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Office of the Federal Auditor General

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AUDIT FOR THE BENEFIT OF CITIZENS

The Financial Audit Manual was produced with support of the Technical Facility Unit as part of the European Union Support to Public Financial Management Reforms in Ethiopia

FINANCIAL AUDIT MANUAL

SECOND EDITION, 2025

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HOW TO USE THIS MANUAL

Overview of the financial audit process

The information in this financial audit manual provides the audit team with a methodology for completing an audit. This manual is based on ISSAI 200. For further guidance, refer to the INTOSAI standards (ISSAIs) 2000-2899. The audit working papers are standardised, and the manual provides the method of documenting and referencing information to ensure consistency.

- **Chapter 1. Prerequisites** – Covers ethics, quality control, annual overall audit plan, financial reporting framework, communication, and documentation.
- **Chapter 2. Pre-engagement** – Includes an assessment of the audit staff's objectivity, integrity and technical capacity and advises on establishing the budgeted time for the audit. The guidance covers gaining a mutual understanding and setting expectations with an engagement letter.
- **Chapter 3. Understanding the entity** – Guides auditors to understand the auditee's operating environment.
- **Chapter 4. Materiality** – Set overall and performance materiality levels for the audit.
- **Chapter 5. Risk assessment and response** – Assess and respond to risks at a financial statement level. Understand the detailed processes for each material and/or significant class of transactions, account balance or disclosure to assess risks at the assertion level. Identify and design appropriate audit responses to address the risks identified. Conclude on the overall audit strategy.
- **Chapter 6. Performing the audit and evaluating evidence** – Document the performance of the programmes by completing the templates provided. Once audit programmes have been conducted, evaluate the audit results and consider some overall aspects before finalising the audit.
- **Chapter 7. Reporting** – Compile the auditor's report and final management letter arising from the audit process.
- **Chapter 8. Follow-up** – Perform follow-up on audit recommendations to verify that corrective actions have been taken.

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

Financial audit versus compliance audit

When deciding on the most appropriate audit approach, you must consider how the SAI mandate is formulated.

ISSAI 200, paragraphs 7 and 8, states that: *financial audit involves determining, through the collection of audit evidence, whether an entity's financial information is presented in its financial statements in accordance with the financial reporting and regulatory framework applicable. In the case of fair presentation frameworks, the auditor assesses whether the information is fairly presented. In the case of compliance frameworks, the auditor assesses the extent to which compliance is achieved.*

The objective of financial audit is, through the collection of sufficient appropriate evidence, to provide reasonable assurance to the users, in the form of an audit opinion and/or report, as to whether the financial statements or other forms of presentation of financial information are fairly and/or in all material respects presented in accordance with the applicable financial reporting and regulatory framework.

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

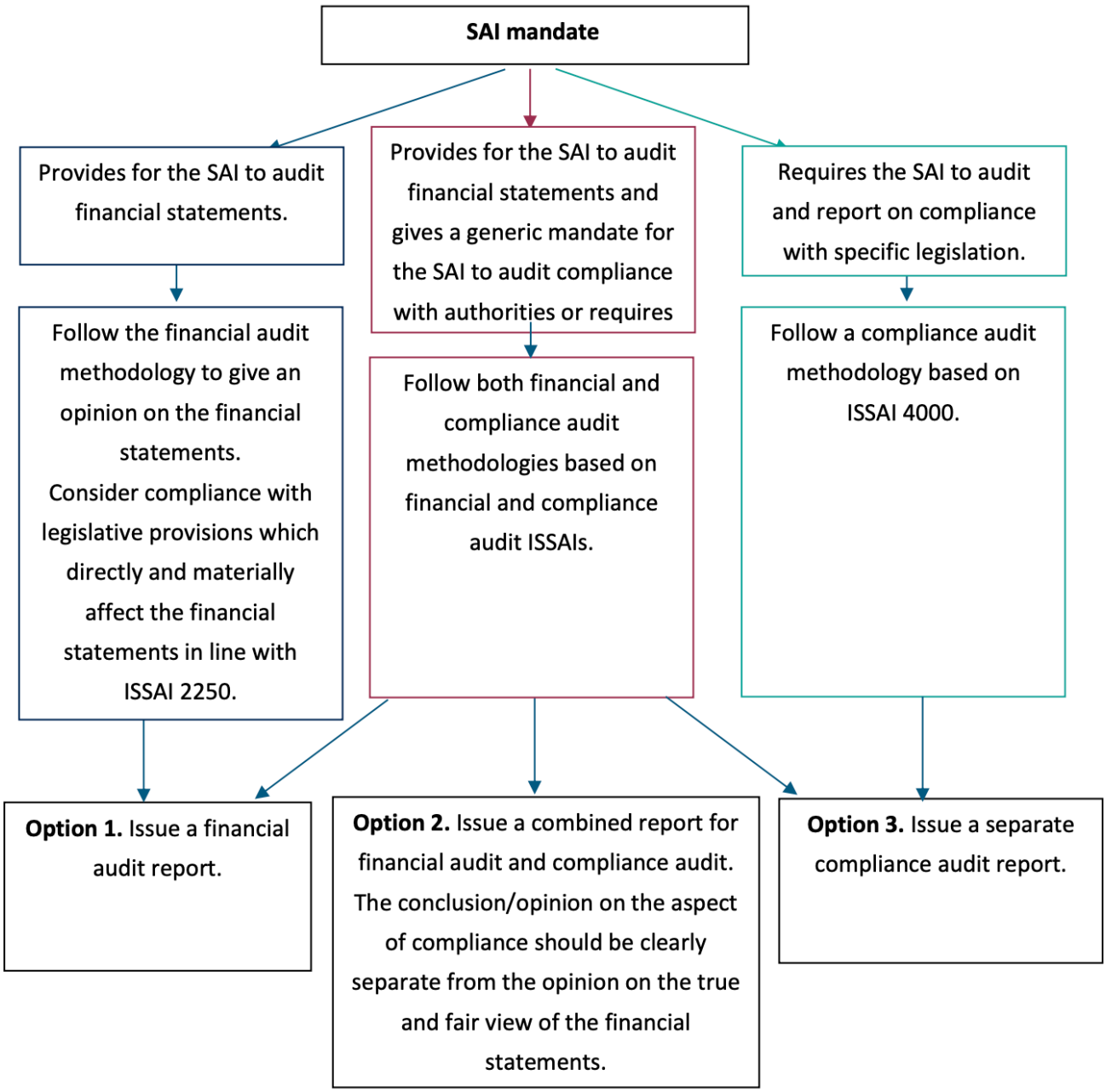
- The SAI is mandated to audit and report on the government's annual accounts or financial statements.

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

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

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

Which audit methodology should be used?

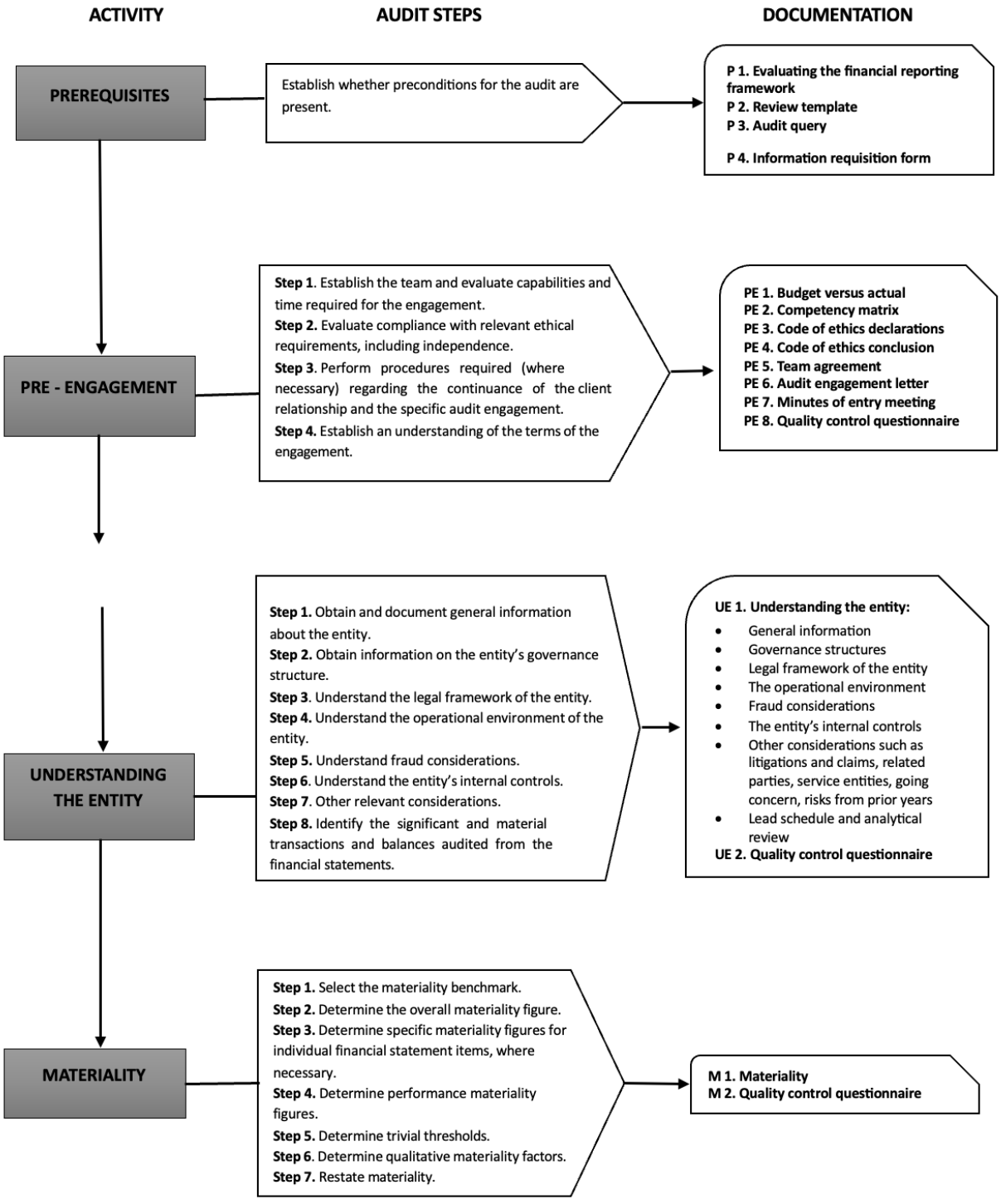


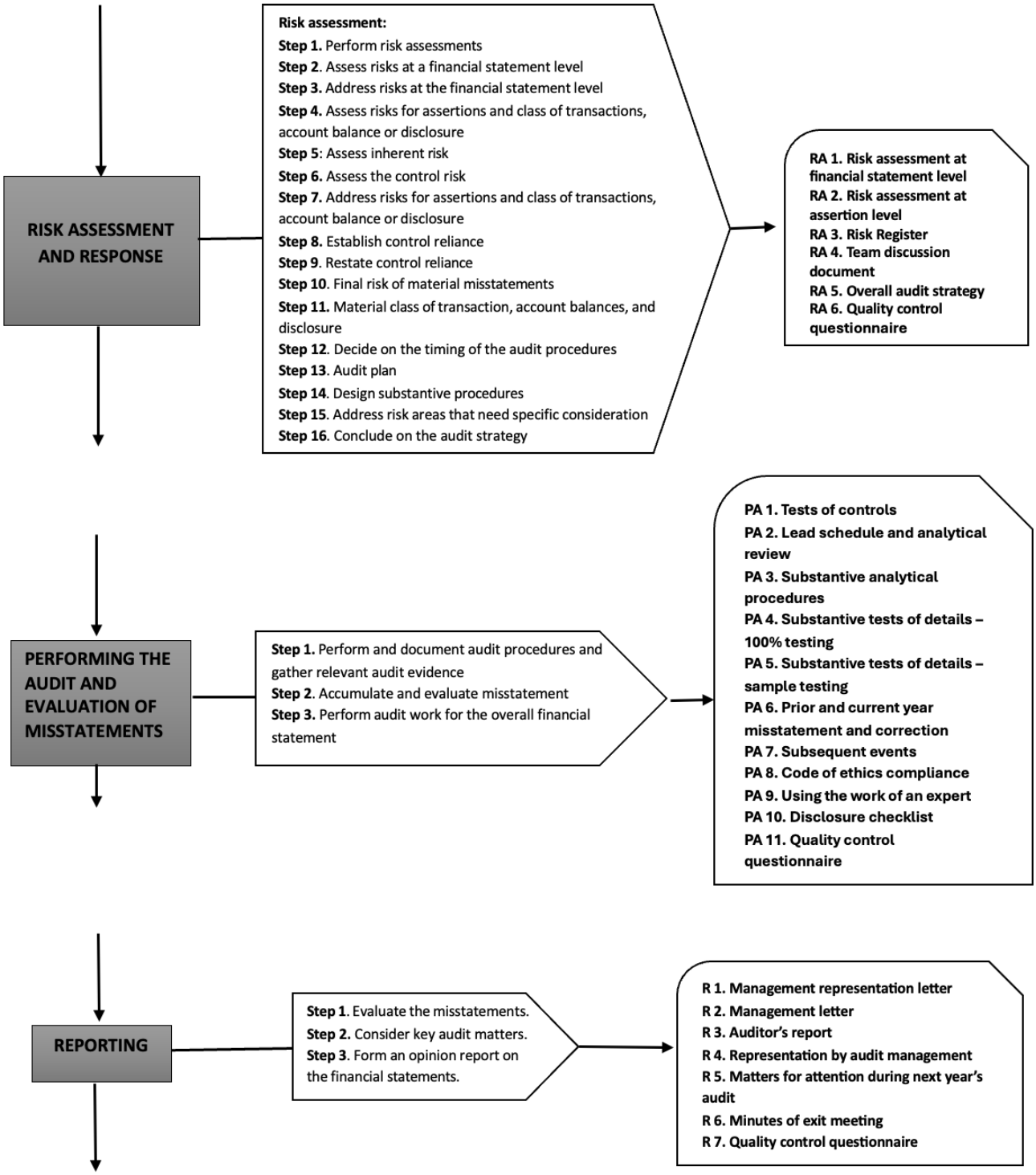
The Mandate of the Office of the Federal Auditor General (OFAG)

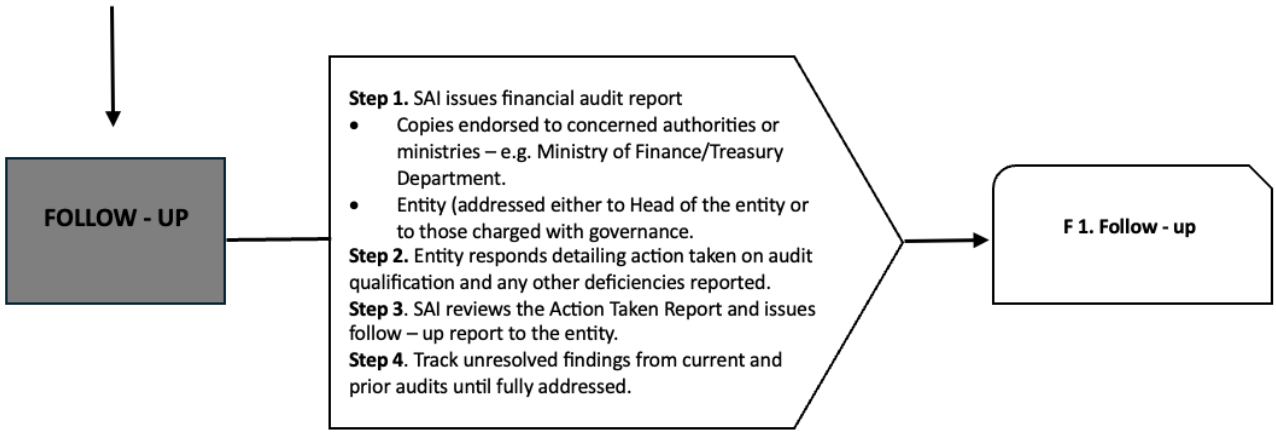
The OFAG is a constitutional body established under the Ethiopian Constitution. Article 101 (2) of the constitution states that "The Auditor General shall audit and inspect the accounts of ministries and other government agencies of the Federal Government to expenditures are properly made for the activities carried out during the fiscal year and in accordance with approved allocations and submit his reports thereon to the House of the Peoples' Representative". Further, OFAG's detailed functions are determined by proclamation No. 982/2016. As per section 4, sub paragraph 2 and 3 of the proclamation, OFAG is mandated to "ascertain that all receivable money and property of the Federal Government are collected, preserved and used properly, in accordance with the laws and regulations of the Federal Government and report same to the council; and "undertake financial, performance, environmental protection, control audit, special audit and other audits of the offices and organisations of the Federal government", respectively.

Therefore, since OFAG is given a generic mandate to carry out both financial and compliance audits, Option 2 is the appropriate approach to its circumstances as stated in the separate Annex 1 referring to Guide on Combined Audit Approach. Accordingly, OFAG shall follow both financial and compliance audit methodologies based on financial and compliance audits ISSAIs and issue combined report for financial and compliance audit.

Audit process flow for financial audit




RISK ASSESSMENT AND RESPONSE
Risk assessment:
Step 1. Perform risk assessments
Step 2. Assess risks at a financial statement level
Step 3. Address risks at the financial statement level
Step 4. Assess risks for assertions and class of transactions, account balance or disclosure
Step 5: Assess inherent risk
Step 6. Assess the control risk
Step 7. Address risks for assertions and class of transactions, account balance or disclosure
Step 8. Establish control reliance
Step 9. Restate control reliance
Step 10. Final risk of material misstatements
Step 11. Material class of transaction, account balances, and disclosure
Step 12. Decide on the timing of the audit procedures
Step 13. Audit plan
Step 14. Design substantive procedures
Step 15. Address risk areas that need specific consideration
Step 16. Conclude on the audit strategy
RA 1. Risk assessment at financial statement level
RA 2. Risk assessment at assertion level
RA 3. Risk Register
RA 4. Team discussion document
RA 5. Overall audit strategy
RA 6. Quality control questionnaire
PERFORMING THE AUDIT AND EVALUATION OF MISSTATEMENTS
Step 1. Perform and document audit procedures and gather relevant audit evidence
Step 2. Accumulate and evaluate misstatement
Step 3. Perform audit work for the overall financial statement
PA 1. Tests of controls
PA 2. Lead schedule and analytical review
PA 3. Substantive analytical procedures
PA 4. Substantive tests of details – 100% testing
PA 5. Substantive tests of details – sample testing
PA 6. Prior and current year misstatement and correction
PA 7. Subsequent events
PA 8. Code of ethics compliance
PA 9. Using the work of an expert
PA 10. Disclosure checklist
PA 11. Quality control questionnaire
REPORTING
Step 1. Evaluate the misstatements.
Step 2. Consider key audit matters.
Step 3. Form an opinion report on the financial statements.
R 1. Management representation letter
R 2. Management letter
R 3. Auditor's report
R 4. Representation by audit management
R 5. Matters for attention during next year's audit
R 6. Minutes of exit meeting
R 7. Quality control questionnaire


FOLLOW - UP
Step 1. SAI issues financial audit report
Copies endorsed to concerned authorities or ministries – e.g. Ministry of Finance/Treasury Department.
Entity (addressed either to Head of the entity or to those charged with governance.
Step 2. Entity responds detailing action taken on audit qualification and any other deficiencies reported.
Step 3. SAI reviews the Action Taken Report and issues follow – up report to the entity.
Step 4. Track unresolved findings from current and prior audits until fully addressed.
F 1. Follow - up

Audit process flow tables

The table below will provide the audit team with a complete understanding of an audit, from planning to reporting. The audit process flow table below indicates this.

PREREQUISITES					
WORKING PAPERS		**PURPOSE / DECISIONS / OUTCOMES**	**MANDATORY WORKING PAPERS**	**COMPLETED BY**	**REVIEWED BY**
P 1	Evaluating the financial reporting framework	The checklist enables the auditor to evaluate whether the financial reporting framework of the auditee is acceptable.	Mandatory	OFAG assigned Committee or Team	OFAG Senior Management
P 2	Review worksheet	To document coaching / review notes issued by the reviewer and the responses to these notes.	Mandatory	Audit Manager	Audit Director
P 3	Audit query	To provide a basis for the communication of findings to the client.	To be completed when findings are raised and communicated.	Senior Auditor	Audit Manager
P 4	Request for information Form	To document audit information requested from the auditee.	Mandatory	Senior Auditor	Audit Manager

PRE-ENGAGEMENT					
WORKING PAPERS		**PURPOSE / DECISIONS / OUTCOMES**	**MANDATORY WORKING PAPERS**	**COMPLETED BY**	**REVIEWED BY**
PE 1	Budget versus actual.	Include the planned budgeted hours (or days) as estimated, including activities that relate to the audit.	Administrative working paper	Senior Auditor/ Team Leader	Audit Manager
PE 2	Competency matrix	Record the names of the audit team allocated to the audit and their respective competencies in relation to the specific audit.	Mandatory, to be completed for each audit.	Senior Auditor/ Team Leader	Audit Manager

PRE-ENGAGEMENT					
WORKING PAPERS		**PURPOSE / DECISIONS / OUTCOMES**	**MANDATORY WORKING PAPERS**	**COMPLETED BY**	**REVIEWED BY**
PE 3	Code of ethics declaration	Consider the compliance of the audit team members with the principles of the code of ethics. Document conflicts of interest and actions taken in response.	Mandatory, to be completed for each audit.	all Team Members	Senior Auditor/ Team Leader
PE 4	Code of ethics conclusion	Conclude on the audit team's compliance with the code of ethics.	Mandatory, to be completed for each audit.	Senior Auditor/ Team Leader	Audit Manager
PE 5	Team agreement	Agreement on the scope of the work required from each team member.	Mandatory, to be completed for each audit.	Senior Auditor/ Team Leader	Audit Manager
PE 6	Audit engagement letter	Communicate the terms of the audit engagement to inform management and agree regarding the expectations of the audit.	To be completed for each audit – administrative working paper	Senior Auditor/ Team Leader	Audit Manager
PE 7	Quality control questionnaire	To confirm that all working papers relating to PE have been correctly completed.	Mandatory, to be completed for each audit.	Senior Auditor/ Team Leader	Audit Manager

UNDERSTANDING THE ENTITY					
WORKING PAPERS		**PURPOSE / DECISIONS / OUTCOMES**	**MANDATORY WORKING PAPERS**	**COMPLETED BY**	**REVIEWED BY**
UE 1	Understanding the entity	Document the understanding of the entity and its environment; identify risks of material misstatement.	Mandatory to complete for each audit.	Auditor/ Senior Auditor/ Team Leader	Audit Manager
UE 2	Quality control questionnaire	To confirm that all working papers relating to UE have been correctly completed.	Mandatory, to be completed for each audit	Senior Auditor	Audit Manager

MATERIALITY					
WORKING PAPERS		**PURPOSE / DECISIONS / OUTCOMES**	**MANDATORY WORKING PAPERS**	**COMPLETED BY**	**REVIEWED BY**
M 1	Materiality	Calculation of overall and performance materiality.	Mandatory to complete for each audit.	Senior Auditor	Audit Manager
M 2	Quality control questionnaire	To confirm that all working papers relating to materiality have been correctly completed.	Mandatory, to be completed for each audit	Senior Auditor	Audit Manager

RISK ASSESSMENT					
WORKING PAPERS		**PURPOSE / DECISIONS / OUTCOMES**	**MANDATORY WORKING PAPERS**	**COMPLETED BY**	**REVIEWED BY**
RA 1	Risk assessment at a financial statement level	Document risks at a financial statement level, if any, and identify appropriate responses to address these risks.	Mandatory, to be completed for each audited component or group of components with largely similar processes.	Audit Manager	Audit Director
RA 2	Risk assessment for each class of transaction, account balance or disclosure	Assess the risk of material misstatement for each class of transaction, account balance or disclosure. Decide whether control reliance or a substantive approach is most appropriate. Formulate audit programmes.	Mandatory, to be completed for each class of transaction, account balance or disclosure with system descriptions.	Senior Auditor	Audit Manager
RA 3	Risk register	This document is completed once for the whole audit. It should list all material and significant or group of class of transaction, account balance or disclosure	Mandatory, to be completed for each audit	Senior Auditor	Audit Manager
RA 4	Team discussion document	Document the discussion by the audit team on the overall objectives of the	Mandatory, to be completed for each	Audit Manager	Audit Director

RISK ASSESSMENT					
WORKING PAPERS		**PURPOSE / DECISIONS / OUTCOMES**	**MANDATORY WORKING PAPERS**	**COMPLETED BY**	**REVIEWED BY**
		audit and the susceptibility of the entity's financial statements to material misstatements.	procedure / grouping of procedures.		
RA 5	Overall audit strategy	Document the audit strategy based on the main risks identified for the audit, including those at a financial statement level and the responses identified for those risks.	Administrative working paper, to be completed for each audit.	Audit Manager	Audit Director
RA 6	Quality control questionnaire	To confirm that all working papers relating to RA have been correctly completed.	Mandatory, to be completed for each audit	Senior Auditor	Audit Manager

PERFORMING THE AUDIT AND EVALUATING OF MISSTATEMENTS					
WORKING PAPERS		**PURPOSE / DECISIONS / OUTCOMES**	**MANDATORY WORKING PAPERS**	**COMPLETED BY**	**REVIEWED BY**
PA 1	Tests of controls	Document the performance of tests of controls.	Mandatory, to be completed for each audited component on which tests of controls are performed.	Auditor	Senior Auditor
PA 2	Lead schedule and analytical review	To break down the audited component and identify any further focus areas relating to the component. Perform an analytical review of the final figures in the financial statements. The objective is to establish if there are any irregular differences that need more audit work.	Mandatory to complete.	Senior Auditor	Audit Manager

PERFORMING THE AUDIT AND EVALUATING OF MISSTATEMENTS					
WORKING PAPERS		**PURPOSE / DECISIONS / OUTCOMES**	**MANDATORY WORKING PAPERS**	**COMPLETED BY**	**REVIEWED BY**
PA 3	Substantive procedures – analytical tests	Document the performance of substantive analytical procedures.	Mandatory to complete for each substantive analytical procedure performed.	Auditor	Senior Auditor
PA 4	Substantive tests of details – 100% testing	Document the performance of substantive procedures when 100% of the population is tested.	Mandatory to complete when applicable.	Auditor	Senior Auditor
PA 5	Substantive tests of details – sample testing	Document the performance of substantive procedures from a sample of transactions.	Mandatory to complete when applicable.	Auditor	Senior Auditor
PA 6	Prior and current year misstatements and correction	Evaluation of the effect of prior year errors on the auditor's report. Documentation of all quantifiable current year misstatements and errors and the evaluation of the effect of these errors on the auditor's report.	Mandatory, to be completed for each audit.	Auditor	Senior Auditor
PA 7	Subsequent events	Identify any subsequent events that should affect the financial statements.	Mandatory, to be completed for each audit.	Senior Auditor	Audit Manager
PA 8	Code of ethics compliance	A follow-up that the team is still independent.	Mandatory, to be completed for each audit.	Audit Manager	Audit Director
PA 9	Using the work of an expert	To determine the extent of use of the work of an expert (if any).	Mandatory, to be completed when reliance is placed on an expert's work.	Senior Auditor	Audit Manager
PA 10	Disclosure checklist	To ensure that the financial statements include all mandatory disclosures.	Mandatory, to be completed for each audit.	Auditor	Senior Auditor

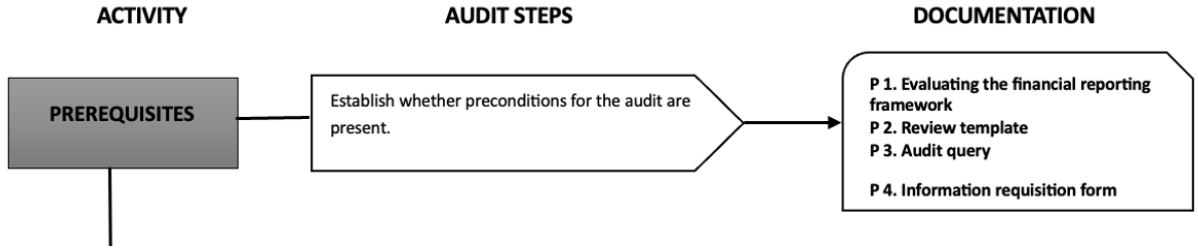
PERFORMING THE AUDIT AND EVALUATING OF MISSTATEMENTS					
WORKING PAPERS		**PURPOSE / DECISIONS / OUTCOMES**	**MANDATORY WORKING PAPERS**	**COMPLETED BY**	**REVIEWED BY**
PA 11	Quality control questionnaire	To confirm that all working papers relating to PA have been correctly completed.	Mandatory, to be completed for each audit.	Senior Auditor	Audit Manager

REPORTING					
WORKING PAPERS		**PURPOSE / DECISIONS / OUTCOMES**	**MANDATORY WORKING PAPERS**	**COMPLETED BY**	**REVIEWED BY**
R 1	Management representation letter	To obtain some audit evidence as to whether management has understood their responsibilities for the financial statements and has provided all information to the auditors.	Mandatory, to be completed for each audit.	Audit Manager	Audit Director
R 2	Management letter	The objective is to report all important findings to the auditee.	To be completed for each audit.	Senior Auditor/Audit Manager	Audit Director
R 3	Auditor's report	The conclusion on the audit of the financial statements.	Mandatory, to be completed for each audit.	Senior Auditor/ Audit Manager	Audit Director
R 4	Representation by audit management	A final documentation of the review done of the audit.	Administrative working paper, to be completed for each audit.	Senior Auditor / Audit Manager/ Audit Director involved in the audit	Audit Director
R 5	Matters for attention during next year's audit	Issues to bring forward to next year's audit. Both things that went well and things that can be improved should be included.	Administrative working paper, to be completed for each audit.	Senior Auditor	Audit Manager
R 6	Quality control questionnaire	To confirm that all working papers relating to reporting have been correctly completed.	Mandatory, to be completed for each audit.	Senior Auditor/ Audit Manager	Audit Director

FOLLOW-UP					
WORKING PAPERS		**PURPOSE / DECISIONS / OUTCOMES**	**MANDATORY WORKING PAPERS**	**COMPLETED BY**	**REVIEWED BY**
F 1	Follow-up	Through a follow-up process, auditors can monitor whether and how the problems or findings have been addressed, if the underlying situation has been remedied, and if the audit recommendations have been implemented by the audited entities.	Mandatory, to be completed for each follow-up audit.	Senior Auditor	Audit Manager

1. PREREQUISITES

Where are we in the process?



1.1 APPLICABLE STANDARDS

ISSAI FRAMEWORK
ISSAI 200

For further guidance, refer to the following ISSAIs:
ISSAI 100
ISSAI 130
ISSAI 140

1.2 CODE OF ETHICS

The OFAG should have ethical rules or codes, policies and practices aligned with ISSAI 130, *Code of Ethics*. They should prevent internal conflicts of interest and corruption, ensure the transparency and legality of their operations, and actively promote ethical behaviour throughout the organisation. The ethical requirements and obligations of auditors, magistrates in the Court model, civil servants or others should be made public. Such policies and procedures should enable the OFAG to monitor its independence and make provision for the following:

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

information about implementing the code of ethics. Monitoring the implementation of a code of ethics is also part of the internal control system of OFAG.

1.3 QUALITY MANAGEMENT

The ISSAI 100 states that the SAI's should adopt quality control procedures as per ISSAI 140, Quality Management for SAIs. The ISSAI 100 (38) further states that: *auditors should perform the audit in accordance with professional standards on quality control. A SAI's quality control policies and procedures should comply with professional standards, the aim being to ensure that audits are conducted at a consistently high level. Quality control procedures should cover matters such as the direction, review and supervision of the audit process and the need for consultation to reach decisions on difficult or contentious matters. Auditors can find further information in ISSAI 140 Quality Management for SAIs*.

The Quality Management should be addressed at two levels: at OFAG level and at audit engagement level for each audit engagement undertaken.

Quality Management at the OFAG level

The ISSAI 140 describes the eight components of the SAI's system of quality management. In line with the standard, the OFAG will develop the Quality Assurance Policy which will address the eight (8) components explained below:

1. Risk assessment process;
2. Governance and Leadership;
3. Relevant Ethical Requirement;
4. Acceptance, initiation, and continuance of engagements;
5. Performing engagements;
6. Resources;
7. Information and communication;
8. Monitoring and remediation.

Risk assessment process

The OFAG must design and implement a risk assessment process that sets quality objectives and identifies risks. The OFAG specific situation and environment is considered and will include technologies employed by OFAG and external service providers. This is an ongoing monitoring process rather than a one – off, enabling the system of quality management to adapt with any changes. This approach will allow OFAG to tailor and address the specific risks within OFAG, and it will vary according to the size of OFAG and its client portfolio.

Governance and leadership

The OFAG should create an environment which demonstrates commitment to quality through its culture

and recognizes its role in serving public interest. This responsibility is OFAG wide rather than at the individual audit level, with the Auditor General assigned the responsibility and accountability for the system of quality management. This should ensure the "the tone at the top" enforces a commitment to quality and ethics across the whole office. Systems and policies should be in place to reward commitment to quality.

Relevant ethical requirements

The system of quality management should include objectives and policies for ensuring the fulfilment of ethical requirements. These processes will again differ depending on the size of OFAG and client portfolio; the scalability of the standard requires OFAG to have in place mitigations for ethical risks arising which are appropriate to OFAG rather than a fixed response to the given risk.

Acceptance and continuance of engagement

The ISSAI 140 places additional emphasis on procedures addressing client acceptance and continuance of existing business relationships. OFAG must assess the integrity and ethical values of the client and its management, as well as OFAG's ability to perform the engagement within legal and professional requirements.

Performing Engagements

Engagement teams must understand their responsibility for ensuring a quality audit. Less experienced members should be appropriately supervised and reviewed. The ISSAI 140 specifically references the need for the audit engagement supervisor to be sufficiently and appropriately involved throughout the engagement. Audit teams should ensure professional scepticism and judgment are exercised by engagement teams. If an engagement team has insufficient time to perform necessary procedures, or team members are not experienced to challenge management or identify misstatements, then detection risk increases, and audit quality will be compromised. For audits to be effective and maintain public trust, they must be performed in a such a way to ensure that audit reports issued are appropriate in the circumstance s and that OFAG and its personnel fulfil their responsibilities in accordance with applicable legal and professional standards. The system of quality management should ensure that teams can consult on contentious matters, difference of opinion with the engagement team are addressed and any issues raised by the engagement quality reviewer are brought to the attention of OFAG management and resolved.

Resources

The OFAG must ensure that appropriate resources are available in a timely manner. This include employees with required competence, training and capabilities to perform engagements to which they are assigned. OFAG should ensure more experienced individuals to work on areas of a complex nature requiring additional judgment and ensuring sufficient review by senior team members or allowing adequate time to do sufficient testing and analysis of the issues.

Consideration should be made to use independent experts where OFAG does not have appropriate personnel, or if OFAG requires additional specialist technological resources.

Information and communication

Information and communication are required to enable other components of the system of quality management to operate. This involves obtaining, generating and using information and communicating the information within OFAG, for example, communicating policies to personnel, communication of information obtained during an audit with an engagement quality review, or communication between group and component auditors. It also includes external communications such as Parliament. The ISSAI 140 considers information and communication to be pervasive to all components of the system of quality management as without it, the system cannot operate.

Monitoring and remediation process

The OFAG must put in place a process for monitoring the system of quality management's effectiveness and ensure deficiencies are identified in a timely manner, allowing corrective actions to be implemented. This process is a continuous cycle which OFAG is specifically required to undertake.

Quality control at the audit level

The engagement team members should perform quality control procedures for every audit per the OFAG policy. Quality control procedures are performed by team members on different levels, including the person with delegated responsibility for the audit. They are designed to ensure that each team member shares the responsibility for the overall quality of the audit assignment.

Team members are also responsible for providing OFAG management with relevant information to enable the functioning of that part of OFAG's quality management system relating to independence.

Role of the person responsible for the audit

The person with delegated responsibility for the audit should take overall responsibility for the quality of the audit assignment. This person should observe the audit throughout for evidence of non-compliance by the audit team with ethical requirements. If any non-compliance becomes known, appropriate action should be taken based on the OFAG policies.

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

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

- Remain alert, note and document any non-compliance with relevant ethical requirements and ensure appropriate actions are taken;
- Take responsibility for the direction, supervision and performance of the audit engagement;
- Take responsibility for the performance of quality reviews throughout the audit;
- Review the audit documentation and hold discussions with the audit team to confirm the sufficiency and adequacy of audit evidence;
- Take responsibility for ensuring that appropriate consultation takes place on difficult or contentious matters, including that appropriate conclusions are reached and implemented. Such consultation should be documented;
- Take responsibility for issuing a report that is appropriate in the circumstances;
- Consider the results of the OFAG's quality control monitoring processes, as per the latest information circulated and the effect this may have on the audit;
- Determine that the OFAG's policies or procedures for the acceptance and continuance of client relationships and audit engagements have been followed, and that conclusions reached in this regard are appropriate;
- That all engagement team members are responsible for contributing to the management and achievement of quality at the engagement level;
- The importance of professional ethics, values and attitudes to the members of the engagement team;
- The importance of open and robust communication within the engagement team and supporting the ability of engagement team members to raise concerns without fear of reprisal;
- The importance of each engagement team member exercising professional scepticism throughout the audit engagement.

1.4 THE AUDIT REVIEW PROCESS

The OFAG's policies and procedures should clearly outline the different audit review levels and the role of each level of review. The review process can be divided into the following levels (please refer to the audit process for recommended review levels for the different phases and working papers)[1]:

- First level – the lowest level of review, for example, Senior Auditor or equivalent;
- Second level – the responsible Audit Manager or Audit Director may review;
- Third level – review by the Audit Director or Deputy Auditor General (DAG)/ Auditor General (AG) leading the OFAG are delegated as the "owner" of the audit.

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

- All mandatory working papers and procedural steps have been adequately completed, signed by the preparer and reviewer, dated, and cross-referenced. When a working paper of procedural steps is omitted, adequate reasons are supplied;

[1] Specific reviewers' level may vary depending on the nature and/or type of audit engagement.

- The audited financial statements (and other relevant audited information) have been identified and clearly linked to the audit through the lead schedule;
- Knowledge of business obtained is adequate to inform the auditors' decision relating to the audit Approach;
- Conclusions were adequately drawn and supported by appropriate and sufficient audit evidence;
- Significant deviations from the overall audit plan and any changes in the scope of the audit have been documented;
- All significant professional judgements have been documented and are supported by appropriate audit evidence;
- The audit was conducted per the relevant audit approach, guidelines and other directives;
- All significant audit matters have been resolved or appropriately reported to management in the management letter and the auditor's report;
- The work performed and results obtained have been adequately documented;
- Based on the underlying audit work and findings, the correct audit opinion has been expressed;
- Reported findings are supported by adequate and sufficient audit evidence.

The working papers should be reviewed as soon as possible immediately after completing the work. The timely review provides better control over the quality of work and the time consumed in its performance. Normally the reviewer will be on a higher level than the preparer.

First level (Senior Auditor)

Depending on the size of the audit, the audit supervisor or manager will conduct the first level of review. In the case of more extensive audits, there may be more than one first-level reviewer. In such cases, the reviewers should focus on the sections allocated to them. The first-level review should be performed on an ongoing basis. For example, each time the preparer has finalised a working paper, it should be reviewed. All working papers, conclusions drawn, professional judgements made and the related audit evidence in the audit file, should be reviewed. This includes the review of the following:

- Adequate and sufficient completion of working papers, including clear and understandable language and spelling;
- Consistency of documented information and decisions made between different working papers;
- Significant decisions made and audit evidence supporting decisions and findings;
- The planning of the audit, balancing audit risk, tests of controls and substantive tests performed; evaluating the sample sizes, conclusions, management letter issues, audit findings (exceptions); and auditor's report issues;
- Inspecting the audit procedures performed and ensuring that all the assertions were addressed.

Second level (Audit Manager/Audit Director)

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

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

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

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

Third level (Audit Director, DAG and/or AG)

The third-level review should be performed by the person who has delegated responsibility for the auditor's report. In certain instances, the review will be performed by more than one person in the OFAG. For example, when the first-level review is performed by the Senior Auditor and the second-level review is performed by the Audit Manager or Audit Director, the third-level review may be performed by the Audit Director, who may still not be responsible for signing off the report. In this case, the person signing off the report will conduct another third-level review.

As far as possible, the person performing a third-level review should be involved in significant decisions relating to the audit. The third-level reviewer should approve the overall audit strategy before any fieldwork is conducted. If this is not possible, the third-level reviewer should at least be consulted to obtain their input regarding the audit plan and scope. This ensures that the correct audit approach is followed and that the person responsible for signing the report is aware of the aspects covered in the audit plan. The third-level reviewer's review should focus on:

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

The scope of the third-level reviewer should be increased if they identify other possible risk areas or if

there is any indication that the audit file does not meet the required technical standards.

Documenting reviews

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

Engagement quality reviews

In addition to the quality control procedures described above, OFAG is required to perform engagement quality reviews of selected audits. This engagement quality review is an independent review performed on a sample of audits that meet the established criteria. OFAG should determine which audits will be subjected to an engagement quality review in their annual overall audit plan. Usually, deciding on such reviews considers aspects such as which audits carry high risk, significant expenditure and person responsible for the audit.

These reviews should form part of OFAG's policies and procedures.

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

The engagement quality reviewer is a suitably qualified person (or a team of individuals) who is not part of the engagement team. Typically, the reviewer(s) are assigned from within OFAG. It is important that such an engagement quality reviewer should have sufficient and appropriate experience and authority to objectively evaluate the audit of the engagement team. The performance of an engagement quality control review does not reduce the responsibility of the engagement partner for the audit engagement and its performance, rather it provides additional assurance on the quality of the work performed and ensure consistency in quality across OFAG.

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

- Discussion of significant matters;
- Review of the financial statements and the proposed auditor's report;
- Review of selected audit documentation relating to significant judgements of the engagement team and its conclusions;

- Evaluation of the conclusions reached in formulating the auditor's report and considering whether the proposed auditor's report is appropriate.

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

1.5 EVALUATING THE FINANCIAL REPORTING FRAMEWORK

The management of the auditee and, where appropriate, those charged with governance in preparing the financial statements, adopts **financial reporting framework**. The financial reporting framework selected should be acceptable given the nature of the entity and the objective of the financial statements. In most cases, it is required by law or regulation. When we refer to the financial reporting framework, this also includes the guidelines that the Ministry of Finance issues on instructions on what makes up a set of financial statements and how these should be prepared. A financial reporting framework is used as a criterion when doing audit. This will serve as your benchmark to evaluate whether the financial statements have been prepared according to the requirement of the reporting framework.

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

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

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

Pre-conditions for the audit

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

- The financial reporting framework used for preparing the financial statements is deemed to be acceptable by the auditor. The auditor should evaluate the financial reporting framework and conclude whether it is acceptable or not. The evaluation process is described below in detail.
- Management of the entity acknowledges and understands its responsibility:
    - For the preparation of the financial statements in accordance with the applicable financial

reporting framework, including, where relevant, their fair presentation.

- For such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.
- To provide the auditor with unrestricted access to:
  - All information of which management and, where appropriate, those charged with governance are aware, which is relevant to the preparation of the financial statements such as records, documentation and other matters.
  - Additional information that the auditor may request from management and, where appropriate, those charged with governance for the purpose of the audit.
  - Unrestricted access to persons in the entity from whom the auditor determines it necessary to obtain audit evidence.

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

Evaluating the financial reporting framework of auditees

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

Evaluating the financial reporting framework

The OFAG-level evaluation of the financial reporting framework

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

The OFAG therefore evaluates the acceptability of the FRF centrally at the beginning of the annual audit cycle for all MDAs as they use the same framework. The central evaluation assesses if all MDAs are preparing financial statements using IPSAS cash basis. In addition, there may also be additional requirements issued by the Ministry of Finance (MoF). In this case, the evaluation will include confirming that the additional requirements are consistent with the requirements of the FRF prescribed by legislation. While some or all aspects may be considered centrally, it remains the responsibility of the auditor to ensure that the acceptability of the FRF is adequately considered, concluded and appropriate actions are taken when necessary.

Criteria for evaluation

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

1. What is the applicable financial reporting framework for the group of entities (for example, ministries)?
2. Is the relevant financial reporting framework acceptable (relevant, complete, reliable, objective and understandable)?
3. Is the financial reporting framework a special-purpose or general-purpose framework?
4. Is the financial reporting framework a fair presentation framework or a compliance framework?

Considering consolidated (government-wide) accounts

The Ministry of Finance issues consolidated financial statements for the entire government. Accordingly, auditors should apply the provisions of ISSAI 2600, Special considerations – Audits of Group Financial Statements. The applicable FRF for the consolidated financial statements needs to be separately identified and evaluated by the auditors. There may be additional considerations when evaluating the acceptability of the group FRF. For example, consideration may include whether it is appropriate for the framework to exclude a specific type of government entity (agency, department, bureau, corporation, fund etc) from the group financial statements. The group auditor needs to consider whether this would result in a misleading group financial statement presentation.

Identifying and evaluating the financial reporting framework for audit

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

Considerations when the financial reporting framework is deemed unacceptable

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

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

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

Where the law or regulation prescribes the financial reporting framework to be used for general purpose

financial statements, such a financial reporting framework may be presumed to be acceptable in the absence of indications to the contrary. However, when it is determined that the framework prescribed by law and regulation is unacceptable, then also consider:

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

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

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

1.6 THE ANNUAL OVERALL AUDIT PLAN OF OFAG

The Audit Standards and Methodology domain of the ICBF require OFAG to have an overall audit plan in place.

Levels of plans

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

Objectives of the annual overall audit plan

The OFAG have a broad mandate including central and local government, public enterprises, donor-funded projects and other special assignments per the OFAG's mandate. The requirements of INTOSAI P-12 (principle 5) include:

- OFAG should evaluate changing and emerging risks in the audit environment and respond to these promptly, for example, by promoting mechanisms to address financial impropriety, fraud and corruption.
- OFAG should be aware of stakeholders' expectations and respond to these promptly, as appropriate, and without compromising their independence.
- OFAG should, in developing their work programme, respond as appropriate to the key issues

affecting society.

- OFAG should keep abreast of relevant matters being debated in domestic and international forums and participate where appropriate.
- OFAG should ensure that stakeholders' expectations and emerging risks are factored into strategic, business and audit plans, as appropriate.
- OFAG should establish mechanisms for information gathering decision-making and performance measurement to enhance relevance to stakeholders.

The annual overall audit-planning process should enable the OFAG to do the following:

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

Implementation of the plan

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

1.7 OFAG POLICIES AND PROCEDURES

Outsourcing audits

Given the mandate to conduct a substantial number of annual audits with limited professional staff, outsourcing is one of the suitable options to close this gap. The limited professional staff in this regard would relate to not having the required number and expertise in OFAG's to conduct their annual audits. Engaging the firms of professional accountants per se to conduct the annual audits may not appear too complicated. The main issue is whether OFAG have technically competent staff to monitor and manage the outsourced audits.

Ensuring the quality of outsourced audits has also become a critical issue, and, if not addressed, it will affect the credibility of OFAG and the confidence of the stakeholders in the financial statements certified by the firms of professional accountants. While outsourcing the audits, OFAG cannot construe that they do not bear any responsibility and accountability. When the authority to outsource the audits rests with OFAG by their respective legislation and INTOSAI - P 20 (*Principle 5*), it is logical and justifiable to conclude that they should also assume the responsibility and accountability to manage it effectively and efficiently. Various guidelines and requirements for using the work of experts are provided in ISSAI 2620. OFAG should consider whether:

- Appropriate policies have been put in place to select the firms of professional accountants and any other suitably qualified persons to be eligible to conduct the audits.
- Proper coordination and communication mechanisms and reporting requirements are in place.
- Quality control procedures to ensure the quality of outsourced audits.

Materiality

The ISSAI 200 (33): *The auditor should apply the concept of materiality, both in quantitative (by amount) and when relevant in qualitative (by nature) terms, when planning and performing the audit, evaluating the findings and reporting on the results*.

The OFAG materiality policy provides guidance for the auditors on how to apply the different types of materiality and the recommended percentages.

The following specific guidance is provided:

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

1.8 COMMUNICATION DURING THE AUDIT

ISSAI 100 (43): *Auditors should establish effective communication throughout the audit process.*

The communication policy of OFAG

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

- The purpose, timing, format and content of the communication;

- The level of responsibilities within the audit team to communicate and the person receiving the communication at the auditee or third party;
- Documentation during meetings and verbal discussions with management and those charged with governance of the audited entity. This is usually done by preparing meeting minutes, which should include references to all matters discussed and decisions made during the meeting;
- Timely dissemination of all documentation forming part of meetings (for example, management letters or draft auditor's report);
- Reasonable time to respond wherever necessary, for example to audit queries and management letters. This may vary depending on the length of communication, where five working days can be used as a benchmark. This can change due to a different arrangement with the client, but it should be discussed and agreed to by both parties. Strict deadlines or other unusual circumstances can be taken into consideration each time.

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

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

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

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

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

Communicating with those charged with governance

Effective two-way communication between auditors, management and those charged with governance is

an essential part of an audit. Communication is aimed at developing a constructive working relationship between auditors and those charged with governance while maintaining the auditor's independence and objectivity. Communication includes:

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

Who are those charged with governance?

Firstly, you need to identify the appropriate person(s) within the entity's governance structure with whom to communicate. In the public sector, governance responsibilities may exist at several organisational levels and in several functions (vertically or horizontally). Thus, there may be instances where there are several distinct groups that are identified as those charged with governance.

In situations where matters are communicated to subgroups of those charged with governance (such as an audit committee or an individual) auditors may need to convey the information, in full or in summary, to the whole governing body. This is particularly relevant in the public sector where it is common for those charged with governance to be involved in managing the entity. Auditors need to be particularly sensitive to meeting the needs and expectations of the legislature or appropriate regulators about matters communicated to other governance levels, particularly where the matters may be of broad public interest or speculation.

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

Good governance principles suggest that:

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

What to communicate?

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

- The form, timing and expected general content of communications.
- The responsibilities of the auditor in relation to the audit, such as the responsibility for expressing an opinion on the financial statements and the fact that the audit does not relieve management or those charged with governance of their responsibilities.
- An overview of the planned scope and timing of the audit.
- Those matters you have determined to be the key audit matters, or
- Your determination that there are no key audit matters to communicate in the auditor's report

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

- Significant findings

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

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

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

You should communicate compliance with relevant ethical requirements including independence and

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

How and when to communicate?

The purpose and form of the communication and the persons involved should be determined by the communication policy of OFAG.

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

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

In the case of oral communication, auditors need to document the date and place of such communication. All written correspondence should be retained and filed.

1.9 DOCUMENTING THE AUDIT

ISSAI 100 (42) states: *Auditors should prepare audit documentation that is sufficiently detailed to provide a clear understanding of the work performed, evidence obtained, and conclusions reached.*

Audit documentation

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

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

Audit documentation refers to all relevant working papers and audit evidence that has been obtained throughout the audit. Where working papers are not applicable, only the fact that they are not applicable, and the reasons therefore should be documented. In some public sector environments, such as in a Court of Accounts environment, auditors may be subject to laws and regulations requiring precise

documentation procedures related to rules of evidence. Public sector auditors should familiarise themselves with these additional requirements relating to audit documentation which are designed to ensure compliance with applicable rules of evidence.

Nature of audit documentation

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

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

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

Types of audit documentation

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

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

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

Purpose of audit documentation

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

The audit documentation is therefore intended to:

- Assist auditors to plan and perform the audit;
- Assist in discharging supervision and review responsibilities;

- Enable the audit team to be accountable for its work;
- Retain a record of matters of continuing significance to future audits;
- Enable the conduct of quality control reviews;
- Enable the conduct of external quality assurance reviews in accordance with applicable legal, regulatory or other requirements.

Extent of audit documentation

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

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

Contents of audit documentation (working papers) and audit evidence

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

- The client's name, year-end, person preparing and reviewing the working paper, and respective dates for preparation and review;
- Explanations of tick-marks used;
- The work performed, for example a description of the audit procedure or review executed;
- The source of the sample of information that was used to perform the audit procedure (for example, the source may be the ledger);
- A list of the transactions that were selected to be audited or the extent of the review performed.
- Sufficient information to enable re-performance of the procedure, for example, document numbers, dates, names, and reference numbers;
- The value or amount of the sample selected, and coverage obtained;
- Results of the procedures performed;
- Conclusion on the work performed based on, and warranted by, the work performed and

supporting audit evidence;

- Explanations, motivations of basis used when using professional judgement and conclusions reached;
- Indication that all schedules prepared by the auditee have been cast and cross-cast;
- Indication of the purpose of photocopied or scanned documents;
- References to other working papers or documents.

Documenting audit findings

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

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

Audit queries are a more informal means of communication. These queries are sent via the accounting officer to the relevant division heads where the queries reside. This way management has an opportunity to give timely feedback or comments and additional information. There is no restriction on the number of queries that may be sent, but it is advised to avoid sending endless numbers of individual queries. The team leader should collect the queries and send them simultaneously. All such arrangements should be communicated and agreed to with the auditee.

Unresolved material findings which will be considered for reporting should nonetheless always be included (and in this way repeated) in the management letter. Repeating unresolved findings will alert management to the items that will potentially appear in the auditor's report. This will ensure that auditor's reports do not contain issues that will "surprise" management.
The management letter is normally issued at the end of the engagement, summarising all unresolved findings previously raised in queries and any new issues not yet raised. Management is requested to comment on the findings raised in the management letter.

The draft auditor's report will be presented to the auditee before it is finalised. Depending on the circumstances, it may be done simultaneously with the management letter (for example, if all findings have already been reported to management).

The final audit files

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

The completion of the assembly of the final audit file after the date of the auditor's report is an

administrative process that does not involve the performance of new audit procedures or the drawing of new conclusions. However, changes may be made to the audit documentation during the final assembly process if they are administrative in nature. Examples of such changes include:

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

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

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

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

Cross-referencing

All the working papers documentation placed in the supporting files should have individual reference numbers.
The following documentation can be regarded as audit evidence:

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

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

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

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

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

Contents of the audit file

For an audit to be completed a set of pre-defined audit files must be compiled. These files are compulsory and should include all the audit phases and applicable working papers.

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

Document retention and confidentiality

Audit files should be retained (with nothing deleted or discarded from them) for the period of retention required by the OFAG.

You need to be aware of any legislative requirements regarding confidentiality of information and balance these requirements with the provisions of transparency, which requires professional judgement. Requests may be made by third parties relating to audit documentation, in which instance OFAG should normally refer the request to the auditee and consult with relevant parties before releasing the information. Legislation may grant access to audit correspondence, for example where electronic or other post journals are open to public scrutiny. Documentation that is of confidential nature should be identified and treated as such. OFAG has clear procedures for different types of information, including lines of responsibility for authorising disclosure of audit documentation and routines for making such information available.

Where the public sector audit work is contracted out by OFAG to private auditors, the private auditors should follow the same documentation requirements as OFAG.

1.10 PROFESSIONAL JUDGEMENT AND PROFESSIONAL SCEPTICISM

ISSAI 100 (37) states: *Auditors should maintain appropriate professional behaviour by applying professional scepticism, professional judgment and due care throughout the audit.*

Professional scepticism

When you conduct an audit, you need to have an attitude that includes a questioning mind, being alert to conditions that may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence.

How can you achieve this, for example by being alert to:

- Audit evidence that contradicts other audit evidence obtained;
- Information that brings into question the reliability of documents and responses to inquiries to be used as audit evidence;
- Conditions that may indicate possible fraud.

Considering whether audit evidence obtained supports the auditor's identification and assessment of the risks of material misstatement considering the entity's nature and circumstances.

Some restriction that can be place on exercising of professional scepticism but not limited to:

- Budget constraints this might influence the team's composition e.g., you might not be able select team members with the necessary technical skills or experience;
- Deadlines which are too short may impact negatively the behaviour of those who perform the work as well as those who direct, supervise and review;
- Inability of the engagement team to settle complicated or contentious issues due to a lack of collaboration or undue pressure from management;
- Lack of obtaining understanding of the entity and its environment, its system of internal control and the applicable financial reporting framework, which may limit the ability of the engagement team to make appropriate judgments and an informed questioning of management's assertions;
- Having restricted or difficulties in e.g., obtaining access to records, facilities, certain employees, customers, which may cause the engagement team to bias the selection of sources of audit evidence and seek audit evidence from sources that are more easily accessible;
- Placing too much reliance on automated tools and techniques, which could lead to the engagement team failing to thoroughly evaluate audit evidence.

Some safeguards that can be implemented against mitigate the restrictions could be:

- Remaining alert to changes in the nature or circumstances of the audit engagement;
- Alerting engagement team where there might be instance/s of vulnerability due to unconscious or conscious might be greater and seeking advice from more experienced members of the engagement team;
- Changing the composition of the engagement team e.g., assigning more experience individuals
- More experience members to be involved when dealing with difficult or challenging auditee management;
- Informing TCWG when management imposes undue pressure or when auditors are having difficulties in obtaining information;
- Using experts on complex or areas that involve a lot of subjectivity.

Professional judgement

Closely linked to professional scepticism is professional judgement. Professional judgement requires that you apply your collective knowledge, skills and experience to the audit process. There are certain decisions made during the audit cannot be made without the application of relevant knowledge and experience to the facts and circumstances for example materiality and audit risk.

Both professional scepticism and professional judgement are integral to ensuring high quality audits are attained.

Using Tick Marks

When the auditor performs the audit procedures, standard tick-marks should be included in the working paper to demonstrate the audit tests performed and the results of these tests. The following tick-marks will be applicable

Tick Marks

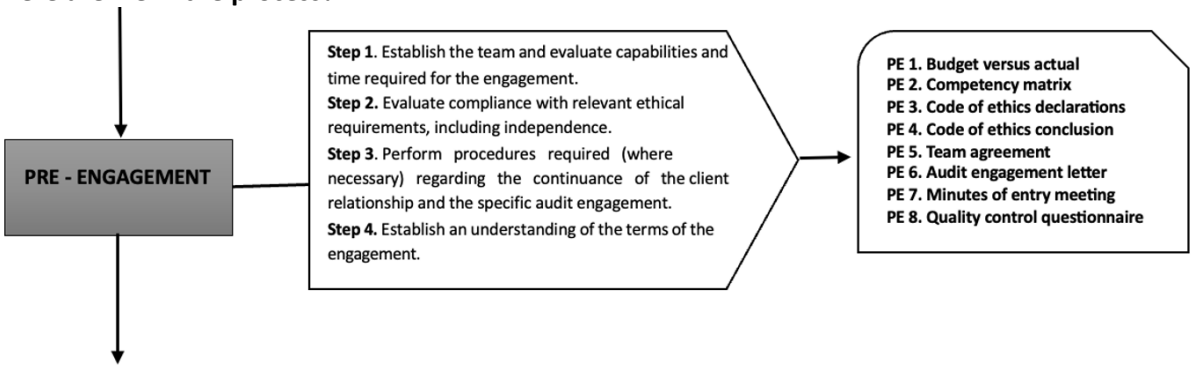
No.	Tick	Description
1	✓	Test results Correct
2	X	Test result not Correct

1.11 WORKING PAPER(S) TO COMPLETE

W/P Ref	Working paper	Objectives of the working paper	Completed by	Reviewed by
P 1	Evaluating the financial reporting framework	The checklist enables the evaluation whether the financial reporting framework of the auditee is acceptable.	OFAG assigned Committee or Team	OFAG Senior Management
P 2	Review template	To document coaching/review notes issued by the reviewer and the responses to these notes.	Audit Manager	Audit Director
P 3	Audit query	To provide a basis for communication of findings with the client.	Senior Auditor	Audit Manager
P 4	Request for Information form	To provide a basis for request of information with the auditee	Senior Auditor	Audit Manager

2. PRE-ENGAGEMENT

Where are we in the process?



2.1 APPLICABLE STANDARDS

ISSAI FRAMEWORK

ISSAI 200

For further guidance refer to the following ISSAIs:

ISSAI 2200
ISSAI 2210
ISSAI 2220
ISSAI 2300

2.2 OBJECTIVES

This is a key phase of the audit which assists you to identify and evaluate events or circumstances that may adversely affect your ability to plan and perform the audit engagement. The person responsible for the audit (as defined in the office policy) and other key members of the engagement team should be responsible for this phase. The objective of carrying out the pre-engagement activities is to ensure that:

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

2.3 AUDIT STEPS

STEPS IN THE PRE-ENGAGEMENT PHASE

Step 1. Establish the team and evaluate capabilities and time required for the engagement.
Step 2. Evaluate compliance with relevant ethical requirements, including independence.
Step 3. Perform procedures required (where necessary) regarding the continuance of the client relationship and the specific audit engagement.
Step 4. Establish an understanding of the terms of the engagement.

Step 1. Establish the audit team and evaluate capabilities and time required for the engagement

By this stage, OFAG plans should already have details of the team which is supposed to undertake the audit. Where the client is highly automated, Information System Auditors should form part of the team. Please refer to the preceding chapter relating to the different types of OFAG plans. The designated person responsible for the audit should be satisfied that the entire audit team, and any external experts, collectively have the competence and capabilities to:

a) Conduct the audit in accordance with the relevant standards and the applicable legal and regulatory requirements.
b) Enable the audit team to issue a report that is appropriate in the circumstances**.**

The team leader should use the *Competency matrix* working paper to record the names of the team allocated to the audit and their respective competencies in relation to the specific audit. This should incorporate Information System Auditors where necessary.

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

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

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

The *Budget versus actual* working paper should be used to fill in the planned budgeted hours (or days) for all the activities which relate, and the budgeted time allocated to each member. The budget time may be estimated or based on actual time spent on the audit activities in the previous year. This working paper should be informed by the budgets set out in the operational plan of OFAG. The budget should be reviewed from time to time to reflect any changes to estimates, for example after the risk assessment. Throughout the audit the actual hours/days taken to perform the audit should be documented. If used correctly, this working paper will allow audit management to monitor the progress of audit work and take corrective action where necessary. Reasons for variances between actual and budgeted hours should be documented and should not exceed 10% (as per current working practice in OFAG) and if the variance exceeds 10%, team leader should include explanation for variance.

The team leader should use the information in the *Budget vs actual* to complete the *Team agreement* working paper. This working paper should be signed by each team member as confirmation that they have

understood the extent of tasks assigned to them relating to the audit and taken note of the timeframes given to complete the tasks.

Step 2. Evaluate and form a conclusion on compliance with relevant ethical requirements, including independence

Each audit team member should complete and sign the *Code of ethics declaration* for the audit assignment. The person responsible for the audit should ensure that team members understand the principles of the code of ethics and based on the individual declarations, conclude for the audit assignment.

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

If the person responsible for the audit cannot resolve the issues, this should be promptly reported to the OFAG senior management.

Step 3. Perform procedures required (where necessary) regarding the continuance of the client relationship and the specific audit engagement

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

The person responsible for the audit must refer to the office policy for acceptance and continuance of auditee relationships and specific engagements. The person responsible for the audit should undertake or continue relationships and engagements where the OFAG:

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

The *Competency matrix* and *Budget versus actual* working papers will assist the person responsible for the audit to conclude in this regard. He or she should use information from previous audits to form a high-level opinion relating to the integrity of the auditee.

Step 4. Establish an understanding of the terms of the engagement

The engagement letter is used to communicate with the management of the audited entity regarding the objective and scope of the financial audit and OFAG's obligations as established by law. Agreement and mutual understanding are reached on the issues communicated. Both parties sign the engagement letter

to evidence this agreement. It is in the interest of both the entity and OFAG that the engagement letter is agreed upon before the commencement of the audit to avoid any misunderstandings.

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

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

The person responsible for the audit must follow the procedures as required by OFAG policy and use the approved templates to complete the engagement letter.

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

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

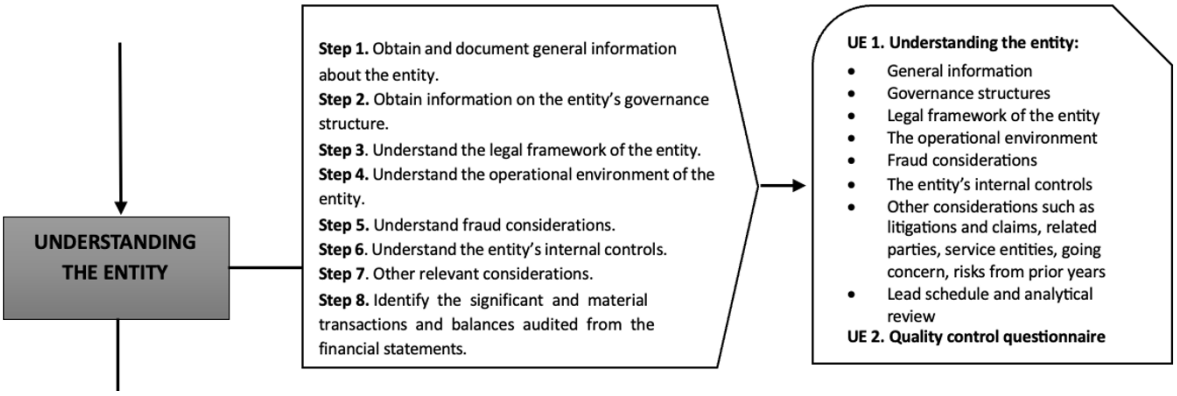
This manual ensures compliance with ISSAI 200 of the framework. Should you be required to comply with ISSAIs 2200-2899, you need to read the relevant standards on to ensure full compliance with all the requirements.

2.4 WORKING PAPER(S) TO COMPLETE

W/P Ref	Working paper	Objectives of the working paper	Completed by	Reviewed by
PE 1	Budget versus actual hours spent.	Include the planned budgeted hours (or days) as estimated including activities that relate to the audit.	Senior Auditor/ Team Leader	Audit Manager
PE 2	Competency matrix	Record the names of the audit team allocated to the audit and their respective competencies in relation to the specific audit.	Senior Auditor/ Team Leader	Audit Manager
PE 3	Code of ethics declaration	Consider the compliance of the audit team members with the principles of the code of ethics. Document conflicts of interest and actions taken in response.	all Team Members	Senior Auditor/ Team Leader
PE 4	Code of ethics conclusion	Conclude on the audit team's compliance with the code of ethics.	Senior Auditor/ Team Leader	Audit Manager
PE 5	Team agreement	Agree on the scope of the work required from each team member.	Senior Auditor/ Team Leader	Audit Manager
PE 6	Audit engagement letter	Communicate the terms of audit engagement to inform management and agree regarding the expectations on the audit.	Senior Auditor/ Team Leader	Audit Manager
PE 7	Minutes of entry meeting	Document the discussions and resolutions of the meeting between the audit team and the management of the auditee.	Auditor/ Senior Auditor	Team Leader
PE 8	Quality control questionnaire	To confirm that all working papers have been correctly completed.	Senior Auditor/ Team Leader	Audit Manager

3. UNDERSTANDING THE ENTITY

Where are we in the process?



3.1 APPLICABLE STANDARDS

ISSAI FRAMEWORK
ISSAI 200

For further guidance refer to the following ISSAIs:
ISSAI 2240
ISSAI 2250
ISSAI 2315
ISSAI 2330
ISSAI 2402
ISSAI 2520
ISSAI 2550
ISSAI 2570
ISSAI 2610

3.2 OBJECTIVES

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

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

3.3 DEFINITIONS

Significant risk is an identified risk of material misstatement:

i. For which the assessment of inherent risk is close to the upper end of the spectrum of inherent risk due to the degree to which inherent risk factors affect the combination of the likelihood of a misstatement occurring and the magnitude of the potential misstatement should that misstatement occur; or
ii. That is to be treated as a significant risk in accordance with the requirements of other ISSAIs.

Inherent risk factors characteristics of events or conditions that affect susceptibility to misstatement, whether due to fraud or error, of an assertion about a class of transactions, account balance or disclosure, before consideration of controls. Such factors may be qualitative or quantitative, and include complexity, subjectivity, change, uncertainty or susceptibility to misstatement due to management bias or other fraud risk factors as far as they affect inherent risk.

Business risk is a risk resulting from significant conditions, events, circumstances, actions or inactions that could adversely affect an entity's ability to achieve its objectives and execute its strategies, or from the setting of inappropriate objectives and strategies.

Relevant assertions an assertion about a class of transactions, account balance or disclosure is relevant when it has an identified risk of material misstatement.

Significant classes of transaction, account balance and disclosure are a class of transactions, account balance or disclosure for which there is one or more relevant assertions.

Material classes of transaction, account balance and disclosure, are those classes of transaction, account balance and disclosure which are above your overall materiality but do not have an identified risk of material misstatement associated with the classes of transaction, account balance and disclosure.

3.4 AUDIT STEPS

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

Step 1. Obtain and document general information about the entity.
Step 2. Obtain information on the entity's governance structure.
Step 3. Understand the legal framework of the entity.
Step 4. Understand the operational environment of the entity.
Step 5. Understand fraud considerations.
Step 6. Understand the entity's internal controls.
Step 7. Other relevant considerations.
Step 8. Identify the significant and material transactions and balances audited from the financial statements.

Identifying risks

Considering the steps 1-8 above you may identify risks. Some of the risks can be clearly linked to an

assertion which will affect a class of transactions, account balance or disclosure, for example, expenditure or assets. These risks will be addressed during the audit work performed for the class of transactions, account balance or disclosure and should be linked to the relevant RA 2 working paper.

There is a need to distinguish between the risk factor vs the risk to ensure that the risks identified specifically addresses how each risk affect the financial statements.

Inherent risk factors" are characteristics of events or conditions that affect susceptibility to misstatement, whether due to fraud or error, of an assertion about a class of transactions, account balance or disclosure, before consideration of controls. Risk factors could be qualitative or quantitative. The following might indicate a risk factor:

- Complexity,
- Subjectivity,
- Change,
- Uncertainty,
- Susceptibility to misstatement due to management bias,
- Other fraud risk factors.

Inherent risk factors also indicate the areas where misstatement is likely to arise. Risk identified'' indicates what could potentially go wrong in the financial statement because of the risk factor identified.

Some risks, however, cannot be linked clearly to an assertion as they are more general, affecting the financial statements as a whole. Those risks that are deemed to be pervasive should be taken to the RA 1 working paper and responses will be identified. Pervasive risks are those which may have a significant effect on the financial statements, for example the tendency of management to override controls.

High-level risks that are not pervasive must be documented in the worksheet and should be monitored during the coming audits. Recommendations relating to these risks should be suggested to the auditee in an audit query or management letter.

Step 1. Obtain and document general information about the entity

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

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

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

Step 2. Obtain information on governance structures

Those charged with governance

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

Those charged with governance (TCWG**)** are defined as the person(s) or organization (s) (for example, a corporate trustee) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process. For some entities in some jurisdictions, those charged may include management personnel, for example, executive members of a governance board of a private or public sector entity, or an owner-manager.

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

Audit committee

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

Internal audit

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

When the auditee has an internal audit function, you should:

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

The scope of the external audit may be reduced due to the reliance placed on the work of internal audit. There is need to strengthen the relationship between external and internal auditors to leverage on the efficiencies especially when the auditor concludes that work can be relied on.

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

It is important to understand and try to meet the expectations of the legislature. This is often something that is taken care of by OFAG management, but it can also be relevant to the individual audit.

Sometimes it is impossible to meet the expectations of the legislature within the mandate of a financial audit. If so, OFAG management should discuss the expectations with the legislature and consider examining previous Public Accounts Committee reports on the auditee.

Other external oversight structures

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

Step 3. Understand the legal framework of the auditee

Laws and regulations

Laws and regulations fall under the following two categories:

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

For laws that directly affect the determination of material amounts in the financial statements, you need to obtain audit evidence regarding the auditee's compliance. For laws that directly affect the determination of material amounts in the financial statements, auditors are required to obtain audit evidence regarding the auditee's compliance. For laws and regulations that fundamentally affect the operations of the entity, audit work may be limited to specific targeted audit procedures for those aspects that relate to amounts in the financial statements, unless decision is made by OFAG management to carry out separate full compliance audit on the subject matter simultaneously. This will help identify instances of non-compliance with other laws and regulations that may have a material effect on the financial statement.

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

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

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

During the phase of understanding the entity you should gain an understanding of which laws may fall into which category and the impact they may have on the financial statements. When a risk of material misstatement is identified due to non-compliance with laws and regulations, the risk should be linked to an assertion and responses should be identified in the relevant RA 2 working paper.

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

Financial reporting framework

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

At an engagement level, there is a need for the person responsible for the audit to discuss the application of financial reporting framework and susceptibility of the entity financial statement to ensure that each team member understands financial reporting framework applicable to the entity being audited. This should be documented in the form of minutes of the meeting.

Accounting policies

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

For a new auditee, get an understanding of the accounting policies in place along with its accounting framework for consistency purposes.

Step 4. Understand the operational environment of the entity

The mandate of the audited entity

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

Decisions due to political processes

Changes in geographic locations or closures of existing locations, reorganisations, including transfer of activities to other entities, new programme areas, budgetary constraints or cutbacks are all examples of decisions that have a major impact on the entity and may lead to increased costs.

Programme objectives and strategies

Programme objectives and strategies may include public policy elements and therefore have implications for the risk assessment. A new strategy or programme objective for the entity may indicate increased cost or cutbacks. Linked to objectives and strategies is a general understanding of the business risks facing the entity, an understanding of the business risks increases the likelihood of identifying risk of material misstatement. However, you do not have a responsibility to identify or assess all business risks. Only those risks that can have an effect on the financial statements assists you in identifying risks of material misstatement.

Step 5. Understand fraud risks

What is fraud?

Misstatements in the financial statements can arise from either fraud or error. The distinction is that fraud is caused intentionally while an error is unintentional. It is the responsibility of management and those charged with governance to implement internal controls to prevent and detect fraud. During the phase of understanding the entity you should identify and assess the risks of material misstatement due to fraud at the financial statement level, and at the assertion or class of transactions, account balance or disclosure level.

Objectives of the auditor in auditing fraud

Your objectives are:

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

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

You should obtain evidence regarding:

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

In terms of this, you should be able to identify the **red flags (fraud risks)** in a particular audit area or class of transactions, account balance or disclosure. For a comprehensive list refer to ISSAI 2240 appendix 1.

Some examples of risk factors relating to misstatements arising from fraudulent financial reporting:

- New legislation and regulations or directives.
- Major changes to existing programs.
- New accounting, statutory, or regulatory requirements.
- Changes in political leadership.
- Outsourcing of government activities.
- Weak budgetary controls.
- Programs without sufficient allocated resources and funding.

Excessive pressure exists for management to meet the requirements or expectations of third parties or those charged with governance due to the following:

- Increased public expectations.
- Higher than normal expectations to meet budget.
- Reduction in budgets without corresponding reduction in service delivery expectations.

Some examples of risk factors relating to misstatements arising from misappropriation of assets:

- Personal financial obligations may create pressure on management or employees with access to cash or other assets susceptible to theft to misappropriate those assets.
- Adverse relationships between the entity and employees with access to cash or other assets susceptible to theft may motivate those employees to misappropriate those assets. Adverse relationships may be created by the following:
    - Known or anticipated future employee layoffs. Recent or anticipated changes to employee compensation or benefit plans.
    - Promotions, compensation, or other rewards inconsistent with expectations.
    - Rigid public sector compensation structures that are seen to be inconsistent with expectations.
    - Rewarding seniority instead of performance.

Management override – significant risk

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

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

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

Communicating fraud

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

Step 6. Understanding the entity's internal controls

Internal controls of the auditee

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

- Communication and enforcement of integrity and ethical values to understand the control environment.
- Relevant internal controls including the manual and the information system (IS) environment.

- Procedures, within the entity, for identifying business risks relevant to financial reporting objectives.

The entity is responsible for to establish internal controls to prevent and detect material misstatements. You are responsible to ascertain whether these controls were effectively designed which relate to the financial statements these will be:

- Controls that address a significant risk
- Controls over journal entries, including non-standard journal entries used to record non-recurring, unusual transactions or adjustments.
- Controls for which you plan to test operating effectiveness in determining the nature, timing and extent of substantive testing,
- Controls that address risks for which substantive procedures alone do not provide sufficient appropriate audit evidence.

Other controls that address the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion level the design and implementation of the controls. Internal controls are adequately designed when they can prevent or detect misstatements and errors. If controls are not appropriately designed, you should not consider their implementation, but report the ineffective design to management.

Internal control consists of the following components:

Figure 1: Internal control components



Control environment

The control environment serves as a foundation for the other components of the internal control system to function. The control environment does not directly prevent, or detect and correct, misstatements. It may, however, have an impact on the effectiveness of controls in other parts of the internal control system.

The entity's risk assessment process and system of internal control monitoring process are designed to support the overall system of internal control.

If there are deficiencies in this foundation of internal control system operation it could have a pervasive effect on the preparation of financial statements.
It is important for the auditor to assess management commitment to integrity and ethical values. This will enable the auditor to obtain an understanding of:

- How the entity demonstrates behaviour consistent with the entity's commitment to integrity and ethical values.
- Whether the control environment provides an appropriate foundation for the other components of the entity's system of internal control.
- Whether any identified control deficiencies undermine the other components of the system of internal control.
- Potential issues in the other components of the system of internal control.

As part of your evaluation of the control environment, you need to evaluate the entities control environment that relates to the entity's use of information technology (IT). You need to obtain information to gain an understanding of the entity's control environment that will be useful in your assessment of the IT environment. You may consider the following on how management uses IT that is relevant for the financial statements:

- Whether IT governance supports the nature and complexity of the entity and its business operations enabled by IT.
- Complexity or maturity of the entity's technology platform or architecture
- The management organizational structure regarding IT and the resources allocated.
- How management controls access information systems and information processing facilities.
- How management ensure adequate information security, program change management and IT continuity.

Based on the understanding obtained on the entity's information systems, you will need to make a sub conclusion as guided in the understanding the entity working paper UE1, step 6.

Entity's risk assessment process

You need to obtain an understanding of the entity's risk assessment process. The way management and

TCWG identifies business risk that affect the preparation of the financial statement may indicate a deficiency in the internal control. Not all business risk will have an impact on the audit.

Furthermore, the entity does not have risk assessment processes you need to evaluate the impact on the preparation of the financial statements.

While gaining the understanding of the risk assessment process of the entity and you identify risks of material misstatement that management failed to identify, you shall determine whether any such risks are of a kind that you would expect could have been identified by the entity's risk assessment process and, if so, obtain an understanding of why the entity's risk assessment process failed to identify such risks of material misstatement. Based on the understanding
obtained you will conclude whether the entity's risk assessment process is appropriate to the entity's circumstances considering the nature and complexity of the entity

Based on the understanding obtained on this component, you will need to make a sub conclusion as guided in the understanding the entity working paper.

Monitoring

The process in place that management must assess the effectiveness of internal controls performance over a period. The assessment must be timely and remedial action implemented. The monitoring of internal controls by management might be ongoing or separate evaluations or combination of the two.

You may consider the following on how management monitors internal controls:

- The design of the monitoring activities, for example whether it is periodic or ongoing monitoring.
- The performance and frequency of the monitoring activities.
- The evaluation of the results of the monitoring activities, on a timely basis, to determine whether the controls have been effective.
- How identified deficiencies have been addressed through appropriate remedial actions, including timely communication of such deficiencies to those responsible for taking remedial action.

Management may use information in communicating from external parties in its monitoring activities. You must understand the sources of information used by entity in its system of internal control to enable you to assess whether the information used is relevant and reliable. This understanding will assist in evaluation whether the entity's process to monitor internal control is appropriate.

The evaluation of about how entity undertakes its ongoing or separate evaluations for monitoring effectiveness of internal controls will assist you to understand whether the other components of the internal control system are present and functioning. This evaluation will assist you to identify and assess the level of risk of material misstatement at financial statement and assertion level.

When obtaining the understanding of the control environment, the entity's risk assessment process and the entity process to monitor internal control components are more likely to affect the identification and assessment of risk of material misstatement at financial statement. Furthermore, the controls are primary indirect controls.

Based on the understanding obtained on this component, you will need to make a sub conclusion as guided in the understanding the entity working paper.

Information system and communication

Your understanding of the entity's accounting systems and the related accounting records, supporting information used to initiate, record, process and report transaction in preparation of financial statement, may aid you in identifying and assess the risk of material misstatement at assertion level. Most government entities use Integrated Financial Management Information Systems (IFMIS) and/or Integrated Budget Expenditure Management (IBEX) to process financial transactions. As part of understanding the operations of the auditee there is also a need to evaluate the IT environment.

The controls in information system and communication, and control activities components are primarily direct controls.

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

1. Identify major application systems involved in processing financial information. If the systems have different modules, auditor should also understand which modules are implemented. These modules may include General ledger, payroll, and account receivable. For example, the auditee may use an Integrated Financial Management Information Systems (IFMIS) system to document financial transactions. However, there may be other systems such as a payroll system calculating and documenting transactions relating to payroll;
2. Understand how different financial and non-financial systems (including manual systems) capture, process and interlink or feed information into the system that generates information for the financial statements;
3. Understand the accounting records, specific accounts in the financial statements and other supporting records relating to the flows of information in the information system;
4. Understand the financial reporting process used to prepare the entity's financial statements, including disclosures;
5. Understanding key resources (for example, human resources) used in information processing activities that has an impact on the financial statements. including the IT environment relevant to the flows of transactions and processing of information in the entity's information system;
6. Understanding how the entity communicates significant matters that support the preparation of the financial statements and related reporting responsibilities in the information system and other components of the system of internal control.

You, as financial auditor, have a responsibility to look at the IS functions that are relevant to the preparation of financial statements within the auditee. This understanding and evaluation may result in the identification of risks of material misstatement at the financial statement level. However, in the case of a centralised system some risks may be addressed by centralised controls. These controls may be applicable to all ministries, local authorities, or sometimes the entire government. These controls may be audited by a central team – often IS auditors of the OFAG. You, as the financial auditor, should still identify and audit the risks and relevant controls within the auditee. For example, there may be a password policy on a governmental level, but it will be applied on an entity level. You need to establish whether the policies are applied by the auditee.

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

It is recommended that Financial Auditors and IS Auditors cooperate in identifying and evaluating IT systems and automated controls.

Control activities

Control activities components are controls designed to ensure that management achieves proper application of policies and procedures, in all other components of entity's internal control system.

The controls might be manual or automated, which includes both direct and indirect controls. Controls you are required to identify and evaluate the design and implementation of are:

- Controls which the auditor plans to test the operating effectiveness of in determining the nature, timing and extent of substantive procedures. Also includes controls that address risks for which substantive procedures alone do not provide sufficient appropriate audit evidence.
- Controls that address significant risks and controls over journal entries.

If any of the identified controls is depending on an it systems (automated control) you need to:

1. Identify IT applications and other relevant aspects of IT environment (e.g. network, operating systems, databases and interfaces) that are subject to risks related to financial statements.
2. Based on (1) above, identify risk arising from use of IT.
3. Identify whether there are general IT controls (GITC) that addresses such risk.

The auditor's identification and evaluation of controls in the control activities component is focused on **information processing controls**, which are controls applied during the processing of information in the entity's information system **that directly address risks to the integrity of information** (i.e., the completeness, accuracy and validity of transactions and other information). However, the auditor is not required to identify and evaluate all information processing controls related to the entity's policies that define the flows of transactions and other aspects of the entity's information processing activities for the

significant classes of transactions, account balances and disclosures.[2]

Therefore, you need to consider:

- whether it is relevant or necessary to test general IT controls.
- which areas within the general IT controls you should focus on in the current year.
- whether it is necessary to test parts of the internal controls at the service provider organisation if the entity is using their services/IT-systems in the process of producing financial statements or obtain a confirmation (audit report) from third-party on the internal control at the service provider.

More guidance on when and how to test general IT controls is provided in chapter 5.3, step 7 and working paper RA2, tab for GITC.

Step 7. Other relevant considerations

Litigations and claims against the entity

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

Service organisations

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

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

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

[2] ISSAI 2315 para A148

When the outsourced function is relevant

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

Related parties

A related party can be defined as:

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

Government entities under common control by a state (national, regional or local government) are not considered to be related unless they engage in significant transactions or share resources to a significant extent with one another. You should ask management of the entity about any related parties and investigate if there are significant transactions with these related parties. There may also be instances where no transactions are recorded where they should have been, i.e. rent has not been charged to a related party.

The objectives of the audit are to:

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

Understanding the work of an expert

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

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

- Valuations of certain types of assets, for example land and buildings.
- Determination of amounts using specialised techniques or methods, for example an

actuarial valuation.

- Legal opinions concerning interpretations of agreements, statutes and regulations.

The objectives of the work you need to perform are:

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

During the phase of understanding the entity you only need to identify when the use of the expert is appropriate.

Going concern/sustainability of services

How does the going concern assumption apply in the public sector?

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

Governments, and in particular central governments, ordinarily do not become legally insolvent or bankrupt because these governments have wide-ranging powers to levy rates, fees or taxes and so are able to adjust their revenues to meet their obligations. However, in some cases governments themselves may have large liabilities and rely on assistance from other governments. Such governments may become "insolvent" in the sense of not being able to meet their obligations when they become due.

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

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

- No services delivered on primary mandates of the entity (such as no health services provided, closing of schools etc.).
- Significant impact on the services (nurses are appointed instead of doctors) because of lack of

ability to attract the right level of skills.
- Lack of ability to pay creditors including consultants who perform work on behalf of the entity, which has a negative impact on the economics of the country on an overall level.

Factors which may influence your assessment of risk:

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

Additional procedures when events or conditions are identified

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

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

Prior year's audit reports

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

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

Step 8. Identify significant and or material class of transactions account balances and disclosures to be audited based on the financial statements

Identifying class of transactions, account balance or disclosure

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

If you start the audit before the financial statements are finalised, interim or budgeted figures can be inserted in the column titled "current year's final figures". Preliminary analytical review can be completed

using interim figures to identify risks. However, interim figures should be updated with final figures as soon as these are available.

Populating the lead schedule begins with looking at the audited financial statements and identifying all material and significant balances on the main financial statements separately. For this you need to consider both quantitative and qualitative materiality. For example, a class of transactions, account balance or disclosure that is not material may be identified for audit due to its nature and the risks attributed to it. There may also be instances where two or more immaterial balances of the same nature, i.e. expenditures, can be grouped together to form a material class of transactions, account balance or disclosure. When an immaterial financial statement figure is not going to be audited in the current audit, this should be explained in the working paper.

As you need to have an idea about which balances are material and or significant, it is suggested that an overall materiality figure is calculated before identifying class of transactions, account balance or disclosure from the financial statements. Compiling the lead schedule requires you to understand the nature of the account balances. This will enable you to group items with similar processes into the same class of transactions, account balance or disclosure.

You should try and keep the main lead schedule on a high level. If it is necessary to break the balances and transactions down into sub- class of transactions, account balance or disclosure for audit work, this may also be done in the relevant working paper RA 2, *Risk assessment and response for* class of transactions, account balance or disclosure. Breaking the balances on the face of the financial statements up into sub- class of transactions, account balance or disclosure may result in too many audits class of transactions, account balance or disclosure with possibly similar risks and processes. This may lead to duplication of audit work for risk assessment and even sampling, which can be avoided if the class of transactions, account balance or disclosure are grouped together.

Analytical review

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

Keep in mind that merely stating that there are differences is not enough to identify risks. You need to request management to comment on the differences and evaluate the risks considering these explanations. Below listed is the practical instruction related to budget versus actuals variance:

- If the variance between budget and actuals for utilised budget exceeds any amount, those in charged with budgets should provide explanation for variance.
- If the variance between budget and the actual for unutilised budget exceeds 10%, those in charged with budgets should provide explanation for variance.

3.5 HOW TO OBTAIN AN UNDERSTANDING OF THE AUDITEE

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

- **Inquiries** of management and other personnel within the entity. This may include discussions with personnel on different levels of the entity, knowledgeable persons outside the entity, other auditors involved in other audits running within the entity.
- **Analytical procedures** whereby the following relationships are considered:
  - Expenditure versus appropriation.
  - Benefit payments, such as child support and pensions versus demographic allocations.
  - Interest as a percentage of debt compared to the established borrowing rate.

- **Observing or inspection** of documents such as:
  - Legislative reports or minutes.
  - Additional documents prepared by management for the legislature, such as performance reports or funding requests.
  - Testimonies of agency officials.
  - Ministerial and other directives.
  - Official records of proceedings of the legislature.
  - Strategic and annual operational plans

- **Observing/re-performing** the application of specific controls.

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

Using the previous year's audit work

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

3.6 NOTE FOR REVIEWER

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

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

This manual ensures compliance with ISSAI200 of the framework. Should you be required to comply with ISSAIs 2200-2899, you need to read relevant standards to ensure full compliance with all requirements.

3.7 CONCLUSION

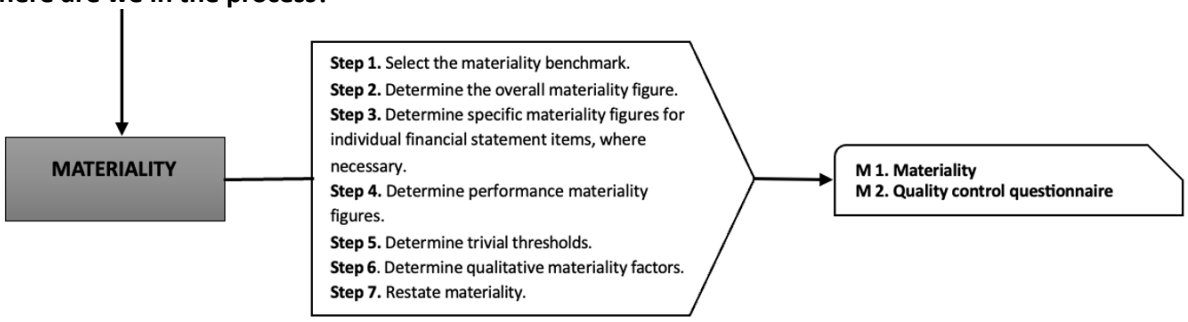
After gaining an understanding of the auditee and identifying risks, proceed to the risk assessment phase of the audit. There you will consider the risks identified so far. Those risks which affect the financial statements as a whole and those which can be linked to an assertion will be documented in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

3.8 WORKING PAPER(S) TO COMPLETE

W/P ref	Working paper	Objectives of the working paper	Completed by	Reviewed by
UE 1	Understanding the entity	Gain understanding of different aspects of the auditee's external and internal environment which may influence the financial statements.	Auditor/Senior Auditor/ Team Leader	Audit Manager
UE 2	Quality control questionnaire	To confirm that all working papers have been correctly completed	Senior Auditor	Audit Manager

4. MATERIALITY

Where are we in the process?



4.1 APPLICABLE STANDARDS

ISSAI FRAMEWORK
ISSAI 200

For further guidance refer to the following ISSAIs:
SSAI 2320

4.2 OBJECTIVES

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

- Identifying class of transactions, account balance or disclosure s to be audited (overall planning).
- Determining the nature, timing and extent of audit procedures (detailed planning)
- Evaluating the effect of misstatements (reporting**).**

4.3 WHAT IS MATERIALITY

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

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

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

4.4 AUDIT STEPS

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

Step 1. Select the materiality benchmark.
Step 2. Determine the overall materiality figure.
Step 3. Determine specific materiality figures for individual financial statement items, where necessary.
Step 4. Determine performance materiality figures.
Step 5. Determine trivial thresholds.
Step 6. Determine qualitative materiality factors.
Step 7. Restate materiality.

Step 1. Select the materiality benchmark

The first step in calculating the overall materiality figure is to select an appropriate benchmark. The benchmark relates to what the entity is about (the entity and its mandate), what drives the entity, what is important to users of the entity's financial statements, the environment within which the entity operates, the entity's financing structure, etc., as well as the benchmark's consistency as an indicator of these issues in the long term. In an audit of a public sector entity, total expenditure or revenue is most often used as benchmark. Where a public sector entity has custody of public assets, assets may be an appropriate benchmark. Examples of benchmarks that may be appropriate, depending on the circumstances of the entity, include categories of reported income such as total revenue or expenses, total or net asset value, total equity and profit before tax for some entities. When the most appropriate item is volatile, other items may be more appropriate to base materiality on. For example, when an asset-rich entity has changing asset figures from one year to the next, this may not be appropriate to base materiality on.

Step 2. Determine the overall materiality figure

Overall materiality is expressed in percentage terms. The percentage ranges from 0.25 to 2 per cent based on the degree of sensitivity in the area under consideration. The percentage selected represents the level of error which the users of financial statements are prepared to accept overall within the financial statements. Auditor should calculate the overall materiality figure using benchmark selected in step 1. The percentage used in the calculation should be based on the guidelines set by OFAG management as shown in the table below.

Benchmark	User's Tolerance for Misstatements				
	Low	Low to Medium	Medium	Medium to High	High
Total Expenditure	2%	1.56%	1.125%	0.68%	0.25%
Revenue	2%	1.56%	1.125%	0.68%	0.25%
Profit Before Tax	5%	4%	3%	2%	1%

Benchmark	User's Tolerance for Misstatements				
	Low	Low to Medium	Medium	Medium to High	High
Total Assets	2%	1.75%	1.5%	1.0%	0.5%
Net Assets	5%	4%	3%	2%	1%
Equity	5%	4%	3%	2%	1%

Step 3. Determine specific materiality figures for individual financial statement items

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

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

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

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

Step 4. Determine performance materiality figures

The purpose of setting the performance materiality at a lower level than overall materiality is to provide

for a buffer to reduce the probability that the total of uncorrected and undetected misstatements in the financial statements exceeds the overall materiality level. If you perform the audit to identify individual misstatements exceeding overall materiality only, there would still be a risk that the aggregate of individually immaterial misstatements would exceed the overall materiality. So, you should perform some additional work that is sufficient to allow for a margin or buffer for possible undetected misstatements. For this reason, performance materiality is used for determining the nature, timing and extent of audit procedures to be performed.

The performance materiality is identified as a percentage of the overall materiality. The percentage used to calculate performance materiality is based on the conclusions on the risk of material misstatement at a financial statement level (refer to working paper RA 1, *Risk assessment and response at a financial statement level*). The higher the risk of material misstatement is for the audit, the lower the level of performance materiality and vice versa.
As the performance materiality calculation requires the assessment of the risk of material misstatement, auditors should confirm at the end of completing working paper RA 1 that the correct percentage has been used.

Performance materiality is based on the level of risk of material misstatement (RMM), where:

- Low overall conclusion gives a performance materiality of 75% of the overall materiality.
- Medium overall conclusion gives a performance materiality of 50% of the overall materiality.
- High overall conclusion gives a performance materiality of 25% of the overall materiality.

This means that if the overall conclusion is identified as low, fewer items will be picked for the risk assessment, because there is a perception that the internal controls will prevent or detect any errors.

Step 5. Determine trivial thresholds

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

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

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

Step 6. Determine qualitative materiality factors

In the public sector, you also have to consider qualitative aspects of materiality due to the public interest. The public interest reflects the fact that all public funds represent the taxpayers' money and therefore the accountability for spending public money is much greater than for a private business. ED GUID 2900 ISSAI 2320.A3 gives more guidance on the issues to be considered as follows:
When determining whether a particular class of transactions, account balance, disclosure, or other assertion which is part of the financial reporting framework, is material by virtue of its nature, public sector auditors take into account qualitative aspects such as:

- *The context in which the matter appears, for example if the matter is also subject to compliance with authorities, legislation or regulations, or if law or regulation prohibits overspending of public funds, regardless of the amounts involved.*
- *The needs of the various stakeholders and how they use the financial statements.*
- *The nature of the transactions that are considered sensitive to users of the financial statements.*
- *Public expectations and public interest, including emphasis placed on the particular matter by relevant committees in the legislature, such as a public accounts committee, including the necessity of certain disclosures.*
- *The need for legislative oversight and regulation in a particular area.*
- *The need for openness and transparency, for example if there are particular disclosure requirements for frauds or other losses.*

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

Step 7. Restating materiality

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

You also must revise the materiality if you become aware of information during the audit that would have caused you to determine a different materiality. At the end of the audit, you should consider whether the materiality level(s) is still appropriate. You document any revision to the materiality in the working paper *Audit differences*. The table below summarises the different types of materiality and how they are used during the audit.

	Overall	Specific	Performance
Purpose	To establish the threshold for determining whether the financial statements are free from material misstatement, whether due to error or fraud.	To establish a threshold(s) (lower than overall materiality) to be applied to particular classes of transactions, account balances, or disclosures where misstatements of lesser amounts than overall materiality for the financial statements could reasonably be expected to influence the economic decisions of users.	To establish the threshold(s) (lower than overall or specific materiality) that ensures immaterial misstatements (less than overall or specific materiality) are identified and provides you with a safety margin.
Basis of calculation	What level of misstatement in the financial statements would be tolerable to users? Normally a percentage of total expenditure or total revenue is used.	What level of misstatement relating to special circumstances in a particular class of transactions, account balances, or disclosures could reasonably be expected to influence the economic decisions of users?	What amounts of audit work will be required to: - Identify misstatements below, - overall or specific materiality, - Leave a sufficient buffer for undetected misstatements.
Rules of thumb ***(For use as a starting point)***	Materiality is a matter of professional judgement rather than a mechanical exercise.	Establish a lower, specific materiality amount (based on professional judgement) for the audit of specific or sensitive financial statement areas.	No specific guidance is provided in the standards. Percentages range from 60% (of overall or specific materiality), where there is a higher risk of material misstatement, up to 85%, where the assessed risk of material misstatement is less. Suggested percentages are included in the working paper.
Use in audit	Determining whether uncorrected misstatements individually or in aggregate exceed overall materiality.	Determining whether uncorrected misstatements, individually or in aggregate, exceed the specific materiality.	- Determining the extent of audit testing,

Revision as the audit progresses	A change in circumstances that occurred during the audit due to: - New information. Change in OFAG policy.	A change in general circumstances.	- Change in assessed risks, - Nature and extent of misstatements found when performing further audit procedures, - Change in understanding of the entity.

4.5 CONCLUSION

Once you have set materiality levels you may proceed to the risk assessment phase of the audit. Remember that the selection of significant or material class of transactions, account balance or disclosure from the financial statements in the working paper *Understanding the entity* should be based on the overall materiality figure. Refer to part 8 of that working paper if this was not done.

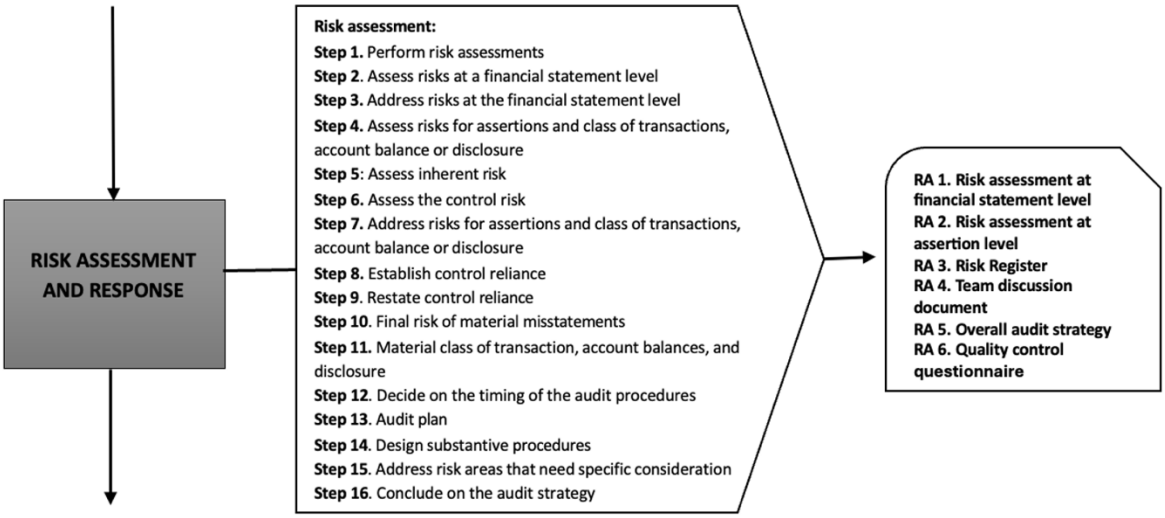
This manual ensures compliance with ISSAI 200 of the framework. Should you be required to comply with ISSAIs 2200 - 2899, you need to read the relevant standards on to ensure full compliance with all the requirements.

4.6 WORKING PAPERS TO COMPLETE

W/P Ref	Working paper	Objectives of the working paper	Completed by	Reviewed by
M 1	Planning materiality	Document the following with relevant explanations for calculations: a) Overall materiality for the financial statements as a whole. b) If applicable, the materiality level or levels for particular classes of transactions, account balances and disclosures. c) Performance materiality. d) Any revision to materiality.	Senior Auditor	Audit Manager
M 2	Quality control questionnaire	To confirm that all working papers have been correctly completed	Senior Auditor	Audit Manager

5. RISK ASSESSMENT AND RESPONSE

Where are we in the process?



5.1 APPLICABLE STANDARDS

RISK ASSESMENT
ISSAI FRAMEWORK
ISSAI 200

For further guidance refer to the following ISSAIs:
ISSAI 2315

RISK RESPONSE
ISSAI FRAMEWORK
ISSAI 200

For further guidance refer to the following ISSAIs:
ISSAI 2240
ISSAI 2300
ISSAI 2330
ISSAI 2540
ISSAI 2550
ISSAI 2570
ISSAI 2501
ISSAI 2505

5.2 OBJECTIVE

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

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

At the end of the risk assessment, your focus should be in the areas where we have identified risk for material misstatements.

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

5.3 AUDIT STEPS

Step 1. Perform risk assessments.
Step 2. Assess risks at a financial statement level.
Step 3. Address risks at the financial statement level.
Step 4. Assess risks for assertions and class of transactions, account balance or disclosure.
Step 5: Assessing inherent risk.
Step 6. Assess the control risk.
Step 7. Address risks for assertions and class of transactions, account balance or disclosure.
Step 8. Establish control reliance.
Step 9. Restate control reliance.
Step 10. Final risk of material misstatements.
Step 11. Material class of transaction, account balances, and disclosure.
Step 12. Decide on the timing of the audit procedures.
Step 13. Audit plan.
Step 14. Design substantive procedures.
Step 15. Address risk areas that need specific consideration.
Step 16. Conclude on the audit strategy.

Step 1. Perform risk assessments

What are risks and why are we looking at them?

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

Audits of financial statements carry the risk that you will express an inappropriate conclusion if the subject

matter information is materially misstated (this is called the audit risk). The audit risk links closely to the risk that material misstatements will not be detected during the audit (detection risk). The audit therefore should be carefully planned, including risk identification procedures followed by selecting adequate responses to reduce the audit risk to an acceptable level.

While gaining knowledge of the entity, you may have identified various weaknesses in evaluating the auditee's financial information, internal controls, control environment, risk management practices etc. We have also identified significant and material class of transactions, account balance or disclosure for the audit and performed a basic analytical review.

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

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

Inherent risk factors

Inherent risk factors are characteristics of events or conditions that affect susceptibility of an assertion about a class of transactions, account balance or disclosure, to misstatement, whether due to fraud or error, and before consideration of controls. Such factors may be qualitative or quantitative, and include complexity, subjectivity, change, uncertainty or susceptibility to misstatement due to management bias or other fraud risk factors

Inherent risks

Inherent risk refers to the susceptibility of a class of transactions, account balance or disclosure to a misstatement that could be material before considering any related controls

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

Spectrum

The degree to which inherent risk varies at an assertion level from low to high. The ranking of the inherent risk on the spectrum is mainly based professional judgement.

Control risks

Control risk refers to the risk that a misstatement that could occur in an assertion about a class of transactions, account balance or disclosure and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity's internal controls. For example, if the inherent risk is that cash may be stolen, the control risk may be that management has not instituted controls to prevent or detect money going missing.

Significant risks

Significant risks are an identified risk of material misstatement that will be close to the upper end of the spectrum. This is due to the degree to which inherent risk factors affect the combination of the likelihood of a misstatement occurring and the magnitude of the potential misstatement should that misstatement occur or is treated as such based-on ISSAI 2240 or 2550. It is important to note that not all inherent risks are significant and not all entities necessarily have any significant risks. When identifying significant risks, you need to apply professional judgement. However, the standard outlines the instances when auditors should identify significant risks:

- If there is a risk which can lead to fraud.
- Transactions involving related parties.
- Transactions for which there are multiple acceptable accounting treatments such that subjectivity is involved.
- Accounting estimates that have high estimation uncertainty or complex models.
- Complexity in data collection and processing to support account balances.
- Account balances or quantitative disclosures that involve complex calculations.
- Accounting principles that may be subject to differing interpretation.
- Changes in the entity's business that involve changes in accounting, for example, mergers and acquisitions.
- Complexity and inconsistency in regulations and directives.
- Non-compliance with authorities.
- The budget process and the execution of the budget.

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

Material misstatements

It is important to understand the concept of material misstatement and how it relates to risks. By the end of the audit, you need to be reasonably sure that all material misstatements have either been identified

and corrected by internal controls or picked up and reported during the audit.

The ISSAI 2450 describes misstatement as a difference between the amount, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework. Misstatements can arise from error or fraud and may result from:

1. An inaccuracy in gathering or processing data from which the financial statements are prepared.
2. An omission of an amount or disclosure.
3. An incorrect accounting estimate arising from overlooking or clear misinterpretation of facts.
4. Management's judgments concerning accounting estimates that the auditor considers unreasonable or the selection and application of accounting policies that the auditor considers inappropriate.

High or significant risk does not mean that there the specific class of transactions, account balance or disclosure will have a material misstatement. Assessing the risk is the first step in identifying areas where we might have material misstatements and therefore would require more audit work and our attention.

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

Key audit matters

Key audit matters are those matters that, according to professional judgement, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance. Key audit matters are identified at every stage of executing the audit taking into consideration your significant risks identified, hence it is a process rather than an event that is only considered at the reporting stage.

Step 2. Assess risks at a financial statement level

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

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

When pervasive risks are identified, they should be documented in working paper RA 1, *Risk assessment at a financial statement level.* When there is no overall risk that can be identified, this fact should also be documented in the working paper.

It is important that you should only document pervasive risks in RA1 and not business r risks identified in the working paper *Understanding the entity*.

How do we identify risks at a financial statement level?

As pointed out earlier, risks are identified during the phase of the audit, *Understanding the entity*. In addition, for continuing engagements it is recommended that the person responsible for the audit should undertake an initial high-level risk assessment together with the team leader. This assessment is based on professional judgement and experience and is intended to capture the risks of material misstatement at financial statement level.

Questions at this point may include:

- What are the main areas where misstatements could occur for this entity?
- Are there any known cases of internal control breaches?
- Are there any risks of irregularities?
- Are there any risks related to transactions with related parties?
- Are there accounting policies aligned with the financial reporting framework?
- Does the entity have adequate knowledge, skills and capabilities about accounting?

Evaluate the risk of material misstatement at a financial statement level

You need to evaluate risks and decide whether the overall level of risk or the risk of material misstatement (RMM) is high, medium or low. This is based on professional judgement and considering the type of risks that were identified

The risk of material misstatement at financial statement level, RA1, is used to calculate performance materiality. This means that if the overall RMM is low, fewer items will be tested, as there is a perception that the internal controls will prevent, detect and correct any errors.

Step 3. Address risks at the financial statement level

Risk at the financial statement level needs specific considerations by you and cannot be handled by a specific audit procedure. Instead, these risks might in several cases affect all the accounts, due to their nature (as explained in step 1).

To address these risks, you could consider the following activities:

- Ensure that the team has more skilled and competent resources.
- Ensure that the person responsible for the audit is present when audit work is performed and pay more attention to the review of audit papers and documentation.
- Adjust the timing of the audit and plan for more unannounced visits.
- Use sceptical thinking more "extensively", especially when evaluating audit evidence.
- In cases where the risk is referred to as risk of manipulation of the financial statements, you should consider more extensive tests (tests of details).
- In cases where risk of fraud has been identified, the team should consider having more discussions and follow-up meetings to ensure that everybody is focused and looks for relevant audit evidence.
- Consider using external confirmations more extensively when possible.
- More in-depth analytical reviews by the end of the year.
- Consider using own experts in more complicated areas instead of relying on management experts or internal audit.

Risk at financial statement level may be related to fraud, deficiencies in the internal control environment, or may be more general in nature. Further guidance on specific risk may be found in the working paper RA 1, Risk assessment at a financial statement level.

Step 4. Assess risks for assertions and audited class of transactions, account balance or disclosures

The RA 2 working paper is completed for each significant class of transactions, account balance or disclosure for the audit. For all class of transactions, account balance or disclosure identified in the lead schedule (Step 8. Understanding the business working paper), you need to identify relevant inherent and control risks.

Step 5. Assessing inherent risk

Inherent risks for all class of transactions, account balance or disclosure are documented in working paper RA 2, risk and response for class of transactions, account balance or disclosure.

Once the inherent risks have been identified you need to assess the combination of likelihood and magnitude to determine the risk rating on the spectrum. When assessing both the magnitude and likelihood, it will mainly be based on your professional judgement.

You are required to evaluates the probability of a misstatement while assessing the **likelihood** of a misstatement, considering the inherent risk factors.

To determine the possibility of likelihood the following may be used as a guidance:

- 1 = **Unlikely**: Not expected to happen, but there is remote possibility that it will occur. No misstatements occurred in the prior year.

- 2 = Possible **Likely:** May occur on more occasions than not. Prior year misstatements occurred, and management has implemented internal controls, but you still foresee the likelihood of misstatements occurring although it is not high.
- 3 = **Certain:** Likely to occur in many occasions. Prior year misstatements occurred, and management has not implemented internal controls likelihood of misstatements occurring, but it is high.

Together with the likelihood, you are also required to consider the magnitude of a misstatement. In considering the magnitude, you consider both the qualitative and quantitative aspects of the possible misstatement. This may be judged to be material due to size, nature or circumstances.

To determine the possibility of magnitude the following may be used as guidance:

- 1 = **Minor:** No impact on materiality, i.e. below performance materiality and qualitative factors.
- 2 = **Moderate:** May have an impact on performance materiality (between 80 and 99% of PM) and qualitative factors.
- 3 = **High:** impact on materiality, i.e. above performance materiality and qualitative factors

To illustrate the impact of the combination of the likelihood and magnitude calculation use the table below as an example. Remember the assessment is based on your professional judgement.

Likelihood	Magnitude	Combination	Rating on the spectrum
1 No misstatement occurred in the prior Year	2 below your materiality	1 X 2 = 2	Low
2 Misstatements occurred in the prior year; however, management has implemented internal controls to prevent the misstatement from occurring	2 has an impact on materiality	2 X 2 = 4	Medium
3 Misstatements occurred in the prior year and management has not implemented any internal controls to prevent the misstatement from reoccurring	3 above materiality and complex accounting treatment	3 X 3 = 9	High

The combination of likelihood and magnitude will result in rating on the risk spectrum. The results on your table will mean the following:

- 1 – 2 = Low, your risk will be sitting at the bottom end of the spectrum,
- 2 – 4 = Medium, your risk will be sitting in the middle of the spectrum,
- 6 – 9 = High/Significant, will be close to the upper end of the spectrum.

In demonstrating the use of the determining risk rating on the spectrum, let us have a look at the example below:

You are an auditor at a local municipality, you are currently auditing revenue and you noted that the entity customers make payments in cash and there are no internal controls in place over monies received from customers by cashiers. As part of your inherent risks, you identified that cash may be stolen.

Example on the risk rating

Identify your risks		Analyse the likelihood and potential magnitude of the identified risks by scoring between 1 and 3 (Risk Rating Table below for guidance)			Category of Risk
#	Risk	Likelihood (1–3)	Magnitude (1–3)	Overall Scoring	1 - 2 = L 3 - 4 = M 6 - 9 = H/significant
1	Cash intensive environment – There is high risk that cash may be stolen.	3	2	6	High

In the above example, the risk will be sitting on close to the upper end of the spectrum before considering your controls.

Step 6. Assessing control risk

Once you have identified and assessed your inherent risk, you need to identify if there is an internal control that mitigates the inherent risk at assertion level. The control can be manual or automated. You need to evaluate whether the control has been designed and implemented. When evaluating the design of the control you need to consider whether the control is capable of effectively preventing, or detecting and correcting, material misstatements. When evaluating the implementation of the control you consider whether the control exists, and the entity is using the control for its intended purposes. If the control has been designed and implemented appropriately you will need proceed to perform a walkthrough test. If the control is not designed and implemented, there will be no need for you to perform a walkthrough or rely on controls.

You only need to assess control risk if you plan to test the operating effectiveness of controls. Therefore, if control risk is not assessed, your final risk of material misstatement will be the same as your assessed inherent risk on the spectrum.

Step 7. Address risks at assertion level

Risk response at assertion level

The key to understanding processes and controls addressing risks is to perform walkthroughs at the

auditee in the form of observing such processes, inspecting documents or enquiring from employees. Inherent risks have already been identified in the risk at assertion level. Now you need to put these risks into the process steps and link them to the relevant internal controls of the auditee. The process steps and internal controls are identified by performing walkthroughs.

What are walkthroughs?

A walkthrough is performed by taking a specific transaction through the processes from beginning to end to understand how the whole system works. For example, by selecting a payment made you can trace the order form, payment voucher, goods receipt notes, inventory schedules etc. You can also identify what controls are in place to ensure that only valid transactions are processed by the auditee. The specific transaction selected needs to be documented in the working paper, RA 2.

Performing the walkthrough

The walkthrough is aimed at answering the question: has the auditee designed and implemented the control so it mitigates the specific risk on assertion level that we have identified?

Inquiring about the entity's people is not sufficient when assessing the design of selected controls and verifying whether they have been applied. Observation, inspection, and/or tracing transactions through the information system are used to verify inquiries. You will have to:

a) When evaluating the design of a control, assess whether it can effectively prevent, identify, and correct material misstatements on its own or in combination with other controls. It also entails determining if the control is effective in the way it was designed, how it should be applied in principle, and who should be doing so.
b) When evaluating implementation of the control, determine whether the control is present and being used in accordance with its design.

Document the internal controls identified in the *Internal controls'* column in the row of the related process and inherent risk. The process steps applicable to the class of transactions, account balance or disclosure and the internal controls are identified by interviewing the auditee and tracing one or more sample transaction(s) through the process steps. Keep in mind that a single transaction may not go through all the internal controls that may be implemented by the auditee for the risk. In this case, you may have to pick more than one or even three different items to understand all the processes and the working of internal controls. You need to document the items that were used for the walkthrough on the system description.

Step 8. Establish control reliance

Can you place reliance on internal controls?

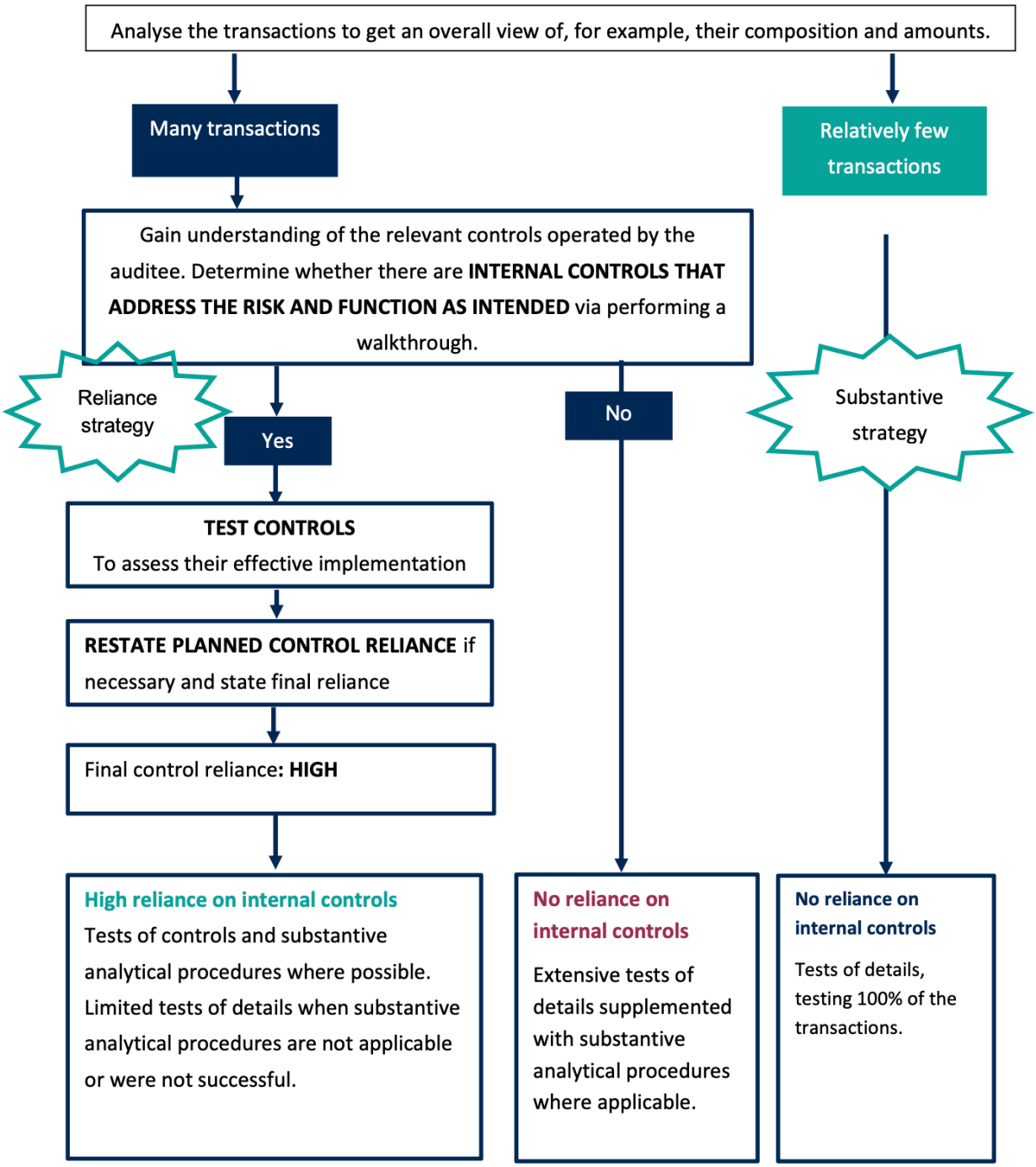
After performing your walkthrough, you make a conclusion on your planned internal controls reliance. A

control reliance approach is only considered if you have noted working internal controls implemented by the auditee (for example, authorisation requirements, independent checks and reconciliations).

For those class of transactions, account balance or disclosure where a control reliance approach is selected, you need to include the tests of control procedures and conclude on the final reliance in the risk assessment and response at class of transactions, account balance or disclosure working paper after the test have been completed.

After the final control reliance has been decided and tests of controls have been performed, you should go back to the risk assessment and response working paper and update it with the selected audit approach.

Decision tree for deciding on the audit approach



Your decision whether to rely on the controls or not should be supported by whether the controls are operating effectively or not, and the extent of reliance should be supported by an understanding of the internal controls and a walkthrough. The below table depicts whether the controls are working or not.

Document the planned reliance on controls

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

When a control reliance approach is successfully followed, you will be able to reduce the extent of substantive procedure tests.

When would you decide to use the substantive strategy?

Here are three situations:

- After your preliminary analysis of internal controls, you determine that the control itself is either not in place or it is ineffective. For example, regarding cash disbursements, the auditee's cheque-signing policy may not be stringent enough (in most cases two or more signatures are required on cheques over a certain amount), or perhaps blank company cheques are not kept under lock and key.
- After a preliminary analysis of the transactions, you identify that the population consists of a limited number of transactions. In this case testing the control would be inefficient.
- When your assessment of inherent risks is low or minimum, except when it's impossible for example, the class of transaction, account balance or disclosure is more IT driven.

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

When can tests of controls be used?

Tests of controls should only be used when:

- You have concluded that internal controls can be relied upon. You may choose to rely on controls when these adequately address the risk and they are implemented by the auditee (based on the

walkthrough). You may identify a high reliance on internal controls as appropriate. (Input from your risk assessment for the *Assertions, RA 2* working paper.)

- Substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level, for example when there are many transactions (although the internal control system has to be reliable).
- When class of transaction, account balance or disclosure is more IT driven and substantive procedures are not possible.

Considerations when planning tests of controls

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

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

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

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

Considerations when planning test of general IT controls

ISSA 2315 para 26 and A150 requires the auditor to identify and evaluate general IT controls for IT applications and other aspects of the IT environment that the auditor has determined to be subject to risks arising from the use of IT, because general IT controls support the continued effective functioning of information processing controls. A general IT control alone is typically not sufficient to address a risk of material misstatement at the assertion level.[3]

If the control you are considering to test, is an automated control, you as an auditor would expect and be able to rely on that the control (application control) is effective every time and functioning/effective. An

[3] ISSAI 2315 para A150

IT application is a program or a set of programs that is used in the initiation, processing, recording and reporting of transactions or information. IT applications include data warehouses and report writers.[4]

When you have tested that an automated control is functioning according to the description of that particular control, for example, tested once a year, you need to support your conclusion on the effectiveness of the control by testing the relevant general IT controls. You will then be able to obtain assurance of whether the control has been functioning in the same manner throughout the entire year.

Some of the controls that you are evaluating the effectiveness of might also be based on/depend on other controls. For example, when the entity has control for verifying the account balance for accounts payable and the report is checked manually, but the report has been produced by the IFMIS or any other IT/accounting system or a module related to it such as accounts payable. The auditor in this regard would need to verify the report's and/or the data's completeness to evaluate the control as a whole to be effective. This may be performed by testing the general IT-controls but can also be tested through other techniques such as CAAT.

The figure below depicts where in the audit process the auditor needs to focus on the entity's use of IT and how it will affect the audit approach. In the processes that are highly automated, it will be necessary to gather audit evidence, for that the information systems are secured sufficiently, and that the integrity is maintained. General IT controls are relevant in this regard, and the auditor must identify those GITC that support the effective functioning of the application controls.

General IT controls are implemented to address the risks that are arising from the use of IT. Examples of risks arising from use of IT include risks related to inappropriate reliance on IT applications that are processing data inaccurately, processing inaccurate data, or both, such as[5]:

- Unauthorised access to data that may result in destruction of data or improper changes to data, including recording of unauthorised or non-existence transactions (such as salary to ghost employees or fake invoices). Risks may arise when multiple users have access to common database.
- IT personnel are granted access privileges beyond what is required or necessary to perform their assigned duties, resulting in breaking down segregation of duties.
- Unauthorised changes of master data/permanent data (e.g., change of bank account number) or changes to data in master files.
- Unauthorised changes to IT applications or other aspects of the IT environment.
- Failure to or postponing necessary changes to IT applications (updates) or other aspects of the IT environment. (We can relate to how important it is that we update our laptops and mobiles/cell phones with the latest updates).
- Potential loss of data or inability to access data as required. (Loss of data might be records that

[4] ISSAI 2315 para 12 g)
[5] ISSAI 2315 appendix 5 para 18

were captured for the financial statements. If there is no back-up the data cannot be restored, in the same way as when someone forgets to save a file on laptop or system/laptop has crashed that information/data is lost permanently).

- Inappropriate manual intervention.

If the auditor is planning to rely on application controls, then the auditor must assess whether it is appropriate to test general IT controls. The more the automated a process is, the more important it is to test general IT controls. General IT controls are very often IT-dependent manual controls and are indirect controls because they affect the conclusion on operating effectiveness of the other controls. See appendix 1 for examples on GITC and ISSAI 2315 para A165.

When you have decided to test general IT controls you may use working paper template RA2, General IT controls (tab). In case you would like to test application controls you may refer to the IT Manual/working papers for further guidance. When you have assessed that the general IT controls are operating effectively only then you may proceed to carry out application controls, but for IFMIS these controls will be typically carried out by the central IT-team and in that regard, it is not necessary for the audit team to test application controls. If the central team has performed application controls, you need to obtain evidence from that team and understand whether they are effective or not to decide on how much substantive procedures are necessary as you move forward to the next phase of the audit.

What are the consequences of weaknesses/deficiencies identified in the general IT controls?

If the auditor's conclusion on general IT controls is that controls are not functioning effectively (including compensating controls), then the auditor must identify other options for confirming that these control weaknesses/deficiencies have not had any impact/effect on application controls that the auditor was planning to rely on in the audit.

It is important that auditor attempts/try to isolate the consequences of control weaknesses/deficiencies as much as possible. The main goal is to identify the transactions flow/account balances that are affected, and which audit procedures the auditor can perform (to reduce the risk of material misstatements to an acceptable level.)

Relying on the work performed during previous audits

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

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

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

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

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

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

Step 9. Restate control reliance

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

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

It may also be that you placed reliance on internal controls and the controls were tested satisfactorily. During substantive testing, however, you detect misstatements that are not consistent with an internal

control system that is working well. In such a case, you should revise the high control reliance to low or no reliance and perform more extensive substantive tests. Further guidance is provided in the chapter *Performing the audit and evaluation of misstatements*.

Step 10. Final risk of material misstatement

After performing test control and obtaining your conclusion on operating effectiveness of internal controls, you need to determine your final risk of misstatement per assertion. This will be based on your inherent risk rating and your conclusion on your test of controls results. The assessment of the final risk of material misstatement will be based on your professional judgement.

Your final risk of misstatement of misstatement will be either:

- 1 = Low: minimal risk.
- 2 = Medium: Standard risk.
- 3 = High: Significant or high risk.

If you have assessed the controls and find them to be working , your inherent risk would be reduced , from the example above you might find that during the testing of controls over cash you ascertained that there is a daily reconciliation performed by the clerk and authorised by the Senior manager and any discrepancies are followed up and corrected , even though your initial assessment was that the risk is sitting at higher end of the spectrum, with the results of control , the overall final risk will be sitting on medium as a results of controls working.

Step 11. Material class of transaction, account balances, and disclosure

All account balance, class transactions or disclosure that were considered material but are not considered to be significant class of transactions, account balance or disclosure after reassessment of risks, these will be listed in RA3, risk register working paper. You still required to perform further audit work on these account balances as indicated by ISSAI 2330. The risk rating on these material class of transactions, account balance or disclosure will be minimal. You are not required to test the controls however you should perform substantive procedures.

Step 12. Decide on the timing of the audit procedures

Timing of the tests of controls

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

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

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

- Interviewing those responsible for the controls to verify that controls have been in place up to the final date.
- Following up on documentation on the performed tests (overall level).

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

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

Timing of tests of details

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

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

Step 13. Audit plan

You need to develop an audit plan to aid you to obtain sufficient appropriate audit evidence on your assessed risk of material misstatement. The audit plan covers nature, extent and timing of the audit procedures to be performed by you and your audit team to obtain audit evidence relating significant or material class of transactions, account balance and disclosure.

The plan will indicate the level of assurance required and how you are going to obtain that level of assurance. Either you will obtain this through a wholly substantive approach or a combine approach.

Level of assurance is further explained in the performing the audit chapter.

Step 14. Design substantive procedures

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

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

Substantive analytical procedures

What are substantive analytical procedures?

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

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

When can substantive analytical procedures be used?

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

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

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

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

Substantive tests of details

What are tests of details?

Tests of details could be:

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

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

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

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

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

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

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

How to design an audit procedure?

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

If your risk relates to the assertion **completeness**, you need to know that this risk usually requires that you have a good picture of the internal controls relating to the entire process, from the time the transaction is initiated, received and then accounted for. This means that it would often be required to do some tests of controls (especially when it refers to large transaction volumes) or a more extended walkthrough. In those cases where you choose tests of details as audit procedure instead of tests of controls, you should be careful when defining the population and remember that it will probably be more

than the transactions accounted for on the specific account, as there might be a risk that the transaction is not accounted for at all or accounted on other accounts.

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

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

Responses for significant risks

Significant risks

Regardless of whether you plan to test the operating effectiveness of controls that address significant risks, the understanding obtained about management's approach to addressing those risks may provide a basis, for example entity has designed and implemented controls for significant risks arising from non-routine or judgmental matters may include whether and how management responds to the risks.

Such responses may include:

- Controls, such as a review of assumptions by senior management or experts.
- Documented processes for accounting estimations.
- Approval by those charged with governance.

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

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

Step 15. Address risk areas that need specific consideration

The audit areas that need specific considerations

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

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

Accounting estimates

If your risk relates to estimates, you must consider:

- How management has chosen the method/technique used.
- Whether this technique is common within the business.
- How management has considered alternative assumptions or scenarios and why these have not been used.
- How management has dealt with uncertainty in the estimates and whether they are disclosing the level of uncertainty in the financial statements.
- If the assumptions management has used are relevant.
- The purpose of the estimates and whether management has the relevant capacity.

If you conclude that management has not dealt with uncertainty in an adequate way, you need to perform additional audit procedures.

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

For more information refer to ISSAI 2540.

Response to fraud

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

The risk of fraud can be at both the financial statement level and the assertion level. When the risk of fraud is related to the assertion level, you should consider the following when designing your audit procedures:

- More sceptical behaviour towards audit evidence.
- If fraud is related to management override, you should place no reliance on internal controls for

the relevant component.

- Plan for unexpected audit visits when performing audit procedures such as tests of details.
- Interview employees related to the transactions where risk of fraud has been identified.
- If you are dealing with a large population of transactions, use CAATs to analyse and identify any transactions that might be odd, for example large amounts, same amounts that appear repetitively, “too even” amounts, and extremely small amounts that appear repetitively.
- Consider using external confirmations, for example when the risk relates to payables/debts or bank.
- Use an expert in complicated areas.
- If risk refers to risk of fraudulent behaviour related to cash, you should make sure to count the cash/bank deposits more regularly.
- If risk refers to property being misused, then you could consider participating in inventory missions.

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

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

For more information refer to ISSAI 2240.

Related parties

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

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

The risk is not about the authorisation, but that the financial statements will not reflect the transactions, for example, rent is not charged, machinery is used by different entities, staff members are given loans without accounting consequences. The financial statements will not reflect truly all the expenses for the period.

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

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

For more information refer to ISSAI 2550.

Going concern

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

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

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

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

For more information, refer to ISSAI 2570.

Inventory

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

- Evaluate management's instructions and procedures for recording and controlling the results of the entity's physical inventory counting.
- Observe the performance of management's counting procedures.
- Inspect the inventory and perform test counts.

- Perform audit procedures on the entity's final inventory records to determine whether they accurately reflect actual inventory count results.

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

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

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

For more information refer to ISSAI 2501.

Segment information

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

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

Audit procedures to be performed:

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

For more information, refer to ISSAI 2501.

Litigations and claims

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

The following procedures are applicable:

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

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

For more information refer to ISSAI 2501.

Service organisations

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

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

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

In certain situations, a service organisation is a centralised government entity OFAG will audit this entity. You can ensure that relevant audit work on the internal controls is performed by having discussions and looking at audit reports of the service organisation.

When OFAG does not audit the service organisation, you should consult the *Guidance on using the service organisation's auditor's report* to identify suitable actions.

When you are not able to obtain a sufficient understanding from the user entity, the following procedures

may be performed:

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

For more information, refer to ISSAI 2402.

Step 16. Conclude on the audit strategy

Discuss risks among the engagement team

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

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

It also allows more experienced members of the team to share significant aspects regarding the auditee. When it is not practical to include all audit members in the discussion, the person responsible for the audit should decide who will participate and determine what must be communicated to engagement team members not involved in the discussion.

The discussions should be driven by the person responsible for the audit and all resolutions should be documented in working paper RA 4, *Team discussion*.

Document the overall audit strategy

The overall audit strategy is based on the main risks identified at a financial statement level and for class of transactions, account balance or disclosure important enough to have been identified as main risk areas. The overall audit strategy also includes a short description of audit responses to these risks. This may be a short document summing up the main issues from the risk assessment procedure.

Additional information, such as a list of audited class of transactions, account balance or disclosure, may be included as per OFAG requirement. This is documented in working paper RA 5, *Overall audit strategy*.

5.4 NOTE FOR REVIEWER

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

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

5.5 CONCLUSION

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

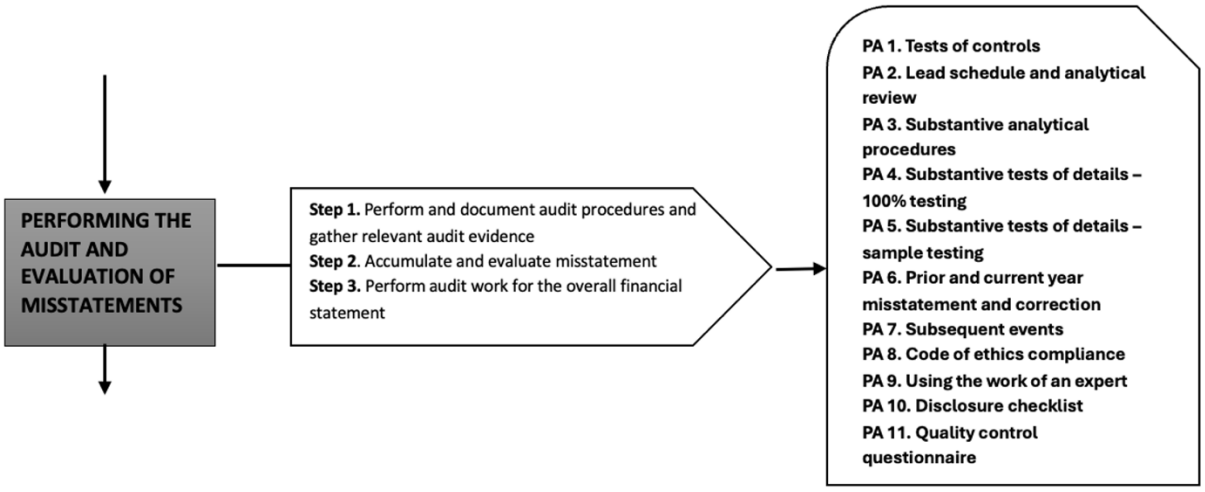
This manual ensures compliance with ISSAI 200 of the framework. Should you be required to comply with ISSAIs 2200 – 2899, you need to read the relevant standards to ensure full compliance with all the requirements.

5.6 WORKING PAPERS TO COMPLETE

W/P ref	Working paper	Objectives of the working paper	Completed by	Reviewed by
RA 1	Risk assessment at a financial statement level	Document risks at a financial statement level, if any and identify appropriate responses to address these risks.	Audit Manager	Audit Director
RA 2	Risk assessment at assertion level	Assess the risk of material misstatement for each assertion which affects class of transactions, account balance or disclosure. Consider to test general IT controls.	Senior Auditor	Audit Manager
RA 3	Risk register	Document the processes, risks and controls for each assertion which affects class of transactions, account balance or disclosure Document the selected audit approach for assertion	Senior Auditor	Audit Manager
RA 4	Team discussion document	Document the discussion by the audit team on the overall objectives of the audit and the susceptibility of the entity's financial statements to material misstatements.	Audit Manager	Audit Director
RA 5	Overall audit strategy	Document the audit strategy based on the significant risks identified for the audit, including those at a financial statement level and the responses identified for those risks.	Audit Manager	Audit Director
RA 6	Quality control questionnaire	To confirm that all working papers have been correctly completed	Audit Manager	Audit Director

6. PERFORMING THE AUDIT AND EVALUATION OF MISSTATEMENTS

Where are we in the process?



6.1 APPLICABLE STANDARDS

ISSAI FRAMEWORK
ISSAI 200

For further guidance refer to the following ISSAIs:
ISSAI 2240
ISSAI 2250
ISSAI 2315
ISSAI 2330
ISSAI 2450
ISSAI 2500
ISSAI 2520
ISSAI 2530
ISSAI 2560
ISSAI 2580
ISSAI 2701

6.2 OBJECTIVES

This chapter gives guidance to the auditor in meeting the following audit objectives:

- Performing relevant procedures for each material or significant class of transactions, account balance and disclosure, respective of the assessed risks of material misstatement.
- Determining the extent of testing (sample sizes).
- Documenting audit procedures in such a way as to obtain sufficient appropriate audit evidence and thus draw conclusions on which to base the auditor's opinion.
- Keeping a full record of misstatements identified during the audit.

- Identifying key audit matters and concluding on whether sufficient audit work has been done for all class of transaction, account balance or disclosure.

6.3 AUDIT STEPS

Step 1. Perform and document audit procedures and gather relevant audit evidence.
Step 2. Accumulate and evaluate misstatement.
Step 3. Perform audit work for the overall financial statement.

Step 1. Perform and document audit procedures and gather relevant audit evidence

Perform tests of controls

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

Step 1. Determine the sample size.
Step 2. Select the sample items.
Step 3. Perform the planned procedures on the selected items.
Step 4. Evaluate the sample results and conclude.
Step 5. Determine the level of assurance obtained.

Step 1. Determine the sample size

If you decide the testing of controls is a relevant audit procedure, you should identify the sample size for the population which is relevant to the audit programme. The table below gives you guidance on how many controls needs to be tested.

Recommended sample sizes for tests of controls

Level of assurance	**0**	**1**
Levels of reliance on internal controls	**No reliance**	**High reliance**
Yearly	**0**	**1**
Quarterly	**0**	**4**
Monthly	**0**	**9**
Weekly	**0**	**30**
Daily	**0**	**50**
More than daily	**0**	**50**
Automatic system controls	**0**	**1**

Step 2. Select the sample items

The purpose of sampling is to draw conclusions about the entire population. You should select a representative sample by choosing sample items that have characteristics typical of the population, and

the sample needs to be selected so that bias is avoided. The following two methods may be used:

Random number sampling

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

Interval sampling

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

Step 3. Perform the planned procedures on the selected items

You should test controls on each item selected. You should document the work done in the working paper *Tests of controls*, PA1.

Step 4. Evaluate the sample results and conclude

When performing the planned procedures on the items selected for the sample, the auditor may identify control deviations. You may encounter a situation where the number of control deviations indicates that controls cannot be relied upon even before testing is completed. You should then stop testing.

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

You should document the work done in the working paper *Tests of controls, PA 1*.

The conclusion reached on the operating effectiveness of the control(s), PA1, should be transferred to RA2 working paper.

Step 5. Determine the level of assurance obtained

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

You need to consider the following:

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

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

- You may extend the sample size if you wish to obtain a high level of reliance, which could be possible if the sample size is increased, and you only have reasonably few numbers of deviations (1 to 2).
- If there are more than 10% deviations in the population, you must restate to no/ low reliance, as you cannot rely on the controls; therefore, you need to perform more extensive substantive procedures.
- You may decide that reliance on a different/alternative control could provide the assurance that is being sought.

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

Performing substantive analytical procedures

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

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

The maximum level of assurance that can be obtained from substantive analytical procedures is 1, if SAP were successful.

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

Step 1. Establish the expected value of the population being audited.
Step 2. Define the tolerable error margin.

Step 3. Compare results and conclude.

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

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

EXAMPLE 1:

If the auditor audits the assertion occurrence for salaries, it will not be enough to compare the outcome of salaries with the auditor's knowledge about changes in the number of staff. The auditor should be able to specify:

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

EXAMPLE 2:

The expected value for school fees can be calculated by multiplying the number of students by the annual fee charged per student.

You should use professional judgement to establish how detailed an analysis should be:

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

Step 2. Define the tolerable error margin (deviation)

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

Step 3. Compare results and conclude

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

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

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

such as:

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

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

When you cannot accept the explanation of the deviation, you cannot rely on the substantive analytical procedure and should proceed to perform tests of details.

Perform substantive tests of details

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

Tests of details are planned as part of the overall mix of procedures to obtain sufficient appropriate audit evidence based on the reliance on test of control final reliance – either a no reliance or high reliance level and where applicable substantive analytical procedure outcome.

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

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

Step 1. Determine the sample size

To select items for testing, the auditor must consider what represents the population for testing in the circumstances. There are many ways of sampling; for the purposes of this manual, we recommend that you choose one of the following three:

- **Selecting all items**

The auditor may decide that it will be most appropriate to examine the entire population of items that

make up an account balance, class of transactions or disclosure (100% examination) based on the decision tree, where it mentions this approach is more practicable when your population is made up of few transactions. This approach ensures that the auditor obtains direct evidence in relation to the entire population under consideration; however, it may not always be practicable or efficient. The decision when to examine 100% should be guided by the decision tree on page 86

- **Selecting specific items (stratification)**

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

- **Selecting a sample of items**

You may decide to select a sample from the whole population. The level of assurance is determined by your final risk assessment at the assertion level for individual classes of transactions, account balances and disclosures. The level of assurance will guide you on the amount of evidence to obtain to ensure that you have sufficient audit evidence based on your risk assessment.

Your level of assurance is based on:

- 1 = Low: Minimal risk.
- 2 = Medium: Standard risk.
- 3 = High: Significant or high risk.

RELIANCE ON INTERNAL CONTROLS	**LOW**	**MEDIUM**	**HIGH**
Reliance factor used for sampling for tests of details	3.0	1.6	0.9
If substantive analytical procedures are successful reduce the reliance factor to calculate sample size for tests of details	-0.9	-0.9	-0.9
Reliance factor for tests of details if substantive analytical procedure is successful	2.1	0.7	0.0

From the level of assurance obtained from RA 2, it should be borne in mind that the final level of assurance should consider whether the test of controls worked effectively or not. The second part to the final level of assurance is whether the analytical substantive procedures are necessary for that class of transaction, account balance or disclosure.

If during your testing you concluded that the test of controls worked effectively, the inherent risk rating obtained on your understanding the likelihood and magnitude of the risk happening should be adjusted, i.e. the amount of work to be performed on the test of detailed is reduced as the controls are working. For example, you are auditing a provision for bad debts and have concluded that the combination of the likelihood and magnitude is sitting at the upper end of the spectrum, i.e. significant risk. The inherent risk rating allocated is 3 (refer to guidance in RA 2) however after the conclusion that the controls worked, the

final level of assurance will be sitting at 2 i.e. 3 from inherent risk minus 1 which is the reliance obtained from internal controls working resulting in the final risk of misstatement sitting at a 2. Your audit approach will then be a combination of test of controls and substantive procedures. Please note that even if you have tested the control to be working effectively, you are still required to do some work through substantive procedures, it is not sufficient to obtain audit evidence through test of controls alone.

If your assessment of inherent risk is sitting at low: minimum risk (RA 2), the guidance in this regard is that you go straight to substantive procedures and there is no need to test the controls.

You will **only do** substantive analytical procedure if that account class of transaction can be predicted, or the variables are known to the auditors and can be predicted with close to precision. If both the test of controls worked and analytical procedures were necessary for that account balance or class of transaction, there may not be a need to do further work however that would depend on inherent risk rating obtained from RA 2.

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

Sample size = Population balance x level of assurance/Tolerable misstatement (performance materiality)

While it is acceptable to use interim, prior year audited figures or current year budgeted amounts to calculate the sample size, you have to ensure that the final sample size calculated should be based on the account balance reflected on the final financial statements. The level of assurance is identified after tests of controls and based on the table above. The tolerable misstatement is usually the performance materiality.

Step 2. Select the sample items

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

Random number sampling

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

Interval sampling

Interval sampling is the selection of sampling units at uniform intervals throughout the population, beginning randomly. The sizes of the population and the sample determine the uniform interval. The number of items in the population is divided by the required sample size to determine the interval. For example, a population of 10 000 items divided by a required sample of 100 items would give a sampling

interval of 100 (10 000/100). Interval sampling also gives every sampling unit the same probability of being selected.

Step 3. Perform the planned procedures on the selected items

The tests of details concerned must be capable of being performed on each item selected. Once a sample of items to be tested has been selected, you must test all the sample items. It may happen that evidence is provided for some but not all items selected. The auditor must test the whole sample and may not stop even if the misstatements already identified exceed materiality. You can only be assured that the sample provides a reasonable basis for concluding on the population when all the sample items have been tested (of replacement items, if appropriate). In addition, without testing all the items the auditor will not be able to make the requisite projection of the misstatement in the sample to the population. This is documented in the working paper *Tests of details*.

Step 4. Evaluate the sample results and conclude

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

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

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

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

When your audit finding is that you cannot obtain audit evidence, the sample size should not be extended. It is also not possible to select replacement items. Once a sample of items to be tested has been selected and evidence is provided for some but not all items, the auditor is required to test the whole sample and may not stop even if the misstatements already identified exceed materiality. The auditor cannot conclude whether the sample provides a reasonable basis for concluding on the population that has been tested without performing the procedures on all the items selected in the sample.

Step 2. Accumulate and evaluate misstatements

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

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

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

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

a. Obtain an understanding of the results of audit procedures performed on individual financial statement items

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

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

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

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

b. Accumulate the misstatements taking into consideration the correction of misstatements

You should accumulate misstatements identified during the audit.

You as an auditor are concerned with whether particular classes of transactions, account balances or disclosures (at the level of the individual financial statement line items) are free from material misstatement. Therefore, as the audit progresses identified misstatements are *accumulated* in the working paper PA 5, *Prior and current year misstatements and correction* – which is a specific schedule of misstatements for each particular financial statement item.

c. Consider the effect of uncorrected misstatements from the prior period

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

You should consider whether uncorrected misstatements from the prior period have an effect on the auditor's opinion of the current period by including all prior year misstatements in the working paper on *Prior and current year misstatements and correction*.

Uncorrected misstatements of the prior period should be evaluated against current period materiality (relevant current period materiality figures and qualitative factors in relation to the effect(s) or possible effect(s) in the context of the financial statements of the current period).

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

d. Determine whether uncorrected misstatements are material individually or in aggregate

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

Considering any revision of materiality that may be required, you should use the following materiality figure(s) for purposes of evaluating the effect of uncorrected misstatements:

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

Your evaluation commences with evaluating each uncorrected misstatement individually in terms of its

effect on the particular financial statement item (class of transactions, account balance or disclosure) concerned. Compare the quantum/amount value of each uncorrected misstatement with the relevant materiality figure:

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

Step 3. Perform audit work for the overall financial statements

After concluding on the audit work for the different class of transactions, account balance or disclosure, you need to consider overall aspects and conclude on the audit as a whole This can be done by agreeing the final set of financial statement and the accounting records as well as correcting journal entries processed during the audit by performing some substantive procedures in this regard.

The following **five sub-steps** are performed in respect of the performing audit work for the overall financial statements (discussed separately hereunder):

Step 1. Confirm the team's independence.
Step 2. Consider subsequent events.
Step 3. Update the lead schedule and perform a final analytical review.
Step 4. Financial statements closing process.
Step 5. Conclude on the adequacy of audit work performed.

Step 1. Confirm the team's independence

Before starting the evaluation and reporting you should confirm that the team is still independent of the auditee. This is documented in the working paper PA 8, *Code of ethics compliance*. This is important since things may have changed since the start of the audit and any independence issue must be cleared. Some independence issues may be handled through counteractions in the team.

Step 2. Consider subsequent events

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

known after the date of the auditor's report and which, had they been known at that date, might have caused the auditor to amend the auditor's report.

Normally subsequent events are more relevant under accrual accounting. With cash-based accounting you can more or less disregard subsequent events.

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

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

The types of events that would ordinarily be identified are:

- Events that provide evidence of conditions that existed at the date of the financial statements (for example, a verdict in a legal procedure).
- Events that provide evidence of conditions that arose after the date of the financial statements (for example, value of assets or similar).

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

Note that if the entity has an obligation to include performance information in the financial statements, there could be events that affect this information too.

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

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

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

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

If you have identified any such events, you should discuss with management how they intend to address the matter and consider the possibility of issuing a new auditor's report. But if you decide to do so, it is

crucial to ensure that stakeholders can identify that there is a new auditor's report so that they do not rely on the old report. This is done partly by including an *Emphasis of matters* paragraph in the new auditor's report, referring to a note in the amended financial statements explaining the reason for the amendment.

Step 3. Update the lead schedule and perform analytical reviews

Update the lead schedule with any changes in the final financial statements. If there are any changes, re-perform your analytical review on these class of transactions, account balance or disclosure. Document your work in the lead schedule: Step 8. *Understanding the entity*.

Step 4. Financial statements closing process

Once all the necessary amendments are made by the auditee and you are satisfied by all the changes, the closing process for the financial statement for the year under review starts in preparation for those financial statements to be included in the annual report of the auditee which will be accompanied by the audit report therein.

Step 5. Conclude on the adequacy of audit work performed

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

6.4 NOTE FOR REVIEWER

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

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

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

6.5 CONCLUSION

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

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

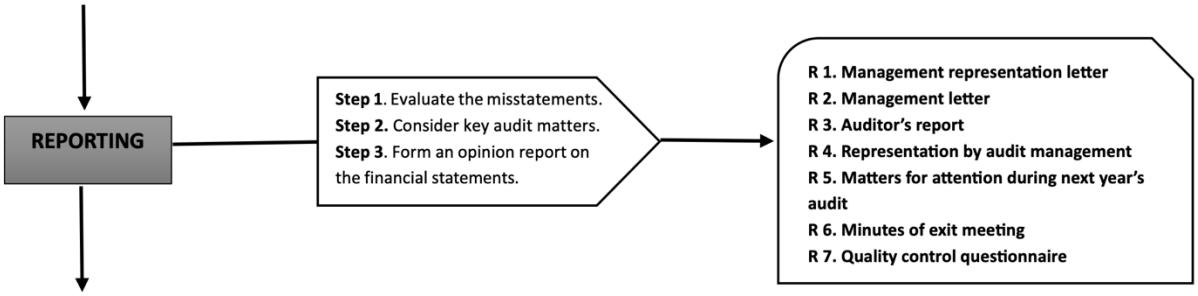
6.6 WORKING PAPERS TO COMPLETE

W/P ref	Working paper	Objectives of the working paper	Completed by	Reviewed by
PA 1	Tests of controls	Document the performance of tests of controls.	Auditor	Senior Auditor
PA 2	Lead schedule and analytical review	Break down the audited class of transactions, account balance or disclosure and identify any further focus areas relating to the class of transactions, account balance or disclosure. Perform an analytical review of the final figures in the financial statements. The objective is to establish if there are any irregular differences that need more audit work.	Senior Auditor	Audit Manager
PA 3	Substantive procedures – analytical tests	Document the performance of substantive analytical procedures.	Auditor	Senior Auditor
PA 4	Substantive procedures – detailed tests 100% testing	Document the performance of substantive procedures.	Auditor	Senior Auditor
PA 5	Substantive procedures – detailed tests Sample testing.	Document the performance of substantive procedures.	Auditor	Senior Auditor
PA 6	Prior and current year misstatements and correction	Evaluation of the effect of prior year errors on the auditor's report. Documentation of all quantifiable current year misstatements and errors and the evaluation of the effect of these errors on the auditor's report.	Auditor	Senior Auditor
PA 7	Subsequent events	Identify any subsequent events that should affect the financial statements.	Senior Auditor	Audit Manager
PA 8	Code of ethics compliance	A follow-up that the team is still independent.	Audit Manager	Audit Director

PA 9	Using the work of an expert	To determine the extent of use of the work of an expert (if any).	Senior Auditor	Audit Manager
PA 10	Disclosure checklist	To ensure that the financial statements include all mandatory disclosures.	Auditor	Senior Auditor
PA 11	Quality control questionnaire	To confirm that all working papers have been correctly completed.	Senior Auditor	Audit Manager

7. REPORTING

Where are we in the process?



7.1 APPLICABLE STANDARDS

ISSAI FRAMEWORK
ISSAI 200

For further guidance on the ISSAI framework refer to:
ISSAI 2260
ISSAI 2265
ISSAI 2700
ISSAI 2705
ISSAI 2706
ISSAI 2720

7.2 OBJECTIVES

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

7.3 AUDIT STEPS

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

Step 1. Evaluate the misstatements found in the audit

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

Gather and document all misstatements

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

Evaluate the misstatements

You should evaluate whether uncorrected misstatements are material, individually or in aggregate. When doing so you use the set materiality from planning. However, the materiality is just a benchmark and misstatements below the set materiality may still be considered material, when using your professional judgement.

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

Further guidance on evaluating misstatements is included in ISSAI 2450.

Decide on the level and timing of communication

You should report the misstatements to the auditee in good time. Reporting is normally done in a management letter to the auditee, but the ISSAIs allow for verbal communication as an alternative. You should choose the alternative that is most efficient or, when there are set procedures in the office, follow these procedures. Describe the misstatements clearly, and when appropriate include recommendations. It is important to have a clear picture of the message to be conveyed to the auditee so that it is understood. Try to give a broader picture and include descriptions of why the misstatement occurred, rather than just describing the misstatements. Also try to find the cause of the misstatements. The reason for reporting in good time and during the audit is to give the auditee a chance to correct the misstatements.

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

There is more guidance on communication with management and those charged with governance in ISSAI 2260 and 2265.

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

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

Obtain a written representation

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

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

There is more guidance on written representation in ISSAI 2580.

Issue the final management letter

After getting feedback and comments from the auditee you can now finalise the management letter. The senior manager should issue management letters. Prior to the issuance of the audit report a final management letter should be issued to ensure that all findings from the audit are included in one management letter. The person responsible for the audit should sign this management letter, or a suitable delegated high- level official.

Step 2. Consider key audit matters

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

The purpose of reporting KAM in the audit report is precisely to address the following:

a) Increase transparency about the audit that was performed.

b) Focus users of the financial statements on areas in the financial statements that are subject to significant management judgment and significant auditor attention.
c) Provide users a basis to further engage with management and those in charge of governance.
d) Renew auditor focus on matters to be communicated, which could indirectly result in an increase in professional scepticism, among other contributors to audit quality.

Key audit matters are areas that you think have been important in the audit work you have performed. It could be high-risk areas where you have performed a lot of audit work, difficult areas where you may have had difficulties obtaining audit evidence, or circumstances that occurred during the audit and which had a significant impact on the audit plan, matters which involved the most communication with those charged with governance, matters determined to be important to the users of the financial statements and where management's selection of an accounting policy was complex or involved subjectivity choose the most significant of these matters to describe as KAMs in the auditor's report.

KAM should not be confused with the following as it is NOT:

a) A substitute for disclosures in the financial statements.
b) A substitute for a modified opinion.
c) A substitute for reporting a material uncertainty related to going concern.
d) A separate opinion on individual matters.
e) An implication that a matter has not been resolved by the auditor.

KAM not reported when the auditor expresses the disclaimer opinion
Describe KAMs in the auditor's report under the heading *Key audit matters*. The description of each KAM should include:

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

See also the template *Auditor's report*.

OFAG policy is that KAM will be included in all audited entities with the highest impact on the state budget, largest impact on the consolidated financial statements and entities which will affect market such as national debt.

Step 3. Form an opinion and report on the financial statements

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

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

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

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

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

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

The opinion has a separate paragraph in the auditor's report and the title of the paragraph should indicate what type of opinion is given.
An unqualified opinion should read: "The financial statements give a true and fair view/present fairly, in all material respects, the financial position of [auditee] as at [date] and its financial performance and its cash flows for the year then ended in accordance with [the financial reporting framework]" for a fair presentation framework. For a compliance framework, the opinion should read: "The financial statements are prepared, in all material respects, in accordance with [the financial reporting framework]".

A qualified opinion should read: "Except for the effects of the matter/s described in the *Basis for qualified opinion* paragraph the financial statements …. (Same as for unqualified opinion)."

An adverse opinion should read: "Because of the significance of the matter/s described in the *Basis for adverse opinion* paragraph the financial statements … (same as for unqualified opinion)."

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

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

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

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

Example 1.1 – qualified opinion:
The entity has not collected revenue regarding xx. I estimate that the uncollected revenue amounts to xx.

Example 1.2 – qualified opinion:
The financial statement includes assets that are no longer with the entity. The value of these assets is xx and the financial statements are misstated by this amount.

Example 2 – adverse opinion:
The entity's internal control system has not been effective and therefore there are many material errors in the financial statements.

Example 3 – disclaimer of opinion:
The management has not allowed access to a significant part of the books and relevant documentation to support the financial statements.

Add any *Emphasis of matter* paragraphs or *other matter* paragraphs

Emphasis of matter and *other matter* paragraphs should be used sparingly to highlight information that is important for the user's understanding of the financial statements and the audit thereof. *Emphasis of matter* paragraphs refer to matter included in the auditor's report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements, for example, information about a pending litigation with a possible big impact on the financial statements. *Other matter* paragraphs give you an opportunity to communicate a matter that is not presented or disclosed in the financial statements and that you think is relevant to the users' understanding of the audit, the auditor's responsibilities or the auditor's report.

When using *Emphasis of matter* or *other matter* paragraphs, it is important to include that your opinion is not modified in respect of the matter. There should be consideration of the provisions of section 7 of GUID 5100, where an *Emphasis of matter* paragraphs or *other matter* paragraph has elements of Information System audit issues.

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

If the financial statements contain any supplementary information or are issued together with supplementary information, you have to make sure it is separated so that you can clearly define in the auditor's report which parts are included in the audit. Or, if this is not possible, you should read the information to ensure that it is consistent with the audited financial statements. If there are inconsistencies with the audited financial statements, you should conclude what needs to change and ask management to make the correction. You should describe any uncorrected inconsistencies in the o*ther matters* paragraph.

7.4 NOTE FOR REVIEWER

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

7.5 CONCLUSION

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

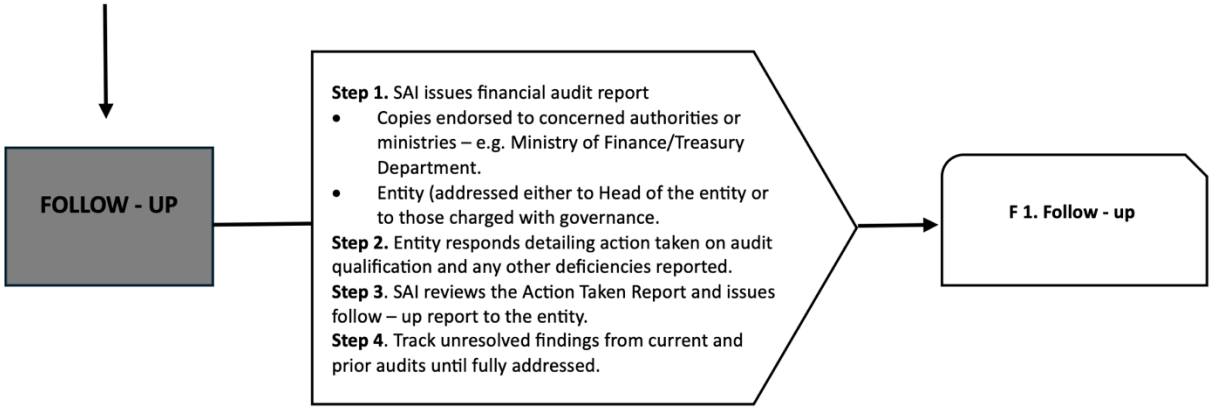
This manual ensures compliance with ISSAI 200 of the framework. Should you be required to comply with ISSAIs 2200 - 2899, you need to read the relevant standards to ensure full compliance with all the requirements.

7.6 WORKING PAPERS TO COMPLETE

W/P ref	Working paper	Objectives of the working paper	Completed by	Reviewed by
R 1	Management representation letter	To obtain some audit evidence as to whether management has understood its responsibilities for the financial statements and has provided all information to the auditors.	Audit Manager	Audit Director
R 2	Management letter	The objective is to report all important findings to the auditee.	Audit Manager	Audit Director
R 3	Auditor's report	The conclusion on the audit of the financial statements.	Audit Manager	Audit Director
R 4	Representation by audit management	A final documentation of the review done of the audit.	Audit Manager	Audit Director
R 5	Matters for attention during next year's audit	Issues to bring forward to next year's audit. Both things that went well and things that can be improved should be included.	Audit Manager	Audit Director
R 6	Minutes of exit meeting	Document the discussions and resolutions of the meeting between the audit team and the management of the auditee.	Senior Auditor	Audit Manager
R 7	Quality control questionnaire	To confirm that all working papers have been correctly completed	Audit Manager	Audit Director

8. FOLLOW-UP

Where are we in the process?



8.1 APPLICABLE STANDARDS

ISSAI FRAMEWORK
ISSAI 100

For further guidance refer to the following ISSAIs:
ISSAI 2300

8.2 OBJECTIVES

Follow-up is deemed to be one of OFAG's good practices under Principle 3 of INTOSAI-P 20. In addition, ISSAI 100 recognizes that OFAGI's have a role in monitoring action taken by the responsible party in response to those matters raised in their audit reports.

The main objective of a follow-up audit in financial auditing is to assess the progress of implementing recommendations from a previous audit, ensuring that the audited entity has adequately addressed identified issues and remedied underlying problems. This process verifies the effectiveness and timeliness of corrective actions taken by management, ultimately ensuring that the organization's operations are aligned with audit recommendations and risk management practices.

Follow-up can help auditors to determine what actions the audited entities has taken to remedy any weaknesses identified as a result of the audit. Determine the impacts which can be attributed to the audit. The follow-up can reveal cost savings and non-financial improvements that can be attributed to the audits.

8.3 AUDIT STEPS

Step 1. SAI issues financial audit report:

- Copies endorsed to concerned authorities or ministries – e.g. Ministry of Finance/Treasury Department.

- Entity (addressed either to Head of the entity or to those charged with governance.

Step 2. Entity responds detailing action taken on audit qualification and any other deficiencies reported.
Step 3. SAI reviews the Action Taken Report and issues follow – up report to the entity.
Step 4. Track unresolved findings from current and prior audits until fully addressed

8.4 STATUTORY REQUIREMENTS AND PURPOSE

Besides statutory requirements, one of the purposes of conducting financial audits is to help improve the systems and procedures including the financial reporting process in the entity. By conducting a follow-up, the OFAG would also be able to establish the value added by the financial audit in terms of improvements introduced in the system. Unless this follow-up is put in practice, the OFAG cannot gauge whether the desired impact of audit has been effective or not. Therefore, a follow-up audit is one of the important components of the audit process, and that process cannot be complete without it. Further, even management and those charged with governance may not be motivated to take action if there is no follow-up system in the OFAG.

8.5 INDEPENDENCE OF FUNCTION

It may be appropriate to have an independent follow-up function in the OFAG to carry out objective assessment of the action taken by management and to exercise professional judgement. If, for instance, the same audit team who conducted the audit does the follow- up, it may tend to defend its audit findings and audit qualification, even if management or those charged with governance have taken appropriate action on those audit issues.

8.6 LEVELS: ROLES AND RESPONSIBILITIES

Based on the OFAG's model and parliamentary structure prevalent in the OFAG's jurisdiction, the Public Accounts Committee plays an active role in the review and follow-up of the audit reports tabled in House of Representatives. Therefore, there are two levels of follow-up of audit findings and recommendations, i.e. one at the OFAG's level and another at the Public Accounts Committee level.

8.7 PROCESS

The audit report as discussed in previous chapter may contain a qualified audit opinion on the financial statements, key audit matters, audit findings covering deficiencies in internal controls and non-compliance with laws and regulations that may or may not have direct effect on the financial statements.

Follow-up focuses on whether the audited entity has adequately addressed the matters raised by the audit, including any wider implications. Insufficient or unsatisfactory action taken by the audited entity may call for a further report by the OFAG.

Auditors must always follow-up on material observations they have raised to ensure the issues that have been identified have been resolved by the audited entity. In the context of an ISSAI financial audit, the auditor will typically perform this follow-up as part of the audit process of the subsequent year audit since unresolved prior year issues may represent risks of material misstatement of the financial statements of the subsequent year. As explained in previous sections, public sector auditors may report additional information that is not required to be reported when applying the financial audit ISSAIs to perform the audit. Such additional reporting may require additional follow-up activities to be performed.

8.8 ACTIONS TAKEN

Depending on the issues reflected in the audit report and the requirements of relevant laws, OFAG's may be required to endorse copies of audit reports to the concerned authorities or government ministries say, Ministry of Finance as well as to management and those charged with governance. However, it should be the responsibility of Head of the entity or those charged with governance to take action on outstanding audit issues referred to in the audit report.

The OFAG's and/or laws and regulations may indicate the deadline for auditees to respond to the auditor's report having qualified opinion and other deficiencies, for example weaknesses in internal controls that are reported in the form on audit findings, detailing the corrective action to be taken by the entity (suggested as Action Taken Report).

The OFAG reviews the Action Taken Report on audit findings and prepares a follow-up report. The follow-up can be done as either a desk review or a visit to the entity for factual confirmation of the response provided by management or those charged with governance. The follow-up report should also go through the due process of quality control.

8.9 CONTINUOUS PROCESS: OUTSTANDING ISSUES

A follow-up of an audit report could be for just one accounting year/fiscal year on which the audit was conducted, and the report issued. However, there could be outstanding issues from earlier years' audit reports (financial or other) regarding the same entity, which may also have to be followed up along with the report recently issued.

Follow-up in the OFAG should be a continuous process, until the outstanding audit findings are resolved based on appropriate action taken by management or those charged with governance. After issuance of the initial audit report and upon receiving a first response from management or those charged with governance, the frequency of the follow-up thereafter may be decided by the OFAG, or the OFAG may have certain regulations or laws guiding this process. However, it is in the best interest of both the OFAG and the entity to resolve outstanding audit issues, including any qualified opinion on the financial statements, as early as possible.

8.10 WORKING PAPERS TO COMPLETE

W/P Ref	Working paper	Objectives of the working paper	Completed by	Reviewed by
F 1	Follow-up	The main objective of a follow-up working paper is to document on action taken by the entity on earlier year(s) audit report(s).	Senior Auditor	Audit Manager

GLOSSARY

Term	Explanation
Access controls	Procedures designed to restrict access to online terminal devices, programs and data. Access controls consist of "user authentication" and "user authorisation." "User authentication" typically attempts to identify a user through unique login identifications, passwords, access cards or biometric data. "User authorisation" consists of access rules to determine the computer resources each user may access. Specifically, such procedures are designed to prevent or detect: (a) Unauthorised access to on-line terminal devices, programs and data. (b) Entry of unauthorised transactions. (c) Unauthorised changes to data files. (d) The use of computer programs by unauthorised personnel; and (e) The use of computer programs that have not been authorised.
Accounting estimate	An approximation of the amount of an item in the absence of a precise means of measurement.
Accounting records	Generally, include the records of initial entries and supporting records, such as checks and records of electronic fund transfers; invoices; contracts; the general and subsidiary ledgers; journal entries and other adjustments to the financial statements that are not reflected in formal journal entries; and records such as work sheets and spreadsheets supporting cost allocations, computations, reconciliations and disclosures.
Accruals accounts	A financial statement that discloses payments in the period they are incurred and income in the period it is earned.
Adverse opinion	(See Modified auditor's report)
Agreed-upon procedures engagement	An engagement in which an auditor is engaged to carry out those procedures of an audit nature to which the auditor and the entity and any appropriate third parties have agreed and to report on factual findings. The recipients of the report form their own conclusions from the report by the auditor. The report is restricted to those parties that have agreed to the procedures to be performed since others, unaware of the reasons for the procedures, may misinterpret the results.
Analytical procedures	Evaluations of financial information are made by a study of plausible relationships among both financial and non-financial data. Analytical procedures also encompass the investigation of identified fluctuations and relationships that are inconsistent with other relevant information or deviate significantly from predicted amounts.
Annual report	A document issued by an entity, ordinarily on an annual basis, which includes its financial statements together with the auditor's report thereon.
Applicable financial reporting framework	The financial reporting framework adopted by management in preparing the financial statements that the auditor has determined is acceptable in view of the nature of the entity and the objective of the financial statements, or that is required by law or regulations.
Application controls in information system	Manual or automated procedures that typically operate at a business process level. Application controls can be preventative or detective in nature and are designed to ensure the integrity of the accounting records. Accordingly,

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

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

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

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

Compilation engagement	An engagement in which accounting expertise, as opposed to auditing expertise, is used to collect, classify and summarise financial information.
Component	A division, branch, subsidiary, joint venture, associated company or other entity whose financial information is included in financial statements audited by the principal auditor.
Component of a complete set of financial statements	The applicable financial reporting framework adopted in preparing the financial statements determines what constitutes a complete set of financial statements. Components of a complete set of financial statements include, a single financial statement, specified accounts, elements of accounts or items in a financial statement.
Comprehensive basis of accounting	A comprehensive basis of accounting comprises a set of criteria used in preparing financial statements which applies to all material items, and which has substantial support.
Computer-assisted audit techniques	Applications of auditing procedures using the computer as an audit tool (also known as CAATs).
Computer information systems (CIS) environment	Exists when a computer of any type or size is involved in the processing by the entity of financial information of significance to the audit, whether that computer is operated by the entity or by a third party.
Confirmation	A specific type of inquiry that is the process of obtaining a representation of information or of an existing condition directly from a third party.
Control activities	Those policies and procedures that help ensure that management directives are carried out. Control activities are a component of internal control.
Control environment	Includes the governance and management functions and the attitudes, awareness and actions of those charged with governance and management concerning the entity's internal control and its importance in the entity. The control environment is a component of internal control.
Control procedures	The policies and procedures adopted by an entity's management to protect against fraud, losses, illegality or error, and to achieve its objectives. Control procedures may prevent illegality or error (such as a requirement for two authorising signatures before the entity purchases items above a stated value) or enable the entity to detect and correct them (Reconciliations for instance).
Control risk	(See Risk of material misstatement)
Corresponding figures	(See Comparatives)
Criteria	The benchmarks used to evaluate or measure the subject matter include, where relevant, benchmarks for presentation and disclosure. Criteria can be formal or less formal. There can be different criteria for the same subject matter. Suitable criteria are required for reasonably consistent evaluation or measurement of a subject matter within the context of professional judgement. *Suitable criteria* Exhibit the following characteristics: (a) Relevance: relevant criteria contribute to conclusions that assist decision-making by the intended users.

	(b) Completeness: criteria are sufficiently complete when relevant factors that could affect the conclusions in the context of the engagement circumstances are not omitted. Complete criteria include, where relevant, benchmarks for presentation and disclosure. (c) Reliability: reliable criteria allow reasonably consistent evaluation or measurement of the subject matter including, where relevant, presentation and disclosure, when used in similar circumstances by similarly qualified practitioners. (d) Neutrality: neutral criteria contribute to conclusions that are free from bias; and Understandability: understandable criteria contribute to conclusions that are clear, comprehensive, and not subject to significantly different interpretations.
Current file	Includes all the working papers applicable to the current audit year. For instance, it includes the planning memorandum, audit programme, and the results of audit tests.
Current period figures	Amounts and other disclosures relating to the current period.
Database	A collection of data that is shared and used by many different users for different purposes.
Date of the financial statements	The date of the end of the latest period covered by the financial statements, which is normally the date of the most recent balance sheet in the financial statements subject to audit.
Date of approval of the financial statements	The date on which those with the recognised authority assert that they have prepared the entity's complete set of financial statements, including the related notes, and that they have taken responsibility for them. In some jurisdictions, the law or regulation identifies the individuals or bodies (for example, the directors) that are responsible for concluding that a complete set of financial statements has been prepared and specifies the necessary approval process. In other jurisdictions, the approval process is not prescribed in law or regulation and the entity follows its own procedures in preparing and finalising its financial statements in view of its management and governance structures. In some jurisdictions, final approval of the financial statements by shareholders is required before the financial statements are issued publicly. In these jurisdictions, final approval by shareholders is not necessary for the auditor to conclude that sufficient appropriate audit evidence has been obtained. The date of approval of the financial statements for purposes of the ISSAIs is the earlier date on which those with the recognised authority determine that a complete set of financial statements has been prepared.
Date of the auditor's report	The date selected by the auditor to date the report on the financial statements. The auditor's report is not dated earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the opinion on the financial statements. Sufficient appropriate audit evidence includes evidence that the entity's complete set of financial statements has been prepared and that those with the recognised authority has asserted that they have taken responsibility for them.
Date the financial statements are	The date that the auditor's report and audited financial statements are made available to third parties, which may be, in many circumstances, the date that

issued	they are filed with a regulatory authority.
Detection risk	The risk that the procedures performed by the auditor to reduce audit risk to an acceptably low level will not detect a misstatement that exists and that could be material, either individually or when aggregated with other misstatements.
Disclaimer of opinion	(See Modified auditor's report)
Double entry accounting	An accounting practice that requires that for any accounting entry, there is a matching debit and credit recorded in the general ledger.
Electronic data interchange (EDI)	The electronic transmission of documents between organisations in a machine-readable form.
Emphasis of matter paragraph(s)	(See Modified auditor's report)
Employee fraud	Fraud involving only employees of the entity subject to the audit.
Encryption (cryptography)	The process of transforming programs and information into a form that cannot be understood without access to specific decoding algorithms (cryptographic keys). For example, the confidential personal data in a payroll system may be encrypted against unauthorised disclosure or modification. Encryption can provide an effective control for protecting confidential or sensitive programs and information from unauthorised access or modification. However, effective security depends upon proper controls over access to the cryptographic keys.
Engagement documentation	The record of work performed, results obtained, and conclusions the practitioner reached (Terms such as "working papers" or "workpapers" are sometimes used). The documentation for a specific engagement is assembled in an engagement file.
Engagement letter	An engagement letter documents and confirms the auditor's acceptance of the appointment, the objective and scope of the audit, the extent of the auditor's responsibilities to the client and the form of any reports.
Engagement quality control review	A process designed to provide an objective evaluation, before the report is issued, of the significant judgements the engagement team made and the conclusions they reached in formulating the report.
Engagement quality control reviewer	A partner, other person in the firm, suitably qualified external person, or a team made up of such individuals, with sufficient and appropriate experience and authority to objectively evaluate, before the report is issued, the significant judgements the engagement team made and the conclusions they reached in formulating the report.
Engagement team	All personnel performing an engagement, including any experts contracted by the firm in connection with that engagement.
Entity's risk assessment process	A component of internal control that is the entity's process for identifying business risks relevant to financial reporting objectives and deciding about actions to address those risks, and the results thereof.
Environmental matters	(a) Initiatives to prevent, abate, or remedy damage to the environment, or to deal with conservation of renewable and non-renewable resources (such initiatives may be required by environmental laws and regulations or by contract, or they may be undertaken voluntarily). (b) Consequences of violating environmental laws and regulations. (c) Consequences of environmental damage done to others or to natural resources.

	(d) Consequences of vicarious liability imposed by law (for example, liability for damages caused by previous owners).
Environmental performance report	A report, separate from the financial statements, in which an entity provides third parties with qualitative information on the entity's commitments towards the environmental aspects of the business, its policies and targets in that field, its achievement in managing the relationship between its business processes and environmental risk, and quantitative information on its environmental performance.
Environmental risk	In certain circumstances, factors relevant to the assessment of inherent risk for the development of the overall audit plan may include the risk of material misstatement of the financial statements due to environmental matters.
Error	An unintentional misstatement in financial statements, including the omission of an amount or a disclosure.
Evaluate	Identify and analyse the relevant issues, including performing further procedures as necessary, to come to a specific conclusion on a matter. "Evaluation", by convention, is used only in relation to a range of matters, including evidence, the results of procedures and the effectiveness of management's response to a risk. (Also see Assess)
Expected error	(See Audit sampling)
Experienced auditor	An individual (whether internal or external to the firm) who has a reasonable understanding of: (a) Audit processes. (b) ISSAIs and applicable legal and regulatory requirements. (c) The business environment in which the entity operates. (d) Auditing and financial reporting issues relevant to the entity's industry.
Expert	A person or firm possessing special skill, knowledge and experience in a particular field other than accounting and auditing.
External audit	An audit performed by an external auditor.
External auditor	(See auditor)
External confirmation	The process of obtaining and evaluating audit evidence through a direct communication from a third party in response to a request for information about a particular item affecting assertions made by management in the financial statements.
Fair value	The amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.
Financial audit	Financial audit involves determining, through the collection of audit evidence, whether an entity's financial information is presented in its financial statements in accordance with the financial reporting and regulatory framework applicable. In the case of fair presentation frameworks, the auditor assesses whether the information is fairly presented. In the case of compliance frameworks, the auditor assesses the extent to which compliance is achieved. The objective of financial audit is, through the collection of sufficient appropriate evidence, to provide reasonable assurance to the users, in the form of an audit opinion and/o report, as to whether the financial statements or other forms of presentation of financial information are fairly and/or in all material respects presented in accordance with the applicable financial

	reporting and regulatory framework.
	Internal controls intended to help entities minimise their exposure to avoidable financial risks and ensure that financial information is reliable. Financial controls include control procedures intended to help the entity maintain proper accounting records, safeguard assets, and prevent and detect fraud.
Financial statements	A structured representation of historical financial information, including related notes, intended to communicate an entity's economic resources or obligations at a point in time or the changes therein for a period in accordance with a financial reporting framework. The related notes ordinarily comprise a summary of significant accounting policies and other explanatory information. The term "financial statements" ordinarily refers to a complete set of financial statements as determined by the requirements of the applicable financial reporting framework (such as IPSAS) but can also refer to a single financial statement.
Firewall	A combination of hardware and software that protects a WAN, LAN or PC from unauthorised access through the Internet and from the introduction of unauthorised or harmful software, data or other material in electronic form.
Firm	A sole practitioner, partnership or corporation or other entity of professional accountants.
Forecast	Prospective financial information prepared based on assumptions as to future events which management expects to take place and the actions management expects to take as of the date the information is prepared (best-estimate assumptions).
Fraud	An intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage. Two types of intentional misstatement are relevant to the auditor: misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets (also see Fraudulent financial reporting and Misappropriation of assets).
Fraudulent financial reporting	Involves intentional misstatements, including omissions of amounts or disclosures in financial statements, to deceive financial statement users.
Financial reporting framework	The financial reporting framework adopted by management and, where appropriate, those charged with governance in the preparation of the financial statements that is acceptable in view of the nature of the entity and the objective of the financial statements, or that is required by law or regulation. The term "fair presentation framework" is used to refer to a financial reporting framework that requires compliance with the requirements of the framework and: (i) Acknowledges explicitly or implicitly that, to achieve fair presentation of the financial statements, it may be necessary for management to provide disclosures beyond those specifically required by the framework; or (ii) Acknowledges explicitly that it may be necessary for management to depart from a requirement of the framework to achieve a fair presentation of the financial statements. Such departures are expected to be necessary only in extremely rare circumstances.

General IT- controls	Policies and procedures that relate to many applications and support the effective functioning of application controls by helping to ensure the continued proper operation of information systems. General IT-controls commonly include controls over data centre and network operations; system software acquisition, change and maintenance; access security; and application system acquisition, development, and maintenance.
General ledger	An entity's accounting record holds details of individual transactions processed. General Ledger accounts typically group transactions, for example, salaries.
Going concern assumption	Under this assumption, an entity is ordinarily viewed as continuing in business for the foreseeable future with neither the intention nor the necessity of liquidation, ceasing trading or seeking protection from creditors pursuant to laws or regulations. Accordingly, assets and liabilities are recorded on the basis that the entity will be able to realise its assets and discharge its liabilities in the normal course of business.
General purpose financial statements	Financial statements are prepared in accordance with a financial reporting framework that is designed to meet the common information needs of a wide range of users.
Government business enterprises	Businesses that operate within the public sector ordinarily to meet a political or social interest objective. They are ordinarily required to operate commercially, that is, to make profits or to recoup, through user charges, a substantial proportion of their operating costs.
Historical financial information	Information expressed in financial terms in relation to a particular entity, derived primarily from that entity's accounting system, about economic events occurring in past time periods or about economic conditions or circumstances at points in time in the past.
Independence	Comprises: (a) Independence of mind − the state of mind that permits the provision of an opinion without being affected by influences that compromise professional judgement, allowing an individual to act with integrity, and exercise objectivity and professional scepticism. (b) Independence in appearance − the avoidance of facts and circumstances that are so significant a reasonable and informed third party, having knowledge of all relevant information, including any safeguards applied, would reasonably conclude a firm, or a member of the assurance team's, integrity, objectivity or professional scepticism had been compromised.
Information system relevant to financial reporting	A component of internal control that includes the financial reporting system and consists of the procedures and records established to initiate, record, process and report entity transactions (as well as events and conditions) and to maintain accountability for the related assets, liabilities and equity.
Inherent risk	(See Risk of material misstatement)
Initial audit engagement	An audit engagement in which either the financial statements are audited for the first time; or the financial statements for the prior period were audited by another auditor.
Inquiry	Inquiry consists of seeking information from knowledgeable persons, both financial and non-financial, throughout the entity or outside the entity.
Inspection (as an	Examining records or documents, whether internal or external or tangible assets.

audit procedure)	
Interim financial information or statements	Financial information (which may be less than a complete set of financial statements as defined above) is issued at interim dates (usually half-yearly or quarterly) in respect of a financial period.
Internal audit	An appraisal activity is established within an entity as a service to the entity. Its functions include, amongst other things, examining, evaluating and monitoring the adequacy and effectiveness of internal control.
Internal auditor	(See auditor)
Internal control	The process is designed and effected by those charged with governance, management and other personnel to provide reasonable assurance about the achievement of the entity's objectives regarding reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations. Internal control consists of the following components: (a) The control environment. (b) The entity's risk assessment process. (c) The information system, including the related business processes, relevant to financial reporting, and communication. (d) Control activities. (e) Monitoring of controls.
Investigate	Inquire into matters arising from other procedures to resolve them.
IT environment	The policies and procedures that the entity implements and the IT infrastructure (for example, hardware, operating systems) and application software that it uses to support business operations and achieve business strategies.
Limited assurance engagement	(See Assurance engagement)
Limitation on scope	A limitation on the scope of the auditor's work may sometimes be imposed by the entity (for example, when the terms of the engagement specify that the auditor will not carry out an audit procedure that the auditor believes is necessary). A scope limitation may be imposed by circumstances (for example, when the timing of the auditor's appointment is such that the auditor is unable to observe the counting of physical inventories). It may also arise when, in the opinion of the auditor, the entity's accounting records are inadequate or when the auditor is unable to carry out an audit procedure believed desirable.
Local area network (LAN)	A communications network that serves users within a confined geographical area. LANs were developed to facilitate the exchange and sharing of resources within an organisation, including data, software, storage, printers and telecommunications equipment. They allow for decentralised computing. The basic components of a LAN are transmission media and software, user terminals and shared peripherals.
Management	The person(s) with executive responsibility for the conduct of the entity's operations. For some entities in some jurisdictions, management includes some or all of those charged with governance, for example, executive members of a governance board.
Management fraud	Fraud involving one or more members of management or those charged with governance.

Management representations	Representations made by management to the auditor during an audit, either unsolicited or in response to specific inquiries.
Material	A matter is material if knowledge of it would be likely to influence the user of the financial statements.
Material inconsistency	Exists when other information contradicts information contained in the audited financial statements. A material inconsistency may raise doubt about the audit conclusions drawn from audit evidence previously obtained and, possibly, about the basis for the auditor's opinion on the financial statements.
Material misstatement of fact	Exists in other information when such information, not related to matters appearing in the audited financial statements, is incorrectly stated or presented.
Material weakness	A weakness in internal control that could have a material effect on the financial statements.
Materiality	Information is material if its omission or misstatement could influence the economic decisions of users made based on the financial statements. Materiality depends on the size of the item or error judged in the circumstances of its omission or misstatement. Thus, materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic which information must have if it is to be useful.
Misappropriation of assets	Involves the theft of an entity's assets and is often perpetrated by employees in small and immaterial amounts. However, it can also involve management who are usually more capable of disguising or concealing misappropriations in ways that are difficult to detect.
Misstatement	A difference between the amount, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework. Misstatements can arise from error or fraud. Where the auditor expresses an opinion on whether the financial statements are presented fairly, in all material respects, or give a true and fair view, misstatements also include those adjustments of amounts, classifications, presentation, or disclosures that, in the auditor's judgement, are necessary for the financial statements to be presented fairly, in all material respects, or to give a true and fair view.
Modified auditor's report	An auditor's report is modified if either an emphasis of matter paragraph(s) is added to the report or if the opinion is other than unqualified: *Matters that do not affect the auditor's opinion* Emphasis of matter paragraph(s) − An auditor's report may be modified by adding an emphasis of matter paragraph(s) to highlight a matter affecting the financial statements which is included in a note to the financial statements that more extensively discusses the matter. The addition of such an emphasis of matter paragraph(s) does not affect the auditor's opinion. The auditor may also modify the auditor's report by using an emphasis of matter paragraph(s) to report matters other than those affecting the financial statements. *Matters that do affect the auditor's opinion*

	Qualified opinion − A qualified opinion is expressed when the auditor concludes that an unqualified opinion cannot be expressed but that the effect of any disagreement with management, or limitation on scope is not so material and pervasive as to require an adverse opinion or a disclaimer of opinion. Disclaimer of opinion − A disclaimer of opinion is expressed when the possible effect of a limitation on scope is so material and pervasive that the auditor has not been able to obtain sufficient appropriate audit evidence and accordingly is unable to express an opinion on the financial statements. Adverse opinion − An adverse opinion is expressed when the effect of a disagreement is so material and pervasive to the financial statements that the auditor concludes that a qualification of the report is not adequate to disclose the misleading or incomplete nature of the financial statements.
Monetary unit sample	A method of sampling transactions for direct substantive procedures whereby a high value item is more likely to appear in the sample than a lower value item.
Monitoring (in relation to quality control)	A process comprising an ongoing consideration and evaluation of the firm's system of quality control, including a periodic inspection of a selection of completed engagements, designed to enable the firm to obtain reasonable assurance that its system of quality control is operating effectively.
Monitoring of controls	A process to assess the effectiveness of internal control performance over time. It includes assessing the design and operation of controls on a timely basis and taking necessary corrective actions modified for changes in conditions. Monitoring of controls is a component of internal control.
Non-compliance	Refers to acts of omission or commission by the entity being audited, either intentional or unintentional, that are contrary to the prevailing laws or regulations.
Non-sampling risk	(See Audit sampling)
Non-statistical sampling	(See Audit sampling)
Objective	(See Audit objectives)
Observation	Consists of looking at a process or procedure being performed by others, for example, the observation by the auditor of the counting of inventories by the entity's personnel or the performance of control activities.
Opening balances	Those account balances that exist at the beginning of the period. Opening balances are based upon the closing balances of the prior period and reflect the effects of transactions of prior periods and accounting policies applied in the prior period.
Opinion	The auditor's report contains a clear written expression of opinion on the financial statements. An unqualified opinion is expressed when the auditor concludes that the financial statements give a true and fair view or are presented fairly, in all material respects, in accordance with the applicable financial reporting framework. (Also see Modified auditor's report)
Other auditors	(See auditor)
Other information	Financial or non-financial information (other than the financial statements or the auditor's report thereon) included – either by law or custom – in the annual report.

Overall audit strategy	Sets the scope, timing and direction of the audit, and guides the development of the more detailed audit plan.
PCs or personal computers (also referred to as microcomputers)	Economical yet powerful self-contained general-purpose computers consisting typically of a monitor (visual display unit), a case containing the computer electronics and a keyboard (and mouse). These features may be combined in portable computers (laptops). Programs and data may be stored internally on a hard disk or on removable storage media such as CDs. PCs may be connected to online networks, printers and other devices such as scanners and modems.
Permanent file	Contains information about the audited entity of continuing interest and relevance from year to year. For instance, this file contains the entity's legal framework, and working papers setting out previous years' assessment of inherent risk and control risk.
Planning	Involves establishing the overall audit strategy for the engagement and developing an audit plan, to reduce audit risk to an acceptably low level.
Population	(See Audit sampling)
Principal auditor	(See auditor)
Professional judgement	The application of relevant training, knowledge and experience, within the context provided by auditing, accounting and ethical standards, in making informed decisions about the courses of action that are appropriate in the circumstances of the audit engagement.
Professional scepticism	An attitude that includes a questioning mind, being alert to conditions that may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence.
Professional standards	IAASB engagement standards, as defined in the IAASB's *Preface to the International Standards on Quality Control, Auditing, Assurance and Related Services*, and relevant ethical requirements, which ordinarily comprise Parts A and B of the IFAC *Code of Ethics for Professional Accountants* and relevant national ethical requirements.
Programming controls	Procedures designed to prevent or detect improper changes to computer programs that are accessed through on-line terminal devices. Access may be restricted by controls such as the use of separate operational and program development libraries and the use of specialised program library software. It is important for online changes to programs to be adequately documented, controlled and monitored.
Public sector	National governments, regional (for example, state, provincial, territorial) governments, local (for example, city, town) governments and related governmental entities (for example, agencies, boards, commissions and enterprises).
Qualified opinion	(See Modified auditor's report)
Quality controls	The policies and procedures adopted by a firm are designed to provide it with reasonable assurance that the firm and its personnel comply with professional standards and regulatory and legal requirements, and that reports issued by the firm or engagement partners are appropriate in the circumstances.
Reasonable assurance (in the context of quality control)	A high, but not absolute, level of assurance.

Reasonable assurance (in the context of an audit engagement)	A high, but not absolute, level of assurance, expressed positively in the auditor's report as reasonable assurance, that the information subject to audit is free of material misstatement.
Reasonable assurance engagement	(See Assurance engagement)
Recalculation	Consists of checking the mathematical accuracy of documents or records.
Reconciliations	Where entity officials compare two pieces of financial data, or financial and non-financial data, to ensure complete and accurate processing of transactions. For instance, comparing ("reconciling") a bank statement with internal records of payments made or money received, establishing the reasons for any difference, and making corrections where differences have been caused by incomplete or inaccurate processing. A kind of control procedure.
Financial audit	An audit that aims to assess whether transactions accord with relevant laws and regulations.
Related party	A party is related to an entity if: (a) Directly, or indirectly through one or more intermediaries, the party: i. Controls, is controlled by, or is under common control with, the entity (this includes parents, subsidiaries and fellow subsidiaries). ii. Has an interest in the entity that gives it significant influence over the entity; or iii. Has joint control over the entity. (b) The party is an associate (as defined in International Accounting Standard (IAS) 28, *Investments in Associates*) of the entity. (c) The party is a joint venture in which the entity is a venturer (see IAS 31, *Interest in Joint Ventures*). (d) The party is a member of the key management personnel of the entity or its parent. (e) The party is a close member of the family of any individual referred to in (a) or (d). (f) The party is an entity that is controlled, jointly controlled or significantly influenced by, or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in (d) or (e). (g) The party is a post-employment benefit plan for the benefit of employees of the entity, or of any entity that is a related party of the entity.
Related party transaction	A transfer of resources, services or obligations between related parties, regardless of whether a price is charged.
Related services	Comprise agreed upon procedures and compilations.
Re-performance	The auditor's independent execution of procedures or controls that were originally performed as part of the entity's internal controls, either manually or using CAATs.
Responsible party	The person (or persons) who:

	(a) In a direct reporting engagement, is responsible for the subject matter; or (b) In an assertion-based engagement, is responsible for the subject matter information (the assertion) and may be responsible for the subject matter. The responsible party may or may not be the party who engages the practitioner (the engaging party).
Review (in relation to quality control)	Appraising the quality of the work performed and conclusions reached by others.
Review engagement	The objective of a review engagement is to enable an auditor to state whether, based on procedures that do not provide all the evidence that would be required in an audit, anything has come to the auditor's attention that causes the auditor to believe that the financial statements are not prepared, in all material respects, in accordance with an applicable financial reporting framework.
Review procedures	The procedures deemed necessary to meet the objective of a review engagement, primarily inquiries of entity personnel and analytical procedures applied to financial data.
Risk assessment procedures	The audit procedures performed to obtain an understanding of the entity and its environment, including its internal control, to assess the risks of material misstatement at the financial statement and assertion levels.
Risk of material misstatement	Risk of material misstatement is the risk that the financial statements are materially misstated prior to audit. This consists of two components, described as follows at the assertion level: (i) Inherent risk – The susceptibility of an assertion about a class of transactions, account balance or disclosure to a misstatement that could be material, either individually or when aggregated with other misstatements before consideration of any related controls. (ii) Control risk – The risk that a misstatement that could occur in an assertion about a class of transactions, account balance or disclosure and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity's internal control.
Sampling risk	(See Audit sampling)
Sampling unit	(See Audit sampling)
Scope of an audit	The audit procedures that, in the auditor's judgement and based on the ISSAIs, are deemed appropriate in the circumstances to achieve the objective of the audit.
Scope of a review	The review procedures deemed necessary in the circumstances to achieve the objective of the review.
Scope limitation	(See Limitation on scope)
Segment information	Information in the financial statements regarding distinguishable components of industry and geographical aspects of an entity.
Significance	The relative importance of a matter, taken in context. The significance of a matter is judged by the practitioner in the context in which it is being considered. This might include, for example, the reasonable prospect of its changing or influencing the decisions of intended users of the practitioner's report; or, as another example, where the context is a judgement about

	whether to report a matter to those charged with governance, whether the matter would be regarded as important by them in relation to their duties. Significance can be considered in the context of quantitative and qualitative factors, such as relative magnitude, the nature and effect on the subject matter and the expressed interests of intended users or recipients.
Significant risk	An identified risk of material misstatement for which the assessment of inherent risk is close to the upper end of the spectrum of inherent risk due to the degree to which inherent risk factors affect the combination of the likelihood of a misstatement occurring and the magnitude of the potential misstatement should that misstatement occur.
Small entity	Any entity in which: (a) There is concentration of ownership and management in a small number of individuals (often a single individual); and (b) One or more of the following are also found: i. Few sources of income. ii. Unsophisticated record-keeping. iii. Limited internal controls together with the potential for management override of controls. Small entities will ordinarily display characteristic (a), and one or more of the characteristics included under (b).
Special purpose auditor's report	A report issued in connection with the independent audit of financial information other than an auditor's report on financial statements, including: (a) A complete set of financial statements prepared in accordance with another comprehensive basis of accounting. (b) A component of a complete set of general purpose or special purpose financial statements, such as a single financial statement, specified accounts, elements of accounts, or items in a financial statement. (c) Compliance with contractual agreements. (d) Summarised financial statements.
Statistical sampling	(See Audit sampling)
Stratification	(See Audit sampling)
Subject matter information	The outcome of the evaluation or measurement of a subject matter. It is the subject matter information about which the practitioner gathers sufficient appropriate evidence to provide a reasonable basis for expressing a conclusion in an assurance report.
Subsequent events	IAS 10, *Events After the Balance Sheet Date*, deals with the treatment in financial statements of events, both favourable and unfavourable, that occur between the date of the financial statements (referred to as the "balance sheet date" in the IAS) and the date when the financial statements are authorised for issue and identifies two types of events: (a) Those that provide evidence of conditions that existed at the date of the financial statements.

	(b) Those that are indicative of conditions that arose after the date of the financial statements.
Substantive procedures	Audit procedures performed to detect material misstatements at the assertion level; they include: (a) Tests of details of classes of transactions, account balances, and disclosures. Substantive analytical procedures.
Sufficiency	Sufficiency is the measure of the quantity of audit evidence. The quantity of the audit evidence needed is affected by the risk of misstatement and by the quality of such audit evidence.
Summarised financial statements	Financial statements summarising an entity's annual audited financial statements for the purpose of informing user groups interested in the highlights only of the entity's financial performance and position.
Supplementary information	Information that is presented together with the financial statements that is not required by the applicable financial reporting framework used to prepare the financial statements, normally presented in either supplementary schedules or as additional notes.
Supreme Audit Institution	The public body of a State which, however designated, constituted or organised, exercises by virtue of law, the highest public auditing function of that State.
Test	The application of audit procedures to some or all items in a population.
Tests of controls	Tests performed to obtain audit evidence about the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements at the assertion level.
Those charged with governance	The person(s) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process. For some entities in some jurisdictions, those charged with governance may include management personnel, for example, executive members of a governance board of a private or public sector entity or an owner-manager.
Tolerable error	(See Audit sampling)
Total error	(See Audit sampling)
Transaction	An individual payment made by an entity, or an individual amount received by an entity.
Transaction logs	Reports that are designed to create an audit trail for each on-line transaction. Such reports often document the source of a transaction (terminal, time and user) as well as the transaction's details.
Trial balance	An accounting record that summarises all debit and credit entries recorded in the general ledger, and which is the basis for producing the financial statements. The net value of transactions recorded in the trial balance should be zero.
Uncertainty	A matter whose outcome depends on future actions or events not under the direct control of the entity but that may affect the financial statements.
Unqualified opinion	(See Opinion)
Walkthrough test	Involves tracing a few transactions through the financial reporting system.
Wide area network (WAN)	A communications network that transmits information across an expanded area such as between plant sites, cities and nations. WANs allow for on-line access to applications from remote terminals. Several LANs can be interconnected in a WAN.

Working papers	The material prepared by and for, or obtained and retained by, the auditor in connection with the performance of the audit. Working papers may be in the form of data stored on paper, film, electronic media or other media.

Annex 1. Guide on Combined Audit Approach: Financial and Compliance

Annex 2. Guide on Integrated Audit: e-GP, IFMIS and e-Payment System

Annex 3. Guide on Classes of Transactions, Account Balances, and Disclosure



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AUDIT FOR THE BENEFIT OF CITIZENS