The responses from such discussions should be documented and evaluated. The audit team should reach a conclusion on these responses and perform further audit procedures as appropriate.

2.7 Discussion among the audit team

Members of the audit team are required to hold a team planning meeting to share team knowledge of the entity, including an understanding of the entity, internal controls and results for the period.

Other key areas that should be discussed during the planning meeting including:

- Materiality considerations
- Susceptibility of the entity's financial statements to material misstatements due to fraud or error
- An overall assessment of risk and the team's audit strategy

2.8 Other Risks Assessment Procedures

In addition to the auditor's assessment of fraud risks, the auditor is expected to consider other risk assessment procedures which include the following:
- An understanding of how the entity complies with applicable laws and regulations;

- Assess management's preliminary assessment of going concern and any events that may cast significant doubt about the entity's ability to continue as a going concern and management's plan to address them.
- Obtain an understanding of related party transactions and assessment of the completeness of related party transactions.

In accordance with ISA 200, the auditor shall maintain professional skepticism throughout the audit, recognizing the possibility that a material misstatement due to fraud could exist, notwithstanding the auditor's past experience of the honesty and integrity of the entity's management and those charged with governance. (Ref: ISA 240 Para. A7- A8)

ISA 315 requires a discussion among the engagement team members and a determination by the engagement partner of which matters are to be communicated to those team members not involved in the discussion. This discussion shall place particular emphasis on how and where the entity's financial statements may be susceptible to material misstatement due to fraud, including how fraud might occur. The discussion shall occur setting aside beliefs that the engagement team members may have that management and those charged with governance are honest and have integrity. (Ref: ISA 315 Para. A10-A11).

Response to Risks

3.1 Identify Internal Controls in Place within the Entity That Respond To the Risks

Internal control is a process implemented by an entity's management, employees, other personnel and those charged with governance that is designed to achieve three objectives: effective and efficient operations, reliable financial reporting, and compliance with laws and regulations. Establishing and maintaining effective internal control is an important management responsibility and requires continuous management supervision in order to ensure that controls are operating as intended and appropriately modified as needed.

Identifying and understanding the internal controls to enable the audit team to achieve their intended control reliance strategy for each risk and tailor the tests of details appropriately.

Internal control is designed, implemented and maintained to address identified business risks that threaten the achievement of any of the entity's objectives that concern (ISA 315.A52):

- The reliability of the entity's financial reporting;
- The effectiveness and efficiency of its operations; and
- Its compliance with applicable laws and regulations.

The way in which internal control is designed, implemented and maintained varies with an entity's size and complexity.

3.1.1 Internal Control Framework

The division of internal control into the following five components, for purposes of the ISAs, provides a useful framework for auditors to consider how different aspects of an entity's internal control may affect the audit (ISA 315.A59):

Control environment;

The auditor shall obtain an understanding of the control environment. As part of obtaining this understanding, the auditor shall evaluate whether:

- Management, with the oversight of those charged with governance, has created and maintained a culture of honesty and ethical behavior; and
- The strengths in the control environment elements collectively provide an appropriate foundation for the other components of internal control, and whether those other components are not undermined by deficiencies in the control environment.

Risk assessment process

The entity's risk assessment process forms the basis for how management determines the risks to be managed. If that process is appropriate to the circumstances, including the nature, size and complexity of the entity, it assists the auditor in identifying risks of material misstatement. Whether the entity's risk assessment process is appropriate to the circumstances is a matter of judgment.

Information and Communication
The information system, including the related business processes, relevant to financial reporting, and communication.

The auditor shall obtain an understanding of the information system, including the related business processes, relevant to financial reporting, including the following areas:

- The classes of transactions in the entity's operations that are significant to the financial statements;
- The procedures, within both information technology (IT) and manual systems, by which those transactions are initiated, recorded, processed, corrected as necessary, transferred to the general ledger and reported in the financial statements;
- The related accounting records, supporting information and specific accounts in the financial statements that are used to initiate, record, process and report transactions; this includes the correction of incorrect information and how information is transferred to the general ledger. The records may be in either manual or electronic form;
- How the information system captures events and conditions, other than transactions, that are significant to the financial statements;
- The financial reporting process used to prepare the entity's financial statements, including significant accounting estimates and disclosures; and
- Controls surrounding journal entries, including non-standard journal entries used to record non-recurring, unusual transactions or adjustments.

This understanding of the information system relevant to financial reporting shall include relevant aspects of that system relating to information disclosed in the financial statements that is obtained from within or outside of the general and subsidiary ledgers.

The auditor shall obtain an understanding of how the entity communicates financial reporting roles and responsibilities and significant matters relating to financial reporting, including:

- Communications between management and those charged with governance; and
- External communications, such as those with regulatory authorities.

Control activities
The auditor shall obtain an understanding of control activities relevant to the audit, being those the auditor judges it necessary to understand in order to assess the risks of material misstatement at the assertion level and design further audit procedures responsive to assessed risks. An audit does not require an understanding of all the control activities related to each significant class of transactions, account balance, and disclosure in the financial statements or to every assertion relevant to them.

In understanding the entity's control activities, the auditor shall obtain an understanding of how the entity has responded to risks arising from IT.
Control activities are policies and procedures that help ensure that management's directives are carried out. They include business performance reviews, application controls, including safeguarding of assets, and general computer controls.

Monitoring of controls.

The auditor shall obtain an understanding of the major activities that the entity uses to monitor internal control relevant to financial reporting, including those related to those control activities relevant to the audit, and how the entity initiates remedial actions to deficiencies in its controls.

If the entity has an internal audit function, the auditor shall obtain an understanding of the nature of the internal audit function's responsibilities, its organizational status, and the activities performed, or to be performed.

The auditor shall obtain an understanding of the sources of the information used in the entity's monitoring activities, and the basis upon which management considers the information to be sufficiently reliable for the purpose.

3.1.2 COSO Framework

The ISA internal control framework is similar to the one used in the COSO framework, published by the Committee of Sponsoring Organizations (COSO) of the Treadway Commission (Internal Control - Integrated Framework) in 1992.

The COSO framework addresses the entity's business operations, their need to prepare reliable financial statements, and compliance with laws and regulations to which the entity is subject. These overlapping high level internal control objectives can be applied to the entity's different business.

In an "effective" internal control system, the following five components work to support the achievement of an entity's mission, strategies and related business objectives.

1. Control Environment

- Integrity and Ethical Values
- Commitment to Competence
- Board of Directors and Audit Committee
- Management's Philosophy and Operating Style
- Organizational Structure
- Assignment of Authority and Responsibility
- Human Resource Policies and Procedures

2. Risk Assessment

- Company-wide Objectives
- Process-level Objectives
- Risk Identification and Analysis
- Managing Change

3. Control Activities
- Policies and Procedures
- Security (Application and Network)
- Application Change Management
- Business Continuity/Backups
- Outsourcing

4. Information and Communication
- Quality of Information
- Effectiveness of Communication

5. Monitoring
- Ongoing Monitoring
- Separate Evaluations
- Reporting Deficiencies

These components work to establish the foundation for sound internal control within the company through directed leadership, shared values and a culture that emphasizes accountability for control. The various risks facing the company are identified and assessed routinely at all levels and within all functions in the organization.
Control activities and other mechanisms are proactively designed to address and mitigate the significant risks. Information critical to identifying risks and meeting business objectives is communicated through established channels up, down and across the company. The entire system of internal control is monitored continuously and problems are addressed timely.

Refer to **Appendix 4** on sample documentation for test of internal control.

3.2 Performing Walkthroughs

The objectives of a walkthrough are to:

- *Verify and update the understanding of internal control*. For example, an audit team may gather the information necessary to document their understanding for a new client principally through inquiry and observation with reference to the entity's procedures manual. This understanding may be verified by walking through one or more transactions for a transaction cycle. The audit team performs walkthrough tests to update and verify this understanding in a similar manner in subsequent years; however, as a matter of efficiency, instead of first updating the understanding for any changes and later walking through transactions, the audit team may consider performing the walkthrough tests at the same time they make the inquiries and observations necessary to update their understanding.

- *Verify that controls are implemented*. When determining whether controls are implemented, the audit team should also consider the effectiveness of the design of the control in preventing or detecting errors or fraud. Identification of ineffective control procedures at this time will help avoid performing tests of controls that do not function well enough to justify lower control risk assessments.

When performing a walkthrough, the audit team ordinarily traces transactions through the transaction cycle beginning with the documentation resulting from a boundary event, such as the issuance of a receiving report while observing the operation of identified controls, the audit team follows the transaction through the system until it is ultimately summarized and recorded in the client's general ledger. Refer to **Appendix 5** for sample of walk through documentation.

3.3 Design and Perform Tests of Controls

The auditor shall design and perform further audit procedures whose nature, timing and extent are based on and are responsive to the assessed risks of material misstatement at the assertion level. (Ref: ISA 330 Para. A4-A8)

In designing the further audit procedures to be performed, the auditor shall:

a) Consider the reasons for the assessment given to the risk of material misstatement at the assertion level for each class of transactions, account balance, and disclosure, including:

- The likelihood of material misstatement due to the particular characteristics of the relevant class of transactions, account balance, or disclosure (i.e., the inherent risk); and

- Whether the risk assessment takes account of relevant controls (i.e., the control risk), thereby requiring the auditor to obtain audit evidence to determine whether the controls are operating effectively (i.e., the auditor intends to rely on the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures); and (Ref 130 Para. A9-A18)

b) Obtain more persuasive audit evidence the higher the auditor’s assessment of risk. (Ref: ISA 330 Para. A19)

As part of the risk assessment procedures, auditors are required to get an understanding of the internal control measures the entity has in place to prevent or detect material misstatements due to fraud or error and document them appropriately. After these controls are understood and documented, the audit team should evaluate their design effectiveness. Design effectiveness relates to whether the appropriate controls are implemented to prevent and detect errors or fraud.

The strength and effectiveness of internal controls as evaluated by the audit team determine the extent the audit team can rely on them to obtain sufficient appropriate audit evidence.

A typical example of internal control is the accounting systems that initiate, process, and record transactions. When the audit team evaluates these systems and concludes that the controls are designed effectively, the amount of check of the details of the transactions that passed through these systems can be reduced, thereby enhancing the cost-effectiveness of the audit approach.

The audit team should select key controls in every *important* process related to areas in the financial statements or the entity as a whole where the risk of material misstatements is adjudged to be high.

Not all controls that are implemented within a process are designated as key (and therefore tested). In considering which controls are key, the control(s) should:

- address the same risk(s) as the substantive audit procedures whose scope will be reduced if the controls are operating effectively. For example, many entities have effective control procedures around the periodic counting of inventory. These control procedures directly reduce the likelihood of errors in the existence of recorded items. Accordingly, substantive procedures can be reduced (observation of inventories) by testing these controls.

- be designed to prevent or detect material misstatements in specific financial statement risks (the controls that accomplish this will vary depending on the nature of the business)

- be capable of being tested by examining documentary evidence, through inquiry and observation, sampling, re-performance, or the use of computer-assisted audit techniques

- contain the appropriate attributes (automated versus manual, preventative versus detective, operational versus foundational, documented versus undocumented) to provide the most efficient and effective test.

In developing the testing strategy, it may be efficient and effective to place reliance on the continued effective operation of the entity's controls and consequently take credit for the reliability of the management information that results in the entity's external financial reporting. Once the level of evidence required is determined i.e. how much evidence will be obtained from testing the operating effectiveness of controls in respect of each relevant assertion, the nature, timing, and extent of substantive testing is then determined.

In most cases however, many small entities do not have these elaborate internal controls. In that situation, copious tests of effectiveness should not be performed on these controls as the audit team will not place much reliance on them. It is therefore recommended that more detailed substantive tests are carried out in areas of the financial statements where the risk of material misstatements is adjudged to be high and the entity does not have strong internal controls that can prevent or detect such misstatements.

The auditor's substantive procedures at the assertion level may be tests of details, substantive analytical procedures, or a combination of both. The decision about which audit procedures to perform, including whether to use substantive analytical procedures, is based on the auditor's judgment about the expected effectiveness and efficiency of the available audit procedures to reduce audit risk at the assertion level to an acceptably low level.

3.4 Substantive Analytical Procedures

3.4.1 Perform Analytical Procedures

According to ISA 520, when designing and performing substantive analytical procedures, either alone or in combination with tests of details, as substantive procedures in accordance with ISA 330, the auditor shall:

- Determine the suitability of particular substantive analytical procedures for given assertions, taking account of the assessed risks of material misstatement and tests of details, if any, for these assertions;
- Evaluate the reliability of data from which the auditor's expectation of recorded amounts or ratios is developed, taking account of source, comparability, and nature and relevance of information available, and controls over preparation;
- Develop an expectation of recorded amounts or ratios and evaluate whether the expectation is sufficiently precise to identify a misstatement that, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated;
- Determine the amount of any difference of recorded amounts from expected values that is acceptable without further investigation.

3.4.2 Investigating Results of Analytical Procedures

If Substantive Analytical Procedures identify fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, the auditor shall investigate such differences by:

- Inquiring of management and obtaining appropriate audit evidence relevant to management's responses; and
- Performing other audit procedures as necessary in the circumstances.

3.5 Tests of Details

Depending on the circumstances, the auditor may determine that performing only test of details are appropriate. Tests of details are substantive audit procedures designed to identify the correctness of the related account balances. The nature of the risk and assertion is relevant to the design of tests of details. Because the assessment of the risk of material misstatement takes account of internal control, the extent of substantive procedures may need to be increased when the results from tests of controls are unsatisfactory. However, increasing the extent of an audit procedure is appropriate only if the audit procedure itself is relevant to the specific risk. (Ref ISA 330: Para 18, A46).

If the auditor has determined that an assessed risk of material misstatement at the assertion level is a significant risk, the auditor shall perform substantive procedures that are specifically responsive to that risk. When the approach to a significant risk consists only of substantive procedures, those procedures shall include tests of details. (Ref ISA 330:21 Para. A53).

The decision whether to use tests of details and which tests to apply may include considerations such as:

- the risk of material misstatements
- whether the tests would likely provide the needed evidence for the pertinent risks
- the costs and benefits of using tests of details versus applying other procedures, such as analytical procedures
- the costs and benefits of performing tests of controls to achieve the intended control reliance

3.5.1 Methods of Testing Details

The methods used to test details as noted by ISA 500 para 10A52:

- audit sampling

- selecting all items (100% examination)
- selecting specific items based on risk or value (target testing).

The application of any one or combination of these means may be appropriate depending on the particular circumstances, for example, the risks of material misstatement related to the assertion being tested, and the practicality and efficiency of the different means. (ref ISA 500 Para 10 A53).

The auditor may decide to select specific items from a population. In making this decision, factors that may be relevant include the auditor’s understanding of the entity, the assessed risks of material misstatement, and the characteristics of the population being tested. The judgmental selection of specific items is subject to non-sampling risk. Specific items selected may include: high value or key items, all items over a certain amount, items to obtain information. (ISA 500 para 10A54).

For a particular account balance, the audit team might use more than one of these testing methods. For example, the audit team could decide to test high value items and identify risk areas within the remaining population for further testing.

Tests of details are performed using examination, observation or confirmation procedures. Although tests of details may be used to test any risk, they are rarely used to test risks associated with presentation and disclosure.

3.5.2 Choosing Between Sampling and Other Testing Methods

The following guidance may be helpful to the audit team in considering the appropriate method of testing to employ:

- Where a large amount of a population's value consists of only a few items, testing those items and reviewing the rest against expectations, perhaps testing some, will often provide as much audit reliance as a sample and will cost less than a sample.
- Where there is a high risk of material misstatement and controls will not be tested or control tests have failed, statistical sampling is the preferred response because it provides a supportable estimate of error.
- There may be other situations influenced by the audit team's view of the likelihood of errors, such as when the entity focuses attention only on major accounts. For example, if the entity has four major customers, and keeps these under scrutiny, while paying significantly less attention to the rest, the audit team may be concerned about errors in the smaller accounts and wish to use direct testing to address the risk of misstatement in the smaller accounts, rather than restrict testing to the major customers.
- When the sample size is small, other tests of details or substantive analytical procedures should be considered, because the reliability of the results of small samples is questionable.
- If the sample size is very large, the decision to sample should be reconsidered to determine if there is a more efficient way to obtain the necessary audit evidence. If the audit team decides that the sampling is appropriate, the sample size calculator inputs should be reexamined to ensure that a sample is not being selected based on incorrect inputs or assumptions.

3.5.3 Sample Design, Size, and Selection of Items for Testing (ISA Requirements)

- When designing an audit sample, the auditor shall consider the purpose of the audit procedure and the characteristics of the population from which the sample will be drawn. (Ref: Para. A4-A9)

- The auditor shall determine a sample size sufficient to reduce sampling risk to an acceptably low level. (Ref: Para. A10-A11)
- The auditor shall select items for the sample in such a way that each sampling unit in the population has a chance of selection. (Ref: Para. A12-A13)

3.5.4 Performing Audit Procedures

- The auditor shall perform audit procedures, appropriate to the purpose, on each item selected.
- If the audit procedure is not applicable to the selected item, the auditor shall perform the procedure on a replacement item. (Ref: Para. A14)
- If the auditor is unable to apply the designed audit procedures, or suitable alternative procedures, to a selected item, the auditor shall treat that item as a deviation from the prescribed control, in the case of tests of controls, or a misstatement, in the case of tests of details. (Ref: Para. A15-A16)

3.5.5 Nature and Cause of Deviations and Misstatements

- The auditor shall investigate the nature and cause of any deviations or misstatements identified, and evaluate their possible effect on the purpose of the audit procedure and on other areas of the audit. (Ref: Para. A17)
- In the extremely rare circumstances when the auditor considers a misstatement or deviation discovered in a sample to be an anomaly, the auditor shall obtain a high degree of certainty that such misstatement or deviation is not representative of the population. The auditor shall obtain this degree of certainty by performing additional audit procedures to obtain sufficient appropriate audit evidence that the misstatement or deviation does not affect the remainder of the population.

3.5.6 Projecting Misstatements

- For tests of details, the auditor shall project misstatements found in the sample to the population. (Ref: Para. A18-A20)

3.5.7 Evaluating Results of Audit Sampling

- The auditor shall evaluate:
  1. The results of the sample; and (Ref: Para. A21-A22)
  2. Whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested. (Ref: Para. A23)

3.6 External Confirmations

Objective

The objective of the Auditor, when using external confirmation procedures, is to design and perform such procedures to obtain relevant and reliable audit evidence.

3.6.1 External confirmations procedures

When using external confirmation procedures, the auditor shall maintain control over external confirmation requests, including:

- Determining the information to be confirmed or requested;
- Selecting the appropriate confirming party;
- Designing the confirmation requests, including determining that requests are properly addressed and contain return information for responses to be sent directly to the auditor; and
- Sending the requests, including follow-up requests when applicable, to the confirming party.

3.6.2 Management's refusal to allow the auditor to send a confirmation request

If management refuses to allow the auditor to send a confirmation request, the auditor shall:

1. Inquire as to management's reasons for the refusal, and seek audit evidence as to their validity and reasonableness;
2. Evaluate the implications of management's refusal on the auditor's assessment of the relevant risks of material misstatement, including the risk of fraud, and on the nature, timing and extent of other audit procedures; and

Perform alternative audit procedures designed to obtain relevant and reliable audit evidence.

If the auditor concludes that management's refusal to allow the auditor to send a confirmation request is unreasonable, or the auditor is unable to obtain relevant and reliable audit evidence from alternative audit procedures, the auditor shall communicate with those charged with governance in accordance with ISA 260 (Revised). The auditor also shall determine the implications for the audit and the auditor's opinion in accordance with ISA 705 (Revised).

3.6.3 Results of the external confirmation procedures

<u>Reliability of responses to confirmation requests</u>

If the auditor identifies factors that give rise to doubts about the reliability of the response to a confirmation request, the auditor shall obtain further audit evidence to resolve those doubts. If the auditor determines that a response to a confirmation request is not reliable, the auditor shall evaluate the implications on the assessment of the relevant risks of material misstatement, including the risk of fraud, and on the related nature, timing and extent of other audit procedures.

<u>Non-responses</u>

In the case of each non-response, the auditor shall perform alternative audit procedures to obtain relevant and reliable audit evidence.

When a response to a positive confirmation request is necessary to obtain sufficient appropriate audit evidence

If the auditor has determined that a response to a positive confirmation request is necessary to obtain sufficient appropriate audit evidence, alternative audit procedures will not provide the audit evidence the auditor requires. If the auditor does not obtain such confirmation, the auditor shall determine the implications for the audit and the auditor's opinion in accordance with ISA 705 (Revised).

Exceptions

The auditor shall investigate exceptions to determine whether or not they are indicative of misstatements.

Negative confirmations

Negative confirmations provide less persuasive audit evidence than positive confirmations. Accordingly, the auditor shall not use negative confirmation requests as the sole substantive audit procedure to address an assessed risk of material misstatement at the assertion level unless all of the following are present:

1. The auditor has assessed the risk of material misstatement as low and has obtained sufficient appropriate audit evidence regarding the operating effectiveness of controls relevant to the assertion;
2. The population of items subject to negative confirmation procedures comprises a large number of small, homogeneous account balances, transactions or conditions;
3. A very low exception rate is expected; and

The auditor is not aware of circumstances or conditions that would cause recipients of negative confirmation requests to disregard such requests.

Evaluating the evidence obtained

The auditor shall evaluate whether the results of the external confirmation procedures provide relevant and reliable audit evidence, or whether further audit evidence is necessary.

3.7 Related Parties

Objectives

According to ISA 550, the objectives of the auditor concerning related parties transactions and relationships are:

Irrespective of whether the applicable financial reporting framework establishes related party requirements, to obtain an understanding of related party relationships and transactions sufficient to be able:

- To recognize fraud risk factors, if any, arising from related party relationships and transactions that are relevant to the identification and assessment of the risks of material misstatement due to fraud; and

- To conclude, based on the audit evidence obtained, whether the financial statements, in so far as they are affected by those relationships and transactions:
- Achieve fair presentation (for fair presentation frameworks); or
    - Are not misleading (for compliance frameworks); and

In addition, where the applicable financial reporting framework establishes related party requirements, to obtain sufficient appropriate audit evidence about whether related party relationships and transactions have been appropriately identified, accounted for and disclosed in the financial statements in accordance with the framework.

Substantive procedures

1. Perform the following procedures for related parties relationships and transactions as applicable:
    - Confirm or discuss the nature of the transactions with intermediaries (Such as banks, law firms, guarantors, or agents)
    - Confirm the purpose, specific terms and conditions or amounts of the transactions with related parties
    - Inspect significant contracts with related parties
    - Review accounting records for transactions with newly identified related parties
2. Perform required procedures where relationships or significant related party transactions that management had not previously identified or disclosed are identified.
3. Perform required procedures on significant related party transactions outside the entity's normal course of business.
4. Evaluate whether the identified related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the applicable framework.

3.8 Contingencies and Commitments

Inquire of management and obtained detailed analysis of contingent liabilities and commitment and perform each of the following:

- Verify completeness of detailed analysis based on our knowledge of the business and prior period and the following procedures –
- Consider the results of the review of minutes of meetings of shareholders, directors and oversights bodies
- Consider understanding of significant contracts and agreements
- Consider bank and loan confirmations for items such as guarantees or other liabilities
- Consider the results of the search for unrecorded liabilities
- Examine legal correspondence
- Consider related party transactions and arrangements
- Consider understanding of applicable laws and regulations
- Test mathematical accuracy of the detailed analysis

Agree contingencies and commitments to supporting documentations and assessed their nature to verify whether they have been treated appropriately.

3.9 Sample Test of Details Procedures

The procedures suggested here are meant to address assertions made by management in the financial statements. The approach is to obtain audit evidence on those assertions by splitting the financial statements into the different elements that make a complete set of financial statements and test them differently. For every element, the objectives of the tests will be highlighted and then the possible audit procedures to achieve those objectives will then be listed. **See Appendix 6.**

3.10 Extent of Audit Evidence Required

The extent to which the audit team places reliance on audit evidence derived from tests of details varies according to the circumstances. In general, it is a function of the:

- effectiveness of the particular procedure, and
- scope of the procedure (i.e., the number and monetary value of the items examined)

The effectiveness of the procedure increases with the:

- audit team's understanding of the entity and its environment
- relevance and reliability of the audit evidence provided
- extent to which it covers the population being audited

Misstatements found while testing details should be added to the Summary of Unrecorded Misstatements. The audit team should consider the implications of any misstatements on risk assessments (inherent risk, control reliance, and fraud) and whether the results of the tests imply the likelihood of additional misstatements in unexamined portion of the population. If so, risk assessments should be reevaluated, audit programs modified and additional testing performed.

3.11 Financial Statements Related Procedures

3.11.1 Financial statements tie-out

- Agree amounts from the financial statements with the underlying accounting records (e.g., trial balance), including agreeing or reconciling information in disclosure, whether such information is obtained from within or outside of the general and subsidiary ledgers,
- Agree that the grouping of general ledger accounts into the reported FSLIs is appropriate, consistent and complete.
- Verify the mathematical accuracy if the general ledger
- Perform consistency and quality review procedures on financial statements

3.11.2 Comparative information

- Determine whether the accounting policies reflected in the comparative information are consistent with those applied in the current period.
- Consider if a material misstatement in the comparative information has been identified while performing the current period audit. (Perform appropriate audit procedures to address any identified material misstatement)
- Determine if the financial statements include the comparative information required by the applicable framework, by performing each of the following:
    - Agree comparative financial information with the amounts and other disclosures presented in the prior period
    - Agree that financial information is appropriately classified
    - Where appropriate, agree that prior period information has been restated

3.11.3 Disclosures

- Complete a Financial Statements Disclosure Checklist (Refer to **Appendix 7**) or its equivalent, tailored to the entity's circumstances and addressing the relevant accounting and other issues, in order to consider whether the financial statements are presented in a manner that reflects the appropriate:
    - Classification and description of financial information and the underlying transaction, events and conditions, and
    - Presentation, structure and content of the financial statements. Audit evidence obtained as a direct written response to the auditor from a third party (the confirming party), in paper form, or by electronic or other medium.
- Where not previously tested in the audit areas to which they relate, test the supporting schedules for financial statement disclosures.

- Test the disclosure of related party transactions (e.g. disclosure of key management compensation and transaction stated as being conducted on arm's length basis) as required by the applicable framework.
- Test other specific presentation and disclosure items.

3.11.4 Other information presented in documents (e.g. annual reports) containing audited financial statements

- Determine, through discussion with management, the documents that will comprise the annual report, obtain management's planned timing for issuance of these documents and make appropriate arrangements to obtain final version of the documents in a timely manner.
- Obtain and read other information (financial and non-financial) documents received before the date of our report and compare amounts or other items in the other information with the financial statements to identify any material inconsistencies between:
    - The other information and the financial statements
    - The other information and the knowledge we obtained during the audit, including the audit evidence obtained and conclusions reached.

- In reading the other information, remain alert for indications that the other information not related to the financial statements or our knowledge obtained during the audit appears to be materially misstated.

3.11.5 Overall presentation of the financial statements

Evaluate whether the financial statements are prepared, in all material respects, in accordance with the requirements of the applicable framework, including consideration of each of the following:

- Overall presentation and disclosure is in accordance with the applicable framework, and the financial statements adequately refer to or describe the applicable financial reporting framework
- Qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments
- Segment reporting (PIEs and other entities required to present segment reporting) (Unchecked where not applicable)

- Adequate disclosure of the significant accounting policies selected and applied, including consideration of the relevance of the accounting policies to the entity, and whether they have been presented in an understandable manner
- Accounting policies selected and applied are consistent with the applicable framework and are appropriate
- Accounting estimates made by management are reasonable
- Information presented in the financial statements is relevant, reliable, comparable, and understandable, including consideration of whether:
- The information that should have been included has been included, and whether such information is appropriately classified, aggregated or disaggregated, and characterized
- The overall presentation of the financial statements has been undermined by including information that is not relevant or that obscures a proper understanding of the matters disclosed
- Financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements
- Terminology used in the financial statements, including the title of each financial statement, is appropriate

Conclusion and Reporting

This stage of the audit involves the audit team making sense of the evidence they have obtained from the client and seeing whether they have enough competent evidence to support management assertions. This step of the audit involves using professional judgment to make sure the evidence gathered is appropriate (relevant and reliable) and sufficient.

Having thoroughly evaluated the audit evidence, an appropriate audit report is issued.

4.1. Documentation of the Audit Procedures Performed and Audit Evidence Obtained

4.1.1 Form, content and extent of audit documentation

The auditor shall prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand:

- The nature, timing and extent of the audit procedures performed to comply with the ISAs and applicable legal and regulatory requirements;
- The results of the audit procedures performed, and the audit evidence obtained; and

- Significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions.

In documenting the nature, timing and extent of audit procedures performed, the auditor shall record:

- The identifying characteristics of the specific items or matters tested;
- Who performed the audit work and the date such work was completed; and
- Who reviewed the audit work performed and the date and extent of such review.

The auditor shall document discussions of significant matters with management, those charged with governance, and others, including the nature of the significant matters discussed and when and with whom the discussions took place.

If the auditor identified information that is inconsistent with the auditor's final conclusion regarding a significant matter, the auditor shall document how the auditor addressed the inconsistency.

4.1.2 Departure from a relevant requirement

If, in exceptional circumstances, the auditor judges it necessary to depart from a relevant requirement in an ISA, the auditor shall document how the alternative audit procedures performed achieve the aim of that requirement, and the reasons for the departure.

4.1.3 Matters arising after the date of the auditor's report

If, in exceptional circumstances, the auditor performs new or additional audit procedures or draws new conclusions after the date of the auditor's report, the auditor shall document:

The circumstances encountered;

- The new or additional audit procedures performed, audit evidence obtained, and conclusions reached, and their effect on the auditor's report; and
- When and by whom the resulting changes to audit documentation were made and reviewed.

4.1.4 Assembly of the final audit file

The auditor shall 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, ordinarily not more than 60 days after the date of auditor's report.

After the assembly of the final audit file has been completed, the auditor shall not **delete** or **discard** audit documentation of any nature before the end of its retention period of seven (7) years after the date of auditor's report.

In circumstances other than those envisaged above where 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 shall, regardless of the nature of the modifications or additions, document:

- The specific reasons for making them; and
- When and by whom they were made and reviewed.

4.2 Evaluating the Sufficiency and Appropriateness of Audit Evidence

An audit of financial statements is a cumulative and iterative process. As the auditor performs planned audit procedures, the audit evidence obtained may cause the auditor to modify the nature, timing, or extent of other planned audit procedures. Information may come to the auditor's attention that differs significantly from the information on which the risk assessment was based. For example,

- The extent of misstatements that the auditor detects by performing substantive procedures may alter the auditor's judgment about the risk assessments and may indicate a significant deficiency in internal control.
- The auditor may become aware of discrepancies in accounting records, or conflicting or missing evidence.
- Analytical procedures performed at the overall review stage of the audit may indicate a previously unrecognized risk of material misstatement.

In such circumstances, the auditor may need to reevaluate the planned audit procedures, based on the revised consideration of assessed risks for all or some of the classes of transactions, account balances, or disclosures and related assertions. ISA 315 contains further guidance on revising the auditor's risk assessment.

The auditor's judgment as to what constitutes sufficient appropriate audit evidence is influenced by such factors as the following:

- Significance of the potential misstatement in the assertion and the likelihood of its having a material effect, individually or aggregated with other potential misstatements, on the financial statements.
- Effectiveness of management's responses and controls to address the risks.
- Experience gained during previous audits with respect to similar potential misstatements.
- Results of audit procedures performed, including whether such audit procedures identified specific instances of fraud or error.
- Source and reliability of the available information.
- Persuasiveness of the audit evidence.
- Understanding of the entity and its environment, including the entity's internal control.

4.2.1 Evaluating the operating effectiveness of control

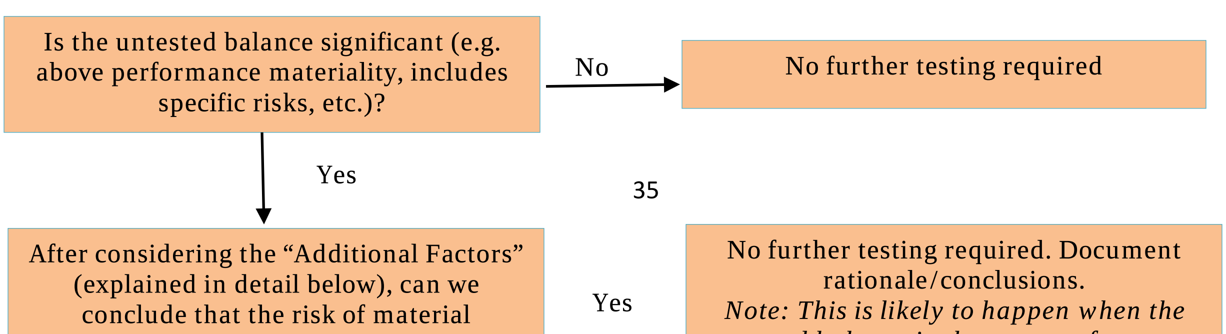
When evaluating the operating effectiveness of relevant controls, the auditor shall evaluate whether misstatements that have been detected by substantive procedures indicate that controls are not operating effectively. The absence of misstatements detected by substantive procedures, however, does not provide audit evidence that controls related to the assertion being tested are effective.

If deviations from controls upon which the auditor intends to rely are detected, the auditor shall make specific inquiries to understand these matters and their potential consequences, and shall determine whether:

- The tests of controls that have been performed provide an appropriate basis for reliance on the controls;
- Additional tests of controls are necessary; or
- The potential risks of misstatement need to be addressed using substantive procedures.

4.2.2 Evaluate results of planned substantive procedures

If we apply targeted testing to less than 100% of a population we need to evaluate the remaining risk of material misstatement of the untested balance at the assertion level. The following flowchart provides an overview of the steps to be considered with more detailed guidance in the following paragraphs:



Yes

While it is not appropriate to project misstatements from targeted testing to the entire population as is done in audit sampling, targeted testing may allow us to make judgments about the untested items in the population, depending on the nature of the test and the population. For example, if coverage is the method used and all transactions are processed in the same way by the same system, then the items target tested would likely provide some information about untested items. However, items targeted because they are unusual or near period-end may provide little or no information about untested items.

Additional Factors

When targeted testing is applied to less than 100% of a population, consider whether additional evidence is needed for the remaining balance not subject to targeted testing. When the total value of the account balance not subject to targeted testing exceeds performance materiality, understand the characteristics of the remaining population and use professional judgment to evaluate the risk of a material misstatement at the assertion level. In addition to the relationship of performance materiality to the amount of the account balance not subject to targeted testing, factors that are relevant to the conclusion on whether sufficient appropriate audit evidence has been obtained include the following:

- Significance of uncorrected misstatements and the likelihood of their having a material effect, individually or in combination, on the financial statements, considering the possibility of further undetected misstatement
- Effectiveness of management's responses and controls to address the risks
- Experience gained during previous audits with respect to similar potential misstatements
- Results of audit procedures performed in the audit of financial statements, including whether the evidence obtained supports or contradicts management's assertions and whether such audit procedures identified specific instances of fraud
- Auditor's risk assessment
- Source and reliability of available information
- The appropriateness (i.e., the relevance and reliability) and persuasiveness of the audit evidence
- Understanding of the entity and its environment, including its internal control

4.3 Update Preliminary Risk Assessment and Independence

4.3.1 Minutes and contracts

- Update review of all minutes of meetings of shareholders, directors and other relevant oversight bodies to identify potential matters of significance to the audit, update review of new or amended significant contracts and agreements to identify potential matters of significance to the audit.

4.3.2 Laws and regulations

- Consider the results of audit procedures performed and evidence obtained throughout the audit.

4.3.3 Related parties

- Consider the results of audit procedures performed and evidence obtained throughout the audit. Specifically, considered the results of each of the following procedures:

- Review of bank and legal confirmations obtained as part of our audit procedures
- Inspection of minutes of meetings of shareholders and of those charged with governance
- Inspection of other records or documents as a result of planned audit procedures

4.3.4 Going concern

- Evaluate the appropriateness of management's assessment of the entity's ability to continue as a going concern, including whether the form (e.g. in-depth knowledge of the business or detailed analysis) is appropriate given the nature of the entity, the period covered is at least 12 months from the date of the financial statements, and all relevant information has been included.
- Inquire of management as to its knowledge of events or conditions beyond the period of management's assessment that may cast significant doubt on the entity's ability to continue as a going concern.
- Evaluate whether sufficient appropriate audit evidence has been obtained regarding, and conclude on, the appropriateness of management’s use of the going concern basis of accounting in the preparation of the financial statements.

4.3.4 Accounting estimates

- Considered the results of audit procedures performed and evidence obtained throughout the audit, in respect of judgments and decisions made by management in respect of accounting estimates, to identify whether there are indicators of possible management bias.

4.3.5 Fraud

- Consider the results of audit procedures performed and evidence obtained throughout the audit.

4.3.6 Independence

Non-audit services

- Consider whether any additional non-audit services have been provided to the entity since planning, if yes, update/document safeguards in place for the potential independence threats.

Independence of the engagement team, chain of command, firm and network

- Consider any independence implications of changes in the engagement team since planning and any matters affecting independence of the engagement team (including any specialists and auditor's internal experts)

4.4 Evaluating Misstatements

4.4.1 Materiality

- Reassess materiality to confirm whether it remains appropriate in the context of the entity's actual financial results and perform more tests if required.

4.4.2 Misstatements

- Accumulate misstatements, including disclosure and cash flow misstatements, identified during the audit (other than those that are clearly trivial based on their size, nature or circumstances) and determine whether the audit strategy and plan needs to be revised.
- Communicate on a timely basis all misstatements (uncorrected and corrected) to the appropriate level of management and requested that the uncorrected misstatements be corrected.
- Determine whether uncorrected misstatements are material based on the size and nature.
- Determined whether misstatements affecting prior periods (corrected in current period or remaining uncorrected) are material based on the size and nature.
- Considered whether misstatements identified throughout the audit, individually or in aggregate, are indicative of fraud.

4.5 Overall Conclusion Analytics

- Perform conclusion analytics to evaluate if the financial statements are consistent with our understanding.
- Based on the overall conclusion analytics performed:

4.6 Other Auditing and Completion Procedures

4.6.1 Litigation and claims

- Consider the results of audit procedures performed and evidence obtained throughout the audit, to identify previously unidentified litigation or claims.
- Review legal expense accounts after period-end to identify any litigation or claims that were not previously identified.
- Evaluate responses received from legal counsel(s).
- Performed additional procedures when management refuses to allow legal letters of inquiry to be sent or where the entity's external legal counsel is prohibited from responding.

4.6 2 Required significant matters

Prepared the following required significant matters:

- Significant matters regarding the appropriate selection, application, and consistency of accounting principles (e.g., accounting for complex or unusual transactions or estimates and uncertainties)

- Results of audit procedures indicating that the financial information is or could be materially misstated
- Significant deficiencies in the entity's internal control
- Material inconsistencies and/or material misstatements of fact in other information
- Circumstances that cause us significant difficulty in applying necessary audit procedures
- Known or possible departures from laws or regulations, including details of the entity's response and the courses of actions considered and judgments and decisions made by the engagement team in concluding on the matter
- Suspected fraud or other irregularity
- The alternative procedures performed, where the engagement team considers it is necessary to depart from an ISA requirement and the justification for this
- Failure to achieve an ISA objective, including consideration of the implications for the overall audit objective and the audit opinion
- Disagreements among members of the engagement team or with others consulted on the engagement about final conclusions reached on significant accounting or auditing matters
- Significant matters reported to those charged with governance
- Circumstances where, after consultation, the agreed action is not implemented by the entity
- Significant doubts about whether the entity is a going concern

4.6.3 Internal control deficiencies

- Determined whether any identified deficiencies in internal control individually or in combination, represent significant deficiencies.
- Communicated significant deficiencies (in writing) and other identified deficiencies that merit attention to management.

4.6.4 Subsequent events

Performed subsequent events procedures as near as practicable to the date of the auditor's report by performing each of the following:

- Obtain understanding of management's procedures to identify subsequent events
- Inquire of management and, where appropriate, those charged with governance as to whether any subsequent events have occurred.
- Review all minutes of meetings of shareholders, directors and other relevant oversight bodies held after the financial

statement date and inquired about matters discussed at meetings for which minutes are not yet available.

- Read the entity's latest subsequent interim financial statements (internal or external), if available
- Consider whether additional subsequent events review procedures are necessary.
- Determine whether identified subsequent events are appropriately reflected in the financial statements.

4.6.5 Communicate with those charged with governance

Communicate each of the following required matters on a timely basis:

- Our views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures
- Significant difficulties, if any, encountered during the audit
- Any significant matters arising from the audit
- Written representations requested of management
- Any circumstances that affect the form and content of our audit report
- Other matters significant to the oversight of the financial reporting process
- Any independence breaches

Communicate other required matters, to the extent applicable:

- Changes to the planned scope or timing of the audit
- Fraud - identified or suspected fraud and any other matters related to fraud (also reported to management, where appropriate)
- Laws and regulations - matters involving non-compliance, other than where clearly inconsequential
- Significant deficiencies in internal control (in writing)
- Uncorrected misstatements - individual/aggregate impact and effect on audit report, including any material items
- Uncorrected misstatements - related to prior periods
- Management's refusal to allow external confirmation requests
- Related parties – significant matters

- Going concern - events or conditions that may cast significant doubt
- Auditor's report - emphasis of matter or other paragraphs
- Auditor's report - modifications
- Other information - material inconsistencies or misstatements of fact
- Initial audit engagements - misstatements affecting prior period financial statements

4.6.6 Management representation letter

Obtained management representation letter from management, including agreeing each of the following:

- That an appropriate template is used
- That the letter is dated as near as practicable, but not after, the date of our audit report
- That the representations cover all financial statements and period(s) referred to in our audit report
- That the need for an updated letter (e.g., a substantial delay in actually issuing the audit report) has been considered

However, if representations are not provided or doubts are identified as to the reliability of the representations received, discuss with management, reevaluate management integrity, consider any impact on reliability of audit evidence, consider need for further actions and any impact on audit report.

4.6.7 Audit report

Form an opinion on whether the financial statements are prepared, in all material respects, in accordance with the applicable framework, by considering each of the following:

- Whether sufficient appropriate audit evidence has been obtained
- Whether uncorrected misstatements are material, individually or in aggregate
- Whether the financial statements are prepared, in all material respects, in accordance with the requirements of the applicable framework - see work on 'Financial statement related procedures'
- Whether the financial statements achieve fair presentation
- Whether the financial statements adequately refer to or describe the applicable framework
- Unmodified opinion will be issued using an appropriate template, or modified opinion will be issued using an appropriate template and consultation was performed as required.
- Consider whether it is necessary to include an emphasis of matter or other matter paragraph in the audit report.

- Verified that the audit report refers to the appropriate period(s).
- Where supplementary information that is not required by the applicable framework is presented, evaluated whether the information is nevertheless an integral part of the financial statements due to its nature or how it is presented.