Section 1

THE AUDIT PRINCIPLES

1.3 QUALITY CONTROL FOR AN AUDIT OF FINANCIAL STATEMENTS (CONT'D)

1.3.6 Engagement Performance (Cont'd)

ISA220.A15 Supervision includes matters such as:

- Tracking the progress of the audit engagement.
- Considering the competence and capabilities of individual members of the engagement team, whether they have sufficient time to carry out their work, whether they understand their instructions, and whether the work is being carried out in accordance with the planned approach to the audit engagement.
- Addressing significant issues arising during the audit engagement, considering their significance and modifying the planned approach appropriately.
- Identifying matters for consultation or consideration by more experienced engagement team members during the audit engagement.

ISA220.16 The engagement partner shall take responsibility for reviews being performed in accordance with the firm's review policies and procedures.

ISA220.A16 Under ISQC 1, the firm's review responsibility policies and procedures are determined on the basis that work of less experienced team members is reviewed by more experienced team members.

ISA220.A17 A review consists of consideration whether, for example:

- The work has been performed in accordance with professional standards and applicable legal and regulatory requirements;
- Significant matters have been raised for further consideration;
- Appropriate consultations have taken place and the resulting conclusions have been documented and implemented;
- There is a need to revise the nature, timing and extent of work performed;
- The work performed supports the conclusions reached and is appropriately documented;
- The evidence obtained is sufficient and appropriate to support the auditor's report; and
- The objectives of the engagement procedures have been achieved.

1.4 PLANNING AN AUDIT OF FINANCIAL STATEMENTS (CONT'D)

1.4.2 Planning Activities (Cont'd)

1.4.2.6 Communications with Those Charged with Governance and Management

ISA300.A3 The auditor may decide to discuss elements of planning with the entity's management to facilitate the conduct and management of the audit engagement (for example, to coordinate some of the planned audit procedures with the work of the entity's personnel). Although these discussions often occur, the overall audit strategy and the audit plan remain the auditor's responsibility.

1.4.2.7 Additional Considerations in Initial Audit Engagements

ISA300.13 The auditor shall undertake the following activities prior to starting an initial audit:

(a) Performing procedures required by ISA 220 regarding the acceptance of the client relationship and the specific audit engagement; and

(b) Communicating with the predecessor auditor, where there has been a change of auditors, in compliance with relevant ethical requirements.

Considerations Specific to Smaller Entities

ISA300.A11 In audits of small entities, the entire audit may be conducted by a very small audit team.

Many audits of small entities involve the audit engagement partner (who may be a sole practitioner) working with one engagement team member (or without any engagement team members).

With a smaller team, co-ordination of, and communication between team members are easier.

Establishing the overall audit strategy for the audit of a small entity need not be a complex or time-consuming exercise; it varies according to the size of the entity and the complexity of the audit.

For example, a brief memorandum prepared at the completion of the previous audit, based on a review of the working papers and highlighting issues identified in the audit just completed, updated in the current period based on discussions with the owner-manager, can serve as the documented audit strategy for the current audit engagement.

1.4 PLANNING AN AUDIT OF FINANCIAL STATEMENTS (CONT'D)

1.4.3 Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and its Environment (Cont'd)

1.4.3.3 Understanding the Entity and Its Environment, Including the Entity's Internal Control (Cont'd)

1.4.3.3.5 The Entity's Internal Control (Cont'd)

Considerations Specific to Smaller Entities

ISA315.A76 The control environment within small entities is likely to differ from larger entities.

ISA315.A77 Audit evidence for elements of the control environment in smaller entities may not be available in documentary form, in particular where communication between management and other personnel may be informal, yet effective.

ISA315.A78 Consequently, the attitudes, awareness and actions of management or the owner-manager are of particular importance to the auditor's understanding of a smaller entity's control environment.

ISA315.15 The auditor shall obtain an understanding of whether the entity has a process for:

(a) Identifying business risks relevant to financial reporting objectives;

(b) Estimating the significance of the risks;

(c) Assessing the likelihood of their occurrence; and

(d) Deciding about actions to address those risks.

ISA315.A79 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 assessment process is appropriate to the circumstances is a matter of judgment.

1.4 PLANNING AN AUDIT OF FINANCIAL STATEMENTS (CONT'D)

1.4.3 Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and its Environment (Cont'd)

1.4.3.3 Understanding the Entity and Its Environment, Including the Entity's Internal Control (Cont'd)

1.4.3.3.5 The Entity's Internal Control (Cont'd)

ISA315.A88 Control activities are the policies and procedures that help ensure that management directives are carried out. Control activities whether within IT or manual systems, have various objectives and are applied at various organisational and functional levels. Examples of specific control activities include those relating to the following:

- Authorisation.
- Performance reviews.
- Information processing.
- Physical controls.
- Segregation of duties.

ISA315.A89 Control activities relevant to the audit are:

- Those that are required to be treated as such, being control activities that relate to significant risks and those that relate to risks for which substantive procedures alone do not provide sufficient appropriate audit evidence; or
- Those that are considered to be relevant in the judgment of the auditor.

Considerations Specific to Smaller Entities

ISA315.A93 The concepts underlying control activities in small entities are likely to be similar to those in larger entities, but the formality with which they operate may vary. Further, small entities may find that certain types of control activities are not relevant because of controls applied by management.

ISA315.A94 Control activities relevant to the audit of a smaller entity are likely to relate to the main transaction cycles such as revenues, purchases and employment expenses.

ISA315.21 In understanding the entity's control activities, the auditor shall obtain an understanding of how the entity has responded to risks arising from IT.

ISA315.A95 The use of IT affects the way that control activities are implemented.

From the auditor's perspective, controls over IT systems are effective when they maintain the integrity of information and the security of the data such systems process, and include effective general IT-controls and application controls.

1.4 PLANNING AN AUDIT OF FINANCIAL STATEMENTS (CONT'D)

1.4.3 Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and its Environment (Cont'd)

1.4.3.4 Identifying and Assessing the Risks of Material Misstatement (Cont'd)

ISA315.A111 Assertions used by the auditor to consider the different types of potential misstatements that may occur fall into the following three categories and may take the following forms:

(a) Assertions about classes of transactions and events for the period under audit:

- (i) *Occurrence* – transactions and events that have been recorded have occurred and pertain to the entity.
- (ii) *Completeness* – all transactions and events that should have been recorded have been recorded.
- (iii) *Accuracy* – amounts and other data relating to recorded transactions and events have been recorded appropriately.
- (iv) *Cut-off* – transactions and events have been recorded in the correct accounting period.
- (v) *Classification* – transactions and events have been recorded in the proper accounts.

(b) Assertions about account balances at the period end:

- (i) *Existence* – assets, liabilities, and equity interests exist.
- (ii) *Rights and obligations* – the entity holds or controls the rights to assets, and liabilities are the obligations of the entity.
- (iii) *Completeness* – all assets, liabilities and equity interests that should have been recorded have been recorded.
- (iv) *Valuation and allocation* – assets, liabilities, and equity interests are included in the financial statements at appropriate amounts and any resulting valuation or allocation adjustments are appropriately recorded.

(c) Assertions about presentation and disclosure:

- (i) *Occurrence and rights and obligations* – disclosed events, transactions, and other matters have occurred and pertain to the entity.
- (ii) *Completeness* – all disclosures that should have been included in the financial statements have been included.
- (iii) *Classification and understandability* – financial information is appropriately presented and described, and disclosures are clearly expressed.
- (iv) *Accuracy and valuation* – financial and other information are disclosed fairly and at appropriate amounts.

1.4 PLANNING AN AUDIT OF FINANCIAL STATEMENTS (CONT'D)

1.4.3 Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and its Environment (Cont'd)

1.4.3.4 Identifying and Assessing the Risks of Material Misstatement (Cont'd)

ISA315.26 For this purpose, the auditor shall:

(a) Identify risks throughout the process of obtaining an understanding of the entity and its environment, including relevant controls that relate to the risks, and by considering the classes of transactions, account balances, and disclosures in the financial statements;

(b) Assess the identified risks, and evaluate whether they relate more pervasively to the financial statements as a whole and potentially affect many assertions;

(c) Relate the identified risks to what can go wrong at the assertion level, taking account of relevant controls that the auditor intends to test; and;

(d) Consider the likelihood of misstatement, including the possibility of multiple misstatements, and whether the potential misstatement is of a magnitude that could result in a material misstatement.

1.4.3.4.1 Risks that Require Special Audit Consideration

ISA315.27 As part of the risk assessment, the auditor shall determine whether any of the risks identified are, in the auditor's judgment, a significant risk.

In exercising this judgment, the auditor shall exclude the effects of identified controls related to the risk.

ISA315.28 In exercising judgment as to which risks are significant risks, the auditor shall consider at least the following:

(a) Whether the risk is a risk of fraud;

(b) Whether the risk is related to recent significant economic, accounting or other developments and, therefore, requires specific attention;

(c) The complexity of transactions;

(d) Whether the risk involves significant transactions with related parties;

(e) The degree of subjectivity in the measurement of financial information related to the risk especially those involving a wide range of measurement uncertainty; and

(f) Whether the risk involves significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual.

1.4 PLANNING AN AUDIT OF FINANCIAL STATEMENTS (CONT'D)

1.4.8 Analytical Procedures (Cont'd)

1.4.8.2 Substantive Analytical Procedures

ISA520.5 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:

(a) Determine the suitability of particular substantive analytical procedures for given assertions, taking account of the assessed risks of material misstatement and test of details , if any, for these assertions;

(b) 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;

(c) 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; and

(d) Determine the amount of any difference of recorded amounts from expected values that is acceptable without further investigation.

1.4.8.3 Analytical Procedures that Assist When Forming an Overall Conclusion

ISA520.6 The auditor shall design and perform analytical procedures near the end of the audit that assist the auditor when forming an overall conclusion as to whether the financial statements are consistent with the auditor's understanding of the entity.

1.4.8.4 Investigating Results of Analytical Procedures

ISA520.7 If 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:

(a) Inquiring of management and obtaining appropriate audit evidence relevant to management's responses; and

(b) Performing other audit procedures as necessary in the circumstances.

1.4.9 Other Planning Considerations

1.4.9.1 Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)

ISA600.8 The objectives of the auditor are:

(a) To determine whether to act as the auditor of the group financial statements;

(b) To communicate clearly with component auditors about the scope and timing of their work on financial information related to components and their findings; and

(c) To obtain sufficient appropriate audit evidence regarding the financial information of the components and the consolidation process to express an opinion whether the group financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

1.4 PLANNING AN AUDIT OF FINANCIAL STATEMENTS (CONT'D)

1.4.9 Other Planning Considerations (Cont'd)

1.4.9.4 Related Parties (Cont'd)

ISA550.A22 During the audit, the auditor may inspect records or documents that may provide information about related party relationships and transactions, for example:

- Third-party confirmations obtained by the auditor (in addition to bank and legal confirmations).
- Entity income tax returns.
- Information supplied by the entity to regulatory authorities.
- Shareholder registers to identify the entity's principal shareholders.
- Statements of conflicts of interest from management and those charged with governance.
- Records of the entity's investments and those of its pension plans.
- Contracts and agreements with key management or those charged with governance.
- Significant contracts and agreements not in the entity's ordinary course of business.
- Specific invoices and correspondence from the entity's professional advisors.
- Life insurance policies acquired by the entity.
- Significant contracts renegotiated by the entity during the period.
- Internal auditors' reports.
- Documents associated with the entity's filings with a securities regulator (e.g., prospectuses).

1.4.9.5 Going Concern

ISA570.9 The objectives of the auditor are:

(a) To obtain sufficient appropriate audit evidence regarding the appropriateness of management's use of the going concern assumption in the preparation of the financial statements;

(b) To conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern; and

(c) To determine the implications for the auditor's report.

1.4 PLANNING AN AUDIT OF FINANCIAL STATEMENTS (CONT'D)

1.4.9 Other Planning Considerations (Cont'd)

1.4.9.5 Going Concern (Cont'd)

ISA570.A2 The following are examples of events or conditions that, individually or collectively, may cast significant doubt about the going concern assumption. This listing is not all-inclusive nor does the existence of one or more of the items always signify that a material uncertainty exists. (cont'd)

Operating

- Management intentions to liquidate the entity or to cease operations.
- Loss of key management without replacement.
- Loss of a major market, key customer(s), franchise, license, or principal supplier(s).
- Labour difficulties.
- Shortages of important supplies.
- Emergence of a highly successful competitor.

Other

- Non-compliance with capital or other statutory requirements.
- Pending legal or regulatory proceedings against the entity that may, if successful, result in claims that the entity is unlikely to be able to satisfy.
- Changes in law or regulation or government policy expected to adversely affect the entity.
- Uninsured or underinsured catastrophes when they occur.

Considerations Specific to Smaller Entities

ISA570.A4 The size of an entity may affect its ability to withstand adverse conditions. Small entities may be able to respond quickly to exploit opportunities, but may lack reserves to sustain operations.

ISA570.A5 Conditions of particular relevance to small entities include the risk that banks and other lenders may cease to support the entity, as well as the possible loss of a principal supplier, major customer, key employee, or the right to operate under a license, franchise or other legal agreement.

ISA570.11 The auditor shall remain alert throughout the audit for audit evidence of events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.

ISA570.12 The auditor shall evaluate management's assessment of the entity's ability to continue as a going concern.

1.5 CONDUCTING THE AUDIT (CONT'D)

1.5.1 Tests of Controls (Cont'd)

1.5.1.2 Timing of Tests of Controls (Cont'd)

ISA330.13 In determining whether it is appropriate to use audit evidence about the operating effectiveness of controls obtained in previous audits, and, if so, the length of the time period that may elapse before retesting a control, the auditor shall consider the following: (cont'd)

(d) 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;

(e) Whether the lack of a change in a particular control poses a risk due to changing circumstances; and

(f) The risks of material misstatement and the extent of reliance on the control.

1.5.1.3 Extent of Tests of Controls

ISA330.A28 When more persuasive audit evidence is needed regarding the effectiveness of a control, it may be appropriate to increase the extent of testing of the control. As well as the degree of reliance on controls, matters the auditor may consider in determining the extent of the auditor's tests of controls include the following:

- The frequency of the performance of the control by the entity during the period.
- The length of time during the audit period that the auditor is relying on the operating effectiveness of the control.
- The expected rate of deviation from a control.
- The relevance and reliability of the audit evidence to be obtained regarding the operating effectiveness of the control at the assertion level.
- The extent to which audit evidence is obtained from tests of other controls related to the assertion.

1.5.2 Substantive Procedures

ISA330.18 Irrespective of the assessed risks of material misstatement, the auditor shall design and perform substantive procedures for each material class of transactions, account balance, and disclosure.

ISA330.19 The auditor shall consider whether external confirmation procedures are to be performed as substantive audit procedures.

ISA330.20 The auditor's substantive procedures shall include the following audit procedures related to the financial statement closing process:

(a) Agreeing or reconciling the financial statements with the underlying accounting records; and

(b) Examining material journal entries and other adjustments made during the course of preparing the financial statements.

1.5 CONDUCTING THE AUDIT (CONT'D)

1.5.2 Substantive Procedures (Cont'd)

ISA330.21 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.

1.5.2.1 Timing of Substantive Procedures

ISA330.22 If substantive procedures are performed at an interim date, the auditor shall cover the remaining period by performing:

(d) substantive procedures, combined with tests of controls for the intervening period; or

(e) If the auditor determines that it is sufficient, further substantive procedures only,

that provide a reasonable basis for extending the audit conclusions from the interim date to the period end.

ISA330.A43 Depending on the circumstances, the auditor may determine that:

- Performing only substantive analytical procedures will be sufficient to reduce audit risk to an acceptably low level. For example, where the auditor's assessment of risk is supported by audit evidence from tests of controls.
- Only tests of details are appropriate.
- A combination of substantive analytical procedures and tests of details are most responsive to the assessed risks.

ISA330.A45 The nature of the risk and assertion is relevant to the design of tests of details.

ISA330.A46 Because the assessment of 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.

1.5.3 Audit Evidence

ISA500.4 The objective of the auditor is to design and perform audit procedures in such a way as to enable the auditor to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion.

ISA500.5(c) "Audit evidence" – Information used by the auditor in arriving at the conclusions on which the auditor's opinion is based. Audit evidence includes both information contained in the accounting records underlying the financial statements and other information.

Section 1

THE AUDIT PRINCIPLES

1.5 CONDUCTING THE AUDIT (CONT'D)

1.5.5 Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures

ISA540.7(a) "Accounting estimate" – An approximation of a monetary amount in the absence of a precise means of measurement.

This term is used for an amount measured at fair value where there is estimation uncertainty, as well as for other amounts that require estimation. Where this ISA addresses only accounting estimates involving measurement at fair value, the term "fair value accounting estimates" is used.

ISA540.A2 Some accounting estimates involve relatively low estimation uncertainty and may give rise to lower risks of material misstatements, for example:

- Accounting estimates arising in entities that engage in business activities that are not complex.
- Accounting estimates that are frequently made and updated because they relate to routine transactions.
- Accounting estimates derived from data that is readily available, such as published interest rate data or exchange-traded prices of securities. Such data may be referred to as "observable" in the context of a fair value accounting estimate.
- Fair value accounting estimates where the method of measurement prescribed by the applicable financial reporting framework is simple and applied easily to the asset or liability requiring measurement at fair value.
- Fair value accounting estimates where the model used to measure the accounting estimate is well-known or generally accepted, provided that the assumptions or inputs to the model are observable.

ISA540.A3 For some accounting estimates, however, there may be relatively high estimation uncertainty, particularly where they are based on significant assumptions, for example:

- Accounting estimates relating to the outcome of litigation.
- Fair value accounting estimates for derivative financial instruments not publicly traded.
- Fair value accounting estimates for which a highly specialised entity-developed model is used or for which there are assumptions or inputs that cannot be observed in the marketplace.

ISA540.A6 Additional examples of situations where accounting estimates, other than fair value accounting estimates, may be required include:

- Allowance for doubtful accounts.
- Inventory obsolescence.
- Warranty obligations.
- Depreciation method or asset useful life.
- Provision against the carrying amount of an investment where there is uncertainty regarding its recoverability.
- Outcome of long term contracts.
- Costs arising from litigation settlements and judgments.

1.6 COMPLETING THE AUDIT (CONT'D)

1.6.3 Initial Audit Engagements – Opening Balances (Cont'd)

ISA510.6 The auditor shall obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements by:

(a) Determining whether the prior period's closing balances have been correctly brought forward to the current period or, when appropriate, have been restated;

(b) Determining whether the opening balances reflect the application of appropriate accounting policies; and

(c) Performing one or more of the following:

- (i) Where the prior year financial statements were audited, reviewing the predecessor auditor's working papers to obtain evidence regarding the opening balances;
- (ii) Evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances; or
- (iii) Performing specific audit procedures to obtain evidence regarding the opening balances.

ISA510.A3 The nature and extent of audit procedures necessary to obtain sufficient and appropriate audit evidence regarding opening balances depend on such matters as:

- The accounting policies followed by the entity.
- The nature of the account balances, classes of transactions and disclosures and the risks of material misstatement in the current period's financial statements.
- The significance of the opening balances relative to the current period's financial statements.
- Whether the prior period's financial statements were audited, and, if so, whether the predecessor auditor's opinion was modified

1.6.4 Comparative Information – Corresponding Figures and Comparative Financial Statements

ISA710.7 The auditor shall determine whether the financial statements include the comparative information required by the applicable financial reporting framework and whether such information is appropriately classified. For this purpose, the auditor shall evaluate whether:

(a) The comparative information agrees with the amounts and other disclosures presented in the prior period or, when appropriate, have been restated; and

(b) The accounting policies reflected in the comparative information are consistent with those applied in the current period or, if there have been changes in accounting policies, whether those changes have been properly accounted for and adequately presented and disclosed.

Section 1

THE AUDIT PRINCIPLES

1.6 COMPLETING THE AUDIT (CONT'D)

1.6.9 Forming an Opinion and Reporting on Financial Statements (Cont'd)

1.6.9.2 Auditor's Report (Cont'd)

1.6.9.2.6 Auditor's Opinion (Cont'd)

ISA700.36 When expressing an unmodified opinion on financial statements prepared in accordance with a compliance framework, the auditor's opinion shall be that the financial statements are prepared, in all material respects, in accordance with [the applicable financial reporting framework].

1.6.9.2.7 Other Reporting Responsibilities

ISA700.38 If the auditor addresses other reporting responsibilities in the auditor's report on the financial statements that are in addition to the auditor's responsibility under the ISAs to report on the financial statements, these other reporting responsibilities shall be addressed in a separate section in the auditor's report that shall be sub-titled "Report on Other Legal and Regulatory Requirements", or otherwise appropriate as to the content of the section.

1.6.9.2.8 Auditor's Signature

ISA700.40 The auditor's report shall be signed.

1.6.9.2.9 Date of the Auditor's Report

ISA700.41 The auditor's report shall be dated no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor's opinion on the financial statements, including evidence that:

(a) All the statements that comprise the financial statements, including the related notes, have been prepared; and

(b) Those with the recognised authority have asserted that they have taken responsibility for those financial statements.

1.6.9.2.10 Auditor's Address

ISA700.42 The auditor's report shall name the location in the jurisdiction where the auditor practices.

1.6.10 Modifications to the Opinion in the Independent Auditor's Report

1.6.10.1 Types of Modified Opinions

ISA705.5(b) Modified opinion – A qualified opinion, an adverse opinion or a disclaimer of opinion.

ISA705.2 The decision regarding which type of modified opinion is appropriate depends upon:

(a) The nature of the matter giving rise to the modification, that is, whether the financial statements are materially misstated or, in the case of an inability to obtain sufficient appropriate audit evidence, may be materially misstated; and

(b) The auditor's judgment about the pervasiveness of the effects or possible effects of the matter on the financial statements.